

PROMESA HAS FAILED: HOW A COLONIAL BOARD IS ENRICHING WALL STREET AND HURTING PUERTO RICANS

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**POPULAR
DEMOCRACY
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ACRE
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ON RACE & THE ECONOMY

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**POPULAR
DEMOCRACY
IN ACTION**



Contributors

Popular Democracy in Action and its affiliates know that everyday people have the power to change the world. We upend politics as usual to forge a representative, multiracial government and society where we all thrive, no exceptions.

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The Action Center on Race & the Economy (ACRE) is a campaign hub for organizations working at the intersection of racial justice and Wall Street accountability.

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Acknowledgements

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EXECUTIVE SUMMARY

2021 marks the five-year anniversary of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which created a legal framework for restructuring Puerto Rico's \$74 billion debt and established the Financial Oversight and Management Board (the Board).¹

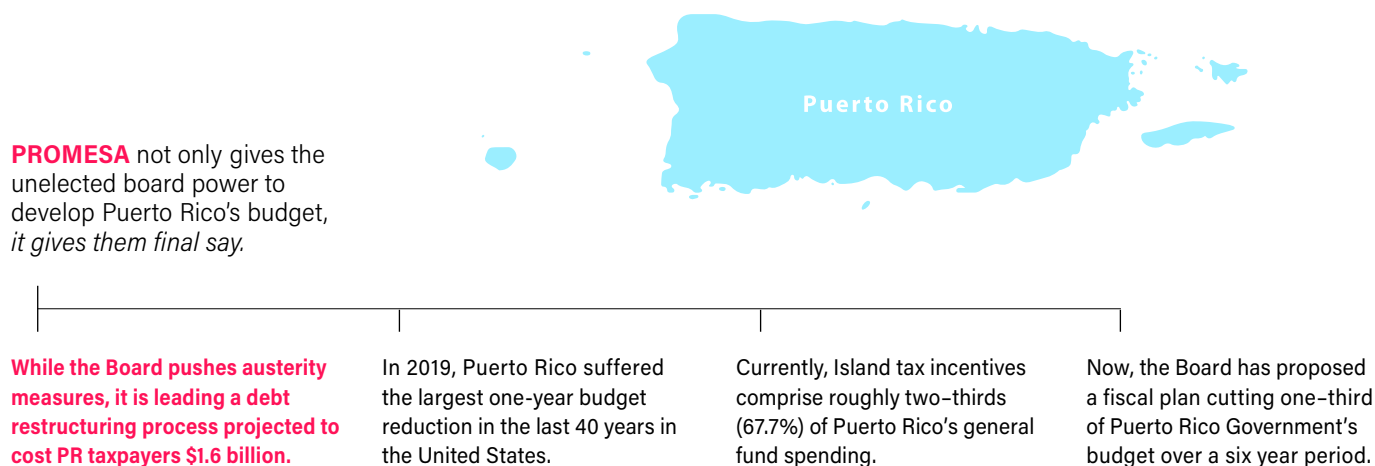
Although Congress passed PROMESA to provide much-needed relief to **Puerto Rico** in the midst of a crushing debt crisis, **the Board has used its power to impose devastating austerity measures and negotiate unsustainable debt restructuring plans that enrich Wall Street and hurt Puerto Ricans.** These two approaches both stunt economic development and growth, and make it very likely that Puerto Rico's debt will soon become unsustainable again. The unelected and unaccountable Board has failed to deliver on PROMESA's key mandates of representing the interests of Puerto Rico in the debt restructuring proceedings, and helping Puerto Rico achieve balanced budgets and regain access to capital markets.

Since 2006, Puerto Rico's residents have suffered a protracted economic recession. In recent years, the island has been battered by a series of natural disasters as well as the COVID-19 pandemic. Throughout this devastating series of natural and public health crises, the Board has continued to push fiscal plans that: 1) impose harmful austerity cuts, 2) ensure hefty payments to bondholders and Wall Street firms, and 3) take advantage of federal disaster relief funds to secure larger payouts for Wall Street bondholders.

Under the Board's watch, Puerto Rican communities are contending with decimated public services, limited resources to rebuild their homes and businesses, and a struggling economy that cannot support them.² During its tenure, the Board has privatized the publicly-owned power grid and pushed rate hikes on utility customers; weakened labor protections for workers; imposed massive cuts in education funding and over 250 school closures; proposed cutting pensions for public sector workers by 8.5%; imposed significant cuts to healthcare and the state-run Medicaid program; and narrowed eligibility for vital food assistance programs.³ These austerity measures are being imposed on communities that already face an enormous degree of economic precarity. Over 43% of the island lives in poverty, one-third of the island's residents are food insecure, and the unemployment rate is consistently nearly double that in the United States.⁴

While the Board forces sweeping service cuts on residents of Puerto Rico, it is leading a debt restructuring process projected to cost a total of \$1.6 billion through 2026, the entirety of which is funded by Puerto Rican taxpayers.⁵ To make matters worse, several Board members appear to have significant conflicts of interest, raising questions about whether members of the Board are truly acting in the best interests of Puerto Rico.⁶ Indeed, the overwhelming sentiment amongst those on the island and the diaspora is that the Board represents an extreme and undeniable manifestation of the colonial relationship between the United States and Puerto Rico.⁷

In the years before PROMESA became law, Wall Street predation was a driving factor in Puerto Rico's debt spiral.⁸ The banks that underwrote Puerto Rico's bonds did not merely enable its borrowing spree; in many cases they targeted the island with unsustainable levels of debt that they knew it would not be able to pay back, all in order to pad their profits. Puerto Rico was subject to a host of predatory Wall Street financial instruments, including capital appreciation bonds (CABs) and toxic swaps.⁹ This allowed banks like Santander, Wells Fargo, Goldman Sachs, and JPMorgan Chase to close more deals and collect more fees, while making Puerto Rico's debt portfolio significantly riskier and more costly.¹⁰ In fact, a large portion of Puerto Rico's debt isn't debt at all; it is unpaid interest on CABs—the municipal version of a payday loan.¹¹ Additionally, a staggering \$6 billion of Puerto Rico's general obligation (GO) debt was allegedly issued illegally, as it violated Puerto Rico's constitutional debt limit.¹²



Rather than rein in Wall Street speculation, the unelected Board has overseen a slow and expensive debt restructuring process using a bevy of high-paid consultants and lobbyists. In some cases, their restructuring plans have proposed awarding hedge fund creditors close to the full amount of their investment even though they bought bonds at steep discounts,¹³ while at the same time seeking to cut 80% of the payments owed to local small businesses, public sector workers, and individuals who won civil rights claims against the government.¹⁴ These deals are a boon to Wall Street speculators but fail to provide fiscal and economic stability for the island.¹⁵ The Board's debt restructuring plans are unsustainable¹⁶ and, even based on the Board's own estimates, would result in deficits as early as 2036.¹⁷

This report offers a comprehensive overview of the failings of PROMESA over six parts

Part one delves into the root causes of the Puerto Rico debt crisis, tracing its origins back to the island's colonial status, historically and today, and Wall Street's predatory practices

Part two acts as a primer on PROMESA, including the bill's key mandates and the creation of the expensive and conflict-ridden Financial Oversight and Management Board.

Part three discusses the severe austerity measures imposed on Puerto Rico by the Board and their harmful impacts on local communities.

Part four turns to the debt restructuring process, which has secured significant profits for Wall Street speculators at the expense of local communities and Puerto Rico's long-term fiscal stability and economic health.

Part five highlights how PROMESA is a cautionary tale for other financially struggling municipalities and states in the United States, and draws important parallels with Detroit, where unelected leaders radically reshaped local finances.

