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Broken PROMESA: Puerto Rico Sinks, But the Life Rafts Can't Save Everyone

By Nico Grant

The Battle for Borinquen

Every night, Carlos Morales leaves his job maintaining buildings for the Puerto Rican government to join the front lines of his island's latest battle.

Armed with pepper spray, Morales crisscrosses San Juan, Carolina and Guaynabo as an Uber driver, picking up tourists in his blue Nissan Sentra.

It's an economic struggle against the taxi hegemony, which has the sole authorization to do pick ups at the airport and major hotels, and has been infuriated by the rise of Uber.

One night, his phone buzzed. Two women staying at the Marriott in swanky Condado requested him. When he arrived, a taxi driver grabbed one of the women's arms to prevent her from getting into the Uber. Morales got the pepper spray and rolled down the window.

"I marinated the dude," he said. "I don't feel too proud about doing that. I actually told them listen if you want to go to the cops and make a complaint I'm more than happy to do that. But they didn't want to."

Morales, otherwise a law-abiding citizen, supervises janitors and plumbers at the Puerto Rican Public Buildings Authority. But as the government shrinks, he expects to be laid off, and he's desperate to pay off his debts before then.

Morales is one of thousands of Puerto Ricans weathering the economic storm behind the wheel of an Uber for the extra cash and flexible hours.

But the cost is conflict with cabdrivers. With tourism now the only thriving sector on the island, Puerto Ricans are fighting one another for the last crumbs of the pie.

Puerto Rico may still be a balmy paradise popular with tourists. But just beneath the sandy shores and palm tree roots, there's an island cracking into shards along economic, social and political lines.

Puerto Rico is \$73 billion in debt, spread among the commonwealth government, municipal governments and state-owned companies, including banks. Puerto Rico accrued the debt by selling triple-tax-exempt bonds to investors in order to finance its budget. But in July 2016, the island defaulted on \$1 billion of constitutionally guaranteed debt.

It's a bleak picture for an island with a GDP of \$104 billion, which dwarfs that of other Caribbean islands. Puerto Rico's debt to GDP ratio is more than three times that of New York, the most indebted state. It's also significantly more than that of the Dominican Republic, a regional competitor with a ratio of 45.6 percent.

The gross domestic product annual growth rate of Puerto Rico has been negative in seven of the last eight years, going down -0.6 percent last year. Ordinary residents haven't escaped unscathed. The unemployment rate is 12.1 percent in Puerto Rico, more than double the U.S. average.

To stop the bleeding, the U.S. Congress passed PROMESA, which is the Spanish word for 'promise.' The law installed a seven-member fiscal oversight panel to help Puerto Rico reduce its debt and jumpstart its economy.

But the fiscal board's desire to impose austerity on the island further dwindles economic output without any guarantees it will be offset in other areas to grow the economy.

The board says part of its strategy is "right sizing government."

"Despite significant potential gains from making government more efficient, the Government will need to make substantial, necessary cuts and revenue changes to balance its budget," the board said in a letter to the departing governor, Alejandro Garcia Padilla, and incoming governor, Ricardo Rosselló Nevares.

In particular, the fiscal board put education and health care spending on the chopping block. The board seeks to slash more than \$1 billion from education alone by reducing the number of schools across the island.

Reducing education, health care and other services that the board deems "non-essential" means cutting jobs and increasing the number of unemployed people. These displaced workers would then be free to leave the island, like the hundreds of thousands who have already left. That would only exacerbate Puerto Rico's viscous economic cycle, in which measures meant to improve competitiveness diminish quality of life and exacerbate the exodus of residents.

Those who stay are expanding the island's tech sector – toiling away with second jobs in the gig economy or trying to bring Silicon Valley innovation to the 'island of enchantment.' But the sector isn't yet large enough to make a difference.

So long as Puerto Ricans keep leaving their homeland, there won't be enough workers to power growth and steer the island to calmer waters. Until something changes, efforts by the board, commonwealth government and ordinary citizens won't be enough to stop the Puerto Rican economy from sinking beneath the Caribbean Sea.

“Say the board is successful with tax collection, budget cuts, efficiency, disclosure and there's a haircut on the bonds. But none of those things are going to fix the economy. The continued loss of Puerto Rico's labor force makes it far, far harder for their economy to come back,” said John Ceffalio, vice president of municipal credit research at AllianceBernstein L.P.

The Response

Puerto Rico finds itself on the precipice. The island's government faces a \$68 billion revenue shortfall over the next 10 years – money it needs to fund health care and pension payments for its people.

