

ECONOMY

A tale of two islands

THINK STRATEGICALLY:

Private Sector Pays for Public Employee Salary Hikes

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Government Employees: Happiness is Living on the Island of the Public Sector

Early last week, on July 18 to be precise, 246 Institute of Forensic Sciences employees staged a massive absenteeism effort in protest of not receiving a \$1,000 salary increase on the first payroll of fiscal year 2023.

The president of the union of forensic sciences employees, Mr. Carlos Vélez, interviewed in Notiuno 630, said the walkout was due to not having salaries increase in 16 years, and the administration had promised a \$1,000 raise.

The walkout forced a meeting in La Fortaleza with Chief of Staff Noelia García and María Conte, director of the Forensic Science Institute, regarding the budget the government submitted included some \$3 million to fund the salary increases. However, since the Financial Oversight and Management Board implemented its version of the budget, that specific allocation was absent from the government's version of the budget.

Following the meeting in La Fortaleza, Gov. Pedro Pierluisi announced that he would transfer \$3 million in federal funds to cover the Institute of Forensic Sciences' salary increases. With the sheer speed of how the salary funding was found, it dawned on me how life on the Island of the Public Sector works: If it is a benefit or increase, the funds appear like magic.

However, the initiative to provide relief for all Puerto Ricans at the pump by temporarily eliminating the so-called "Crudita Tax" took 11 weeks and two days, or 21.64 percent of the year 2022, and was finally approved on June 14.

As you wonder about the differences in speed and execution, recall that we live as if there are two different islands. On one island, salary increases and benefits appear like magic, that is, in the Island of the Public Sector, and on the other, where misery and sacrifice are the norm and where all the funding to pay for government excesses comes from the Island of the Private Sector.

In 2015, when the Puerto Rico government chose the easier route and decided not to honor the constitution by preferring to default on \$69 billion in bonded debt, that was the day we became segregated on two different islands, inhabited respectively by people from the public and private sectors.

These differences have grown more profound as the years go by, with the latest example being the forensic sciences employees.

Salary Increases Drive Government Payroll to Unmanageable Levels

We have seen sizable salary increases for teachers, police officers, firefighters and emergency workers, among other government employees. Before going any further, let me clarify my sincere wish is for high-ranked government employees in a meritocracy to receive a bonus or salary increase.

However, it seems that government employees think that because the plan of adjustment was approved, Puerto Rico is no longer in bankruptcy, and it is far from it.

The most significant expense in most government agencies are salaries and benefits, often as much as 85 percent of some agency budgets, which leaves

only 15 percent for other expenses to offer services.

So it is evident that by granting raises, the government is establishing new fixed costs while making additional promises hoping to fulfill them once federal funds expire in two or three years. The gamble is that the new, incremental Medicaid funds could free up general funds to pay these promised pay increases.

While it would make sense to grant one-time bonuses with the available federal funding, it is not financially prudent to phase in permanent and recurrent pay increases for the government's salaries in the hundreds of millions of dollars without a recurring funding source.

The more than half a billion in salary increases include teachers, firefighters, police and corrections officers, and emergency medical technicians; the list is long and costly.

Can the Government of Puerto Rico Afford these Raises?

For the past 30 years, the government has consistently overpromised and under-delivered. It has also implemented the practice of celebrating initiatives instead of results, and these actions

constitute the essence of imprudent financial management and the same reason we have the Puerto Rico Oversight, Management and Economic Stability Act, or Promesa. Additionally, from 1999 until just before the bankruptcy, it increased salaries at the rate of 6.5 percent, when Puerto Rico's economy was in contraction.

While we would love to see government workers paid well, I think we must also implement a meritocracy system in all functions of the government.

Since 2006, and more pronounced since the government defaulted in 2015, the private sector has been adjusting, absorbing more than 150 new tax laws, accepting the highest sales tax in the nation at 11.5 percent. You see, the Government of Puerto Rico does not create any wealth, jobs or value; it spends and mismanages all the capital and wealth that the private sector creates.

Week in Markets: Greater than Expected Earnings Drive Wall Street Higher

Although the U.S. stock market ended the week with disappointing tech earnings from Snap and Twitter, most corporate earnings beat estimates and gave investors a renewed sense of confidence.

Netflix lost one million subscribers, which we are supposed to assume was great news; also, Snapchat fell close to 40 percent, following a worse than expected second-quarter (2Q) loss. Finally, before the pain goes away, we have to factor in that other social media companies may experience worse than expected advertising declines.

With Apple, Microsoft, Alphabet and Meta reporting next week, we must closely examine results, as they could point to increased weakness in the tech sector and a stark reduction in advertising spending.

As the macroeconomic conditions worsen, we may see analysts' expectations trending downward with revision for the entire 2022 outlook.

However, bear in mind that the stock markets are all yielding negative double-digit returns, so there are great opportunities for investment with great valuations.

On that point, we highlight five of the companies that beat 2Q expectations.

– First Bancorp (FBP): reported \$227.1 million in revenue, up 5.46 percent, beating estimates, and net income of \$74.7 million, up 5.53 percent; the company has a price target of \$17.20 and its stock closed at \$14.66.

– OFG Bancorp. (OFG): reported \$146.3 million in revenue, up 6.8 percent, beating estimates, and \$40.4 million in net income, up 7.07 percent; the company has a price target of \$35 and its stock closed at \$26.49.

– Bank of America (BAC): reported \$22.7 billion in revenue, up 5.28 percent, beating estimates, and \$6.2 billion in net income, down 32.6 percent, beating estimates. The company has a price target of \$42.45 and its stock closed at \$33.43.

– Goldman Sachs (GS): reported revenues of \$11.86 billion, down 23 percent, but beating estimates, and net income of \$2.93 billion, down 47 percent. The company stock has a price target of \$395.50, and closed at \$323.93.

– American Express (AXP): reported \$13.4 billion in revenue, up 31 percent, beating estimates, and earned \$1.96 billion, down 14 percent; the company has a price target of \$170.50, and the stock closed at \$153.01.

Weekly Wall Street Summary for July 22:

– Dow Jones Industrial Average closed at 31,899.29, up 601.03 points, or 1.92 percent and a year-to-date (YTD) return of -12.22 percent.

– S&P 500 closed at 3,961.63, up 98.47 points, or 2.55 percent, for a YTD return of -16.89 percent.

– Nasdaq Composite closed at 11,834.11, up 381.69 points, or 3.33 percent, for a YTD return of -24.36 percent.

– Birling Capital Puerto Rico Stock Index closed at 2,751.40, up 119.51 points, or 4.54 percent, for a YTD return of -4.44 percent.

– The U.S. 10-year Treasury note closed at 2.77 percent.

– The U.S. 2-year Treasury note closed at 2.98 percent.

Weekly Market Close Comparison	7/22/22	7/15/22	Return	YTD
Dow Jones Industrial Average	31,899.29	31,288.26	1.92%	-12.22%
Standard & Poor's 500	3,961.63	3,863.16	2.55%	-16.89%
Nasdaq Composite	11,834.11	11,452.42	3.33%	-24.36%
Birling Puerto Rico Stock Index	2,751.40	2,631.89	4.54%	-4.44%
U.S. Treasury 10-Year Note	2.77%	2.93%	-5.46%	1.20%
U.S. Treasury 2-Year Note	2.98%	3.13%	-4.79%	1.40%

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