

## U.S. Colonialism and Puerto Rico's Fiscal Crisis

The mainstream media looks at the illness, ignores the root causes

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Puerto Rico, is usually thought of as a tourism destination or is usually invisible in the U.S. media. In recent times, its fiscal and economic crisis has led to show up in the business pages of the mainstream media with inaccurate comparisons with Detroit or Greece whose fiscal crisis had attracted much media attention. As usual, the mainstream press looks at the illness without looking at the root causes. And the comparisons are usually risky because they tend to ignore history and the nuances of each case. Unfortunately for Puerto Rico, its fuzzy political relationship with the United States is always described with euphemisms by the supporters of the governing Popular Democratic Party ("Commonwealth") in order to avoid the undeniable truth: Puerto Rico is a colonial possession of the United States in the 21<sup>st</sup> century.

The colonial model that was developed after World War II is entering a stage of complete collapse and the colonial government has few alternatives to repair the economic crisis. Without the power to enter trade agreements, forced to use the U.S. Merchant Marine, no control over its currency Puerto Rico and inability to protect its economic sectors with tariffs Puerto Rico is like a ship adrift without the oars to set a direction. But the United States, and the Puerto Rican supporters of the colonial status, like an alcoholic, has always been in denial of the fact that a democratic nation should not have colonies. But in Puerto Rico the wall of denials is cracking and threatening to impact the U.S economy and national security.

In mid-march Puerto Rico's colonial government chose to drink of the same medicine that has ailed its economy during the last five decades. After having its credit rating downgraded to junk status it negotiated with the Wall Street vultures and was able to finagle another emission of \$3.5 billion in the municipal bond market at 8 per cent interest, one of the highest rates the island has ever paid for borrowing funds. In Wall Street they rang bells in celebration and Puerto Rican government officials with smiles in their faces were photographed celebrating the occasion. These funds, which would have been effective as a stimulus to the economy that could have increased employment by repairing the deteriorated infrastructure, including schools, highways, pipelines, energy, and funding higher education. Instead these funds will be used to pay the public debt.

And, in order to gain the trust of the Wall Street bond holders the Popular Democratic government, elected in an anti-neo-liberal wave in 2012 chose to "reform" the Teachers' Pension Fund which reduces their benefits significantly. Despite the fact that there were less onerous possible measures the government, in order to appease the Wall Street interest chose to reduce the retirement to 75,000 teachers. This has caused that close to 7,000 will likely retire in August in order to get other jobs or emigrate. This will create a crisis in the public school system. The teachers went on a two-day strike in January and have their legal case pending in the Island's Supreme Court.

More recently, the legislature is considering a euphemistically called reform of the public agency which produces electricity, a publicly-owned agency with strong unions, which will essentially privatize one of the last remaining bulwarks of the local “new deal” in the 1940s efforts to create local control over basic resources. This public agency, just like the Tennessee Valley Authority, created to provide the infrastructure for the economic development of the island by offering energy at reasonable prices. But, the colonial governments that have mishandled the economy in the last five decades chose to milk the agency by providing a subsidy their local cronies in municipal governments throughout the island, an outflow that has risen to \$400 million a year. That is 95% of the \$276 million loss the agency had in 2013. The colonial government has chosen a slippery slope that will only end when the economy and its people hit rock bottom. The most patent consequence of the crisis and the policies implemented by the colonial government is the gradual depopulation of the island.

### Declining Population

An analysis performed by the Center of Puerto Rican Studies (2014) indicates that the population of Puerto Rico declined from 3,721,208 in 2010 to 3,615,086 in 2013. A decline rate of 1 per cent per year while at the same time the natural growth of the population has declined 13 per cent between 2012 and 2013. Also 200,000 have emigrated since 2000. The median age of the Puerto Rican population is 37.8 which means it is higher than the median of the U.S. population. Puerto Rico is the only area under the U.S. jurisdiction that has declined so dramatically in population. Florida is catching up on New York as a site of Puerto Ricans settlement. In fact, in the 2012 elections President Obama received the electoral votes of this state thanks to the Puerto Rican vote which nationally voted 83 per cent for Democrats.

But there is not a massive “brain drain” occurring in the emigration flow. In fact, most of the emigrants are less educated than the non-emigrant population according to a study covering 2000-2011 by Kurt Birson of the Center for Puerto Rican Studies of Hunter College, CUNY. While there are a significant number of professionals among the emigrants, only 15 per cent hold a bachelor’s degree and 5 per cent a graduate degree, a slightly smaller representation than the non-emigrant population. Many of these emigrants, especially those with lower levels of education, although U.S. citizens (Puerto Rican had U.S. citizenship imposed statutorily by the 1917 Jones Act) are finding themselves competing with undocumented workers in certain job markets in the south.

