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Written Testimony
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WRITTEN TESTIMONY

CHAIRMAN RAÚL GRIJALVA, MEMBERS OF THE UNITED STATES HOUSE OF REPRESENTATIVES COMMITTEE ON NATURAL RESOURCES.

Good morning. Thank you for the opportunity to appear today before this Committee to discuss the lessons learned since the enactment of Puerto Rico Oversight, Management, and Economic Stability Act, PROMESA, almost three years ago.

The enactment of PROMESA and establishment of Puerto Rico's Financial and Oversight Management Board, to which I will henceforth refer as "the Board," occurred in the context of a deep debt crisis.

A basic tenet of modern capitalism is that insolvent debtors need a fresh start. And it is well known that decentralized bargaining processes for debt restructuring often lead to poor outcomes, with costly delays and the relief obtained being insufficient to restore debt sustainability. Delays in concluding debt restructurings make economic recessions deeper and longer. Aware of these premises, Congress took action and enacted PROMESA, a law ostensibly designed to facilitate debt restructuring and economic recovery for Puerto Rico.

The Board was in charge of designing and implementing a plan for restoring the sustainability of the public debt that would allow for the Commonwealth's recovery of access to capital markets and create the necessary foundation for economic growth and to restore opportunity to the people of Puerto Rico.

The Board certainly faced a difficult task, one that was of essence for the future of Puerto Rico. The critical question that I would like to address today is whether the policies that the Board has promoted have been aligned with the mission that it received. I will argue that, unfortunately for Puerto Ricans, but more fortunately for a group of bondholders, they have not.

In March of 2017, the Board certified a fiscal plan that was going to be the basis of Puerto Rico's fiscal and debt policies over the following decade. The consensus among the economists that had been analyzing Puerto Rico's case was that the plan was severely flawed. In a letter published on January 24, 2018, twenty-six internationally renowned economists argued that "*the pre-hurricane fiscal plan did not provide for economic recovery*," that it included "*a number of* *unrealistic assumptions*," and that the new fiscal plan had to be "*fundamentally different than the previous one if Puerto Rico is to have a chance for recovery.*"[1]

In September of 2017, Hurricane Maria aggravated Puerto Rico's troubles. Though Maria was a tragedy, it also created an opportunity to rewrite the fiscal plan and to come up with a sensible debt restructuring plan.

The island now has a new fiscal plan and an approved restructuring deal with the COFINA bondholders. In this testimony, I intend to shed light on the implications of both.

Let's start with the basics. The sustainability of Puerto Rico's debt restructuring needs to be assessed and addressed comprehensively. The critical question is how much debt reduction the island needs in order to take its debt position to a sustainable level. A sensible approach would be to calculate a range of how much debt could have been paid in total before the hurricane and use that range as the basis of how much debt can be sustained after the hurricane. Otherwise, part of the expansionary effects that the federal relief will have on Puerto Rico's economy will constitute an implicit bailout to the bondholders.

In a study published in 2018 by the institution that I represent on this occasion, Espacios Abiertos, as well as later by the *National Bureau of Economic Research* and by the peer-reviewed journal *CENTRO*,[2] professors Pablo Gluzmann, Joseph Stiglitz, and myself analyzed the fiscal plan of March 2107 and computed the debt relief that Puerto Rico needed in order to restore debt sustainability. In a study published on Tuesday by Espacios Abiertos,[3] conducted under my direction, the analysis has been updated. Our research, as well as related analyses from reputed colleagues, suggests a number of conclusions that I would like to share.

First, while there is a strong consensus among economists on the macroeconomic debt policies that Puerto Rico needs to adopt in order to escape from the current debt trap, the Board's

1 A Fiscal Plan for Puerto Rico Recovery (2018). Available at http://recovery4pr.org/

2 Gluzmann, Pablo A., Martin M. Guzman, and Joseph E. Stiglitz (2018). "An Analysis of Puerto Rico's Debt Relief Needs to Restore Debt Sustainability." National Bureau of Economic Research Working Paper No. 25256. Also available as Espacios Abiertos Paper: http://espaciosabiertos.org/wp-content/uploads/DSA-English.pdf

3 Espacios Abiertos (2019), "Puerto Rico's Debt Dilemma." Available at http://espaciosabiertos.org/wp-content/uploads/Puerto-Ricos-Debt-Dilemma-Final-Report-May-2019.pdf

debt policies are not being aligned with the conclusions reached by that consensus. Instead, they are leaving a legacy of debt and risk that may undermine the future of Puerto Rico's economy.

Second, the COFINA deal poses a serious risk of a failed debt restructuring. The deal makes sense only if the other groups of Puerto Rico's bondholders get a very large haircut. The arithmetic is simple. According to our calculations, as well as calculations by others who arrived at similar results with different methodologies, the generosity with the COFINA bondholders can only be sustained if the reduction on the rest of the public debt lies between roughly 85% and 95%—a conclusion that rests on the assumption that the entire public debt restructuring is designed with the goal of restoring debt sustainability.

Third, the terms of the COFINA deal imply that COFINA bondholders will be getting far more than they could have expected a year ago, as reflected in market prices. Overall, the outcome of the political game among the Board, the government of Puerto Rico, the U.S. Congress, and the bondholders over disaster relief funds is contrary to the interests of Puerto Rican citizens. Those who bought COFINA bonds in the months that followed Hurricane Maria have made massive profits at the expense of the future of Puerto Rico's economy. In fact, with this deal, COFINA bondholders will be among the main beneficiaries of the effects that the federal relief will have on the island's economy.

Fourth, the Board is still supporting too much debt service and is addressing one piece of the debt restructuring at a time in a way that will likely prove inconsistent. If terms similar to the COFINA deal are agreed to with creditors who hold General Obligation bonds, Puerto Rico will be forced to default again or else suffer even more fiscal austerity, which will lead the economy once again into a destabilizing spiral of recession and outmigration by the time the federal relief assistance decreases.

Fifth, the Board and the government of Puerto Rico have overstated the savings that the COFINA deal will deliver for Puerto Rican taxpayers and understated the distributional consequences as well as the risks that the outcomes of those debt negotiations entail. In my view, the people of Puerto Rico have been misled and not accurately informed of the actual meanings of this deal by those who are supposed to represent them.

While I am sure the last two years have brought difficult challenges to the Board, I still do not see a well-oriented restructuring process. My concern with the evolution of events that we are witnessing is that the recovery induced by the federal relief assistance will be short-lived. While in the short term we will observe that Puerto Rico grows, if the problem of unsustainable debt is not resolved, we will see again a declining economy with further outmigration and a prolonged humanitarian crisis by the time the federal relief starts to cease. That path will inevitably end in the need for another costly restructuring.

Thank you again for the opportunity to share my views. I hope my testimony contributes to a better-informed policy debate.

Sincerely,
Martin Guzman