

PART 1 THE FISCAL CRISIS

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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 know now there will be a fiscal control board. This board will have broad scope and involvement in day-to-day decisions as defined by the authority that establishes it: Congress. The Board will not be responsible for economic development, and we can be assured that:

- New financing options for operations will be nil.
- Restructuring of debt will be accomplished.
- Puerto Rico's assets will be considered for sale to raise funds and/or cut expenses.
- 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 while maintaining the funding for the important programs, but that is unlikely to happen.)

The question that social and commercial media has spent much space and time on is: Who's to blame? We can see that 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. Residents were encouraged to buy them to support our local economy. Other individuals bought them without much research and relied on ratings. Credit unions and cooperatives were **required by a 2009 law** to buy significant portions of the debt. 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 actually provide a needed service by purchasing from other investors who need to liquidate or choose 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 are demonized (justly or unjustly) because 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 some of 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 this is not likely 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 highly 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 was created to benefit 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 US citizens 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 significant blame can be deservedly assigned!