### The Fiscal Debt of Puerto Rico

The basic problem of the Puerto Rico model is the failure of its economic system to provide the revenue to pay for services. While in the early stages of what was called “Operation Bootstrap” there was a closing of the gap in wages between Puerto Rico and the United States. But after the 1970s the gap began to expand. Part of the reason was the decline in unionization rates, and the decline in the economic development efforts which led to less revenues going to the government coffers. Since the 1970s, they began to rely on debt to pay for basic public services and to pay for previous debt. Since last February 4, 2014, Standard & Poor’s, Moody’s and Fitch have downgraded its debt to junk status, brushing aside a series of austerity measures taken by the new governor which were considered necessary but only helped to avoid a further lowering of the credit rating. Also, despite the announced radical measures by the governor of Puerto Rico’s Governor Alejandro Garcia

Padilla to reduce appropriations by \$170 million and plans to have a balanced budget for 2015, Standard & Poor the government issued new debt and may have to return to the market to cover a 2015 deficit. This is a chaotic situation given that the public debt of Puerto Rico is \$71 billion dollars or 102 per cent of the island's GNP the highest of any state in the U.S. The debt income ratio is 83 per cent (Villamil, 2014) almost 14 times the same measure as New York, California or Illinois. The island is paying close to \$3.7 billion a year to service the debt. To compound the situation the labor participation rate has declined to 41.3 per cent (one of the lowest in the world). In addition, the unemployment rate is 15.4 per cent, highest than any state of the U.S.

### The Genealogy of the Crisis

In order to obtain some revenue from these newly incorporated "controlled foreign corporations" the colonial government instituted Law 154 to tax these corporations at a rate of 4 per cent, in an industry that has become addicted to low taxes this measure has not been received well. In 2012 the government received \$1.8 billion dollars from this measure. A local economist Argeo Quiñones has argued that instead of this tax the government should legislate to increase the backward linkages of these enterprises. In other words to provide incentives so that they buy a higher percentage of their industrial inputs to infuse more money into the economy and further increase employment. Pharmaceutical corporations, for example, produce goods that are not available to the local retail drug establishments, this "crisscross" effect leads to these products being sent to their matrix in the U.S. and there re-sold to the local drug establishments.

Because of the reliance on local tax exemptions, "controlled foreign corporations" are not subject to federal taxes and at times they sell their intellectual rights (like Microsoft USA) to their local foreign owned subsidiary (since Puerto Rico is foreign for tax purposes) and are able to save billions of dollar in the sales in the U.S. market. The Congress Committee on Homeland Security and Governmental Affairs (October 12, 2012), chaired by Senator Max Baucus found that: "In 2011, this corporate sleight of hand enabled Microsoft USA to shift 47 cent of every dollar in U.S. sales totaling \$6 billion, to its Puerto Rican subsidiary, dodging payments of U.S. taxes on nearly half of its U.S. sales income." In the meantime, foreign corporations in Puerto Rico, predominantly from the U.S. repatriated \$33 billion in profits in 2012. The colony is good for U.S. businesses. It is also good for drug traffickers, Puerto Rico is a transshipment point for drugs into the United States that brought in \$5 billion in drug trafficking activity in Puerto Rico in 2011. This is 10 per cent of the island's gross domestic product (GDP). While 7 per cent of the U.S. bound cocaine trafficking came through the Caribbean in 2011, 14 per cent came along this route in 2013. Although irrational the United States decided to shut down a radar system the Over the Horizon Radar (OHT) located in Puerto Rico and Vieques that was used to track drug trafficking and spying.

### The Eternal Status Issue

Recently, in 2012 the regular election included a referendum on Puerto Rico's status. The referendum had two parts, one in which people had to choose whether they were satisfied with the present "territorial status" status, given the long term efforts to improve it the results of this vote were not a surprise. 54 per cent of the voters chose that they were not satisfied with the present colonial status. In the second part of the referendum people were given three choices but the present status of "commonwealth" was not included. The purpose was to disperse the pro-commonwealth vote and highlight the pro-statehood vote. However, in protest for the language of the ballot the PPD asked its supporters to leave the

ballots blank. In this round, while statehood received the highest percentage of the votes 44.4 per cent it is the lowest pro-statehood vote since 1998 and 1993. When the blank votes are added to the rest 54.7 per cent of voter rejected statehood. But in sum, these results have confused the issue for congress and while the Obama administration approved funding for another plebiscite and another bill is in Congress to ask voter "Yes or No" on statehood no reasonable observer expects any clear result from these efforts. Especially when the General Accounting Office (GAO) in March released a study where the consequences of statehood for Puerto Rico will be dismal, what remains of the manufacturing sector will leave and what will be left is a population dependent on federal subsidies.

Puerto Ricans need a clear path toward the resolution of their political status. This will have dire consequences for all, Puerto Rico and the United States.

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#### Notes

1. Jose R. Villamil. "Why Puerto Rico's Economy Matters for U.S. Security." Washington, D.C.: Center for Strategic & International Studies, January 2014.

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