



PUERTO RICO'S DEBT DILEMMA
EXECUTIVE SUMMARY
MAY 2019

When Hurricane Maria hit Puerto Rico in September of 2017, the country was already in a deep debt crisis. The island's population was in decline and suffering a lack of opportunities. Though Maria was a tragedy that added more suffering to an economy already in a downward economic spiral, it also created an opportunity to rewrite a flawed fiscal plan that had been certified by the Oversight Board in March of 2017 and to come up with a sensible debt restructuring plan. The consensus among economists was that the new plan had to be fundamentally different from the previous one if Puerto Rico was to have a chance of recovery. The island now has a new fiscal plan and an approved restructuring deal with the COFINA bondholders.

This study analyzes the fiscal plan and the COFINA deal from a macroeconomic perspective. It updates the analysis by Pablo Gluzmann, Martin Guzman, and Joseph E. Stiglitz published by Espacios Abiertos in 2018 on the debt relief necessary for restoring Puerto Rico's public debt sustainability, and it draws conclusions on the implications of the COFINA deal for the future of Puerto Rico's economy. It also reviews other related recent literature that analyzes what needs to be done in Puerto Rico. The study reaches the following main conclusions:

- There is a strong consensus among economists on some of what needs to be done in Puerto Rico in order to escape the current debt trap. The debt policies that have been implemented recently by the FOMB are not aligned with the conclusions reached by that consensus. Instead, those debt policies are leaving a legacy of debt and risk that may undermine the future of Puerto Rico's economy.

- The COFINA deal poses a serious risk of a failed debt restructuring; if similar terms 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 that will lead the economy once again into a destabilizing spiral of recession and outmigration by the time the federal disaster relief funds start to cease, rather than allowing the economy to prolong its recovery.
- The COFINA deal makes sense only if the other groups of Puerto Rico's creditors get a large haircut. The arithmetic is simple. The ability to pay revealed by our calculations, as well as by calculations by others who arrived at similar results with different methodologies, implies that 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.
- The terms of the COFINA deal also imply that COFINA bondholders will be getting far more than they could have expected a year ago. Overall, the outcome of the political game among the FOMB, the Puerto Rican government, the U.S. Congress, and the bondholders over disaster relief funds has been playing out contrary to the interests of Puerto Rican citizens.
- The FOMB and the government of Puerto Rico have overstated the savings that the COFINA deal will deliver for Puerto Rican taxpayers and have understated the distributional consequences as well as the risks that the outcomes of those debt negotiations entail.
- The sustainability of Puerto Rico's debt restructuring needs to be assessed and addressed comprehensively. This is not happening. Overall, the FOMB 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.

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. Recent events suggest that COFINA bondholders will be among the main beneficiaries of the effects that the federal relief will have on Puerto Rico's economy.