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THEDIALOGUE


FEATURED Q&A

## Will Puerto Rico Tumble Into a Series of Defaults?

In announcing a default earlier this month, Puerto Rico Gov. Alejandro García Padilla said the island was unable to make a debt payment without making unacceptable cuts to public services. // File Photo: Government of Puerto Rico.

**Q Puerto Rico on May 2 missed a deadline to pay most of a $422 million debt payment, its largest default to date, but just one in what could be "a series of cascading defaults," U.S. Treasury Secretary Jacob Lew said in a letter to House Speaker Paul Ryan. Should Congress give Puerto Rico new powers to restructure its more than $70 billion in debt? If lawmakers do not act, what would happen to Puerto Rico and its economy? How much political will exists in Congress to allow the territory greater restructuring powers?**

**A Sergio Marxuach, policy director at the Center for a New Economy:** "Puerto Rico is over-indebted; it has $70 billion in public debt plus an additional $43 billion in unfunded pension liabilities. This debt vastly surpasses Detroit's $19 billion—the largest municipal bankruptcy in U.S. history. Indeed, Puerto Rico has more debt, in absolute terms, than any U.S. state government except California and New York, while its economy is smaller than that of Kansas. Furthermore, since 2006, Puerto Rico's economy has shrunk by 14 percent in real terms, population has declined by 9 percent and total employment has decreased by approximately 17 percent. Puerto Rico simply does not have the ability to pay this massive debt accumulated over the last half century. Delaying a necessary restructuring of Puerto Rico's debt will only lead to the destruction of bondholder value and lower recovery levels through additional unsustainable borrowings, high interest rates and restrictive fiscal policies that amplify the economic contraction. If the current economic contraction intensifies, then the incentive to leave the island will be stronger, and the tax base—the people who earn income—will continue

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**TODAY'S NEWS**

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The country's National Guard blocked opposition demonstrators pushing for President Nicolás Maduro's ouster from marching on the headquarters of the election commission.

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### Caterpillar Eager to Move Into Cuba: CEO

The CEO of the heavy equipment manufacturer said during a trip to Havana that the company wants to do business in the island nation as soon as the U.S. trade embargo is lifted.

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POLITICAL

### Brazil's Rousseff Suspended, to Be Tried in Senate

Brazil's Senate voted early today to suspend President Dilma Rousseff and proceed with an impeachment trial that could last as long as six months. Vice President Michel Temer now becomes the country's acting president.

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Rousseff // File Photo: Brazilian Government.

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POLITICAL NEWS

# Brazil's Rousseff Suspended, to Be Tried in Senate

Following a marathon session that lasted more than 20 hours, Brazil's Senate voted early this morning to suspend President Dilma Rousseff from office and put her on trial in the chamber for allegedly breaking the nation's budget laws. The 55-22 impeachment vote in the Senate against Brazil's first female president results in her suspension for as long as six months while her fate is decided in the Senate. Vice President Michel Temer now becomes the country's acting president during that time and if Rousseff is convicted and removed from office permanently, Temer would then serve out the remainder of Rousseff's term, which lasts through 2018. Only a simple majority of the 81-member Senate was required to suspend Rousseff and proceed to trial, but a two-thirds majority would be needed to permanently remove her from office. Following the vote early this morning, Rousseff's opponents in the Senate broke into applause and posed for congratulatory group photos in the chamber, Agence France-Presse reported. "We could no longer ignore these crimes and thus voted for impeachment," Green Party Senator Álvaro Dias said just before casting his vote, the New York Times reported. "Having been assaulted by incompetence and wrongdoing, Brazilians expect punishment." Rousseff has repeatedly rejected calls to resign and has vowed to fight to remain in office. She is expected to make a statement this morning. Before this morning's vote, Brazil's solicitor general, José Eduardo Cardozo, stood up at the dais in the Senate and told lawmakers that, in the long term, they would be judged harshly if they proceeded to try Rousseff for a crime she did not commit, the newspaper reported. "If this impeachment goes forward, Brazil will become the world's largest banana republic," he said. Just after the vote, Rousseff dismissed all of her key cabinet members, including Chief of Staff Jaques Wagner and Finance Minister Nelson Barbosa, The Wall Street Journal reported. Temer is expected to announce members of his cabinet today. The Senate's move to suspend Rousseff puts an end to 13 years of continuous rule by the center-left Workers' Party. Temer, of the center-right PMDB party, has said his top priorities as acting president are to address the country's severe recession and to end the paralysis over Rousseff's impeachment that has consumed Congress, AFP reported. The controversy surrounding Rousseff's impeachment also was evident outside Congress as hundreds of protesters gathered. At one point late Wednesday, police fired tear gas at a crowd of anti-impeachment demonstrators after firecrackers had been thrown at the officers, The New York Times reported.