Finally, in light of the findings highlighted in this report,

Part six outlines a range of policy solutions that policymakers must pursue to bring sustainable, broad-based fiscal and economic recovery to Puerto Rico.



We Recommend:

Our recommendations outline a range of policy solutions that policymakers must pursue to bring sustainable, broad-based fiscal and economic recovery to Puerto Rico. More detail on the recommendations outlined here can be found in part six of this report.

1. Ensuring Puerto Rico debt is restructured to sustainable levels by:

- Eliminating the Financial Oversight and Management Board;
- Passing the Territorial Relief Act;
- Protecting pensions and local creditors;
- Addressing the undue power and distorting effects of hedge funds in the debt restructuring process;
- Preventing federal relief funds from being used to pay existing debt; and;
- Providing the resources necessary to establish local, centralized, accountable, and transparent public financial management systems.

2. Removing structural barriers to fiscal health and employing tools for economic development and growth by:

- Undoing Board-imposed austerity measures;
- Addressing the economy's dependence on multinational corporations; and;
- Ensuring federal funds are used in accordance with federal policies that promote moving away from fossil fuels and advancing use of renewable energy.

3. Investing in environmental cleanup and healthcare by:

- Investing in public health infrastructure;
- Passing Medicare for All and in the meantime, providing full Medicaid parity; and;
- Ensuring thorough environmental cleanups.

4. Strengthening the municipal bond market by:

- Having the Federal Reserve offer loans with favorable terms to public sector borrowers;
- Investigating underwriting fraud; and;
- Creating an opt-in program for public issuers to obtain SEC review before issuing securities.

5. Advancing a process of decolonization by passing the Puerto Rico Self-Determination Act.

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PART I

The Root Causes of the Debt Crisis: Puerto Rico's Colonial Status Historically and Today

- How Puerto Rico's Colonial Status Enabled United States Intervention in Economic and Political Affairs
- Financial Troubles Predating the Debt Crisis
- Government Increases Borrowing to Meet Expenses
- Wall Street's Role in Puerto Rico's Debt Spiral

Four 'Experiments' in Colonial Governance by the United States

The structural roots of Puerto Rico's current economic crisis reach all the way back to 1898,

when the United States invaded the archipelago during the Spanish-American War. Since then, Puerto Rico has been subject to laws enacted by the US federal government, whose officials Puerto Ricans have practically no say in electing.¹⁸

Puerto Rico has faced what Puerto Rican legal scholar and judge Juan R. Torruella terms four 'experiments' in colonial governance by the United States.¹⁹



'The Plaza, Yauco, Puerto Rico,' photo plate, 1900, Courtesy of the Library of Congress.

The First came with the Foraker Act of 1900, which established a colonial government largely appointed by the US President, subjected Puerto Rico to US laws unless Congress deemed them inadvisable, ...and gave Puerto Rico a non-voting observer in the US House of Representatives.²⁰ This bill also prevented Puerto Rico from imposing tariffs on trade, which effectively dismantled a key source of revenue for Puerto Rico that previously accounted for over 88% of government revenues.²¹

The Second experiment came with the Jones-Shafroth Act, a federal law passed in 1917. While this act gave US citizenship to Puerto Ricans and introduced a popularly elected Senate to the Puerto Rico legislature, the US government retained power to appoint the Governor, judges on the Supreme Court, and other key positions.²² Critically, the law also stipulated that Puerto Rico's government bonds were exempt from federal, state, and local taxes. This dramatically restructured Puerto Rico's public finance system and tax structure to the benefit of investors in municipal bonds.²³

Soon after, the Merchant Marine Act of 1920 (commonly known as the Jones Act) would require all imports between Puerto Rico and the United States to arrive using American ships built in the United States with and staffed by an American crew. This drove up the cost of living for people on the island and made necessary goods incredibly expensive.²⁴

The Revenue Act of 1921 went on to introduce generous corporate tax exemptions designed to attract business to the island.²⁵

The Third experiment in colonial government came in 1947, when the US Congress granted Puerto Ricans the power to elect their own Governor. In 1952, the territory was renamed the "Commonwealth of Puerto Rico."²⁶ While the United States approved a Puerto Rican constitution drafted through a local constitutional convention (after removing significant labor and civil rights provisions), and gave Puerto Rico authority over "internal matters," the island was still subject to the US Constitution's Territory Clause, which ultimately gave Congress the "power to dispose of and make all needful Rules and Regulations"²⁷

The Fourth and most recent experiment in colonial governance began in 2016, when Congress enacted PROMESA, installing an unelected Financial Oversight and Management Board with enormous power over the island's finances and operations—largely replicating the US government's historical strategies to exert financial and governing control over the island.²⁸

How Puerto Rico's Colonial Status Enabled United States Intervention in Economic and Political Affairs

Many factors contributed to Puerto Rico's sharp economic decline in the 2000s, but all were compounded by Puerto Rico's political status. As a US colony, Puerto Rico's government had limited power to shape or counter policies decided by the US government or negotiated in international treaties. Puerto Rico's economic fate was shaped by various laws and tax incentives, as well as the growing dominance of US manufacturing (in particular the pharmaceutical sector) over its economy.²⁹ Notably, the economic development plan known as Operation Bootstrap sought to attract American manufacturers to the island with tax exemptions and low-paid workers. A key part of this plan involved the Industrial Incentives Act of 1947, which eliminated the Puerto Rican corporate tax.³⁰ The resulting economy was heavily reliant on US multinationals, a relationship that would later prove precarious.

During this time, and throughout Puerto Rico's history, the US government intervened in the island's political sphere to maintain the colonial order. Public Law 53, widely known as the "Gag Law," was enacted in 1948 and criminalized any public support of Puerto Rican independence. This led to well-documented instances of pro-independence and labor leaders and uprisings being intentionally undermined by US-backed security forces and FBI counterintelligence programs.³¹ This foreign intervention often explicitly targeted political activists who were seen as a threat to both the political and economic status quo. These efforts to destabilize social movements and quash political uprising further cemented an economic arrangement that served the interests of the United States.³²

Financial Troubles Predating the Debt Crisis

Puerto Rico experienced a forty-year period of sustained economic growth and stability before its financial downturn in the 2000s. The period between 1950 and 1971 was a time of growing prosperity for Puerto Rico, with per-capita income increasing more than 500%.³³ The number of Puerto Ricans employed in manufacturing nearly tripled to 121,000—and the sector's profits jumped by 560%—from the early fifties to the late sixties.³⁴ While Puerto Rico's gross domestic product (GDP) would go on to grow an average of ~3% in the 1980s and 90s, it began declining significantly in the 2000s.³⁵

The 1996 repeal of corporate tax breaks for US multinationals ("section 936" of the tax code)

One key inflection point in Puerto Rico's economic trajectory came in the 1990s when the US government repealed a controversial tax break for corporations (section 936 of the federal tax code). Adopted in 1976, this tax break enabled US manufacturers to avoid paying corporate income taxes on any profits earned in Puerto Rico. What followed was a huge influx of US manufacturers seeking to avoid taxes, in particular from the pharmaceutical sector.³⁶ These breaks resulted in a heavy focus on attracting large multinationals headquartered in the United States, at the expense of investment in activities that would support local Puerto Rican businesses and economies.³⁷ Critics also argued the tax incentives put an unfair burden on Puerto Rican taxpayers and allowed large multinationals to dominate the island's economy. President Bill Clinton signed a bill phasing out the tax break over a ten-year period in 1996.³⁸ According to the Puerto Rican think tank Center for a New Economy, while many attributed Puerto Rico's resulting economic recession in the 2000's solely to the repeal of section 936, various other factors were also at play including "misguided public policy, increased outmigration, high levels of government bureaucracy, rapidly-growing indebtedness, and austerity-based structural reforms, all of which were layered on top of an already fragile economy."³⁹ Moreover, after the corporate tax breaks were phased out, the Puerto Rican government increasingly made up the difference by debt-financing its growing deficits, which later shifted the burden onto Puerto Rican communities most impacted by the debt crisis.⁴⁰

