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Puerto Rico's Bankruptcy Exit Isn't the Finish Line.

The U.S. commonwealth is still saddled with heavy debts relative to its economy.

When I first saw the news on Tuesday that Puerto Rico's bankruptcy judge had approved its debt-restructuring plan, allowing the commonwealth to begin to exit this painful, almost five-year chapter of its history, I had to stop and think. After all, the island's drawn-out struggle with its creditors has been in the background during most of my professional career, dating back to when I helped chronicle its financial collapse as part of Bloomberg News's municipal-bond team in the mid-2010s.

I want to say what Governor Pedro Pierluisi told my colleague Michelle Kaske ahead of the approval. "The bankruptcy of the commonwealth has been like a dark cloud on top of Puerto Rico for too long," he said. "It is a new day for the government and the economy of Puerto Rico."

Of course, exiting a bankruptcy that began in May 2017 and that was prolonged by hurricanes and a global pandemic should be framed as reason for optimism for all Puerto Ricans. However, it's just as important to have a clear understanding that this restructuring plan, even if it lops off tens of billions of dollars of debt, is not a cure-all for what snared the commonwealth in an economic tailspin in the first place. A lot of hard work still remains to put the island on a sustainable fiscal path.

For one thing, it sure looks as if Puerto Rico, after more than $1 billion in costs, still couldn't do much through bankruptcy to impair the holders of its general obligation bonds and commonwealth-backed securities. While those bonds will total only $7.4 billion now instead of $18.8 billion, investors will also get about $7 billion in cash upfront and billions of dollars worth of "contingent" debt that will pay if sales-tax collections exceed projections. It always seemed impossible that bondholders would be made whole — but this agreement isn't all that far off. The legacy debt should be swapped out for the new obligations by March 15.

Puerto Rico will still be on the hook for an average of $666 million a year over the next decade on debt service for the new general obligation bonds alone. For some context, the commonwealth's general fund collections totaled $11.7 billion in the 2021 fiscal year, bolstered by federal disaster funds and pandemic relief aid. Debt service will remain a large slice of the government's expenses.

Meanwhile, the viability of the commonwealth's pension system remains tenuous. The restructuring plan lays out specifics for creating a reserve trust. Still, it owes some $55 billion to current and future retirees because any accrued benefits weren't impaired by the approved restructuring plan. Puerto Rico has been spending about $2.3 billion each year to cover such retirement payouts because its assets are depleted. In an acknowledgment that rebuilding a defined-benefit fund from scratch would be nearly impossible, current workers will move to a 401(k)-type plan.

Perhaps most strikingly, the commonwealth's own multiyear fiscal plan projects budget deficits will flare up again in fiscal 2036, even after factoring in reforms to promote business development and expand workforce participation. That's not exactly a clean bill of health.

Detroit, the largest U.S. city to ever file for bankruptcy, is a useful case study several years removed from its 2014 exit from court protection. Its general obligation bonds are rated BB- by S&P Global Ratings and Ba3 by Moody's Investors Service, both three steps below investment grade. The rating "balances the city's robust reserves and strong financial planning practices with its weak property tax base, significant debt and pension leverage, and substantial resource demands, including the need for further capital investments," Moody's analysts wrote last year. The problems that plagued the Motor City didn't disappear with some of its debt.

Puerto Rico, too, looks poised to have strong financial planning for years to come because its oversight board isn't going anywhere. According to the Puerto Rico Oversight, Management, and Economic Stability Act, the board must remain in place until the island achieves balanced budgets for four consecutive years and can access the bond market at reasonable interest rates. That could take a while — after Detroit's bankruptcy, it needed the state to implement additional safeguards to win over investors. Puerto Rico doesn't have that option.

To be clear, I hope that Puerto Rico will stage a comeback and become an attractive place to work and live. But it's going to take more than just a smattering of hedge fund tax dodgers or a community of crypto advocates building their own paradise on a sliver of the island. It's going to take sensible policies to prevent the "brain drain" of the commonwealth's best and brightest to the U.S. mainland. It's going to take government officials that are technocrats first and foremost, rather than susceptible to scandal and cronyism. And, most likely, it's going to take a good deal of luck to avoid the kind of devastation brought by Hurricanes Irma and Maria in 2017 that could set back any recovery efforts.

Exiting bankruptcy alone won't bring Puerto Rico prosperity and vitality. But it's a crucial first step. Pierluisi is correct that it is a new day for the commonwealth. It's also going to be a workday.

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