U.S. Workers & Puerto Rico's Crisis

written by Rafael Bernabe | January 12, 2016

PUERTO RICO HAS been in the news lately, particularly the financial news. The possibility that its government may default on part of its $73 billion public debt has drawn the attention of Wall Street analysts. The New York Times has deemed the situation worthy of several editorials.

More often than not, the island is offered as a yet another lesson on the consequences of “big government” and of too generous social provisions. Other factors are rarely mentioned — such as the tax privileges of U.S. corporations, or the potential consequences for working people of the austerity measures under consideration.

Working people in the United States need their own analysis of Puerto Rico’s crisis, not the least because the austerity measures under discussion here are similar to those ruling sectors would like to impose there. Our fight in Puerto Rico and the United States should be a joint struggle.

Here we will consider four elements: structure, policy, conjuncture and alternatives.
By structure we refer to long standing features of Puerto Rico’s economy, which are often ignored in discussions about the present crisis.
Policy refers to the measures that the Puerto Rican government has adopted in recent decades to promote economic growth, above all the policy of tax exemption.

Conjuncture refers to the present situation, which combines economic stagnation and debt crisis.
Alternatives refer to the different proposals put forth by creditors, the Puerto Rican government and Puerto Rico’s progressive organizations.

Structure: Colonial Domination

Through the different epochs into which we may divide Puerto Rico’s development since the onset of U.S. rule in 1898 some features have remained constant.

First, since 1900 Puerto Rico’s economy has been shaped by the priorities and preferences of U.S. capital. Such was the case before WWII, when sugar production was the main industry, during the expansion of light-manufacturing from the 1940s to the 1970s, and during the following period, characterized by capital intensive manufacturing (pharmaceuticals, for example).

While specializing in the production for export, largely controlled by U.S. capital, the island has imported most of the consumer goods needed for its reproduction. This one-sidedness is the distinctive second feature of Puerto Rico’s colonial economy. An example of this is the destruction of Puerto Rico’s agriculture, to the point that we now import more than 85% of our food.

Third, an additional consequence of the domination of Puerto Rico’s economy by U.S. capital has been the constant outflow of a significant portion of the income generated in Puerto Rico. At present, around $35 billion leave every year, in the form of payments to external investors. This is around 35% of Puerto Rico’s Gross Domestic Product.

Needless to say, this capital is not reinvested in Puerto Rico, leading to a fourth feature of its economy since 1898: Puerto Rico’s dependent economy has never been able to provide sufficient employment for its workforce.
At present, Puerto Rico has a 40% labor participation rate. The official unemployment rate is 14%.

Even between 1950 and 1964, i.e. during the period of rapid postwar growth, the number of jobs fell. Manufacturing was not able to compensate for the jobs lost in agriculture.

Yet the unemployment rate remained fairly constant due to a fifth feature of Puerto Rico's evolution: given the lack of employment, mass migration has been a feature of Puerto Rican life since the early 20th century. This was the case in the 1910s and 1920s, when the first Puerto Rican colonia took shape in New York, as well as in the mass migration of the 1950s and during the last decade.

Mass unemployment also conspires against higher wages, which deepens economic inequality and insures high levels of poverty. This helps explain the sixth feature: the persistence of the wide gap in living standards between Puerto Rico and the U.S. mainland.

Puerto Rico's per capita income is a third of the U.S. figure. It is half the per capita income of the poorest state. Around 45% of the people in Puerto Rico live under the poverty level. The corresponding figure in the mainland is 15%.
The present crisis has intensified these problems, but it did not create them. It should be the occasion for addressing the problems as such, not only their intensification.

Policy: Corporations Benefit

The attraction of U.S. investors has been the main feature of the official economic policy in Puerto Rico. In turn, since 1947 tax exemption has been one of the main instruments for attracting foreign investors.

Exemption from both federal and Puerto Rico taxes was indeed an attractive proposition for many U.S. corporations. Yet one leg of this two-legged policy disappeared as of 2006: exemption from federal taxation has been phased out. This fact, combined with the global economic recession, has led to a shrinkage of Puerto Rico's manufacturing sector, where jobs have fallen by half in the last 20 years (from close to 170,000 to less than 80,000).

We are thus faced with a paradox: a stagnant economy that nevertheless generates considerable profits for U.S. corporations. As indicated, on the average about $35 billion leave the island every year as earnings of U.S. multinationals. This massive outflow lies at the root of both the present stagnation and the growing debt.