A lost decade of growth: GDP and tax revenues plummet while outmigration skyrockets

By 2005, Puerto Rico's GDP had plummeted and the island saw negative growth in what has been called a 'lost decade.'⁴¹ In fact, from 2004 to 2019, Puerto Rico's annual economic growth fell by 7.3%.⁴² As the Puerto Rican economy declined, people began leaving the island in large numbers to seek jobs and economic opportunity elsewhere. Puerto Rico saw a population decrease of 620,000 between 2005 and 2019, largely due to outmigration—a loss of 16.4% of the island's total population.⁴³

Government Increases Borrowing to Meet Expenses

While the economy faltered and tax revenues shrank, the Puerto Rican government ran large budget deficits that it met by borrowing.⁴⁴ The government increasingly turned to borrowing in the form of bonds, both to maintain services and standards of living for people on the island and to make up for tax revenue the government lost by providing corporate tax breaks that were previously available under section 936.⁴⁵ Historically, Puerto Rico has not received the full federal aid provided to US states and, as a result, has been forced to make up the difference in order to provide healthcare and other services to its residents.⁴⁶ For instance, in 1994 Puerto Rico's government privatized the existing public healthcare infrastructure, but the project was underfunded from the start because of limited federal contributions to the island's Medicaid program.⁴⁷

From 1992 to 2004, general fund revenues increased by 6.2% while the central government's debt increased by 8%.⁴⁸ By 2000, Puerto Rico's bond debt had risen to \$24 billion and unfunded pensions for teachers, judges, and other public employees totaled \$7 billion.⁴⁹ The pace of the borrowing accelerated and Puerto Rico's total debt grew by 75.25% (\$19.7 billion) between 2000 and 2006.⁵⁰ Notably, 2006 marked the last year of the ten-year phase-out of section 936 corporate tax breaks. This was a key precipitating factor in the significant and protracted recession that followed.⁵¹ By 2006, former Puerto Rican Governor Aníbal Acevedo Vilá and the Puerto Rico legislature had reached a stalemate on how to address the fiscal crisis, and Puerto Rico's general obligation (GO) bonds were downgraded to nearly junk status.⁵²

The government then created a new public corporation, the Puerto Rican Sales Tax Financing Corporation (COFINA), to issue bonds backed by sales tax revenues, which secured a high credit rating. Rather than funding infrastructure projects, as proceeds of government bonds issued conventionally do, the proceeds of COFINA bonds were instead used to service Puerto Rico's debt, including covering past debt payments and budget deficits. Puerto Rico's public debt resulted from a combination of public corporations providing electricity, water, transportation, and other services to the island—whose budgets were separate from Puerto Rico's central government⁵³—but also from corporations like COFINA, whose bonds arguably violated the Constitutional debt limit and were largely used to repay Wall Street.⁵⁴ Puerto Rico's largest public pension fund was another significant source of public debt. Many people with Puerto Rico public pensions are not eligible for the federal Social Security Program and must rely on their public pensions for retirement security. Unfortunately, Wall Street firms advised the Puerto Rico Employee Retirement System to issue billions in pension obligation bonds that produced substantial losses.⁵⁵

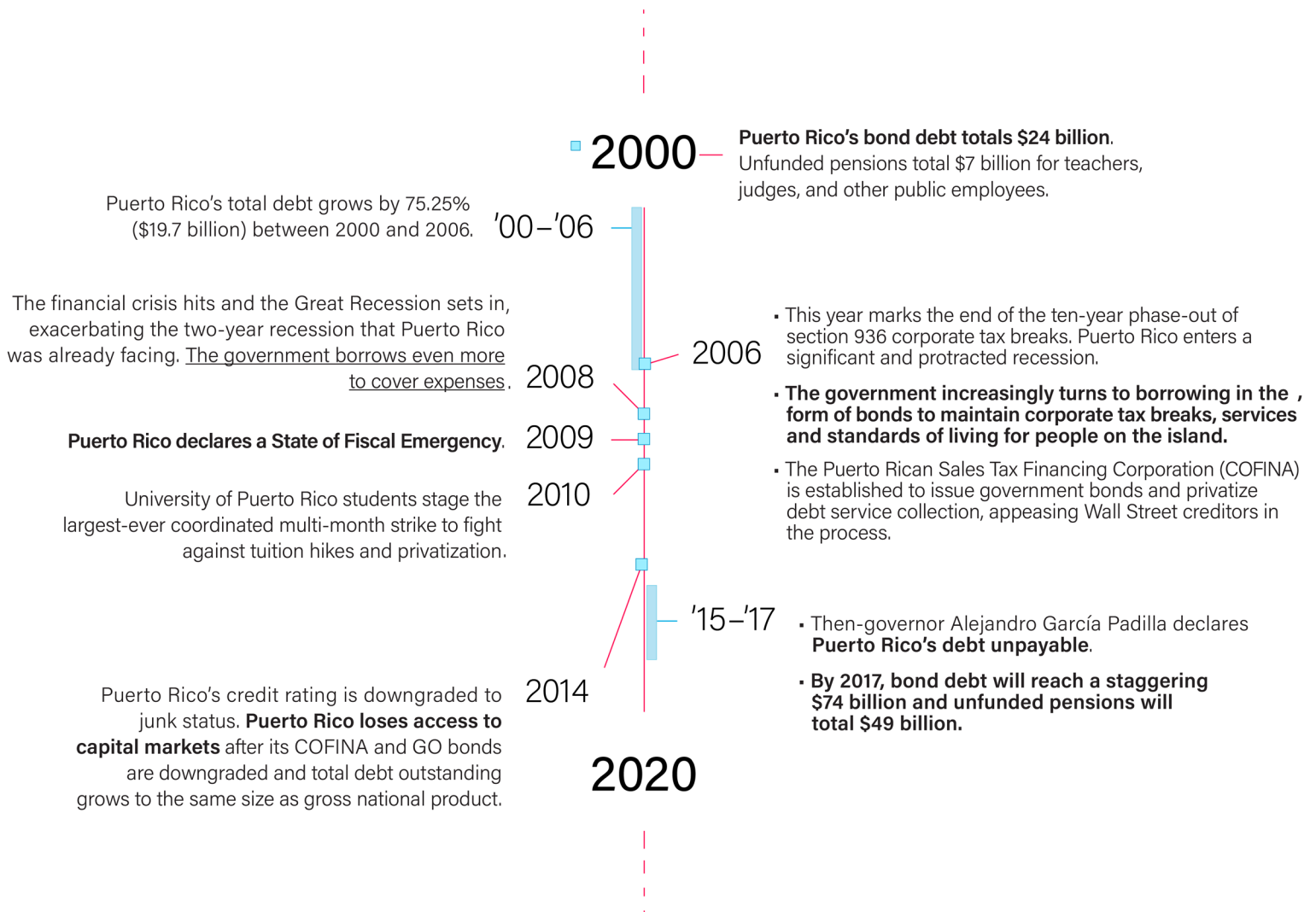
As the 2008 financial crisis exacerbated the two-year recession Puerto Rico was already facing, the government borrowed even more to cover tax and budget expenses.⁵⁶ Puerto Rico declared a State of Fiscal Emergency in 2009.⁵⁷ When former Puerto Rico Governor Alejandro García Padilla took office in 2013, he tried to balance the budget with austerity measures, a slew of regressive tax hikes, and even more borrowing. As Puerto Rico borrowed to balance its budget, it triggered a debt spiral in which the debt incurred in a given year would make the next year's budget deficit even bigger.⁵⁸ Puerto Rico lost access to capital markets in 2014 after its COFINA and general obligation (GO) bonds were downgraded and the island's debt grew to the same size as its gross national product.⁵⁹ That same year, **Puerto Rico turned to a syndicate of hedge funds to buy \$3.5 billion of its GO bonds, largely to enable the government to pay off bank loans.**⁶⁰ **By 2015, former Governor García Padilla went on record saying Puerto Rico's public debts were "unpayable."**⁶¹ **Bond debt reached a staggering \$74 billion, and unfunded pensions totaled \$49 billion, by 2017.**⁶²

