

# Austerity budget deepens Puerto Rico's economic crisis

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Puerto Rico's House and Senate have passed similar versions of an austerity budget for the year beginning July 1, increasing the sales and use tax from 7 percent to 11.5 percent and cutting \$674 million from the budget. The cuts will hit a long list of social needs, including public schools, the University of Puerto Rico system, domestic violence programs, art museums, and the Puerto Rican League Against Cancer.

Despite this plan to balance the island's budget on the backs of its workers, Moody's last week downgraded the debt of Puerto Rico's Government Development Bank by three levels, to Ca; Bloomberg Business is reporting that the GDB will run out of cash by September 30 unless it sells a new bond issue backed by taxes on oil. There is only one rating lower than Ca on Moody's scale.

Moody's also downgraded Puerto Rico's General Obligation bonds by one notch to Caa2. The latter rating falls in Moody's "extremely speculative" category.

Puerto Rico's economic crisis, which began in 2006, predates the global crash of 2008 and is causing social devastation. According to US Bureau of Labor Statistics data, the island's labor force has dropped from more than 1.4 million in January 2006 to less than 1.15 million currently. Approximately 144,000 people left for the US mainland in 2014. The official unemployment rate, which was 15 percent at the end of 2013, is now slightly less than 12 percent even though the number of employed workers has increased by only 10,700.

Puerto Rico, officially a "commonwealth" of the United States, is suffering not just from predatory lending by large banks, but also from inadequate federal funding. While Pedro Pierluisi, the island's non-voting Resident Commissioner in the US House of

Representatives, is advocating an amendment to Chapter 9 of the federal bankruptcy code so that it covers Puerto Rico, its Medicare block grant is so underfunded that it likely will be spent out two years early.

According to the *Independent*, the grant has not paid doctors' fees since March. The paper quotes the president of the Physicians and Surgeons Association as comparing the austerity to "genocide" after an insurance company refused to pay for post-surgery drugs for a liver transplant patient. Three hundred and sixty one doctors left Puerto Rico last year.

Pierluisi, a member of both the New Progressive Party and the US Democratic Party, favors austerity over a sales tax hike. While opposing the latter, he told a recent NPP legislative conference that "what the government needs to do is go line by line in the budgets of all the agencies and eliminate all excessive and unnecessary expenses," according to the Puerto Rican newspaper *La Esquina*.

The Puerto Rican government's planned cuts of \$674 million represent nearly 7 percent of its total budget of \$9.8 billion. The government is claiming that there will be no layoffs, even though 4,000 of its workers will be affected by the consolidation of 18 different agencies. Nearly 100 public schools will be closed, while the University of Puerto Rico system will suffer cuts of \$166 million.

On May 13, thousands of university students marched from the state capitol building toward the Governor's residence at La Fortaleza, but were blocked by police who used a baton to attack one marchers. The police had also set up fencing on the steps of the capitol to keep protesters out. The students carried placards protesting the cuts, including one proclaiming that "Education is an investment, not an expense."

More than 40 percent of Puerto Ricans live below the poverty line, and US Census figures show a median household income of only \$19,500 in 2012. Any increase in the regressive sales tax will worsen conditions for workers. Adding insult to injury, a dedicated portion of the sales tax goes directly to debt service. The island's next debt service payment of \$630 million, scheduled for July, is only slightly less than the ruthless cuts in the budget that are being worked out for next year.

The Puerto Rican government's net tax-supported debt per capita is almost \$15,100 according to Nuveen Asset Management. By comparison, the highest level for a US state—Connecticut—is slightly less than \$5,500. Using May 2014 data from Moody's, Nuveen calculates that Puerto Rico's net debt per capita is 87.5 percent of personal income while the average for all US states is only 3.2 percent.

An 11.5 percent sales and use tax will be split so that 1.5 percent goes to municipalities, 5 percent goes to the Puerto Rican treasury, and 5 percent to the Puerto Rico Urgent Interest Fund Corporation (known by its Spanish acronym, COFINA). COFINA was created in May 2006 and "strengthened" later that year by a law which guaranteed it first dibs on sales tax revenues. That law also set a base for COFINA's sales tax funding, which increases by at least 4 percent each year no matter what the rate of inflation.

While municipal and institutional investors from the mainland are worried about the possibility of a Puerto Rican default, hedge funds are seeking to benefit from the crisis. Some 70 percent of the \$3.5 billion General Obligation bond sale of March 2014 was purchased by hedge funds. The price of those bonds, which have an 8 percent coupon, has increased from 77.6 to 82 cents on the dollar this month, as predatory lenders bet on the outcome.

Sales and oil taxes are not the only methods being used by predatory lenders to bleed Puerto Ricans dry. Companies like UBS are also trying mercilessly to unload their bond holdings on small investors. Wall Street's Financial Industry Regulatory Authority recently ruled that UBS has to pay \$1 million to the retired owner of a bodega after he lost \$737,000 of his life savings to bad bond investments. According to FINRA, UBS was involved in an "internal push" to sell the worthless bonds and "solicited" Juan Burgos

Rosado to put all his money in them.

Reuters reported this month that UBS deliberately tried to dump "its own inventory" on such investors, and that hundreds of additional claims are pending.



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