Puerto Rico faces default on its debts

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Puerto Rico's Development Bank (*Banco Gubernamental de Fomento*, BGF) is in last-minute negotiations with the holders of Puerto Rican bonds over the island government's $72 billion public debt and an impending default on the next bond payment, due January 4.

The negotiations are occurring following a decision by the US Congress not to grant Puerto Rico protections under Chapter 9 of the US bankruptcy laws.

On December 14 Congress postponed action on a bill that would have provided emergency debt relief for Puerto Rico. That bill, sponsored by Republican Senator Orrin Hatch, included a $3 billion subsidy, reduction in federal Social Security taxes and a federal financial control board.

With bankruptcy protection off the table, the administration of Governor Alejandro García Padilla had lobbied Congress to include the Hatch proposal in an omnibus budget bill for the US federal government. It now appears that Puerto Rico has run out of options and will default on payments next week.

To avoid default, Puerto Rico needs to make a $957 million interest payment January 4, followed by $331 million in February. In July another payment of $956 million is due together with $1.024 billion to redeem maturing bonds at face value.

Despite having embraced a measure that would have subordinated his and future administrations to a Wall Street-run control board, García Padilla denounced congressional inaction: "This fiscal crisis will soon become a humanitarian crisis under the American flag and the Commonwealth will be dragged into massive, costly litigation, which will prevent the Commonwealth from providing essential services to its citizens," declared the governor.

"By not acting now, Congress has opted for the US Commonwealth to default on its obligations and unfold into chaos. Once again Wall Street has demonstrated its control over Congress; Wall Street rules Congress."

García Padilla also announced that he would not be running for reelection next November in order to better deal with the payment crisis, thus becoming the fourth one-term governor in a row. The last three carried out layoffs of government employees, school closures, sales tax hikes, attacks on pensions and health benefits and other austerity measures.

In 2009, following the layoff of more than 20,000 employees by governor Luis Fortuño, hundreds of thousands of workers took to the streets in mass protests in a one-day general strike. Another wave of protests of workers and students took place in 2010.

The negotiations between the creditor group and the Puerto Rican government now take place in the heels of an activation, by the García Padilla administration, of a "clawback" clause that would sequester financial resources from various government agencies (transportation, government-owned utilities and others) and transfer those resources to pay holders of Puerto Rican General Obligation bonds (GO bonds) that are constitutionally guaranteed.

Melba Acosta Febo, the BGF's director, predicted that the "clawback" would force the infrastructure fund AFI to default on their January debt service of $34 million. She declined to predict whether the GO bonds would default on next month's debt service payment. In previous statements, Acosta Febo has been categorical in declaring that default is a certainty if no action is taken.

The BGF director said that within the next few days it will make a proposal to a bondholders group that includes Millstein & Co., Cleary Gottlieb & Hamilton and CitiGroup. The proposal involves the creation of a new debt instrument, called a "*superbono*," as part of an austerity package of restructuring government spending.

It is widely acknowledged that the various hedge funds that hold Puerto Rican bonds, including Oppenheimer Funds and others, and those that insure the bonds, through swaps and other financial derivatives, pressured US congressmen of both parties not to take any action that could potentially force them to accept less than the entire face value of the bonds—which now sell at a steep discount—plus interest payments that are now due.

Anticipating this turn of events, so-called vulture funds have bought Puerto Rican bonds for far less than their face value, with the expectation of making a killing.

Both García Padilla and Acosta Febo recognize that, by turning its back on bankruptcy protection and on debt relief, the US government has effectively made a beggar out of Puerto Rico, forcing it to accept the terms the hedge and vulture funds demand: payment in full on the backs of the Puerto Rican people.

Wall Street and Congress have emphasized the supposed fiscal irresponsibility of successive Puerto Rican governments that were borrowing in response to a decade of economic slump, but in truth, the debt crisis itself was made in Wall Street.

In 2006 Puerto Rico sank into its most severe recession since the 1930s, a direct consequence of the deindustrialization of the island. During the preceding decade the number of industrial jobs had fallen from 160,000 to 75,000, as textile and pharmaceutical firms fled to more profitable locations.

Faced with the unraveling of a post-war model of attracting investments through tax breaks and low wages for its largely non-union work force, Puerto Rico resorted to borrowing to make up for the capital flight then occurring.

Compounding the economic crisis were austerity policies that further shrank the economy, accelerating the decline in jobs, living standards and the tax base. Serial indebtedness chased ever-declining living standards. During the last nine years, Puerto Rico has cut pensions and government jobs, slashed health benefits for teachers, shuttered public schools, imposed new sales taxes (and then raised them from 7 to 11.5 percent), while steeply raising fees for water and power and taxes on fuel.

Despite these draconian measures, the so-called structural deficit in government spending kept going up, and each administration since 2006 sold tax-free GO bonds to bridge the gap.

Wall Street hedge funds happily obliged, attracted by the low-risk and usurious yields of the bonds—rated as junk bonds since last year—with the expectation that neither the Obama administration, Congress or the Courts would act against its profit interests.

Meanwhile the economy continues to crumble. Since 2004 Puerto Rican GDP has shrunk by 13 percent. More than 40 percent of youth are unemployed. Since 2006 the amount of capital leaving the island exceeds new investments. Per capita income is 7 percent less than in 2006 and social inequality is exploding. The official November unemployment rate of 12.5 percent is more than double the US rate.

Over 10 percent of the population has migrated to the US since 2006, including thousands of medical doctors, engineers, teachers and other highly qualified personnel. Presently less than 40 percent of working-age Puerto Ricans have a job or are looking; one-third of the population survives on US food stamp benefits.

Despite his protestations over congressional inaction, García Padilla has contributed to the increasing human misery facing Puerto Ricans with draconian austerity measures, raising regressive sales taxes, reducing health and vacation benefits for public employees and cutting food stamps and public transit.

As is the case in Greece, Spain and other indebted nations, each austerity measure further sinks GDP and living standards and the capacity of the government to extract resources with which to pay debt holders, requiring yet another round of austerity.

Among the measures that are being contemplated for 2016 are the gutting of Puerto Rico's schools and health systems, the reduction of minimum wages and legislation making it easier to fire workers.

The *New York Times*, in an article that appeared on December 19, indicated that the Wall Street hedge funds and speculative "vulture" funds oppose any proposal that would allow Puerto Rico, or any of its cities or state agencies, to declare bankruptcy (like Detroit did in 2013).

The article chronicles the campaign of hedge and vulture funds to use their financial clout for Congress to deny bankruptcy protection to Puerto Rico, using massive campaign contributions, deceiving publicity campaigns and self-serving reports on the state of the island's finances.

The funds also bitterly opposed and campaigned against a December 4 decision by the US Supreme Court to involve itself in part of the debt, the $22 billion owed by Puerto Rican utilities and other public agencies.

Furthermore, the vulture funds seek to create a precedent that would apply to US states such as Illinois, New York and California, which are heavily in debt, excluding them from bankruptcy courts. Puerto Rico's outstanding debt of $72 billion in fact is only small part of the $3.2 trillion outstanding US municipal and state debt.