A Timeline: The Root Causes of PUERTO RICO'S DEBT CRISIS





...Continued — A Timeline: The Root Causes of
Puerto Rico's Debt Crisis



Wall Street's Role in Puerto Rico's Debt Spiral

As the Puerto Rican economy faltered, the government exaggerated its tax revenues; hid its expenditures and budget deficits; and increasingly relied on risky Wall Street-driven deals and borrowing schemes.⁶³ However, the common framing of the situation as simply a matter of financial mismanagement and reckless borrowing on the part of Puerto Rico obscures the role of purposeful predation on the part of banks and investors, and the limited options available to the government. Puerto Rico did not come to take on record levels of debt on its own. A set of banks were willing to underwrite every bond it issued, and a set of investors were willing to buy them, well-aware of Puerto Rico's financial situation. Wall Street banks and hedge funds, along with law and accounting firms, had a significant long-term role in advising, underwriting, and buying up much of Puerto Rico's debt.

The banks that underwrote Puerto Rico's bonds did not merely enable its borrowing spree; in many cases they targeted the island with unsustainable levels of debt that they knew it would not be able to repay. All of this was done to pad their profits, in much the same way as when they issued the millions of subprime mortgages that led to the 2008 financial crisis. Wall Street predation was a driving factor in the largest *ever* bankruptcy in the US municipal bond market.⁶⁴

Puerto Rico has four primary types of public debt

General obligation (GO) bonds, and other debt payable through Puerto Rico's Treasury;

Debt from Puerto Rico's public corporations, including the Puerto Rico Electric Power Authority (PREPA); and

Sales tax-backed debt known as COFINA bonds and other revenue-backed debt;

Debt that was issued by localities and smaller entities.⁶⁵

Why Puerto Rico was an attractive target: A constitutional guarantee and triple tax exemption

- Puerto Rico's bonds were highly desirable to investors because most are "triple tax-exempt," meaning that payments to bondholders are exempt from local, state, and federal taxes.⁶⁶ Additionally, Puerto Rico's Constitution guarantees that the holders of the GO bonds issued by the central government will be paid *before* the central government pays any other expense. As Puerto Rico's financial situation deteriorated, its bonds also started generating higher returns for investors. The tax exemptions and higher interest rates, along with the fact that the GO debt was backed by the full faith and credit of the Constitution, made Puerto Rico's debt very attractive to investors. Many of the GO bonds were oversubscribed over the years, meaning that investors wanted to buy more bonds than were available.⁶⁷

Wall Street banks met high investor demand by selling Puerto Rico toxic and predatory financial instruments, including:

- Capital appreciation bonds (CABs): Long-term bonds with compounding interest on which the borrower does not make any principal or interest payments for the first several years and, in some cases, not until the final maturity of the bond, often ultimately paying triple-digit interest rates.
- Scoop and toss deals: The practice of issuing new bonds to refinance older ones in order to push current debt payments into the future, so named because it allows public officials to "scoop" up debt payments that are due today and "toss" them many years into the future.
- Toxic swaps (also termed "interest-rate swaps"): Add-on products pushed by Wall Street firms with the claim that they can help borrowers mitigate risks for variable-rate bonds where interest rates can be volatile.
- Auction rate securities: A type of variable-rate bonds in which the variable interest rate is determined at regularly scheduled auctions.⁶⁸

A large portion of Puerto Rico's debt isn't debt at all

...it is unpaid interest on capital appreciation bonds (CABs).

A **CAB** is a long-term bond with compounding interest on which the borrower does not make any principal or interest payments for the first several years, and, in some cases, until the final maturity of the bond. As a result, the outstanding principal actually grows over time because the unpaid interest gets tacked onto the amount owed and compounds over time.

A large portion of Puerto Rico's debt isn't debt at all; it is unpaid interest on capital appreciation bonds (CABs). A CAB is a long-term bond with compounding interest on which the borrower does not make any principal or interest payments for the first several years, and, in some cases, until the final maturity of the bond.⁶⁹ As a result, the outstanding principal actually grows over time because the unpaid interest gets tacked onto the amount owed and compounds over time. Because of this structure, borrowers often end up paying triple-digit interest rates over the life of the bonds. In this way, a CAB is like the municipal version of a payday loan.⁷⁰ As of 2017, Puerto Rico had \$37.8 billion in outstanding CABs, but the underlying principal on those bonds was just \$4.3 billion. The remaining \$33.5 billion was interest—an effective interest rate of 785%.⁷¹

By this analysis, the Board arguably understated Puerto Rico's overall debt by approximately \$29.87 billion.⁷² **If the entire \$37.8 billion in CABs were factored into the Board's calculations, Puerto Rico's total outstanding debt would actually be \$103.68 billion (excluding pension liabilities).**⁷³ As noted in Part IV of this report, the Board has proposed debt restructuring plans that include CABs, even though they have often proven to be deceptive and dangerous financial instruments.

Puerto Rico was subject to a host of predatory financial instruments that allowed banks like Santander, Wells Fargo, Goldman Sachs, and JPMorgan Chase to close more deals and collect more fees, while making Puerto Rico's debt portfolio significantly riskier and more costly.⁷⁴

At least \$6 billion in allegedly illegal debt

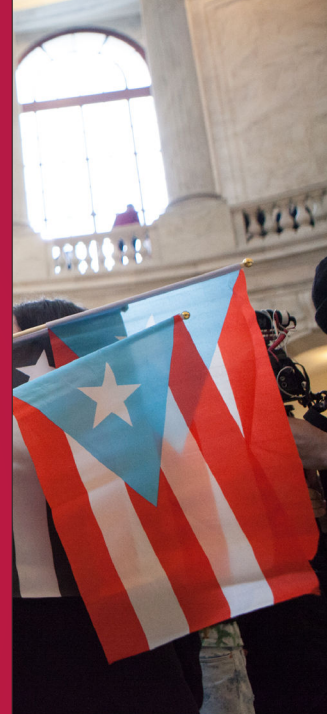
A staggering \$6 billion of Puerto Rico's general obligation debt was allegedly issued illegally by violating Puerto Rico's constitutional debt limit.⁷⁵ Wall Street banks including Barclays, Santander, and Popular made hundreds of millions by underwriting these bonds, while banks like Morgan Stanley and Bank of America double dipped on these deals by securing both underwriting fees and swap termination fees.⁷⁶ In some cases banks, like Popular, initially advised Puerto Rico's Government Development Bank to not pursue the 2014 bond offering but then went on to underwrite the bonds. \$36.8 million in underwriting fees were divided among the banks underwriting this 2014 bond offering.⁷⁷ While Wall Street firms claim no wrongdoing, legal complaints argue that the banks and legal firms involved should have been aware that these bond offerings would push Puerto Rico over its constitutional debt limit.⁷⁸



PART II

Primer on the Puerto Rico Oversight, Management, and Economic Stability Act: A Recipe for Failure

- Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)
- PROMESA for Whom?
- The Financial Oversight and Management Board: Unelected, Unaccountable, Rife with Conflicts of Interest, and a Drain on Taxpayer Dollars





Primer on the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)

Following years of increasingly predatory Wall Street lending to the Puerto Rican government, in 2015 the then-governor of Puerto Rico declared the territory's debt unpayable.⁷⁹ The debt was estimated at \$74 billion in bonds and \$49 billion in unfunded pension liabilities,⁸⁰ and Puerto Rico had no way to restructure it. In the United States, municipalities can declare bankruptcy under Chapter 9 of the US Bankruptcy Code if allowed by their state government.⁸¹ Recent examples of municipalities that availed themselves of Chapter 9 to restructure their debt include Detroit, Michigan⁸² and Stockton, California.⁸³ Because Puerto Rico was written out of the US Bankruptcy Code in 1984, the local government passed its own bankruptcy law to create a framework to restructure the debt of its public corporations. This law, however, was struck down by the Supreme Court in 2016.⁸⁴ Additionally, because Puerto Rico is a territory of the United States, it could not avail itself of any tools available to the international community, including loans offered by the International Monetary Fund (IMF).

