Puerto Rico: Regressive taxes levied on workers as island’s economy falters

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For almost 10 years, since the expiration of a US federal tax credit that benefited corporate investors followed by the financial collapse of 2008, the US Commonwealth of Puerto Rico has suffered through an economic crisis used by hedge funds and bondholders to hold it hostage. As the island’s official unemployment rate remains above 13 percent and workers leave in the tens of thousands for the US mainland, predatory financiers are creating tax havens for themselves and using the federal courts to protect their interests.

The use of Puerto Rico’s crisis to attack workers’ rights was expressed last June in an emergency law that froze wages, sick leave and other benefits for government workers.

At the same time, a second law was passed giving authority to the Puerto Rican Electric and Power Authority (PREPA) to restructure its debts, which total approximately $9 billion. This law, modeled on Chapter 9 of the US federal bankruptcy code, was challenged in US District Court by investors that included Franklin Templeton, Oppenheimer, BlueMountain Capital and others.

Puerto Rico had sought to define PREPA as a “municipality” which, with state approval, could seek bankruptcy under Chapter 9. The federal law, however, explicitly states that Puerto Rico is not defined as a state for this purpose. On February 6, the US District Court for the District of Puerto Rico ruled against the debt restructuring law and in favor of investors.

Last Thursday, the island’s Resident Commissioner in the US Congress, Pedro Pierluisi, introduced a bill in the House of Representatives that would change this definition so that the restructuring can proceed. Pierluisi is the only representative to Congress from an island of 3.7 million people, and does not have a vote. In seeking to amend Chapter 9, he is looking to copy the attacks on workers that have recently occurred in Detroit and Stockton. While predatory lenders are fighting to protect their immediate interests, sections of the Puerto Rican bourgeoisie view bankruptcy as preferable to default or some types of receivership.

In his decision, District Judge Francisco A. Besosa, wrote that “plaintiff bondholders … should not be forced to live with such substantially impaired contractual rights—rights that they bargained for when they purchased the nearly two billion dollars worth of PREPA bonds that they hold collectively.” The rights of PREPA’s workers will not be treated so gingerly by the courts when push comes to shove. The electric authority employs more than 9,500 people, of whom nearly 6,800 are unionized.

Quoting a 2005 Supreme Court ruling, Besosa also issued a warning to PREPA workers and anyone who purchases energy from the agency: that he sought to “bar the government ‘from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.’”

PREPA, under “forbearance agreements” with large creditors that include Citibank and Scotiabank, is already subjected to strict reviews of its Accounts Receivable and meter reading practices. A November 2014 report issued by FTI Capital Advisors noted as a “positive observation” that the agency had lowered its cut-off period for non-payment from 55 to 50 days.

As the only provider of electricity in Puerto Rico, PREPA is essentially a state-run monopoly that runs 14 plants and services about 1.5 million customers. No doubt there are interests lining up behind the scenes to advocate for its privatization.

Puerto Rico’s General Obligation bonds were also downgraded by Moody’s on February 19. GO bonds are funded in part from the island's 7 percent sales and use tax through a government-owned corporation established in 2006. Not satisfied with revenues from this regressive tax, the government is now trying to replace it with a 16 percent value added tax which would be applied to many imports as well as items produced on the island. It argues that there is a large informal economy that is escaping the sales tax. While the VAT (or IVU in Spanish) would supposedly include features to limit its regressivity, they come in the form of refunds that are paid out only three times a year and limited to $600.

Rather than build a movement of workers against capitalism, Puerto Rican labor unions and the New Progressive Party (NPP) are advocating pressure on the government. The *San Juan Daily Star* quoted Luis Pedraza Leduc of the Electrical and Irrigation Workers Union Solidarity Program as advocating "real" tax reform while "recognizing that there is an existing need to restructure the public debt." NPP gubernatorial candidate Ricardo Roselló called for a "united front" to "bring together all sectors and allow them the necessary time to achieve a transparent and thorough discussion."

While workers suffer, the government is giving grotesque tax breaks to the wealthy. Under laws passed in 2012, hedge funds located in Puerto Rico now pay only 4 percent tax on profits from exported services, and no tax is charged on capital gains for people who become Puerto Rican citizens. Citizenship means living on the island 183 days out of the year and, as *Forbes* glibly writes, "your driver's license and yacht should … move with you to the island."

"Puerto Rico-sourced income" of residents is also not subject to US income tax. The arrogance of the financial aristocracy taking advantage of these measures was expressed by a money manager who told *Forbes,* "the way the US tax code is written, I could be on Mars and be taxed on intergalactic income but not if I'm sitting on this island in the Caribbean." Last week the *Orlando Centinel* quoted Rudy Giuliani as saying that more such people would go to Puerto Rico if beggars were taken off the streets.

Criminality is a characteristic of the banking industry. On Friday, the FDIC shut down Doral Financial Corporation and its subsidiary Doral Bank, which have been investigated for fraud and seen their stock prices drop. *El Nuevo Día* reported that workers were crying and in shock as they were escorted from the building. The FDIC waited until the end of the day before tens of its agents descended on the company's headquarters in Guaynabo.

Doral employed more than 800 people, of whom approximately 100 will become employees of FirstBank and 80 will be offered work at Banco Popular. Those two companies are buying Doral's branches, but its central offices will be shut.

The FDIC expects to lose $750 million in the closure. Doral had total assets of $5.9 billion and total deposits of $4.1 billion. While the FDIC claimed on Friday that no deposits would be lost, it will ensure them only to its standard amount of $250,000. Doral had attempted to balance its books with a $230 million tax credit it expected from the Puerto Rican government, but regulators would not allow this maneuver.

Doral is the largest US bank to fail since three other Puerto Rican banks—Westernbank, R-G Premier Bank and Eurobank—collapsed in 2010. As of December 2014, the total losses registered by the FDIC from those failures were also about $5.9 billion.