Puerto Rico’s Fiscal and Economic Problems: The Federal Government Must Play a More Prominent Role

Puerto Rico’s Fiscal and Budget Challenges

The Commonwealth of Puerto Rico needs assistance from the federal government as it struggles to overcome significant and longstanding fiscal and economic problems. After a decade of economic difficulties, Puerto Rico defaulted on a $58 million bond payment in August 2015. In the short term, another $1.4 billion in bond payments are due in December and January and it is unclear whether Puerto Rico will be able to make these bond payments. In the medium term, although current financial and actuarial reports from the pension system are not available, Government Development Bank reports indicate the pension fund may deplete its cash within two to five years. Over the long term, Puerto Rico’s large debt load threatens its economic future.

Puerto Ricans have already suffered nearly a decade of economic difficulties. Puerto Rico’s economy has been in freefall since 2006 – shrinking 14%. In 2015, it is projected to shrink another 1%. Unemployment is double the U.S. average and unusually high numbers of residents are departing for the U.S. mainland. To address budget shortfalls, successive Commonwealth governments have implemented far reaching austerity programs with substantial cuts to public services. Since 2009, public sector employment declined almost 20%; employee compensation increases were delayed or cancelled; pension benefits were reduced; and many taxes were increased.

To address budget shortfalls and maintain public services, Puerto Rico governments have also issued debt. During the last 10 years, Puerto Rico’s total public debt nearly doubled to $73 billion. But as evidenced by the debt default in August, current debt service levels are not sustainable.

The economic challenges afflicting Puerto Rico’s people are compounded because the island is treated inequitably by the federal government compared to states. Puerto Rico receives less federal funding for key federal programs – such as Medicaid – than if it had funding parity with states.

Oppose Austerity Measures

While some propose more budget cuts and related austerity measures, these will only worsen the downward spiral. In addition, efforts to reduce or eliminate minimum wage and other labor standards, and attempts to repeal the Jones Act or suspend its application to Puerto Rico, should be rejected. The welfare of Puerto Rico’s citizens should be the top priority of any recovery plan. Living standards of Puerto Ricans should not be sacrificed for the benefit of hedge fund managers.
Options for Future Debt Payments

Given Puerto Rico’s fiscal problems, the issue of bankruptcy protection has arisen. One proposal would adopt and apply Municipal Bankruptcy (Chapter 9) procedures to the Commonwealth’s municipalities which could include its public corporations. AFSCME recommends a cautious approach to bankruptcy. It is not a panacea and, given the recent experience in Detroit, bankruptcy is likely to further harm workers and retirees by jeopardizing jobs, wages and pensions. It is important to note that the Bankruptcy Chapter 9 process does not provide new financial resources to an entity declaring bankruptcy. Furthermore, in contrast to municipal bankruptcies that occasionally occur on the U.S. mainland, the Commonwealth does not have the structural and financial support of a state government.

The Commonwealth’s debt service burden must be substantially reduced. Much of this reduction can be achieved by refinancing existing debt at lower interest rates and for longer terms. However, refinancing may not provide sufficient relief and, thus, a write down of principal may be necessary.

To enhance transparency and participation, the Commonwealth should conduct a public audit of its debt and allow citizens and stakeholders a meaningful opportunity to participate in this process. The Commonwealth’s financial structure is complex, and an audit should provide a clearer picture of all outstanding debt.

Options for Health Care

Federal health care programs are vital to Puerto Rico, in part because of the high level of poverty. Nearly 60 percent of Puerto Ricans receive their health care from either Medicare or Medicaid. Several bills have been introduced in Congress to increase federal health care funding for Puerto Rico’s government and entities located there. In particular, AFSCME urges the Congress to revise the Federal Medical Assistance Percentage (FMAP) under Medicaid. Currently, the Puerto Rico FMAP reimbursement is 55% of costs but is subject to a cap. By comparison, state reimbursements range from 50% to 83% with poorer states receiving higher reimbursements and no states are subject to a cap on federal financial participation. With a higher poverty rate than any state, an increased FMAP, and elimination of the cap, is a fair and appropriate step. A 2014 Government Accountability Office (GAO) report estimated that if FMAP were applied to Puerto Rico in the same manner as it is to states, the Commonwealth would receive $500 million to $1.5 billion in additional funding annually.

Options for Recovery Plans

Any fiscal recovery plan must provide a fresh start for Puerto Rico. Debt service loads must be manageable on a multi-year basis and not crowd out necessary government services. A fiscal recovery plan must recognize the deep compensation reductions and other continuing sacrifices made by Puerto Rico’s public workers and retirees, including their significant pension benefit concessions in 2013. Workers must be assured there will be no impairment in the payment (refund) of their own contributions, held in trust by the employer.

A fiscal recovery plan must be accompanied by a realistic and robust economic development program that includes the ongoing involvement of the U.S. government. The continued deceleration of economic activity is causing many professional and working class residents to flee. This population loss exacerbates declining economic output, creating a vicious cycle.
A “high road” strategy for rebuilding the economy is necessary. Suggestions to reduce or eliminate labor standards including the minimum wage and/or general compensation levels are not a credible plan for developing economic activity.

New and effective options must be made available to help Puerto Rico’s people. A more prominent and supportive role by the federal government is necessary and inevitable. AFSCME urges the federal government to provide enhanced assistance and supportive options to the Commonwealth of Puerto Rico and its citizens.

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