In other words, the Puerto Rican government's unwillingness to reconsider the tax privileges of U.S. corporations has been the key factor perpetuating the present recession and pushing toward increased and ultimately unsustainable borrowing.

Conjuncture: Debt and Austerity

As government revenues fell, successive administrations applied austerity measures such as new sales taxes (IVU) in 2006, mass firing of public employees (law 7) in 2009, attack on pensions and public sector workers (law 66), plus further sales taxes (gasoline) in 2014 and increased IVU in 2015.

This was combined with increased public debt. Puerto Rico's total public debt (including the central government and public corporations) grew 64% between 2006 and 2014, from $43 to $73 billion. Servicing the growing debt demands an increasing portion of the public budget.
On June 29, 2015 the Governor of Puerto Rico admitted that Puerto Rico's debt is "unpayable," as he put it. In other words, paying it in the terms it was originally contracted would impose unacceptable human sacrifices and prevent the government from financing initiatives needed to revive the economy.

This admission is, in itself, a step forward: the Partido del Pueblo Trabajador (PPT, Working Peoples Party) has been arguing as much since February 2014. Yet the Governor's new position on the need for debt restructuring has not led to he determined campaign required to confront the predictable resistance of creditors and Wall Street interests. Worse: trying to placate the latter, the government seeks to combine debt restructuring with harsher austerity measures, contained in its Fiscal Adjustment Plan, made public on September 9.

Alternatives: Creditors vs. Reconstruction

The perspective of Puerto Rico's creditors has been expressed most openly in "For Puerto Rico There is a Better Way," a report commissioned by the Ad Hoc group, which includes close to 40 investment funds that hold part of Puerto Rico's debt.

The document argues that Puerto Rico's public debt should not be renegotiated. It should be paid in full. To enable such payments it proposes closing schools, reducing public employment, lowering salaries and pension benefits of government employees, privatizing government agencies, selling off state properties, and limiting public health insurance coverage, among other measures.
Such austerity programs have been enacted in many countries, as part of the neoliberal policies dominant since the 1980s. Their results have been so disastrous, both socially and in terms of generating economic growth, that even enlightened sectors of the established economic profession have come out against them.

Joseph E. Stiglitz, Nobel Prize winner and former chief economist at the World Bank has denounced the myopic approach of the creditors. He warns:

"Creditors, focusing narrowly and short-sightedly on repayment, force a cutback in government expenditures (austerity), and the combination of financial constraints and decreases in private and public demand bring on a major recession or depression. They wrongly reason that if the country is spending less on itself it has more to spend on others — to repay its debts. But they forget the large multipliers that prevail at such times: the cutbacks in expenditure decrease GDP and tax revenues. The underutilization of the country's resources makes it more difficult for it to fulfill its debt obligation — the austerity policies are normally counterproductive even from the creditors' perspective."

Unfortunately, creditors have more often than not imposed their narrow policies, with dire consequences. They do so through the threat of both market and legal retaliation (denial of further credits and litigation to collect owed payments).
But according to Stiglitz, the capacity of creditors to impose their terms does not only block the efficient resolution of debt crises when they arise — it promotes their emergence to begin with. Creditors, confident that they will recuperate their investment (through litigation if necessary), lend when they should be more cautious.

Such was the case with the $3.5 billion Puerto Rico bond issue in March 2014, just after the government's credit rating had been degraded to speculative or junk level. Governments, conscious of the difficulties and the political cost of seeking debt restructuration, prefer to borrow more and pass the problem to a future administration. This is what successive administrations did in Puerto Rico.

In order to do so, argues Stiglitz, governments agree to ever higher interest payments and further concessions, such as the litigation of any disputes in U.S. courts. This is what happened in Puerto Rico.

Finally, the foreseeable success of creditors in the courts invites the intervention of vulture funds. They buy distressed bonds at a discount price and seek payment at their nominal value; their business depends on debt renegotiation failing or being insufficient. This is also the situation in Puerto Rico where at least 25%, and perhaps as much as 50% of the debt has been acquired by hedge and vulture funds.

In Puerto Rico, this debt-promoting machine had an additional lever: the exemption of its bonds anywhere in the United States from local, state and federal taxes.

Such are the guilty parties in our drama: a government unwilling to reconsider a failed tax exemption policy, investors eager to acquire triply tax-exempt bonds, intermediaries happy to collect the fees for issuing them, and a creditor-friendly framework that promotes over indebtedness.

