A FISCAL PLAN FOR PUERTO RICO

Faced with physical and economic devastation, Puerto Rico now has a once-in-a-generation chance to rebuild its infrastructure and economic foundation. To succeed, decisive leadership is required on the island and in the US Congress. A new, far-reaching plan must be set to restore economic growth.

On September 20th, Puerto Rico was hit by one of the most powerful hurricanes ever recorded. The damage was severe. Over 1000 people may have been killed, the electrical system was knocked out, and 45 days after the hurricane almost 60 percent of the island was still without electricity. Almost half a million housing units were destroyed by the storm, and over 80 percent of crops died. A large amount of the water supply is still not potable, and many schools have yet to reopen. Hospitals are also operating at a reduced capacity, while funding for government healthcare programs is running out. The Center for Puerto Rican Studies at Hunter College estimates that about 14 percent of the population will leave the island from 2017-2019.

Before the hurricane the Puerto Rican economy was already caught in a serious downward spiral, which included the negative feedback loop of increasing out-migration shrinking the economy and thus causing more to leave the island. The Puerto Rican economy stopped growing in 2005 and entered a "lost decade" of negative GDP growth, which was exacerbated by fiscal austerity. The poverty rate was a staggering 46 percent, and 58 percent for children (nearly three times the rate for the overall US); 11.8 percent of the workforce was unemployed; and population fell by nearly 10 percent between 2007 and 2016. The government coped with the fiscal effects of this downward spiral by issuing more debt.

By 2015 the government could not pay its debt but was not eligible for the same kind bankruptcy proceedings as US municipalities. In June 2016, the US Congress approved the Puerto Rico Oversight, Management and Stability Act (PROMESA). The law did not provide any additional federal funding, whether in the form of Medicaid parity for Puerto Rico with the States, an earned income tax credit ("EITC") or an expanded child-tax credit ("CTC"). But it did create a bankruptcy-like procedure to restructure the islands debt in a court of law. And it established a Financial Oversight and Management Board of Puerto Rico (FOMB) to oversee the island's finances. It approved a 10-year fiscal plan in March of 2017.

The pre-hurricane fiscal plan, proposed by the Governor and certified by the FOMB, did not provide for economic recovery. As a result, the economy was not expected to return to growth for another decade, and probably substantially longer than that, because of a number of unrealistic assumptions. These assumptions included a failure to take into account the full multiplier effect of spending cuts and the loss of tax revenues as the economy declines; an underestimation of expected out-migration (even without the hurricane); and an over-optimistic view of how structural reforms, such as pension and other spending cuts, or downsizing the government labor force might stimulate growth, when the most likely effect is the opposite. Puerto Rico was thus facing one of the longest depressions in this hemisphere for at least the past century, before the hurricane damage.

In the aftermath of the hurricane Puerto Rico is developing a new fiscal plan. The FOMB has issued "core principles" to guide the post-hurricane fiscal plan. These include "sufficient resources to ensure appropriate immediate emergency response and recovery effort in anticipation of federal funds, including provision of public safety, healthcare and education, in order to avoid increased outmigration;" [and a] capital expenditure plan [that] must provide the basis for a long-term economic recovery plan for Puerto Rico, focusing on increased and expedited support for rebuilding critical infrastructure such as energy, water, transportation and housing."

These are positive statements. The new plan for Puerto Rico must address the devastation caused by the hurricane and the problems that caused the prior deterioration of the economy. The plan must be fundamentally different than the previous one if Puerto Rico is to have a chance for recovery. Puerto Rico's leadership, the FOMB and the US Congress all have critical roles to play.

