THE WALL STREET JOURNAL.

http://www.wsj.com/articles/what-the-united-states-owes-puerto-rico-1439506799

OPINION | COMMENTARY

What the United States Owes Puerto Rico

Allowing the U.S. territory to fall prey to the claws of vulture creditors is unjust and unacceptable.

By JOSEPH E. STIGLITZ And MARK MEDISH

Aug. 13, 2015 6:59 p.m. ET

The U.S. flag flies in front of Puerto Rico's Capitol in San Juan. *PHOTO: RICARDO ARDUENGO/ASSOCIATED PRESS*

German Finance Minister Wolfgang Schäuble recently quipped to his American counterpart, Treasury Secretary Jack Lew, that he would gladly trade Greece for Puerto Rico. He was referring to the debt crises in both places and indirectly chiding Mr. Lew for offering unsolicited advice. While there are important differences, the Puerto Rican and Greek situations are similar enough to warrant comparison for policy lessons, though perhaps not the ones intended by Mr. Schäuble.

Both are cases of fiscal mismanagement and unsustainable external debt in the context of fixed exchange rates through a common currency, the U.S. dollar for Puerto Rico and the euro for Greece. Equally striking, both Puerto Rico and Greece represent quasi-colonial dependencies of distant powers in Washington and Berlin (via Brussels). Though there is an important distinction: Greece chose to join the eurozone; Puerto Rico never chose to become an unincorporated U.S. territory. The islands, more than a 1,000 miles south of Miami, were acquired from Spain in 1898 after the Spanish-American War.

Washington has since been content to play absentee landlord. The commonwealth of Puerto Rico is neither fish nor fowl in the constitutional order. It lacks both the privileges of a U.S. state and the powers of a sovereign. Indeed, its relationship to the U.S. gives the lie to the notion of a "commonwealth." The U.S. wants the benefits of an offshore tax haven without the responsibilities to rescue it in time of need.

Washington treats Puerto Ricans as second-class citizens. The list of slights is long and depressing. The territory receives reduced Medicare and Medicaid coverage. Corporate tax holidays were granted and capriciously withdrawn by Congress. The North American Free Trade Agreement has beggared Puerto Rico through substantial trade diversion in favor of Mexico. And the 1920 Jones Act forces the U.S. territory to use high-cost American shipping carriers.

Excluding unfunded pensions, Puerto Rico has a debt burden of more than $70 billion, which it cannot service. Most of Puerto Rico's private creditors—such as OppenheimerFunds and Franklin Templeton Investments, the latter also a large creditor of Ukraine—insist that Puerto Rico merely has a serious short-term liquidity problem but is not insolvent. Yet absent a comprehensive long-term growth strategy, this is a distinction without a difference. The territory can't pay its debts today, and with short-term debt financing at the high interest rates demanded by creditors, it will be even less able to pay its debts tomorrow.

Private creditors are unwilling to admit they made foolish investments, lured by the triple tax break on Puerto Rico's municipal bonds. And once again the investment funds and banks, rating agencies and insurers who failed to do due diligence on the debtor's capacity to pay will attempt to shift the blame. Vulture funds swooped in late, looking for a killing.

At risk is not only Puerto Rico but the safety and soundness of the rest of the $4 trillion U.S. municipal-bond market. After Detroit's bankruptcy, who knows what other jurisdictions have fiscal weaknesses that should be more closely scrutinized? Contagion from Puerto Rico could mean higher municipal borrowing costs across the U.S., especially with muni-bond insurers raising premiums, or even pulling back from providing insurance altogether.

What is to be done? Putting aside a change in sovereign status—a "Prexit" resulting in either independence or U.S. statehood—the practical options for Puerto Rico are limited. But action by Washington is imperative to prevent further social hardship.

First, the U.S. bankruptcy code, which currently excludes Puerto Rico, should be amended to include it and open the way for orderly debt relief. If the code is not amended, Puerto Rico should be allowed to promulgate its own bankruptcy law. Up until now, this common-sense reform has been blocked in the courts by private creditors fearing the haircuts that they richly deserve, and which would enable Puerto Rico to have a fresh start.

Second, if the U.S. is unwilling to provide assistance, Puerto Rico should be allowed to bring in the International Monetary Fund for official assistance. Washington currently rejects IMF involvement, but why exactly? If the IMF is good medicine for Greece, why is it not good medicine for Puerto Rico?

The IMF would certainly conduct a debt sustainability analysis concluding that most of Puerto Rico's debt must be restructured or forgiven, as it has proposed for Greece. Much as the IMF has demanded key legislative changes in Greece to qualify for assistance, it would likely recommend that the U.S. Congress amend the U.S. bankruptcy code and the Jones Act, and adjust the minimum wage in Puerto Rico to make workers there more competitive. The reform in bankruptcy law is especially important: Allowing Puerto Rico to fall prey to the claws of vulture creditors is unjust and unacceptable.

Third, and most fundamentally, the U.S. must take responsibility for its imperialist past and neocolonial present. Washington owes Puerto Ricans a future based on democratic legitimacy and a financially and socially viable development strategy—a development strategy that is more than a set of tax breaks for profitable U.S. corporations.

Mr. Stiglitz, a Nobel laureate in economics, is a professor at Columbia and the author of "The Great Divide: Unequal Societies and What We Can Do About Them" (W.W. Norton, 2015). Mr. Medish was a senior Treasury official during the Clinton administration.