Puerto Rico's Hurricane Damage Should Not Preclude Real Fiscal Reform

Ike Brannon

February 27, 2018

Hurricanes Irma and Maria strafed much of the island of Puerto Rico and worsened what was already a perilous fiscal problem facing the island's government. However, a reconstruction program that has finally kicked into high gear helped its surprisingly robust economy bounce back, and the employment and tax revenue losses from the disaster have been much less than most Puerto Rico watchers (and Puerto Ricans) feared.

Predictably, the island's government has used the disaster as another reason for it to avoid making serious reforms, and instead has continued to insist that the only answer for its fiscal ills is to erase its onerous debt without conditions. Its intransigence is, in a word, maddening, and it threatens the long-term solvency of the island.

Since the 2016 passage of PROMESA and the appointment of an Oversight Board to oversee the woebegone finances of the Puerto Rican government, its government has evinced a notable disinterest in pursuing anything that might constitute actual reform.

Instead, Governor Ricardo Rossello and his administration have dedicated their efforts towards convincing Congress that it needs more financial assistance from the Treasury, as well as relief from its $73 billion debt. Since the Oversight Board's installation, Puerto Rico has made little effort to create a sustainable financial situation.

This strategy did not change in the aftermath of the Hurricanes Maria and Irma; in the hurricanes' immediate aftermath the government pointed to its supposed liquidity crisis as the prime reason it needed greater relief and went so far as to forecast that it would completely exhaust its accounts in a matter days without federal intervention. They apparently took a lesson from Rahm Emanuel: Never let a crisis go to waste.

The only problem is that the Commonwealth's supposed liquidity crisis was apparently untrue. For starters, the hurricanes reduced cash flows much less than the board and the government publicly anticipated: most people continued to work and their employers continued to pay them.

More egregiously, it was revealed in December that the Commonwealth actually had nearly $7 billion in previously undisclosed bank accounts, none of which would have been made public had a whistleblower not leaked it to the press. The government has yet to provide a valid reason

for failing to disclose this fact, or why it could not have tapped some of this money post-hurricane.

The Oversight Board just recently required that a forensic audit be performed on its various accounts to precisely determine just how much money the government does have at its disposal, who has access to these fund balances, and how much dissembling—or outright lying—has been occurring. While such a step is welcome, it is also long overdue.

The hope that the audit—along with the Oversight Board's rejection of the Commonwealth's recently proposed budget—are signals that it is now finally prepared to save the island from its government.

While Governor Rossello has consistently put himself at odds with the Oversight Board, it has done little to force his hand. When the Oversight Board tasked the government with identifying "essential services" to help understand what spending was truly needed and which might be trimmed without creating much inconvenience or stress on the citizenry, the government did no such thing: It merely insisted that virtually 100 percent of its spending was essential, and the Oversight Board did not push back or suggest that they reach agreement on how to define "essential", despite the Congressional mandate to institute fiscal reform.

Thus far being obstinate and ignoring the law has paid off for the Commonwealth's leaders, just as it did for its predecessor. The government and the Oversight Board still have not produced an audited financial statement for 2015 despite being required to do so, which means that the island's reorganization plan was largely based on outdated and unverified data.

While it will still be months until the island is back to normal following the devastation of the hurricanes, its financial situation is far from dire. Besides the billions of dollars it has in the bank, the island will be receiving $4.9 billion in Medicaid funding, along with a promise that the federal government will cover 100 percent of its required match for as long as it is recovering from the hurricane. It will also be given as much as 25 percent of the $28 billion in Community Development Block Grants contained in the recently passed bipartisan budget deal, $2 billion repair its energy grid, and a share of the $23.5 billion being given to FEMA for disaster rebuilding and mitigation.

However, over the last two years the island's government has blithely ignored federal law and its own constitution in an attempt to vilify the investors who bought the island's bonds—whose ranks include millions of U.S. residents saving for retirement—for the island's financial morass rather than taking the necessary steps to fix it.

The creditors' requests—recently reiterated in a letter signed by a large contingent of them—are far from draconian: They want greater transparency, a modicum of fiscal discipline, and a bona fide reform plan for the island that can reasonably be expected to lead to future economic growth.

For the government to essentially be rewarded for its intransigence sets a dangerous precedent that will wreak havoc in the municipal bond market when one of any number of states burdened with a mountain of public pension debt take a page from the Puerto Rican playbook and escape their problems by merely reneging on debt obligations and eschewing reform.

Ike Brannon is a visiting fellow with the Cato Institute and president of Capital Policy Analytics.