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Opinion: Privatize Puerto Rico's Power.

It would reduce the cost of living and spur economic growth.

This article was written by Andrew G. Biggs, Arthur J. Gonzalez, Ana J. Matosantos and David Skeel, four of the seven members of the Financial Oversight and Management Board for Puerto Rico. They were appointed by President Obama based on recommendations by the Democratic and Republican Congressional leadership.

In July 2016, Puerto Rico defaulted on its more than $70 billion of debt, putting at risk those liabilities as well as more than $50 billion in public pension obligations. Just before the default, Congress had enacted the Puerto Rico Oversight, Management and Economic Stability Act, or Promesa, which established the Financial Oversight and Management Board for Puerto Rico. Today, under the board's guidance, Puerto Rico is undertaking the largest municipal restructuring in U.S. history, with the goal of sorting out its longstanding fiscal issues and reigniting economic growth.

The board has worked steadily toward these goals over the past year. After rejecting turnaround plans submitted by two successive Puerto Rican governors, last March the board approved an amended plan that includes a nearly 30% cut in government health spending, sizable reductions in government subsidies, school closings, consolidations of government agencies, and the most extensive public-employee pension reforms ever passed in the U.S.

This week, after much deliberation, the board rejected the Puerto Rico Electric Power Authority's request to move forward with a restructuring support agreement with its creditors. Puerto Rico's electricity costs are two to three times as high as mainland levels. The board concluded that lowering the price of electricity and spurring economic growth depended on reforming Prepa's operations, not merely restructuring its credit. Affordable electricity could boost growth by up to half a percentage point annually, raising family incomes on the island, stemming outmigration and increasing funds available to repay creditors.

Successful reform will require a true transformation of Puerto Rico's power sector. As the Center for the New Economy, a Puerto Rican think tank, put it in a 2009 report: "PREPA's operations are substantially less efficient than the operations of its U.S. counterparts and it underperforms in virtually every area of operations under consideration." While mainland utilities have reduced costs by shifting to natural gas, Prepa relies on outmoded oil-fired generating plants. The company also loses 12% of sales revenue to faulty billing and theft, three times the U.S. average. Prepa has languished under heavy administrative overhead and politicized management, which contribute to its failure to deliver reliable, cost-effective energy.

We believe that only privatization will enable Prepa to attract the investments it needs to lower costs and provide more reliable power throughout the island. By shifting from a government entity to a well-regulated private utility, Prepa can modernize its power supply, depoliticize its management, reform pensions, and renegotiate labor and other contracts to operate more efficiently. A reformed Prepa is key to restoring opportunity for the people of Puerto Rico.

Prepa's credit restructuring proposal would make effective privatization impossible. Under the proposal, bondholders would grant Prepa a five-year reprieve from principal payments and some would accept a 15% reduction in debt. In return, those bondholders would be guaranteed repayment of remaining debt through an electricity surcharge. If demand for electricity continues to decline, the surcharge will have to rise to compensate the creditors. The Prepa proposal and its guarantee to current creditors would increase costs to ratepayers while leaving new investors—the ones Prepa needs to transform its operations—assuming all the risk.

Private investors would not involve themselves with Prepa on those terms, meaning the company would lack the capital to modernize. Electricity costs would remain high, and economic growth, families and bondholders would suffer. The board's economists estimate that without pro-growth energy reforms, funds available to pay Puerto Rico's creditors would be reduced by $15 billion.

The Board's decision was not easy. Promesa gave preferential treatment to the credit support proposal, not requiring it to satisfy the same criteria as other debt restructuring settlements. Some members of Congress have suggested that Prepa's credit agreement should have been considered a "done deal." But not all the proponents of Promesa understood its provisions in that way. The law clearly expresses that the board must authorize any voluntary debt restructuring, and the agreement proposed by Prepa itself explicitly requires board authorization.

The board cannot amend the Prepa agreement, as it did with the fiscal plan submitted by Puerto Rico's government. But the board will pursue improved terms of agreement for creditors, and more equal sharing of risk between current creditors and new investors.

Transformation of Puerto Rico's energy sector is only one part of a broader reform agenda, which must include fundamental public pension and welfare reforms, as well as the modernization of labor laws. Prepa's viability must be addressed in the context of these larger solutions to Puerto Rico's fiscal and economic crisis. But unless Prepa can be modernized, Puerto Rico's economic recovery and its ability to repay its debts will suffer.

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