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Puerto Rico Needs An Effective Financial Control Board – Meaning, Not A Local One

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Governor of Puerto Rico Alejandro García Padilla evidently remains persuaded that the island can deal with its fiscal and economic emergency on its own, even though the evidence to date has been overwhelming that every attempt to "go it alone" has made matters worse. (Photo by Joe Raedle/Getty Images)

Puerto Rico's embattled Governor Alejandro García Padilla is expected to announce a Fiscal Adjustment Plan developed by a high-level task force he appointed two months ago to come up with policy initiatives to address the Commonwealth's deepening fiscal and economic crisis.

The plan is eagerly awaited by institutional and retail investors throughout the United States and on the island, who have been baffled by the Governor's announcement in late June that the Commonwealth's $72 billion debt "is not payable," followed by a decision to default on a payment due by the government's Public Finance Corporation. Indeed, beyond identifying needed budgetary cuts and structural reforms, the Fiscal Adjustment Plan will shed light on "the adjustment of the aggregate debt load of the Commonwealth and its instrumentalities so that such debt can be repaid under sustainable terms," as per the official statement filed by the Puerto Rico Aqueduct and Sewer Authority (PRASA) in connection with its recent, unsuccessful attempt to place revenue-backed bonds.

To help ensure implementation of the plan, Gov. García Padilla will probably endorse the task-force suggestion to establish a local Financial Control Board, to be made up of individuals from Puerto Rico plus one or two confidence-inspiring members from the mainland.

Gov. García Padilla remains persuaded that Puerto Rico can deal with its fiscal and economic emergency on its own

Evidently, the Governor remains persuaded that Puerto Rico can deal with its fiscal and economic emergency on its own, even though the evidence to date has been overwhelming that every attempt to "go it alone" has made matters worse. Exhibit A was last year's "Puerto Rico Public Corporation Debt Enforcement and Recovery Act," a home-grown version of Chapter 9 bankruptcy for Puerto Rico's public sector which the administration rammed through the legislature. In fact, the law undermined investor confidence, triggered a cascade of rating-agency downgrades, was immediately challenged by creditors in the federal courts—and has since been twice ruled unconstitutional. Obtaining a Chapter 9 mechanism from the U.S. Congress has been this year's back-up plan—and that too has failed.

Any attempt to self-impose a Financial Control Board is more likely than not to bite the same dust. There is a reason why these boards are historically established by states in order to clean up a municipality in trouble, or by the federal government in order to discipline a wayward territory under its control. They are chartered by a higher authority because their purpose is to override the decision-makers who caused the municipality or territory in question to dive deeply into the red, thereby causing a loss of access to the municipal bond market. These boards are thus empowered from above to take the tough decisions on management, spending, revenues and assets for which there was no local political support.

A relevant precedent for the island: Washington D.C.

The most relevant historical precedent for Puerto Rico was the federal government's intervention into the affairs of the District of Columbia in the mid-1990s. By then D.C. had reached a point beyond its own ability to stem a grave economic crisis. Federal intervention was not requested—never mind supported—by then Mayor Marion Barry or his city council. The initiative was authored by members of Congress who were alarmed about the city's deteriorating situation, and crucial to its adoption was support from Eleanor Holmes Norton, the District's non-voting representative to Congress—and eventually, from the Republican leadership in both houses.

The legislation that was passed by Congress to end the capital's crisis ("The District of Columbia Financial Responsibility and Management Assistance Authority Act of 1995") set up an independent 5-member board, commonly referred to as "the Control Board," which was empowered to address the problems on the spending side of the District's finances. The board was mandated with balancing the District's budget—and with keeping it balanced for four years—and Congress vested it with broad powers to approve or reject the city's budget and financial plans, spending and borrowing, and key managerial appointments.

Over time, the Board's mandate was expanded because it was clear that D.C.'s revenue side also had to be improved, and because a new compact was needed between the city and the federal government with regard to mandates and unfunded pension liabilities. Therefore, in the summer of 1997, the "National Capital Revitalization and Self-Government Improvement Plan" was passed as part of a broader approach which soon proved eminently successful. The Control Board suspended its activities in late 2001, once the District achieved its fourth consecutive balanced budget, six years after its appointment.

A local Financial Control Board won't work

This history illustrates why setting up a local Financial Control Board is unlikely to work: Such a body will lack the enforcement powers and credibility it must have. And it will do so because its authority is likely to be watered down by the politics of the possible in Puerto Rico's legislature, and because its decisions will be vulnerable to legal challenges in the federal courts. An effective Financial Control Board for Puerto Rico can only be one that is established by the U.S. Congress with the benefit of some distance from local pressure groups—the ones that have been blocking the needed spending cuts and structural reforms.

Puerto Rico's non-voting representative to Congress, Pedro R. Pierluisi, has a historic opportunity to work with the Republican leadership on the Hill to help craft a federally appointed Financial Control Board—the only kind that could get the job done.

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