As San Juan has seen its coffers depleted, it has cut services from its budget. In the last two years, the government shuttered hundreds of schools, shrank hospitals and slashed healthcare plans. Physicians fled, creating a health care crisis on the island – with many people having to wait long stretches to see a doctor.

The fiscal oversight board is set to double-down on these austerity efforts. The board has emphasized the importance of shrinking spending in the aforementioned areas, consolidating Puerto Rico's government and instituting furloughs and freezes.

“Governments that run fiscal surpluses and have a thriving private sector can afford services beyond those that are essential. Puerto Rico is not in that situation,” the board said in a public letter.

But reducing the size of the Puerto Rican government means cutting jobs for ordinary residents.

Grichelle Toledo is a public school teacher at an elementary school in Carolina. Toledo's school still stands for now, even as it withers away.

“Most of our schools are very old and crumbling,” she said. “Right now, I don't have books. I've been asking the administration for two or three years.”

But help hasn't come. Though some students disappear from the classroom as their families move to the mainland, class sizes are still growing, because teachers are leaving too.

Toledo, 54, gets \$3000 a month because she has a Master's degree, while most of her colleagues get \$1750 a month.

“For 15 years, I've been receiving the same salary — not a cent more,” she said.

The only reason Toledo hasn't left is because she feels a sense of loyalty to her students.

“Someone has to stay. If all the good teachers start moving to the states, what’s going to happen to the students who stay here? The ones from the families that don’t have the money to leave?” she said.

Toledo is one of 227,000 people who work for the government on the island, almost a quarter of all employed people.

“The biggest effect will be on the municipal employees who will stop receiving a check,” said Arnaldo Cruz, co-founder of the Center for Integrity and Public Policy (CIPP), a Puerto Rican think tank that promotes government accountability and free markets.

There are 78 municipal governments across the island, and at least 37 of them get most of their revenue from the central government in San Juan. The local governments are not known for their effectiveness, but they hire workers to collect garbage and provide some health and human services.

In some of the smaller municipalities, payroll can be 40 to 50 percent of the budget, Cruz said. While that can foster debates about the best use of taxpayer money, these municipal jobs support thousands of Puerto Rican households.

And when the fiscal board puts these people out of work, the effects will be less consumer spending in an economy yearning for growth and more workers unmoored from the economy and free to leave.

Exodus

The failure of austerity has meant worsening economic opportunities and quality of life on the island. The result has been an outmigration crisis. In 2014 and 2015, 130,000 people have left Puerto Rico for the U.S. mainland. In total, the island has lost 334,000 people since 2000, according to Pew Research.

That’s 10 percent of the population.

Most of those people left after 2010. And the number of people leaving increased in the last few years – coinciding with the loss of jobs and some government services.

It’s a phenomenon that analysts find worrisome.

“When you look at the population decline, that’s catastrophic. That means less people to pay the taxes. Less people to pay debt service,” said Ceffalio, the municipal bond analyst.

Across Puerto Rico, people are making plans to leave the island for more opportunities on the mainland.

Ana Gonzalez Rodriguez is tired of being unemployed for years. She's tired of searching in vain for houses to clean and senior citizens to care for. She's tired of going to the local unemployment office in San Juan to collect \$100 a month.

"It's very difficult. Very difficult. Sometimes I can care for an older person for \$60, but that's it," she said.

Rodriguez isn't sticking around to see whether the PROMESA board can help her. In March, she's off to New Jersey to live with her daughter.

These departures are having a severe impact on the demographics of the island.

"The people who are leaving are of working age, and they're leaving behind a smaller, older population," Ceffalio said.

In 2009, the median age of an islander was 35.3. In 2015, that number leaped to 38.7.

Some young people who are still in school have already decided to move to the mainland to pursue dreams they don't think are possible in Puerto Rico.

Francisco Javier Hernandez has already made up his mind. He sat on a bench at Paseo de Diego, a pedestrian shopping plaza in Rio Piedras whose shops are mostly shuttered. He smoked a cigarette with a friend visiting from New York and they discussed their passion for making music.

Hernandez is enrolled at a barber school in San Juan, until August. But he has no intentions of cutting hair in Puerto Rico.

"In this place I'm not gonna get a better future. I'm gonna go to the U.S. I would like to make my own company," Hernandez said.

Those Who Stay

While most industries in Puerto Rico have withered, new technology has come to this old island. With it, novel work and opportunities have emerged as a source of hope in the Puerto Rican economy.

A diverse cross-section of San Juan residents survives economic strife with the help of Uber.