In the face of this void, Congress had to act. The result was the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which was signed into law on June 30, 2016. Its stated goal is for Puerto Rico to achieve fiscal health and regain access to capital markets. Title III of PROMESA created a unique legal framework for the restructuring of Puerto Rico's debt, incorporating some provisions from Chapter 9 (municipal bankruptcies) and Chapter 11 (corporate bankruptcies) of the US Bankruptcy Code.⁸⁵ PROMESA also created the Financial Oversight and Management Board (the Board)—an unelected, presidentially-appointed board vested with the power to represent Puerto Rico's interests in the debt restructuring proceedings, as well as to both approve and ensure compliance with fiscal plans and budgets. Chief Justice Roberts appointed Judge Laura Taylor Swain, a federal district court judge, to oversee the Title III proceedings.

PROMESA for Whom?

PROMESA did not set up Puerto Rico for success for the simple reason that the law prioritizes Wall Street profits over the long-term economic health of Puerto Rico. Prioritizing the latter would have allowed for long-term debt sustainability.

In October 2019, the House of Representatives Natural Resources Committee held a hearing on discussion draft amendments to PROMESA. Alvin Velazquez, Associate General Counsel of the Service Employee International Union (SEIU), provided testimony, which included an analysis of the fundamental flaws of PROMESA:

[T]he seeds of [PROMESA's] failure were planted at the very beginning, when Wall Street interests wrote the PROMESA law to benefit themselves rather than Puerto Ricans.

In general, PROMESA's authors had a choice between two very different financial paths for Puerto Rico and US territories. One was a path marked by immediate and extreme fiscal austerity for the purpose of squeezing every possible penny out of the Island now in order to repay Wall Street as much as possible as quickly as possible. The other was a path focused on improving the Island and growing its economy to achieve prosperity and long-term economic health, which would include the repayment of a sustainable level of debt over a reasonable period of time.

The first path would sacrifice the Island, its people, and any chance of long-term growth on the altar of quick hedge fund payouts. It is the path that would be chosen by someone with little interest in the Puerto Rican people or the Island's continued viability. The second path would take the Island and its people into account. It is the path that would be chosen by anyone who cares more about Puerto Ricans than about hedge funds for the already rich.

*As you can likely guess, the hedge funds and their lawyers who wrote PROMESA chose the first path. Thus, despite the best efforts of some on this Committee, PROMESA passed with a mandate for austerity and failed to include important stimulus measures such as Medicaid parity or tax credits for workers. **PROMESA's legal framework tilts inexorably toward austerity while ignoring the long-term health of Puerto Rico's economy and the ability of workers on the Island to find jobs that pay a living wage and can support a family.***

The reality of such policies is that they mean the end of Puerto Rico as we know it. These policies are not and were never intended to help Puerto Rico thrive.⁸⁶

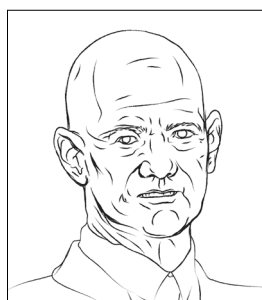
Financial Oversight and Management Board



Board Member, David A. Skeel Jr



Board Member, Andrew G. Biggs



Board Member, Arthur J. González



Board Member, Antonio L. Medina



Board Member, Justin M. Peterson



Board Member, Betty A. Rosa



Board Member, John E. Nixon

CURRENT MEMBERS OF THE BOARD

Unelected and unaccountable

One of the most controversial aspects of PROMESA has been the creation of an unelected and unaccountable Financial Oversight and Management Board. PROMESA outlines two ways for the US government to appoint its seven members. One method is through presidential nomination and Senate confirmation. The other, which is the one that has been used, involves the president choosing members from lists provided by majority and minority leaders from both congressional chambers without Senate approval. One of the members can be appointed by the president without any input from congressional leadership or the Puerto Rican government.

An unsuccessful legal challenge to the latter appointment process went all the way to the Supreme Court. In a concurring opinion, Justice Sotomayor noted that members of the Board, “tasked with determining the financial fate of a self-governing Territory, exist in a twilight zone of accountability, neither selected by Puerto Rico itself nor subject to the strictures of the Appointments Clause.”⁸⁷

In Puerto Rico, the Board is commonly referred to as “la Junta.” When, in the summer of 2019, hundreds of thousands of Puerto Ricans took to the streets to demand that then-governor Ricky Rosselló resign, a common chant was “*Ricky renuncia y llévate a la Junta*” (“Ricky, resign and take the Junta with you”).⁸⁸ For many in Puerto Rico and beyond, the imposition of an unelected and unaccountable board that holds so much power over the territory’s government, its finances, and the future of Puerto Ricans represents an extreme and undeniable manifestation of the colonial relationship between the United States and the island.

Rife with Conflicts of Interest

To make matters worse, questions remain whether several members of the Board can act in the best interest of Puerto Rico. The below concerns were raised about current and former members of the Board:

José R. González and Carlos M. García are former Santander executives who both served as heads of Puerto Rico's Government Development Bank (GDB).⁸⁹ Together, they built the bank's municipal bond business, Santander Securities, which was a leading bond underwriter during the growth in Puerto Rican public debt.⁹⁰ A 2016 report estimated that "Santander has participated in the underwriting of \$61 billion in Puerto Rican bonds, and as part of these bond issues, \$1.1 billion was paid to Santander and others in issuance fees."⁹¹ As Puerto Rico was falling deeper into debt, Santander peddled financial products considered predatory by financial experts, like capital appreciation bonds (CABs) and interest rate swap agreements.⁹²

- Concerns about potential conflicts: While Santander faced claims from the Board for its role in underwriting billions in potentially illegal debt, neither González nor García faced consequences for their roles at Santander or the GDB.⁹³

José R. González was also the Senior Executive Vice President of Banking and Financial Services at OFG Bancorp,⁹⁴ parent company of Oriental Bank and Oriental Financial Services.