> **"We could no longer ignore these crimes and thus voted for impeachment."**
>
> **— Álvaro Dias**

ECONOMIC NEWS

# Brazil's Retail Sales Decline More Than Expected

Brazil's retail sales fell in March more than analysts had expected, Bloomberg News reported Wednesday. Sales contracted 0.9 percent after a 1.1 increase in February, the national statistics agency announced Wednesday. The median estimate from 38 economists surveyed by Bloomberg for March was a 0.6 percent fall in retail sales. Sales declined 5.7 percent in March as compared to the same period the previous year. Consumer confidence plummeted in April to its lowest level on record as unemployment rose and the impeachment proceedings against President Dilma Rousseff wore on. Lower consumer confidence has led to worsening economic activity for Latin America's largest nation; the current recession

NEWS BRIEFS

## Venezuelan National Guard, Opposition Protesters Scuffle

Venezuela's National Guard on Wednesday blocked opposition demonstrators from marching on the headquarters of the country's election commission, using tear gas and blocking roads that led to the building in Caracas, BBC News reported. The opposition wants to put pressure on the election commission to speed up the process of verifying the 1.85 million signatures on petitions calling for a referendum to recall President Nicolás Maduro. The Democratic Unity Roundtable, or MUD, opposition coalition organized the demonstration.

## Violence Has Displaced More Than 35,000 in Mexico: Rights Panel

Violence committed by members of Mexico's organized crime groups has led to the displacement of more than 35,000 people, the country's National Human Rights Commission said Wednesday, the Associated Press reported. Another estimate released Wednesday by the Norway-based Internal Displacement Monitoring Centre said more than 287,000 people have been displaced in Mexico, mainly due to natural disasters.

## Algal Bloom Threatening Fishing Industry Expands: Chilean Government

An algal bloom that turns seawater red and makes seafood toxic, known as "red tide," is widening to an unprecedented extent in southern Chile's fishing waters, the government said. The southern region of Los Lagos has been affected by the largest red tide in its history. Local officials warn that there are signs that the red tide has extended to the Los Ríos region, as well. [Editor's note: See related **Q&A** in Monday's Advisor.]

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to migrate to the mainland United States. The odds of full repayment in that scenario are almost zero; the social costs in terms of lower living standards for those who remain would be dramatic; and the probability of a federal bailout would increase significantly as bondholder groups would insist that Congress intervene to rescue them. In sum, no one benefits from the chaos of a disorderly default, years of nonpayment, protracted multi-forum litigation and social unrest in Puerto Rico."

**Osvaldo M. Medina Hernandez, executive director of the Joint Committee for the Penal Code and Criminal Laws Reform and legal advisor to the Judiciary Committee of the House of Representatives of Puerto Rico:** "Puerto Rico Gov. Alejandro García Padilla finally did the right thing by defaulting on the most recent debt payment. Puerto Rico should have defaulted sooner to prevent further damage to the economy. Since the beginning of García Padilla's term, a group of legislators, including Representatives Vega Ramos, Natal Albelo, Torres Cruz and Senators Nieves Pérez and Tirado Rivera, has declared that the current structure of the debt was unpayable and called for its restructuring. Nevertheless, the government tried to meet payments by imposing special taxes as well as tax reform and pension reform, while also dramatically reducing government spending by almost $2 billion without layoffs and asking Congress for tools to restructure the debt. This strategy has not worked. It deepened the recession, increased the cost of living and spurred the immigration of thousands of Puerto Ricans to the mainland United States. Meanwhile, Congress watched and did nothing as the government of Puerto Rico kept making payments that it couldn't afford. Puerto Rico had to decide between financing the basic operations of the government and paying debt holders. There is another $1.8 billion debt payment due on July 1. It is clear Puerto Rico cannot make this payment, nor should it pay. Sadly, I don't see the political will in Congress needed to act on this issue. The House is divided on at least six caucuses with different opinions on how to deal with Puerto Rico with little room to negotiate. I believe those who will create the political will to act on Puerto Rico are the deep pockets of some Wall Street hedge funds; especially those with an interest in Puerto Rico's bond market. As the defaults continue, debt holders will increase pressure on Washington to impose a Fiscal Control Board on Puerto Rico. This is very dangerous for Puerto Ricans. Any actions from Congress that limit the powers of the people of Puerto Rico to decide where their taxes are spent or that impose more austerity measures have to be loudly rejected."

