Puerto Rico Is America's Greece

BY RICHARD W. RAHN

IT FACES PROBLEMS INCLUDING DEBT AND HOW TO REVIVE ITS ECONOMY

Like Greece, the Puerto Rican government has more debt than it can service, and some are calling for a bailout by U.S. taxpayers. The major Puerto Rican state-owned or controlled enterprises are all losing money, including the power authority which is insolvent.

Puerto Rico is an American territory that was acquired from Spain in 1898 during the Spanish-American War. The island has a population of about 3.6 million, which is declining as many Puerto Ricans emigrate to the U.S. mainland or elsewhere because of the continuing economic stagnation. Puerto Ricans are American citizens, but their per capita income is about half that of Americans living in the mainland. Puerto Ricans are largely self-governing at the local level, and do not pay most U.S. income taxes. Plebiscites have been held periodically concerning Puerto Rico's status as a territory. Most Puerto Ricans prefer a change but they disagree about whether they want independence, a free association with the United States or statehood.

Hong Kong was a small British territory, with the British legal system, but no self-government; yet, it has become rich — having more than twice the per capita income of the average American — without receiving aid and subsidies from Britain, which the United States has and continues to provide to Puerto Rico. The operative question is why has Hong Kong become so much more successful than Puerto Rico?

The most immediate challenges facing Puerto Rico are what to do about the debt problem and how to revive the economy. Some believe if Puerto Rico were given partial debt relief by allowing state entities, such as the power company, to go into Chapter 9 bankruptcy (a provision in U.S. law enabling bankrupt U.S. localities to restructure and discharge some or all of their debt as has recently been done with several California cities and Detroit), all would be well. Chapter 9 only applies to U.S. states and their municipalities, which does not include Puerto Rico. There is a bill before Congress now that would allow Chapter 9 for Puerto Rico. This bill would only apply to a third or less of Puerto Rican debt and would stick it to the bondholders (largely non-Puerto Rican Americans) and American taxpayers.

This is a bad idea on a number of accounts. Many millions of Americans, either directly or indirectly through their mutual funds, have bought Puerto Rican bonds, in large part because the U.S. Congress gave them tax-free status as is provided for U.S. state and local bonds. Those who bought Puerto Rican bonds did so with the legal understanding that they would not be subject to Chapter 9, and that, in case of insolvency, the bond issuing entity, such as public corporations like the power company, would be put under a receivership instead. It is unethical to change the rules in midstream. Chapter 9 might make sense for future bond issues, but the bond buyers should clearly understand the course that would be taken in case the issuing agency was not able to pay.

As long as Puerto Rico and its state-owned entities continue to lose money and run deficits, Chapter 9 provides only a temporary fix on the backs of the bondholders — such as American retirees — rather than on the backs of those who were responsible for the mess. One of the major reasons the power company is insolvent is that the government has not paid its electric bill and it is the single biggest customer.

Puerto Rico has a bloated government with far too many employees, unstainable pension obligations, and an intolerable level of corruption. The proper solution to the Puerto Rican debt problem is for the U.S. government to establish a "control board," which Congress has the authority to do. This past Friday, Rep. Jeff Duncan, South Carolina Republican, of the House Foreign Affairs Committee, sent a letter to his fellow lawmakers advocating a control board for Puerto Rico, much like the one they created for the District of Columbia a couple of decades back, when D.C. was in danger of default because of mismanagement.

Puerto Rico needs fundamental restructuring of its pension and civil service systems. It needs to sell all of its interests in the fully or partially state-owned enterprises. That is, privatize them. (How many more hundreds of years will we need before the political class learns that socialism — i.e. state-owned enterprises — always fails)? In Hong Kong, even most of the transportation infrastructure is in private hands — and it is clean, efficient, attractive, and works without government subsidies.

Puerto Rico needs to radically reduce government spending, taxes and regulation so it begins to attract foreign capital again rather than driving it away. Puerto Rico is now a welfare state with a labor force participation rate one-third less than in the United States. Many of the most productive Puerto Ricans have moved to the mainland — but could be attracted back with their high-level job skills if the economic environment was made attractive again. Puerto Rico needs to embrace the Hong Kong economic freedom model, rather than the Greek model of too much government.

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