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Washington Divided on Response to Puerto Rico Debt Woes.

Puerto Rico faces rolling defaults on its debt and cutbacks in public services, but Congress remains divided about what should be done to address the crisis.

The Obama administration and Puerto Rico want Congress to provide a pathway for the commonwealth to restructure some of its \$72 billion in debt, and Gov. Alejandro García Padilla appealed again to a Senate panel this week, saying the island has “no more cash.”

Forced to choose between paying creditors and paying teachers, police and firefighters in the coming months, the governor he said he would easily choose the latter. He signed an order this week that allowed Puerto Rico to make its latest \$355 million debt payment only after it clawed back revenue used to pay debt for public corporations such as transit and tourism authorities. The government and various agencies face an additional \$950 million due Jan. 1.

Republicans reacted coolly to legislation introduced this year to allow the island’s public corporations to restructure debt. Municipal entities in the 50 states have that right under Chapter 9 of the U.S. bankruptcy code, which Detroit invoked in 2013, but it isn’t available to federal territories.

The White House this fall endorsed an even bolder step, calling for a new regime allowing federal territories to restructure debt issued by the central government, a power not available to states. The proposal is unpopular with the mutual-fund and hedge-fund firms that hold the island’s general obligation bonds.

Some GOP lawmakers say that would set a dangerous precedent for states. “It’s a ludicrous idea,” said Rep. Tom Marino, (R., Pa.), who is chairman of a House panel with jurisdiction over the bankruptcy code.

Puerto Rico’s financial advisers painted a bleak picture this summer when they said more spending cuts, revenue increases and economic growth could close just half of the projected cumulative deficits of \$28 billion in the next five years.

Debt forbearance and restructuring would be needed for the other half because the commonwealth has lost access to bond markets. The island’s economy has been in recession since 2006, and in that time its population has fallen 7% while its debt load has grown 64%.

The White House plan would also expand Medicaid subsidies and make federal tax credits available to the island’s residents. The breaks are designed to boost the island’s unusually low workforce participation rates, but are controversial as Puerto Ricans don’t pay federal income tax.

Aides to some GOP lawmakers acknowledge that Puerto Rico’s fiscal situation is unlikely to improve on its own, potentially leading to federal intervention. But for now those lawmakers have coalesced around the need for stronger oversight of the island’s finances. Some worry local officials won’t follow through with cuts in government expenses or ramped-up tax collection, requiring a federal

control board as part of any congressional response.

Democrats say efforts to maintain the status quo will exacerbate the economic crisis and drain urgency from talks between Puerto Rico and its creditors to complete a voluntary restructuring. Some lawmakers have pushed for Congress to attach a relief package to spending bills it must pass before adjourning this month.

Others have criticized the Obama administration for not promising to act unilaterally. "I urge Treasury to be just as creative in coming up with solutions for Puerto Rico as it was when the big banks called for help," Sen. Elizabeth Warren (D., Mass.) told a Treasury adviser at a recent hearing.

While Washington hasn't intervened in other municipal debt crises like Detroit, Puerto Rico is an anomaly because it is a U.S. territory. The commonwealth has maintained local autonomy since the 1950s, but governance of the island, whose residents are American citizens, ultimately rests with Congress and the president.

Analysts say Congress isn't likely to take action, absent signs of a much more acute humanitarian emergency.

"A crisis to D.C. politicians is Jurassic Park on the island," said Stephen Myrow, managing partner at Beacon Policy Advisors, a research firm. "Until you have that, you don't have the pressure that Congress would need to build a consensus."

Further reducing any urgency: Puerto Rico isn't viewed as a systemic threat to the U.S. economy. Europe ultimately moved to bailout Greece because the risk the crisis would spread through its banking system was high, said Mr. Myrow.

Federal Reserve officials saw "minimal" risks that Puerto Rico's debt crisis could spread through U.S. financial markets at their October meeting, according to minutes released last month.

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