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GOVERNMENT'S NEW FISCAL PLAN CONFIRMS FAILURE OF AUSTERITY MEASURES AND UNSUSTAINABILITY OF PLAN OF ADJUSTMENT FOR THE PUBLIC DEBT

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PRESS SUMMARY

In January of 2018, Espacios Abiertos presented a study co-authored by Martín Guzmán, now the Minister of Finance for Argentina; Joseph E. Stiglitz, Nobel laureate in Economics; and Pablo Gluzmann, economics researcher at the University of La Plata, with a later, post-Maria update in May of 2019. The study, published in the peer-reviewed journal *National Bureau of Economic Research* (NBER), concluded that in order for Puerto Rico to face a sustainable repayment of its debt, that public debt, of some **$72.2 billion**, should be cut approximately **eighty to ninety percent**. That is, its final value, after restructuring, should range from **$14.4 billion to $7.2 billion.**

To date, two restructurings have occurred: under Title III of PROMESA, COFINA bonds were restructured, to a final amount of **$12.02 billion**, and under Title VI of PROMESA, the Government Development Bank (BGF) bonds, for a final amount of **$2.60 billion.**

In February of 2020, the Financial Oversight and Management Board (FOMB, or Board) presented a Plan of Adjustment for restructuring the central government's pending debt. This plan proposed reducing the debt of general obligation bonds (GOs) from **$35 billion** to **$14.48 billion**, divided into **$10.67 billion** in new bonds and **$3.81 billion** in cash payments to bondholders. This sum was the equivalent of a **haircut of 59%.**

Given the new situation created by the COVID-19 pandemic, in March the Board filed a motion in the court in which the island's bankruptcy was being litigated to postpone the hearing to discuss the Plan of Adjustment for the central government's debt. However, on May 3 the government presented the new fiscal plan and at Espacios Abiertos we have analyzed that plan, focusing on the implications entailed by the new, post-pandemic situation, the international situation, and the way the plan and its economic projections affect the sustainability of the island's public debt repayment. As part of this analysis we also include recommendations for contributing to the public discussion of the island's economic sustainability.

What is the global context within which economic experts predict a global debt crisis?

Supranational bodies such as the International Monetary Fund (IMF) and the World Bank (WB) agree that the current crisis, known now as the "great lockdown," will lead to the greatest economic slowdown since the Great Depression of 1930. More than ninety countries have made emergency requests for funds from the IMF and for other types of programmatic resources from the WB. The G20—an organization, made up of 19 countries and the European Union, whose ultimate objective is international financial stability—granted a **moratorium** of at least twelve months on the **repayment of public debt and interest**, in the amount of $20 billion, affecting 76 countries with emerging economies.

How can this proposal be coming from creditor nations? The reason is as simple as it is counter-intuitive: The relief measures needed to generate debt repayments sustainable over time benefit not only debtor countries facing a new and adverse financial situation, but also favor, over the long term and possibly to an even greater extent, the future financial well-being of their creditors.

How does the new fiscal plan interpret this new situation, and how is Puerto Rico affected in the current crisis?

The current fiscal plan, presented on May 3, interprets this new situation as an unprecedented risk scenario for Puerto Rico. For the first time there appears a formal complaint by the government about the **imposition of austerity measures by the Financial Oversight and Management Board**. This could indicate that the official narrative may finally be starting to recognize that austerity is a failed public policy, at least in the face of the current crisis.

According to the new fiscal plan, in the current crisis Puerto Rico is seeing projections of **unheard-of declines in its real Gross National Product (real GNP): -3.8% for fiscal year 2020 and -7.8% for fiscal year 2021**. In addition, the new plan emphasizes that once the structural reforms and austerity measures are implemented, Puerto Rico will have primary financial deficits as early as **2030**, rather than **2039** as had been projected in the February fiscal plan.

In the face of the COVID-19 crisis, how does the plan see Puerto Rico's ability Puerto Rico to generate primary fiscal surpluses that will allow the island to repay the debt in a sustainable way?

The plan gives concise details for projections between 2020 and 2025 under three scenarios:

- The first scenario, called the "upside scenario," assumes a lower impact than the current crisis in the United States: Puerto Rico would have an annual average primary fiscal surplus of approximately **$502 million**, on average, for each fiscal year from 2020 through 2025.