The California-based ride-sharing app launched in the Puerto Rican capital in July. More than 3000 people signed up to be drivers overnight – more than the service could process and approve.

Most of them have never before driven professionally, but feel a desperation and determination to pedal faster than the economic storm.

Isabel Balado was fired as a coordinator in a hospice in July, after their number of patients collapsed. Balado, 56, started looking for a job, but couldn't find anything, even though she has a Masters degree.

"Uber has saved my life," Balado said. "It gave me the opportunity to at least have a cash flow for my expenses as I try to build a business as a realtor."

Balado, a suburban mother of two, is just as improbable an Uber driver as her car is an Uber – a small Hyundai Veloster. But in this economic climate, she feels she doesn't have a choice.

"I'm going to be working until I'm 125," she said.

Also zipping through the highways in search of more money is Rafael Recondo. He said driving for Uber allowed him to set his own hours and spend more time with his two young children. Additionally, he waits tables at a restaurant in Old San Juan and freelances as an insurance agent.

For Recondo, 43, Uber is picking up the slack.

"Uber is very important mostly for the paying of the car and day-by-day expenses: food, medicine and clothes," he said.

Some people are joining the gig economy as independent contractors because other industries are on the rocks. Retail trade has traditionally been a strong employer in Puerto Rico. But for years, retail sales have had negative growth, as customers flee the island and others cut back.

Wilfredo Rodriguez Rivera hopes to one day make enough driving for Uber so that he no longer needs his part-time job at Kmart.

He makes \$200 per week from Uber, the same as he makes from Kmart. Rivera, 45, is uncertain of his future at the store, and wants more self-control over his finances on an island that's rapidly changing.

"I'm saving money. And paying my bills," he said. "Everything is going to change."

But this new source of work and income comes at the expense of professional taxi drivers, who've long relied on the tourists now using Uber.

In front of San Juan hotels and plazas, groups of taxi drivers sit on the curb, asking strolling tourists if they want a lift.

Since July 2016, there have been dozens of reported instances of cabbies confronting or attacking Uber drivers.

Outside of the Sheraton Old San Juan in October, a taxi driver started yelling at an Uber driver at 4 a.m. for picking up two passengers.

“What are you doing man?” he said.

The Uber driver ignored him and got into the car.

The taxi driver threw a rock at the rear windshield as the Uber drove off.

For new Uber drivers, it’s become an occupational hazard.

While not all taxi drivers have become violent, it’s difficult to find one who isn’t upset about Uber.

“They’re taking somebody else’s job. Some taxi drivers are losing their job. That’s not right,” said a taxi driver who only identified himself as Gilberto. Gilberto said that he had taken in a few of his friends who could no longer afford their homes.

Taxi driver Antonio Moll said he hasn’t been as affected by Uber as many of the cabdrivers he knows because he has a network of repeat clients. But he said there’s reason to be angry.

“I understand why people like Uber, because it’s cheap. But they don’t even have a chauffeur’s license. They’re like nomads out here. No regulation at all. No public responsibility. No insurance,” he said.

* * *

Alongside the push to use Silicon Valley technology to help the Puerto Rican economy, entrepreneurs and the government are seeking to cultivate tech innovation to diversify Puerto Rico’s economy.

Sofia Stolberg started Puerto Rico’s first coworking space in 2013, Piloto 151, with an eye toward becoming a growth platform for entrepreneurs. She’s now the CEO of Piloto and CodeTrotters, the first coding school in Puerto Rico and the Caribbean.

“With that, we aim to form and educate the next wave of innovators for the startup and tech ecosystem here,” she said.

Piloto 151 has 300 clients and will expand to a second location in early 2017.

Stolberg said that Puerto Rico's financial catastrophe hasn't stopped tech from growing on the island since 2010, and she sees new opportunities for growth.

"Yes, there is a fiscal crisis. But within that crisis, there is space for new players to come in and create products and services that perhaps wouldn't have been possible prior to the economic recession," she said.

Stolberg is bullish on the power of technology to transform Puerto Rico one day.

"It really only takes one big success story. So what we want is what Skype did to Estonia – just completely changed the economic landscape. That's what we need," she said.

The government in San Juan has also decided that Puerto Rico needs a big tech breakout.

Parallel 18 is a government-funded initiative to develop a startup culture on the island. It was modeled after Startup Chile, and is run by the same man, Executive Director Sebastian Vidal. The program taught 36 startups how to scale up with new skills and connections over a five-month period, as well giving a \$40,000 grant to each company.

Sixty percent of the companies are tech startups, with the rest building hardware, consumer products and offering sustainability solutions.