> **"Sadly, I don't see the political will in Congress needed to act on this issue."**
>
> **– Osvaldo M. Medina Hernandez**

**Antonio Monroig, founding partner of Lasa, Monroig & Veve:** "Puerto Rico's huge problem has its roots in its colonial status, which does not give the island political leverage. It is at the mercy of the Congress by virtue of the U.S. Constitution and its territorial clause. Puerto Rico can't deal with its fiscal burden because Congress has excluded it from bankruptcy authority. The failure of the government to provide Congress with audited financial statements makes it very difficult to assess the real situation and therefore how to deal with it. I think the only way to solve this problem is by appointing a Fiscal Control Board that can take action to reform a bloated bureaucracy and cut wasteful spending. The governor and his fiscal advisors have been totally

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is on track to be the worst on record. Swap rates on the contract due January 2018 fell 14 basis points to 12.6 percent in early morning trading. Sales of food, beverages and tobacco products at hypermarkets and supermarkets decreased by 1.7 percent in March after a 0.8 percent increase the month prior. Sales of furniture and appliances fell 1.1 percent after a 6.1 percent increase the month prior. Retailer Via Varejo's net income for the first quarter was only approximately $870,000, down 99 percent from the same period in 2015, the company said Tuesday. "We believe retailers will have a challenging year ahead, particularly taking into account the effects on the economy of the shaky political situation," the company said in a statement. Brazil's economy shrank 3.8 percent overall in 2015 and is expected to shrink by even more this year.

**BUSINESS NEWS**

# Caterpillar Eager to Move Into Cuba: CEO

Illinois-based heavy equipment maker Caterpillar is ready to move into the Cuban market as soon as the U.S. trade embargo is lifted, Chief Executive Doug Oberhelman said Wednesday after a meeting with Cuban ministers in Havana, Reuters reported. Caterpillar is one of several U.S. companies eager to establish itself early in Cuba, which had been mostly off-limits to U.S. businesses for more than five decades. The recent thaw between the United States and Cuba, however, is giving many in the U.S. business community hope that full commercial ties will be restored between the former Cold War foes. "We have talked about a number of projects," Oberhelman said during his trip to Cuba. "I think the most interesting one in the near term would be the Mariel harbor ... making an efficient modern harbor that competes with others around the world." Cuba is betting much of its economic future on the success of the Mariel port, west of Havana, which would serve as a potential distribution center for the Caribbean and Central and South America.

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incompetent by saying and doing all the wrong things in dealing with the creditors and Congress."

**Jeffrey L. Farrow, chairman of the Oliver Group and former co-chair of President Clinton's Interagency Groups on Puerto Rico and the other U.S. territories:** "The bankruptcy code allows states to authorize instrumentalities to seek debt adjustment in federal court. Puerto Rico, a territory which, in most ways, is similar to a state other than in the code and in most federal law, shouldn't have less authority. The bigger debate is whether its 'state' debt ought to be reduced—which the code doesn't provide for in the case of states—and, if so, under what conditions? Puerto Rico needs to eliminate unnecessary spending, have big businesses and the wealthy that pay virtually no tax contribute more, collect taxes that are rampantly evaded and improve accounting and transparency. Legislation currently in Congress would install a federal board in the insular government, which could overrule local elected officials and propose reduction of any debt. The federal government should assist the territory but respect local government in a place that has no vote in its national government. Without some restructuring, Puerto Rico would have to take measures that would result in undue hardship and would further depress its economy. Regrettably, however, the bill wouldn't address the main causes of the problem other than unwise borrowing and spending: Economic underdevelopment and decline due to incoherent and contradictory treatment in federal laws, particularly including unequal funding in major programs, and international economic changes. And this situation stems from Puerto Rico's status. The island lacks the powers and benefits of a state and the powers and opportunities of a nation. As President Obama's Task Force on Puerto Rico recognized, resolving the question of the island's ultimate status is the fundamental solution to its major economic challenges."

> **"Without some restructuring, Puerto Rico would have to take measures that would result in undue hardship and would further depress its economy."**
>
> **— Jeffrey L. Farrow**

*The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at* **gkuleta@thedialogue.org**.

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