- Concerns about potential conflicts: Oriental escaped liability in the Board's legal actions against underwriters of billions in potentially illegal debt issued during González's tenure.⁹⁵

José B. Carrión III has numerous familial and business ties that represent potential conflicts of interest in his oversight role and fiduciary duties. For example, while serving on the board of a government agency, Carrión's wife voted to approve a lucrative government contract that benefited a private equity firm where he served as an advisor.⁹⁶ Additionally, two employees from Carrión's insurance brokerage firm were appointed to the board of directors of the GDB during a key period of debt issuances.⁹⁷

- Concerns about potential conflicts:
 - The Board signed off on debt restructuring deals that granted immunity to current or former employees of Mr. Carrión's firm while they served as officers and directors of the GDB.⁹⁸ The Carrión family business, Popular Inc., also escaped inclusion in the Board's lawsuits against a long list of underwriters in over \$6 billion of bonds potentially issued illegally.⁹⁹

Justin Peterson is a managing partner at DCI Group, a lobbying firm he founded in 1996. At least three of DCI's big clients have had millions of dollars in claims against the government of Puerto Rico in the last ten years. Peterson was an adviser of the Ad Hoc Group of General Obligation Bondholders (the Ad Hoc Group), one of the key groups of hedge funds in the Puerto Rico debt restructuring proceedings. At present, the Ad Hoc Group has just two members, Aurelius Capital and Autonomy Capital. These two hedge funds had as much as \$1.4 billion invested in general obligation (GO) bonds, as reported in a financial disclosure in March of 2019, and both were key players in Puerto Rico's central government debt restructuring negotiations. They reported holding a combined \$874 million of GO bonds in their last financial disclosure. According to Peterson and DCI, Peterson has not worked with the Ad Hoc Group since mid-2018.¹⁰⁰ It should be noted that the Board's ethics rules do not require disclosure of whether the Ad Hoc Group—or any other entity with an interest in the Board's actions—is a current DCI client.¹⁰¹

- Concerns about potential conflicts: The debt restructuring plan the Board is currently pushing would give predatory bondholders a significant return on their speculative investments while setting aside legal challenges to some of the bonds.¹⁰²

Antonio Medina is a former executive of Merck, a multinational pharmaceutical company. In 2013, he moved to the public sector when he served as the executive director of the Puerto Rico Industrial Development Company (PRIDCO), a public corporation created to promote the establishment of manufacturing industries. PRIDCO supports businesses, especially in the pharmaceutical sector, that want to do business on the island. Medina now runs a consulting firm, Convergent Strategies LLC, which describes itself as “dedicated to accelerate business growth, by helping companies become more competitive and achieve higher levels of financial performance.”¹⁰³

- Concerns about potential conflicts: The Board has authority over tax abatement contracts involving the government of Puerto Rico. Specifically, the Board must approve any contract with an aggregate expected value of \$10 million or more.¹⁰⁴ It can also randomly select other contracts for review “to assure they promote market competition and are not inconsistent with the approved fiscal plan.”¹⁰⁵ Medina could be seen as an asset to the pharmaceutical companies that have taken advantage of huge tax exemptions for many years while residents of Puerto Rico bear the brunt of austerity measures.¹⁰⁶

Conflict of interest concerns have also been raised about another major player in Puerto Rico’s debt crisis: McKinsey & Company. The management consulting firm won a bid to become the Board’s strategic adviser.¹⁰⁷ As McKinsey consultants dove into all aspects of Puerto Rico’s government entities and recommended myriad austerity measures, their level of responsibility ballooned until the firm had “virtually become a shadow agency of the government, and a powerful one at that.”¹⁰⁸ When the *New York Times* revealed that McKinsey had millions invested in Puerto Rican bonds via its internal hedge fund,¹⁰⁹ there was a public outcry over the conflict of interest this represented—advising on austerity measures that could pave the way for larger returns on their bonds. The Board hired a law firm that released a report concluding that the McKinsey hedge fund operated independently of the consultants on the island and that there was no evidence that the consultants changed their behavior because of the investments.¹¹⁰

Conflicts of interest concerns have also been raised about Citigroup, which provided financial advisory services to the Board, and O’Neill & Borges, which provided legal services to the Board.¹¹¹ Both firms were involved in the issuance of over \$2.7 billion of the legally challenged bonds.¹¹²

A Drain on Taxpayer Dollars

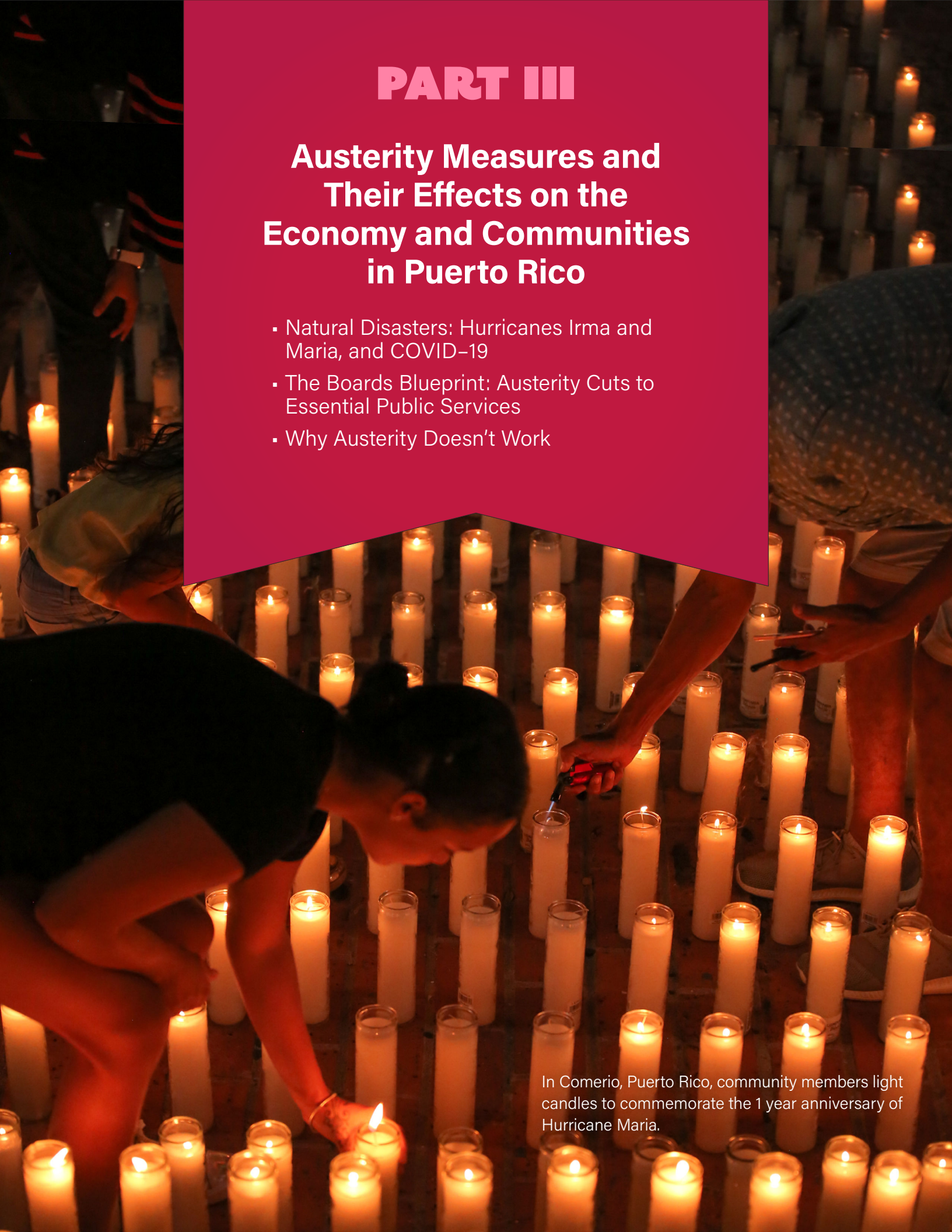
According to the Board’s latest fiscal plan, Puerto Rico will pay an estimated \$1.6 billion for the Board-led debt restructuring process from FY18 to FY26.¹¹³ While the members of the Board are not compensated, their staff and consultants—including McKinsey—receive significant compensation. PROMESA did not provide any federal funds to cover these expenses. Instead, Puerto Rican taxpayers are left to foot the bill for the highly-paid professionals helping implement austerity measures to pay wealthy bondholders.¹¹⁴



PART III

Austerity Measures and Their Effects on the Economy and Communities in Puerto Rico

- Natural Disasters: Hurricanes Irma and Maria, and COVID-19
- The Boards Blueprint: Austerity Cuts to Essential Public Services
- Why Austerity Doesn't Work

A photograph of a woman in a dark shirt lighting a candle in a vigil. She is surrounded by many other lit candles on the floor. Other people are visible in the background, also participating in the vigil.