Vidal extolls the virtues of Puerto Rico as a place for tech investment.

"Puerto Rico has become a very interesting and powerful platform for startups to scale to bigger markets. And bigger markets mean Latin America and the U.S.," he said.

The point of the program is to maximize Puerto Rico's advantages for economic gain, including its bilingual workforce, geography between North and South America, good infrastructure and the protection of U.S. laws.

Vidal says the investment by the cash-strapped Puerto Rican government, including \$1.44 million in grants alone, are worth it.

"After the program ends, there were 75 freelancers, interns and full-time employees working with 36 companies. And that's huge, because those were 75 people who were leaving the island who decided to stay," he said.

One success story has been Gasolina Movil, an app founded in Puerto Rico in 2015 that allows users to pay for gas at stations. During the program, the company forged deals with major oil companies. The app now works at Shell and Gulf stations across Puerto Rico.

The problem is that these companies are startups. They aren't all large enough to fully sustain themselves, far less an economy of three million people.

And it's unclear whether the fiscal oversight board will find Parallel 18 to be a worthwhile investment when the government won't have the cash flow to pay its own employees in February.

Proponents say that these companies will plant the seeds of a more prosperous future for Puerto Rico. But with a shedding workforce, the tech sector can't yet be the savior Puerto Rico needs.

The Narrow Path Forward

If everything goes right for the fiscal board, there's a slim pathway to heal the Puerto Rican economy.

If the board has success reducing Puerto Rican debt and putting the island on a sustainable fiscal trajectory, that could instill confidence among businesses and investors.

That renewed confidence could complement efforts to flatten corporate taxes and Puerto Rico's lowered minimum wage of \$4.25 for those aged 24 and under. These factors could spur some companies to pursue direct investment in Puerto Rico as a way to reduce overhead costs from elsewhere.

That might be especially true during Trump's presidency, if he makes outsourcing to foreign countries more difficult, as he has promised. He vowed to scuttle the Trans Pacific Partnership, and said he would renegotiate NAFTA or punish companies who move jobs to Mexico.

So the Puerto Rican economy, without tariffs, might pitch itself as a 'new' Mexico – eager to absorb slashed-wage jobs snatched from the mainland.

In the short- and medium-term, this could mean more jobs for ordinary Puerto Ricans. And since wages would be low, workers are likely to spend all of the money they earn, so it would circulate throughout the Puerto Rican economy, in a boost to consumption.

But even in Trump's America, this seems too improbable to come to pass.

For one, it would require investors to bet on Puerto Rico before the economy is on solid footing. And few want to be first.

“We'd like to invest in Puerto Rico again, but we're waiting for it to grow again first,” said Ceffalio, the municipal bond investor.

Broader efforts to reestablish Puerto Rican competitiveness face challenges.

The Jones Act, forcing companies that ship goods between U.S. ports to use vessels built, owned and operated by Americans, also puts a wrench in Puerto Rico's potential gain of manufacturing jobs. Also known as the Merchant Marine Act of 1920, the law makes transporting goods between Puerto Rico and the U.S. far more expensive – sometimes costing twice the price of shipping from Jamaica or the Dominican Republic.

Ultimately, the Jones Act makes Puerto Rico less attractive for doing business and limits its growth, according to the Federal Reserve Bank of New York's [analysis](#).

Also, local transportation in Puerto Rico isn't as good for commerce as it is in Mexico or other outsource havens. There's no freight rail in Puerto Rico outside of Ponce. So goods would have to be driven across the island's gridlocked highways, and trucking costs are known to be high on the island.

In that context, Puerto Rican growth would have to start on the inside. The fiscal board aims to spur entrepreneurship on the island, but many working-age people with other opportunities have already left the island in large numbers – shrinking the talent pool. And these businesses might take years to become viable, and would leave behind those without necessary skills. In that time, the exodus of residents will continue because of continued economic pain on the island.

“The best thing about Puerto Rico is they are U.S. citizens. And the worst thing about Puerto Rico is they are U.S. citizens. Fifty percent of engineers left the island because they want to find better opportunities in the U.S.,” said Vidal, the director of Parallel 18.

For now, the Puerto Rican economy is in worse shape than most believe, because the board that's meant to save the island will exacerbate economic distress and displace workers through austerity.

The thriving private sector that the board hopes to see emerge will be too small and slow going to capture all of the Puerto Ricans looking for work.

So this ship will continue sinking, and people won't be able to drive away with an Uber. Until the U.S. Congress tows the boat to shore with more aid, Puerto Rico will continue hemorrhaging residents and economic output.