

Conservative Action Project

The Conservative Action Project (CAP) was founded in 2008 by many conservative leaders with former **Attorney General Edwin Meese III** serving as the Founding Chairman. CAP is currently chaired by **The Honorable Becky Norton Dunlop** and is designed to facilitate conservative leaders working together on behalf of common goals. Participants include the CEOs of over 100 organizations representing all major elements of the conservative movement-economic, social and national security.

Memo for the Movement

Sensible Reform For The People of Puerto Rico

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Washington, DC

Puerto Rico is broke. That means it can't pay its debts. But the majority of the debt is owed not by the Commonwealth of Puerto Rico but by public corporations and specific government authorities.

Puerto Rico is not, yet, bankrupt. Being bankrupt means that a person or entity has been through a legal bankruptcy proceeding. But the U. S. bankruptcy code does not allow U. S. Territories to do the same.

There is now, and there will be more, pressure on Congress both to pass legislation allowing Puerto Rico to file for bankruptcy, and to go a step further and actually bail out Puerto Rico and its public corporations. Both steps are bad policy and both should be avoided.

People, companies, states, and territories don't just "go" broke. Willful prior activity is required.

The danger of a direct taxpayer bailout to the public at large is obvious: it takes funds from the people who are both prudent and who gained nothing from any dealings with the debtor (i.e., the taxpayers) and gives the funds to the imprudent who did profit from dealing with the debtor (in this case, the people and institutions that lent money to Puerto Rico), while at the same time sending a message to other potential lenders that prudence is for losers — that the willful, prior activity of lending to people or institutions that are bad credit risks, and making a profit on those loans, will not result in financial loss.

Puerto Rico has a long history of financial mismanagement brought about by progressive politics and crony capitalism. The private sector has been routinely stifled for decades and workers receive a lower share of income than in any of the fifty states.

Progressive politicians, who are already seeking an indirect bailout – in the form of upending the existing legal structure to allow bankruptcy -- in the U.S. Congress, argue that a bailout or bankruptcy will help the people of Puerto Rico. It will not, nor would a direct taxpayer bailout. What will help the people of Puerto Rico (as differentiated from the crony capitalist lenders) is the application, voluntary or otherwise, of rules and procedures that promote sensible free market activity and democratic accountability.

Sensible economic reforms include allowing Puerto Rico (1) to set its own minimum wage law, including not having a minimum wage law; (2) to be exempt from U.S. overtime rules (which have just been greatly expanded by presidential fiat); and (3) to be exempt from the Jones Act, a protectionist measure that regulates U.S. shipping practices.

Puerto Rico should also be required to make more accurate and uniform pension disclosure a condition of receiving preferential tax treatment for all municipal bonds so that potential investors can know the true liabilities.

In addition, Puerto Rico's legislature should be instructed to enact some simple reforms: make available audited current financial statements; end privileges that allow some customers free access to public utilities; and enact a civil service law and reduce the number of political appointments to a few hundred.

Sensible reforms do *not* include several proposals currently being floated, including: (1) a proposal to further increase transfer payments to Puerto Rico, which Congress did last year in the omnibus; and (2) the creation of a narrowly empowered "Oversight Board" seen as having tyrannical powers. That is a recipe for having enough power to be blamed for failure but not enough to succeed. As in any democracy, the people who make decisions should be accountable to the voters who have to live with those decisions.

Congress should not upend the existing legal system to give Puerto Rico legal protections from its creditors. Federal intervention between debtor and creditor could set a dangerous precedent for troubled state and local governments, and thus potentially disrupt the municipal bond market.

If the current debts of the public corporations and specific government authorities in Puerto Rico go unpaid, the result will be that bondholders will lose money and public utilities may go into receivership. That might result in much-needed reforms.

Puerto Rico's public bonds were issued within specified legal frameworks. Those who bought and sold the bonds can work out the insolvencies under the rules they agreed to when they entered into the contracts. Changing the bankruptcy rules now would set a precedent for tilting the law in favor of political entities.

In the absence of a bailout or change in bankruptcy laws, Puerto Rico's utilities would be forced to deal directly with their creditors, as the electric company PREPA has done for the past few years. Those internal reforms are often painful for insiders, but they are good for customers and they would improve the utilities' long-term viability. It is true

that Puerto Rico may be forced to default on some debts, possibly through an agreement with its creditors. That would offer the creditors the opportunity to demand structural reforms for Puerto Rico's economic regulation and fiscal process, without which the prospects for future repayment are dim. A bailout or change in bankruptcy laws would short-circuit this process, leaving in place the corruption, patronage, and unresponsive government that has prevented Puerto Rican incomes from catching up with those on the mainland. Default is a powerful lesson for profligate lenders.

There will undoubtedly be many more proposals for solving Puerto Rico's financial crisis. But both citizens and legislators, in Puerto Rico and on the mainland, should remember that Puerto Rico's crisis is not just a financial crisis: it's a democracy crisis as well. Puerto Rico has suffered from decades of bad management — but management by legislators elected by the citizens of Puerto Rico. The people of Puerto Rico need to clean their own house if, in the future, they want and expect to live in a house that is clean.

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