Puerto Rico’s pensions in the crosshairs

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The territory of Puerto Rico is facing a serious economic and financial crisis that many analysts describe as the prelude to a default. In response, investors are pursuing policies and measures that would protect their capital by attacking pensions and workers’ living conditions.

Puerto Rico is a US unincorporated territory with commonwealth status. Its practice of offering tax exemption has attracted some of the most rapacious investors in the world—in particular, from the US. The island is home to pharmaceutical, electronics and textile manufacturing multinationals such as Abbott, Johnson & Johnson and Medtronic, which find a fiscal haven as well as a cheap labor pool in Puerto Rico.

Financial problems began to become apparent in 2006, when some of the US Treasury tax breaks came to an end. This reflected deep-seated international problems that took full expression with the global crisis of 2008. Puerto Rico’s economy started spiraling into chronic debt, as it sought to finance its deficits through the issuance of attractive tax-free bonds.

Puerto Rico’s public debt has now reached $70 billion, or about 70 percent of its GDP. Its unfunded pension liabilities amount to $36 billion. Unemployment has reached an official level of 15.4 percent, with an anemic 63 percent total labor participation rate. The island has been in a recession almost the entire time since the 2008 financial crash.

Last February, S&P downgraded Puerto Rico’s credit rating for credit obligation bonds to junk level, instigating a process of capital flight. At the same time, other companies like Seaborne Airlines, Cooper Vision and Eli Lilly have recently established their presence in anticipation of new pro-corporate policies promoted by the political establishment.

Increasing poverty, social inequality and the rise of crime are the logical consequences of such a dire situation.

Comparisons have already been made with Detroit, where similar social conditions plague workers. In what was once the pride of US economic power, Emergency Manager Kevyn Orr’s bankruptcy restructuring plan, implemented through the use of a federal bankruptcy court, reduces pensions by more than 50 percent for old retirees and freezes current employees’ pension benefits.

Since he took office in January 2013, Governor Alejandro Garcia Padilla (Popular Democratic Party, affiliated to the US Democratic Party) has implemented harsh austerity measures against workers, ranging from an increase in taxation equal to 1.1 percent of gross national product to the conversion of traditional pensions to 401(k)-type plans.

As part of his pension “reform,” higher contributions (10 percent from 9 percent) are required from workers, and the retirement age has been increased (from 50 to 62 for new hires, from 55 to 60 for current employees).

Puerto Rico’s status as a US territory differentiates the island from Detroit. Territories, like states, differ from municipalities, as they are considered unable to declare bankruptcy under the United States Code, at least thus far.

In 2012, the Northern Mariana Islands, also a US territory with commonwealth status, filed for bankruptcy, but the filing was rejected on the basis that its Mariana Islands Retirement Fund is a “governmental unit” and cannot be subject to chapter 11 pursuant to the Bankruptcy Code.

But since at least 2010, proposals have been quietly raised by both Senate Democrats and Republicans that explore the ability of states to declare bankruptcy for the express purpose of getting out of the pension debt they have to workers.

US senator John Cornyn (R-TX) has sponsored the idea somewhat discreetly in order to prevent fears of destabilization in the municipal bonds market. As early as 2011, he communicated to Federal Reserve chairman Ben Bernanke concerning the possibility of a hearing, and last December, he introduced the Taxpayer Protection and Responsible Resolution.

The proposal would end bailouts for large financial institutions by instituting a new chapter 14 of the Bankruptcy Code, initially available to "covered financial corporations." An extension to state bankruptcy would still require a constitutional amendment to overcome any interference with state sovereignty.

In the mid-1930s, the Supreme Court initially rejected the New Deal Congress proposal for municipal bankruptcy law, until it approved the 1937 version as it was "carefully drawn so as not to impinge upon the sovereignty of the State."

Some have instead proposed that, in order to avoid the constitutional difficulties as well as "market penalties" resulting in higher borrowing costs for a state and downward pressure on the value of its bonds, the institution of a Greek-style oversight panel for states under financial distress could lead to state restructuring and the dismantling of pensions.

While the specific form in which pensions are to be destroyed may vary based on several factors, one thing is clear: plans are well under way for the gutting of pensions in financially troubled states.

Puerto Rico is certainly next in line. In financial circles, the fear that a default could have a significant impact on the $3.7 trillion US municipal bond market is being utilized to push for prioritizing investors' payback by further attacking pension funds.

There is a material basis to this fear: Puerto Rico's bonds play a similar role to that played by subprime mortgages before 2008. It is estimated that as many as 23 US exchange-traded funds (ETFs) are exposed to Puerto Rico's debt. Top ETFs like the Franklin Double Tax-Free income are exposed by as much as 60 percent of their portfolios.

While state bankruptcy may be an option in the future, a Greek-style bailout is being openly discussed. The S&P downgrade thus serves the purpose of making it more difficult to obtain funding through the market. As of now, the interest to service its debt is estimated to be as high as 9 percent.

The diktats of the International Monetary Fund and exposed US financial institutions like OppenheimerFunds Inc., Goldman Sachs and Franklin Resources Inc. will decide how quickly and how hard workers will be hit by renewed attacks on social programs, jobs and the privatization of public assets.