In Comerio, Puerto Rico, community members light candles to commemorate the 1 year anniversary of Hurricane Maria.

The Board's Harmful Austerity Agenda

Since PROMESA established the unaccountable, conflict-ridden Financial Oversight and Management Board in 2016, Puerto Rico has been battered by a series of natural disasters as well as the COVID-19 pandemic. Throughout this devastating series of natural and public health crises, the Board has continued to push fiscal plans that: 1) impose harmful austerity cuts, 2) ensure hefty payments to bondholders and Wall Street firms, and 3) take advantage of federal disaster relief funds to secure larger payouts for Wall Street bondholders. None of these cuts or reforms have targeted corporate tax abatement programs—an overwhelming majority of these proposed austerity measures are hitting local communities the most.

The Lasting Impact of Hurricanes Maria and Irma

Against the backdrop of the island's fiscal crisis, Puerto Rico was dealt a terrible blow when Hurricanes Maria and Irma both hit the island within a two-week period in September 2017.¹¹⁵ Thousands of people lost their lives, over 470,000 homes were impacted, and key parts of the island's infrastructure were damaged or destroyed. At least \$80 billion in damage resulted, and an estimated \$95 billion was required to rebuild.¹¹⁶ By late 2019, a full two years after Hurricanes Maria and Irma, FEMA and other federal agencies had only disbursed \$14 billion of the \$42.5 billion in disaster relief funding that Congress initially allocated.¹¹⁷ This foot-dragging has impeded recovery on the island and caused protracted suffering for those impacted.

In the wake of one of the deadliest natural disasters in US history, Wall Street saw an opportunity to cash in.¹¹⁸ Following the hurricanes, the Board adjusted its fiscal plan and reversed its predictions of a deficit with a strong projected fiscal surplus, due in part to increased federal support for disaster recovery funding. Wall Street took notice and bond prices soared.¹¹⁹ The Wall Street Journal reported that "the top performing bond investment of 2018" was Puerto Rican debt.¹²⁰ Hedge funds began buying large amounts of distressed bonds for cheap on the assumption that disaster relief funds could be used, in part, to pay back bondholders.¹²¹ This was despite the fact that federal aid was designed to support relief and recovery efforts, not to create a fiscal surplus for creditors to access.¹²²



Citizens and soldiers brought water to a community affected by Hurricane Maria at Lares, Puerto Rico, on Oct. 4, 2017 (Photo by Spc. Agustin Montanez)
"New York and Puerto Rico National Guard," by The National Guard is licensed under CC BY 2.0

2020: Puerto Rico hit by devastating earthquakes and a pandemic

Puerto Rico's problems were further compounded in early 2020 when a series of earthquakes caused significant damage to thousands of homes and led to widespread school closures.¹²³ A few months later, the COVID-19 pandemic arrived, resulting in over 100,000 infections and killing over 2,000.¹²⁴ This public health crisis exacerbated the economic crisis already affecting the island's most vulnerable. Before the pandemic, Puerto Rican poverty rates were twice as high as the poorest US state, and the island's unemployment level was double the national average.¹²⁵ At the peak of the pandemic, nearly one in ten Puerto Rican workers (approximately 98,000 people) were out of work.¹²⁶



THE BOARD'S AUSTERITY MEASURES ARE BEING IMPOSED ON COMMUNITIES ALREADY FACING ECONOMIC PRECARITY

Research has shown that **the poorest 40% of the population** is hurt the most when government services are cut in order to "balance" budgets.¹²⁷ Austerity is hurting those Puerto Ricans who are already hurting the most.

- **Over 43% of the island lives in poverty**—twice the rate faced by Mississippi, the poorest US state.¹²⁸
- **One-third of the island's residents are food insecure.**¹²⁹
- **Nearly one in ten Puerto Ricans under the age of 65** do not have health insurance.¹³⁰
- **Over 35% of Puerto Ricans** indicate their health is "fair or poor," compared to 18% of people living in the United States.¹³¹
- **Two out of every three Puerto Rican workers** do not have access to a pension through an employer and face retirement insecurity.¹³²
- **At the start of 2021, the unemployment rate was over 9% and is consistently nearly double the US unemployment rate.**¹³³ Over half of Puerto Rican adults lack access to the formal labor market.¹³⁴

The Board's Blueprint: Austerity Cuts to Essential Public Services

Since the Board's creation and throughout this devastating series of natural and public health disasters, its preferred response to Puerto Rico's worsening economic crisis has been to impose harmful austerity measures. Puerto Rican communities are contending with closed schools, decimated health services, limited resources to rebuild their homes and businesses, and a struggling economy that cannot support them.¹³⁵ Meanwhile, retirees are facing possible cuts to their pensions,¹³⁶ public sector workers are struggling to provide adequate service in dilapidated government buildings,¹³⁷ and the availability of good jobs is rapidly decreasing.¹³⁸

PROMESA requires that every approved fiscal plan "ensure[s] the funding of essential public services."¹³⁹ In practice, however, the Board has failed to define or discuss essential services in any plan to date.¹⁴⁰ In fact, under PROMESA the Board has proposed cutting nearly one-third of the Puerto Rican government's budget over a six-year period.¹⁴¹ This would slash money for municipal governments, increase tuition at the University of Puerto Rico, and reduce funding for essential services.¹⁴² In addition, the Board's plan proposes to reduce government pensions despite PROMESA's mandate to "provide adequate funding for public pension systems."¹⁴³

What the Board terms "government efficiency measures"¹⁴⁴ are, in reality, cuts to vital services, layoffs, and increases in fees and charges shouldered by the island's most vulnerable. By the Puerto Rican government's estimation, as of mid-2019, it had reduced the number of its employees by over 20,000 through a "voluntary transition program," reduced 20% of its agencies, and reduced 17% of its operating budget.¹⁴⁵ In 2019, Puerto Rico saw the largest one-year budget reduction of the past 40 years in the United States.¹⁴⁶ The debt crisis has forced hundreds of thousands of Puerto Rican families to leave their homes over the past decade, leading to a population loss of over 16% since 2005.¹⁴⁷ Unfortunately, government austerity will likely only exacerbate outmigration from Puerto Rico to the United States, which will further erode the tax base and bring added economic hardship.¹⁴⁸

PROMESA not only gives the unelected Board power to develop Puerto Rico's budget, it also gives them final say.

