ROLL CALL

Puerto Rico Needs Reform, Not Bankruptcy | Commentary

By Arturo C. Porzecanski, June 9, 2015

To allow a poorly managed government to rid itself of its financial obligations is ethically and practically misguided. A Chapter 9 solution to Puerto Rico's economic and financial woes, as the House Judiciary Committee is contemplating via HR 870, is ill-conceived on several grounds. First and foremost, the bill's passage would override with retroactive effect the bond indentures of the millions of investors throughout the United States who — like me — have bought Puerto Rico's bonds, mostly through mutual funds. HR 870 would give carte blanche to the Commonwealth to break its solemn pledge that our bonds would be paid in accordance with the laws and contracts under which they were issued.

Second, HR 870 would authorize only the island's public utilities and agencies to restructure their debts under the supervision of a federal bankruptcy judge. Depending on how broadly implemented, a Chapter 9 process would thus apply merely to between one-fifth and one-third of the Commonwealth's more than $70 billion of debts to bondholders and banks. The bulk of public indebtedness would have to continue to be serviced in full and on a timely basis. HR 870 is no panacea.

The bill is equivalent to trying to address the financial difficulties of a whole state — say, Pennsylvania's — by wringing concessions from the creditors of an entity within — say, the city of Harrisburg's. But Puerto Rico's problems do not stem from one or even a few projects gone wrong, as was the case with a foolhardy investment in an aging incinerator which nearly bankrupted Harrisburg. They stem from pervasive fiscal and financial mismanagement at all levels of the Commonwealth.

HR 870 attempts to right one wrong with another wrong. Congress decided long ago to give Puerto Rico a nationwide tax exemption — something no state has been granted. The exemption allowed the Commonwealth to run a string of budget deficits and to fund them through debt accumulation, to the point where Puerto Rico has become the third-largest issuer of municipal bonds in the United States.

Under HR 870, Congress would bestow on the island the benefit of a federal workout mechanism — as if the territory were a state. Some congressmen favor this intervention because they believe it would not cost the U.S. Treasury any money. That is false, because the permanent capital losses imposed on private creditors would result in reduced income taxes payable to the Treasury.

Congress made a mistake in handing Puerto Rico the equivalent of a credit card with no limit attached. If HR 870 were to pass, it would compound that original mistake by giving the island a free pass out of a portion of its obligations. Congress and Puerto Rico cannot have it both ways: Either the Commonwealth is treated like a state for all purposes — its population paying their share of federal income taxes and its access to our bond markets should no longer be privileged — or it is treated like a territory — held responsible for its quasi-sovereign acts.

Furthermore, HR 870 is unnecessary to deal with the financial problems of state-owned entities and agencies in Puerto Rico. Their enabling acts contemplate the court appointment of a receiver should they find themselves facing unresolved liquidity or solvency problems. The receiver would then take over management of these entities and apply operating revenues in the manner ordered by the courts, with a view to preventing or overcoming any debt-servicing difficulties.

This is precisely the solution Pennsylvania deployed for Harrisburg: It placed the city in receivership rather than allow it to declare bankruptcy, and the city was mandated to sell or lease out its assets, raise taxes and fees, and renegotiate its onerous union contracts — not just its debts. In March 2014, Harrisburg emerged out of receivership and the city resumed its general-obligation debt payments.

Economic and fiscal reform, and not selective bankruptcy, is Puerto Rico's last hope. It must change its business model and consider structural reforms to government services — everything from education to public utilities — needed to lower costs, enhance productivity and facilitate public-private partnerships. If the current political leadership cannot do this on its own, then Congress and the president should appoint a financial control board over Puerto Rico. The approach followed to date — discouraging consumers through higher tax rates and investors through the prospect of selective defaults — is proving destructive.

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