- The second scenario, called the "baseline scenario," assumes a greater impact than the crisis in the United States: Puerto Rico would have an annual average primary fiscal surplus of approximately **$32 million**, on average, for each fiscal year from 2020 through 2025.

- The third scenario, called the "downside scenario," assumes a negative impact in the U.S. economy even greater than in the second scenario: Puerto Rico would have an annual average primary fiscal **deficit of $578 million**, on average, for each fiscal year from 2020 to 2025.

TAKING INTO ACCOUNT THESE THREE SCENARIOS, HOW DOES THE GOVERNMENT'S NEW PLAN PRESENT PUERTO RICO'S ABILITY TO REPAY ITS PUBLIC DEBT?

The new fiscal plan presents an approximation on the basis of three variables: Cash Flow Available before debt repayment; Present Value Rate %; and Contingency %. At Espacios Abiertos, we compared the amounts proposed in the February 2020 plan to the amounts proposed in the May 3 plan. In the February 2020 plan, the government projected the cash flow available for debt repayment as ranging from **$900 million to $1.3 billion** each year, while in the current plan, from May 2020, the cash flow available for debt repayment is projected to range from **$200 million to $600 million** annually.

The primary fiscal surpluses/deficits presented in the May 3 plan will allow us to calculate the present value of the restructured debt at three different rates of interest (4%, 5%, and 6%) and for a certain number of years (20 years).

GIVEN THE INFORMATION PRESENTED IN EXHIBITS 28 AND 32 OF THE FISCAL PLAN, WHAT CUTS TO THE CENTRAL GOVERNMENT'S $35 BILLION DEBT CAN BE INFERRED?

- In the first scenario, the present value of the central government's debt payment after restructuration would range from **$3.588 billion to $3.993 billion, a haircut of approximately 90% to the central government's public debt of somewhat over $35 billion.**

- In the second scenario, the present value of the central government's debt payment after restructuration would range from **$229 million to $254 million, a haircut of approximately 99% to the central government's public debt of somewhat over $35 billion.**

- In the third scenario, the present value of the central government's debt payment after restructuration would be **$0, a cut of 100% to the central government's public debt of somewhat over $35 billion.**

Conclusion

The fiscal plan the government recently presented to the Board suggests a cut of between 90% and 100% to the $35 billion in public debt on bonds issued by the central government. What new scenario of cuts to Puerto Rico's public debt will be proposed by the Board? What measures will it impose on us if it decides not to recognize this new reality? More austerity? Will it continue to insist on cutting pension payments? The government of Puerto Rico seems to finally be beginning to realize the gravity of the situation. Will the Board?

In addition, and given the current level of uncertainty due to the COVID-19 crisis, Espacios Abiertos recommends that the fiscal plan presented by the government be modified to take into account the following suggestions:

- Bring the **audited financial statements** up to date. At this time, financial statements are audited only through fiscal year 2016, while, according to the Board's letter of March 23, 2019, to the government, they should be audited through fiscal year 2018 by March 30, 2020. Without these audited financial statements, Puerto Rico's future access to debt markets remains uncertain. In addition, due to investor mistrust, the rates of indebtedness for the current restructuring process are pushed higher.

- Present an **analysis of the sustainability of the public debt**, incorporating the effects of the COVID-19 pandemic and allowing reconsideration of the payments so far proposed. This analysis will allow the current situation to be reevaluated before presentation of any new proposal for a Plan of Adjustment for restructuring the central government's debt.

- Include a **realistic and plausible macroeconomic plan** for Puerto Rico that emerges out of a new social contract headed up by the island's citizens, and ensure that this plan is aligned with the new sustainability analysis incorporating the effects of the current pandemic.

- **Eliminate austerity measures** as the guiding principle for the island's public policy and **not just postpone them**, as indicated in the government's new fiscal plan.

- Lastly, we ask that given the May 3 fiscal plan's projection of the greatest drop ever in the real Gross National Product in fiscal year 2021 (-7.8%) for Puerto Rico, a **moratorium of at least one year** be implemented for current debt payments, as in the case of the COFINA and BGF bonds.

Access the analysis: https://bit.ly/2LEYoKh