First, the new plan must allow for a return to sustained economic growth, which the previous plan did not. That means a clear rejection of austerity by the Governor and

FOMB and a recognition by Congress of the need for a massive injection of funds for reconstruction, which would provide badly needed economic stimulus. The Governor of Puerto Rico estimates the island needs at least $94 billion to recover. Moody's estimates a similar amount. Although Puerto Rico is a hybrid political entity, it does not have control over monetary policy or its exchange rate, leaving fiscal policy as its only major macroeconomic instrument for economic recovery. Later this month, Congress will take up a supplemental relief act for American regions destroyed by hurricanes and fires. Puerto Rico's reconstruction must be among the most urgent priorities for Congressional leadership and appropriators.

Second, the fiscal plan must deal realistically with the problem of Puerto Rico's more than $70 billion unpayable debt, addressing both the $51.9 billion debt included in the fiscal plan and the more than $20 billion of public sector debt not included in the fiscal plan. If things went as hoped under the pre-hurricane fiscal plan, creditors would only have received $7.9 billion over the ten-year forecast period. But there was no permanent, face value or interest reduction provided by the plan; it did not set forth a debt sustainability analysis or a comprehensive debt restructuring proposal. Not satisfied, some creditors took legal action to try and have the plan invalidated or the appointment of the FOMB declared unconstitutional.

The new fiscal plan must recognize that this debt is unpayable both in the short- and long-term, and propose steps to write down most or all of it, suspending any payments until the economy recovers. Without such a decisive step, the "debt overhang," and legal actions by creditors (including some who bought at huge discounts to seek full payment) will exercise a drag on future investment and growth. Anything that diverts funds away from the people of Puerto Rico, and subtracts from economic growth must be rejected.

Third, Congress must finally recognize that Puerto Ricans are U.S. citizens and entitled to the same federal aid as those who live in the fifty states and the District of Columbia. The island receives only a fraction of the Medicaid support from the U.S. government that the poorest U.S. states receive and also less from Medicare. This federal policy has contributed billions of dollars to Puerto Rico's debt. Puerto Rico needs the same level of support for Medicaid and Medicare as U.S. states. The case is also strong for a federal EITC and an expanded CTC, both of which have enjoyed bipartisan support historically.

The new Puerto Rico fiscal plan must result in a viable economy for Puerto Rico. The alternative—especially a return to austerity in any plan that fails to curtail the debt overhang—would provoke further out-migration and accelerated economic decline, and prolong the current humanitarian crisis.

The following economists and policymakers from the United States, including Puerto Rico have endorsed this fiscal stimulus and debt reduction plan:

Daron Acemoglu, Massachusetts Institute of Technology;

Alan A. Aja, Brooklyn College, City University of New York;

Robert Blecker, American University;

José Caraballo Cueto, University of Puerto Rico, Cayey;

Hector Cordero-Guzman, Baruch College-
City University of New York;

William "Sandy" Darity, Jr., Duke University;

Alberto Dávila, The University of Texas Rio Grande Valley;

Zadia M. Feliciano, Queens College,
City University of New York;

José M. Fernández, University of Louisville;

Richard Freeman, Harvard University;

Jason Furman, Harvard Kennedy School of Government;

Jamie Galbraith, University of Texas, Austin;

Martin Guzman, Columbia University;

Darrick Hamilton, The New School;

Simon Johnson, Massachusetts Institute of Technology;

Thea Lee, Economic Policy Institute;

José Alameda Lozado, University of Puerto Rico, Mayagüez;

Mario Marazzi Santiago, Puerto Rico Institute of Statistics;

Marie T. Mora, The University of Texas Rio Grande Valley;

Francisco L. Rivera-Batiz, Columbia University;

Dani Rodrik, Harvard Kennedy School of Government;

Jeffrey Sachs, Columbia University;

Gene Sperling, Former Director, National Economic Council;

Joseph Stiglitz, Nobel Prize Recipient, Columbia University;

Mark Weisbrot, Center for Economic and Policy Research;

Antonio Weiss, Senior Fellow,
Harvard Kennedy School of Government.

NOTE: The views expressed in this letter are those of the signatory and not necessarily those of the respective institutions and affiliations.

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