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Puerto Rico Bankruptcy is Ending. Next Step: Grow Its Economy

- **Governor sees hope in reconstruction funds, manufacturing base**
- **Federal oversight board warns deficits could reappear by 2035**

After more than four years, Puerto Rico's record municipal bankruptcy is coming to an end. For the U.S. commonwealth, the timing seems auspicious.

The island, which has been in an economic slump for a decade and has been battered by hurricanes, earthquakes and political rifts, will have to grow its more than \$100 billion economy or risk again running the kinds of deficits that pushed it to financial ruin.

Yet it's coming out of bankruptcy just as federal reconstruction funds, pandemic relief and burgeoning bioscience and tourism industries are converging to give local officials confidence they can produce stronger balance sheets going forward.

"In terms of the fiscal challenges that Puerto Rico will be facing, we will have no problem whatsoever in maintaining the fiscal house in order," Governor Pedro Pierluisi said in a phone interview.

The federal judge overseeing the bankruptcy case on Tuesday approved a debt restructuring plan that's seen as the last major hurdle in order to exit court protection. It shrinks \$22 billion of bonds down to \$7.4 billion and establishes a reserve trust to fund the island's broke pension system.

While the bankruptcy process cut Puerto Rico's annual bond payments down to \$1.15 billion, it's not a panacea that resolves underlying issues, including a shrinking population and weak infrastructure. And the government still needs to come up with \$3.4 billion a year to cover all its debt and pension benefits costs.

"It is not a perfect debt restructuring plan, but it will considerably reduce the financial burden on the residents of the island and the local government," Representative Raul Grijalva, the chairman of the U.S. House Natural Resources Committee and an Arizona Democrat, said in a statement.

"Moving forward, the focus must be on rebuilding the Puerto Rican economy so that even its most vulnerable residents are able to thrive."

Pierluisi said the debt deal, along with more than \$40 billion in federal reconstruction funds set to flow into the economy in coming years, have set the stage for transformation.

Manufacturing, which represents about 48% of the island's gross domestic product, has been running strong amid a pandemic that shined a spotlight on the island's bioscience sector. Puerto Rico is home to almost 50 pharmaceutical factories, including for drugmakers such as Merck & Co., Pfizer Inc. and Eli Lilly & Co.

In addition, tourism saw a record-breaking year in 2021 as mainlanders who were locked out of

international markets due to Covid-19 restrictions hopped on domestic flights to the Caribbean destination. And the island's generous tax breaks are attracting a new wave of service-export companies rising amid the work-from-anywhere movement.

"Those three sectors - manufacturing, tourism and professional services - should be driving a lot of our future growth," Pierluisi said.

Population Decline

Still, the island faces monumental hurdles.

Puerto Rico lost 12% of its population from 2010 to 2020 — more than any other U.S. jurisdiction — as years of economic decline and 2017's Hurricane Maria chased away talent.

Growing an economy with a shrinking population "is very difficult," said Sergio Marxuach, the policy director at Center for a New Economy, a Puerto Rico-based think tank.

"That's the real problem for Puerto Rico," he said. "We can always get people to move back if things get better, but increasing the number of live births is more complicated."

There are also questions about the island's reliance on federal money. Since 2012, the economy has only grown during two years — 2019 and 2021 — and in both cases it was directly tied to an influx of federal funds.

Still, local officials are betting more federal funds can improve infrastructure enough to stimulate private industries.

If the government can fulfill its pledge to improve the island's battered electrical grid and rebuild roads "this could be an ideal place to do business," said Yandia Perez, the executive director of the Puerto Rico Manufacturers Association. The island's strategic location and unique status — a Caribbean outpost under U.S. laws — makes it attractive to global firms trying to break into the Latin American and U.S. markets.

"Coming out of bankruptcy also removes a huge stigma for us, which was making it a challenge to attract industry and investment to Puerto Rico," she said.

Looming Tax Threat

Much of Puerto Rico's past success has been tied to generous tax breaks it offers global companies. But a proposal by the G7 nations and supported by Washington would impose a global minimum tax of 15% — striking at the heart of Puerto Rico's appeal.

In addition, U.S. Internal Revenue Service rules that allow companies to deduct a 4% excise tax from their federal contribution sunsets at the end of this year.

"We can still compete based on our productivity and the skills of our labor force in the manufacturing field as long as we are not discriminated against," Pierluisi said. "To the extent that the conditions we are getting are comparable to the ones that foreign countries will be getting, I'm not concerned about it."

As for the excise tax, the administration is in the process of overhauling its tax code to make up for the shortfall.

Puerto Rico's Secretary of Economic Development and Commerce Manuel Cidre said the island can't rely on its existing manufacturing base — or government funding — for future growth. Puerto Rico needs to lure more U.S. midsize companies, boost local agriculture, reinforce its bioscience sector and become more attractive to entrepreneurs, he said.

"Everyone needs to play their part in this transformation," Cidre said, "because the government can't do this alone."

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