Written by **Bob Adelmann** on February 2, 2016

Puerto Rican Senate to Investigate Causes of the Island's Financial Woes

In announcing that he would hold hearings starting Tuesday in order to find out who and what are to blame for his country's financial woes, Puerto Rico's Senate President Eduardo Bhatia perfectly summed up the problem:

> If the towns don't get free energy [provided by the government since 1941], they're going to have to pay for it by increasing their property taxes or something … the people will end up paying.

The most visible culprit is the Puerto Rico Electric Power Authority (PREPA), the brain child of Rex Tugwell, a member of President Franklin Roosevelt's so-called "brain trust." Tugwell, a Columbia University socialist professor who worked to create Roosevelt's New Deal, was appointed governor of Puerto Rico during World War II. He collectivized the private energy producers into PREPA, offering free electricity to municipalities in lieu of taxes that those private companies were paying.

With anything free the demand for it is unlimited, something that Tugwell either didn't consider or didn't care about. Aguadilla, a small town located on the northwestern tip of the island, is a microcosm of Puerto Rico's problems. Formerly a fishing village, it now is the home of industrial high-tech firms such as LifeScan, Micron Technology, Symmetricom, Honeywell, and Hewlett Packard. Other industries there are in rubber, leather, textiles, steel, wood, machinery, and food processing.

What makes Aguadilla unique is that it has consistently run budget surpluses, even going so far as to reward its citizens free tickets to the city's water park. How does that happen on an island that has been suffering recession since 2005?

The electricity is free, that's how. And not just Aguadilla. PREPA has been giving free electricity to all 78 of the island's municipalities, to many government-owned enterprises, and even to some private for-profit businesses. But Aguadilla is the poster child for taking advantage of free electricity. It has 19 city-owned restaurants, a hotel, a water park (the largest in the Caribbean), a minor-league baseball stadium (complete with floodlights for night games), and a waterfront shimmering with dancing water fountains and glimmering streetlights.

It also has an ice-skating rink, complete with a disco ball and laser lights.

Keeping all these amenities glowing costs a fortune, but since it's free, what's the incentive to limit or restrict them?

Originally PREPA was supposed to collect fees from those municipalities when their electrical power usage exceeded what they were no longer collecting in taxes from those private energy companies. But over the years that calculation became so complex that bureaucrats just gave up trying to measure it, and so hundreds of millions of dollars in back fees have simply been ignored.

Across the land the party is ending. The island has the population of Oklahoma and a gross domestic product smaller than that of Kansas, but public debt of $73 billion that is greater than any state in the union except New York and California. Last June Governor Garcia Padilla said his island was “out of money” and couldn’t make some interest payments. He added that unless the economy gets back on its feet, it will remain “in a death spiral.”

In December he skipped making some other interest payments as well, and is now offering the solution to the island’s financial problems: Stiff the bondholders who made it so easy for entities such as PREPA to borrow and then give away massive sums without accountability or repercussions.

His offer isn’t going down well. Bondholders who took advantage of the island’s “triple-tax-free” interest advantage without looking behind the offer to see how or if they would ever get paid back, are pushing back. According to Barron’s:

> The problem with [Padilla’s] proposal is that key groups of bondholders, notably those holding GO [general obligation] debt and senior sales-tax revenue bonds … believe they have strong constitutional and legal protections and … aren’t going to accept the hits [proposed by Padilla].

When all three credit-rating agencies scored Puerto Rico’s bonds as junk back in 2014, those bond holders saw their holdings decline in value by between 20 and 40 percent. They aren’t taking lightly a haircut which would reduce their value by another 50 percent.

Padilla’s options are limited. Puerto Rico isn’t able to declare Chapter 9 bankruptcy, 40 percent of the population already lives below the poverty level, and the sales tax was just raised from 7 percent to 11 percent. There’s not much more blood in the turnip that Padilla can squeeze.

The toxic combination of free electricity, cheap money, careless investors, and Wall Street facilitators devising more and more ways to borrow have all combined to create the island’s untenable situation. As Senate President Eduardo Bhatia should learn, the real culprit isn’t outfits such as PREPA providing free electricity for the asking, but the resultant culture of dependency that springs from it.

Photo: Puerto Rican flag

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