Forbes

# Puerto Rico's Fuzzy Economics

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July 31, 2017

In 2016, Speaker of the House Paul Ryan enthusiastically urged his House colleagues to put Puerto Rico – saddled with billions in debt and underfunded pension liabilities – on the path to fiscal solvency. To help the island achieve this the Speaker worked with President Obama and Congressional Democrats to create a federal oversight board that would be charged with righting this failing Island. Republican leaders assured conservatives that this was no GM-Chrysler bailout of union pensioners. However, thus far it has not quite worked out as Ryan intended, but perhaps exactly as President Obama and Democrats had hoped for.

Normally, when an entity – whether it be an individual, a business, or a government – can't pay its bills, everyone involved has to make a sacrifice: the creditors accept less money, the debtor agrees to reduce expenditures, and the mutual interest in this entity returning to financial health compels those with a fiduciary interest to reach a deal.

The intent of PROMESA, the legislation Congress passed last year, was to create a bipartisan framework for parties to reach agreements to both reduce debt and reform Puerto Rico, but that's not exactly what happened. The bill's sponsors intended for the legislation to encourage the island's government to negotiate with its creditors, which held over $70 billion in debt, and to solve the Island's chronic pension morass.

The previous administration's strategy, led by then-Governor Alejandro Garcia Padilla, seemed to be to forestall any reforms that would actually force the government to reduce spending, reform their bankrupt pension plans, or make any other politically difficult decisions and simply balance the budget entirely on the backs of the bondholders.

That strategy has apparently not changed in the Democrat Ricardo Rosselló's administration, who campaigned as an advocate of a restrained government and fiscal conservatism but has yet to evince much enthusiasm for any such thing since his inauguration.

Unfortunately, the federal oversight board appointed to be the check and balance has done little to address government bloat on the island. Together with Governor Rosselló, their biggest achievement to date has been to unlawfully reprioritize creditor seniority by guaranteeing the island's pensions be paid with monies from the general fund ahead of the general obligation debts. The maneuver appears to directly contradict the island's constitution, which promises that general obligation bondholders will be paid ahead of all other payments, and PROMESA, which stipulates that “the relative lawful priorities or lawful liens” in the Puerto Rican Constitution must be respected. The Board actually ratified this maneuver.

Part of the federal oversight board’s mission was to facilitate negotiations between creditors and the governor, but nothing of the sort occurred; instead, the government went so far as to adopt a legal strategy to attack the validity of creditor contracts and liens without the board attempting to restrain it. After months of delay and obfuscation, the island made a lowball offer to creditors it knew would be rejected and then immediately declared an impasse when that did indeed occur.

What’s more, the federal oversight board was supposed to conduct a review of the pension system before making hasty decisions, such as endorsing the Governor’s move to absorb all pension liabilities and shortfalls on the back of the general fund. However, no review has yet been provided, a glaring omission.

To make matters worse, the Governor and the federal oversight board based their entire fiscal plan on the assumption that Puerto Rico will remain indefinitely in a deep economic slump and that any serious budget-tightening exacerbate the economic crisis and depress tax revenues. However, this does not quite comport with reality: last week the Puerto Rican Department of Treasury reported that general fund revenues are above projections year-to-date by $234.9 million. This follows recent disclosures by the Commonwealth of a cash stockpile of about $1 billion.

Finally, the governor’s recently passed budget increased spending by $575 million next year, belying the promise of a more austere government.

This outcome is nowhere near what Congress had in mind when it passed PROMESA. To right this transgression the Board should insist that the Puerto Rican government negotiate in earnest with its creditors, produce a new budget that constrains spending, and conceive of a pension reform that does more than merely inject more general revenue into the bankrupt program.

Such an outcome would not only be more consistent with PROMESA and the rule of law but it would also have the virtue of being a more sustainable long-run solution for the bereft island.

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