

FISCAL CRISIS PART 1

What is the cause of our fiscal crisis? Pure and simple: Puerto Rico spends more than it earns or collects. In order to accomplish this, the central government must borrow to operate at the level of its current spending. PR has reached a state that is unsustainable, and debt payback is questionable. Therefore, no entity is willing to continue lending to us, and there is too little revenue available to both operate the Commonwealth at its current expense rate and make debt payment to existing creditors. We are technically bankrupt or insolvent. That's it in a nutshell.

What will happen? What are the choices or options? We clearly don't know for sure, but any solution will include some form of "taking control" of the situation by a higher authority. This is because the likelihood of our government being able and willing to structure workout agreements with creditors AND to reduce the expense stream (cut government expenditures) is slim to none. Thus, we will see some form of the following:

- Bankruptcy can refer to liquidation and/or administration of an insolvent or financially distressed entity. Since federal law prohibits bankruptcy options for PR, it is uncertain that PR will be allowed this avenue without Congressional action or the allowing of PR to create its own statute. In the case of PR, restructuring under the order of a court would be the likely path.
- A Fiscal Control Board potentially has a broader scope and involvement in day-to-day decisions as defined by the authority that establishes it.
- Courts of law will be used by creditors if PR stops paying its debts and no other authority is established. This option is chaotic, expensive, and would take years to payout, but if nothing else is established, creditors will certainly use the legal system as best they can.

Some common effects of each approach are:

- New financing options for operations will be nil.
- Restructuring of debt might be possible.
- Through the authority of a board or court appointed judges, assets will be sold to raise funds and/or cut expenses.

No matter what course is selected or imposed, there is going to be reduced government spending. How that manifests itself remains to be seen. We would all like to see government fat, inefficiencies, and obstructionist activities disappear and keep the funding for the important programs, but that is unlikely the way it will proceed.

The question that social and commercial media has spent much space and time on is: Who's to blame? There is a lot to go around.

Vulture Funds and Other Investors

Investors purchased Puerto Rico bonds for two reasons: they had high yields and were triple exempt, as in tax free. These were good justifications. High yield normally means added risk, but the PR government was touting them as excellent investments, rating agencies were giving them decent grades (several years ago), PR couldn't go bankrupt, and the PR Constitution gave many bond debts priority over operational expenses. These factors implied a good degree of security. Many of the investors were not sophisticated. Locals bought them to support our local economy. Other individuals bought them without much research and relied on ratings. The pension and hedge funds that purchased bonds as issued more recently, probably didn't do their homework very well. It seems that many were hoodwinked or asleep.

The “vulture funds” typically buy in the “resale” market after the bonds have been trading for a time and start to decline in value. They purchase from other investors who want to dump their bonds and are willing to sell for a loss. They buy for substantial discounts off of the face value of the bond yet hope to ultimately redeem the bond at or near face value. They play hard ball to get top dollar using influence and the court system to recover their investments.

There is plenty of blame allocated to these investors for their own losses, but it is hard to envision that they are in any way to blame for the crisis. They merely bought instruments touted by the sellers. If this were a deal with an independent third world country, there could be both political and financial benefits gained by the investors in the form of leverage and power over the leaders, but I don't believe this is the case in PR.

US

As spoils of the victory over Spain in 1898, the US acquired the Philippines, Cuba, and Puerto Rico as colonies. While the former two were granted independence long ago, it was not initially intended for PR. It wasn't until about 50 years ago that the options of status were put before us to choose. Up until that point, PR was truly a colony, including the extractive economic practices associated with strong special interests in the States squeezing money out of the island from both imports and exports. Monopolistic practices and labor exploitation were common. Note the 1920 Merchant Marine or Jones Act that has made life here far more expensive for our poor nation to the benefit of the extremely well paid industries of shipping and ship building.

Seemingly well intended efforts to end the colonial era and establish a semi-independent commonwealth brought prosperity through bold programs of educational reform and business development such as Operation Bootstrap in the '50s. The US granted tax incentives to firms that successfully aided the growth of the PR economy. Did Congress grant these advantages out of the goodness of their hearts, or were special interests (US manufacturers) seeking to create their own little tax havens?

Since 1917 PR has enjoyed the beneficial tax treatment that made investment in our government bonds tax free to any US citizen anywhere. Furthermore, in the late '60s many manufacturers (mostly pharmaceuticals) came to take advantage of “Section 936” allowing U.S. manufacturers to repatriate profits from local plants here without incurring federal taxes. 936 was phased out in 2006, and the affected companies have been seeking other venues while our economy has been steadily declining.

Our heavy borrowing began in 1973 and has grown at accelerated rates up until 2015 when it had become widely recognized that default was eminent. Politicians (like many other humans) become addicted to what appears to be a free ride: take the money from any source to benefit themselves and their friends now and retire or get out of town before the consequences are realized. It's a form of “hot potato” or a Ponzi scheme with the public holding the bag. In 1984 the Federal municipal bankruptcy laws were inexplicably modified to exclude PR from eligibility. Was this a backroom (PR representatives and investors lobbying Congress) marketing ploy to actually encourage more investment in PR by ostensibly providing greater security through elimination of the bankruptcy option?

The US contributes an estimated \$20 billion net per year in subsidies, grants, welfare services, etc. as Congress decides. We are not autonomous. We are not sovereign. Being treated as a commonwealth has created a combination of entitlement, paternalism, neglect, and fatalism in many quarters. While the US does not micromanage PR, Congress (with hundreds of bureaucratic departments) is ultimately responsible under the Territorial Clause, so blame can be deservedly assigned!

Puerto Rico Government

A great deal of conversation is not required to indict the government of PR for their role in the fiscal crisis. They collect the revenue, and they write the checks. The rules and conditions may not be what the officials would like them to be, but they are what they are and must be dealt with accordingly – not ignored. Our politicians have been worried more about reelection than fiscal responsibility. They have been more concerned about their own self-interests than the wellbeing of our islands. They have conspired to protect themselves to the detriment of our security. Some are corrupt, and many incompetent. Government run businesses are operated for the benefit of the managers and union members. The citizens pick up the bills and pay the price. Our PR politicians and government personnel deserve most of the blame for the crisis.

Puerto Rico Citizens

Ultimately we blame the citizens for the acts of their governments. After all, it's the citizens who elect (and reelect) the representatives and leaders. People vote to the benefit of their own self-interests, but the deck is somewhat stacked against us in that it's selection by multiple choice. We may not want any of the choices, but in a practical sense, we must select from the list offered. Government employs nearly 40% of the workers, and these people are overwhelmingly from the two major parties. It is nearly impossible to elect a true independent to almost any major position. Maybe as the situation deteriorates further there will be an impetus to elect politicians that are "out of the box." Nonetheless, blame has to be allocated to all of the potential voters.

Vieques

We normally refer to Vieques as the "tail of the dog" to indicate how far removed we are from self-determination. The US is the Master, PR is the Dog, and we are the Tail. We have 9,200 people versus 320,000,000 in the US and 3,500,000 in PR. In our PR representative district, we are less than 10% of the whole. We are remote from the bastions of power. We are a small minority and have no real voice. We haven't been able to get functioning medical facilities or even decent access to the main island. We are impotent and not in any way responsible for the disaster we call Puerto Rico Government.