Escaping Disaster: A Road Forward

According to Stiglitz, overly indebted countries do not need short-term temporary relief, nor regressive austerity measures, but rather measures that allow them to reconstruct their economies. Economies should not be subordinated to the debt; on the contrary, debt payments should be subordinated to the needs of economic rehabilitation.

In Puerto Rico this must include a reconsideration of the tax exemption policy mentioned above, which allows around $35 billion in profits to leave the island every year while not generating economic growth. Yet the government insists in combining its plea for debt restructuring with both unjust and regressive austerity measures and a return to the pre-1996 combined local and federal tax exemption policy. In other words, instead of revising its reliance on tax exemption it seeks to revive it.

The proposed labor “reforms” include redefining overtime in order to reduce compensations for it, weakening seniority rights, making firings easier and reducing severance pay, excluding young workers (under age 25) from increases in the federal minimum wage, eroding the right to an end-of-the-year bonus and eliminating it for young workers, and extending probation periods from 90 days to one year.

Through attrition, the plan also seeks to reduce government employment by 2% every year and extends to 2020 the suspension of labor rights and many contract dispositions, decreed in 2014 through Law 66. The plan also includes the operation of more government services as Public Private Partnerships as well as the privatization of the generation of electricity.

The mix of limited debt relief, extended corporate tax exemptions and/or reductions and austerity measures can only result in extended recession and perpetuation of the present economic structure characterized by the extraction of profits, high unemployment and lack of development funds.

Even debt renegotiation is uncertain. The government is seeking a voluntary agreement with bondholders, which is not likely. It also hopes that Congress will approve legislation extending Chapter 9 of the U.S. bankruptcy code to Puerto Rico, thus allowing its public corporations to file for bankruptcy under federal legislation (as Detroit has done).

So far the bills pending in Congress show little promise. What will the government do if bondholders fail to negotiate or if Congress does not act? Nobody knows.
There seems to be no Plan B.

If Congress does act, Puerto Rico’s situation would be in the hands of a federal judge. In that case, how will the government act to insure that the judge’s decisions are beneficial to Puerto Rico? This

is also unknown.

The PPT has put forward a five-point program for escaping the disaster, including:

• revision of the tax exemption policy, as an emergency revenue measure and as part of a larger shift in economic strategy

• true renegotiation of the debt to prioritize fairness and economic efficiency, a process that must include, first, a citizens' audit of the debt in order to determine which parts of it are illegal or illegitimate and to determine who exactly owns it and under what conditions it was acquired, as well as secondly, a willingness to unilaterally suspend payments when appropriate.

• democratic and participatory public sector reform that transforms how services are provided and resources are used (ending both corruption and mismanagement).

• a program of economic reconstruction that should emphasize internal initiatives (public, cooperative, private) that enhance workers' rights and participation, distribute wealth more equally, and reinvest in the island the surpluses or profits generated.

• federal support and financing for such a project, which would also be funded through tax and debt measures mentioned above.

Fifteen years ago, mass mobilizations and activism in the island and the United States forced the U.S. Navy out of Vieques (an island the U.S. military used as a base for target practice). With or without Chapter 9, similar actions are needed if bondholders, the courts, Congress and the White House are going to respect Puerto Rico's needs. Yet Puerto Rico's government is intent on attacking, not mobilizing Puerto Rico's working people.

Such a project demands an expansion of the public sector, eonomic planning at the expense of the destructive imperatives of capitalist competition, and placing social well-being over private profits, that is to say, the very opposite of the neoliberal policies dominant since the 1980s.

This is not a local agenda. Broadly speaking, this must also be the agenda of working people in the United States, who are suffering the consequences of several decades of pro-business policies promoted by both dominant political parties. All the more reason, then, to combine the agendas of progressive movements in Puerto Rico and the United States.

The fact that these movements are still minority forces in both the United States and Puerto Rico makes it all the more urgent that those seeking to build them join forces and collaborate as effectively as possible.

Notes

• See César J. Ayala, Rafael Bernabe, Puerto Rico in the American Century:
a History Since 1898 (Chapel Hill: U. of North Carolina Press, 2006).

• See Puerto Rico Fiscal and Economic Growth Plan, available in web page of Puerto Rico Government Development Bank. In part, it seeks to replace tax exemptions with lower tax rates for corporations, a simpler way of achieving the same result.

• On the Partido del Pueblo Trabajador see its statements in pueblotrabajador.com and my article in New Politics Summer 2015 "Puerto Rico's New Party of the Working People Fights Austerity" www.newpol.org

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