The Board's first fiscal plan in 2018 called for a staggering \$12.78 billion in spending cuts and revenue-increasing measures to be carried out from FY2018-FY2024.¹⁴⁹

The sweeping cuts put forward by the appointed Board are often at odds with the budgets of Puerto Rico's democratically elected officials. This was seen in the Board's most recent proposed FY2022 fiscal plan, which was \$233 million less than the budget proposed by the Puerto Rican government.¹⁵⁰ Every fiscal plan the board has developed since 2018 was approved without changes.¹⁵¹

The Board often uses the terms "rightsizing" and "agency efficiencies" to describe consolidation of full sectors of the government as well as the reduction and/or elimination of government services.¹⁵² They have called for the merging, closure, or complete privatization of parts of the Puerto Rican government.¹⁵³

The Board's fiscal plans define spending for several of Puerto Rico's instrumentalities including the Puerto Rico Electric Power Authority (PREPA), the Puerto Rico Highway and Transportation Authority (HTA), the University of Puerto Rico (UPR), the Puerto Rico Industrial Company (PRIDCO), and the Puerto Rico Aqueduct and Sewer Authority (PRASA).¹⁵⁴ This gives the Board wide latitude to make sweeping changes. In the most recent fiscal plan proposed by the Board, this includes:

Privatizing the publicly-owned power grid and pushing rate hikes on utility customers in order to pay back bondholders

The Puerto Rico Electric Power Authority (PREPA) was a publicly owned and operated corporation, which had been responsible for providing electricity to Puerto Rico since 1941.¹⁵⁵ The Board recently oversaw the privatization of PREPA's operations.¹⁵⁶ Mere days after the private Canadian company, LUMA Energy, began a 15-year contract to provide power in Puerto Rico, more than one million people were affected by power outages and blackouts stemming from an electrical station fire.¹⁵⁷ The Board's austerity cuts directly hampered the island's ability to respond. The public utility previously employed over 2,000 linemen. Following austerity cuts, that decreased to 700 workers. Today, LUMA Energy only employs 300 workers responding to this outage.¹⁵⁸

Even though Puerto Ricans already pay almost twice as much for electricity than US customers, the Board has consistently pushed for steep rate increases.¹⁵⁹ In previous years, the Board recommended a 13% increase in electric utility prices in order to repay bondholders who owned PREPA debt.¹⁶⁰ Over a year ago, PREPA reached a second restructuring deal with creditors that included a fixed transition charge. By some estimates, customers would pay \$986 more per year as a result of that agreement.¹⁶¹ In early January 2021, the Puerto Rico Energy Bureau approved another rate hike on customers.¹⁶² Across other public utilities, the Board has also called for regressive toll increases for roads¹⁶³ and implemented yearly water rate increases since 2018.¹⁶⁴

Weakening labor protections for workers

The Board has consistently called for sweeping changes to employment law in the public and private sector, including promoting at-will employment to strip workers of decades-old labor protections.¹⁶⁵ In 2018, the Board sent a proposed bill to the Puerto Rican legislature to repeal the 45-year-old Act 80. This law ensures labor protections for over 800,000 private sector employees and employers in Puerto Rico.¹⁶⁶ The Board failed to make a compelling argument on the economic benefits of repealing Act 80. In what appeared to Puerto Rico's legislators as a direct response to their refusal to fully repeal Act 80, the Board approved a fiscal plan that eliminated Christmas bonuses for public sector employees, cut \$25 million in University of Puerto Rico student scholarships, and cut \$50 million in economic development funds.¹⁶⁷

Massive cuts in education funding, including school closures and tuition hikes

The Puerto Rico Department of Education (PRDE) is responsible for providing education for 276,000 students across Puerto Rico.¹⁶⁸ K-12 education is facing the biggest cuts from the Board, with a projected \$2.226 billion decrease from FY2019-FY2024.¹⁶⁹

In 2018, the Board mandated closing 307 schools by FY2020; ultimately, 255 schools were closed in that time period.¹⁷⁰ Unfortunately, even the Board has admitted these school closures failed to secure any cost savings. In the words of the Board: "To date, [the Puerto Rico Department of Education] PRDE has struggled to capture these additional operational savings. The Department has not provided a clear view into how the consolidation of 255 schools has resulted in lower utilities and other operating costs."¹⁷¹

In addition, the University of Puerto Rico, the island's flagship educational and research institution, has been a frequent target of Board cuts. In FY22, they called for an additional \$94 million in cuts while increasing tuition for students.¹⁷² Research on the macroeconomic economic impact of the University of Puerto Rico found that every \$1 million invested in the university yielded a return of \$1.563 million. Similarly, every job generated by the university generates 60 indirect jobs in the surrounding areas.¹⁷³ This has not stopped the Board from frequently targeting the university in its austerity cuts.

Cutting pensions for current and future retirees

The Board has consistently taken aim at pensions. While PROMESA section 201(b)(1)(C) requires it to create and approve fiscal plans that "provide adequate funding for public pension systems," the Board instead oversaw the complete liquidation of the public employee, teacher, and judge pension systems' assets in 2017.¹⁷⁴ The Board has also overseen the purposeful underfunding of the pension funds for people working for the University of Puerto Rico and PREPA, pension funds that are at risk of insolvency in the future.¹⁷⁵ In 2021, the Board has called for imposing an 8.5% cut to the pensions of retirees with benefits of more than \$1,500 a month.¹⁷⁶ The Board has also proposed delaying retirement eligibility by up to three years for those not yet eligible to retire and modifying the current system to freeze future pension accruals.¹⁷⁷ The Board is proposing these dramatic cuts despite the fact that the average annual pension benefit per person in Puerto Rico was only \$14,112 (compared to an average \$26,455 public pension benefit in the United States).¹⁷⁸ Finally, not all public-sector workers in Puerto Rico receive Social Security payments. In fact, as many as one in five current public sector workers do not participate in Social Security, making pension payments even more critical.¹⁷⁹

Significant cuts to healthcare

Even as Puerto Rico continues to grapple with the fallout of the COVID-19 pandemic, the Board's most recent fiscal plan has called for \$5 million in payroll cuts to the Department of Health, \$2 million in cuts to the Diabetes Center, and \$1.2 million in cuts to the Cardiovascular Center.¹⁸⁰ The Board applauded the Department of Health's closure of almost 20 regional Medicaid offices, nearly a 30% reduction in locations island-wide.¹⁸¹ This is especially troubling in light of the fact that the island's health provider infrastructure has not recovered from damage caused by Hurricane Maria in 2017. By 2018, 15% of Puerto Rico's medical specialists had left the island. That meant only 9,500 specialists were serving over three million people.¹⁸² The Board has also called for consolidating six health agencies in order to "enable efficiencies."¹⁸³

Puerto Rico's state-run Medicaid program, Plan Vital, provides health coverage for 37% of the island.¹⁸⁴ That increases to 46% of all Puerto Ricans when counting dual-eligible individuals who are also in Platinos, the Medicare Advantage program.¹⁸⁵ In the past, the Board has

suggested that Plan Vital terminate coverage for medical services including dentistry, vision and hearing exams, and physical therapy, which would erode the quality of care for many patients relying on these services.¹⁸⁶

Cutting funding designed to support the fiscal health of municipalities

The current fiscal plan proposes eliminating the Equalization Fund, which provides over \$130 million in funding for a range of local services, from solid waste management, education and health services, to road repairs.¹⁸⁷ The Puerto Rican government allocates this funding from the general fund, in part to compensate municipalities for revenue they lose from tax exemptions to corporations.¹⁸⁸ The Association of Mayors of Puerto Rico has sounded the alarm, insisting that this would present “a mortal blow to the smallest municipalities.”¹⁸⁹ In some cases, this would amount to a 60% reduction in local municipal budgets.¹⁹⁰

Narrowing eligibility for the Nutritional Assistance Program

The Nutritional Assistance Program (NAP) is Puerto Rico’s largest government social safety net program and currently extends to everyone who needs it, both in and out of the workforce. The Board proposes adding a work/volunteer requirement (at least 80 hours a month) for NAP, while deregulating labor standards purportedly so the island’s Earned Income Tax Credit (EITC) benefit can better “encourage work.”¹⁹¹ Rather than encouraging or supporting people to seek employment, research has shown these work requirements often backfire. The most vulnerable—and those with the least economic opportunities—often lose benefits when they need them most.¹⁹²

Ignoring tax incentives while prioritizing a significant fiscal surplus

The Board has, until recently, consistently cut essential services while ignoring the sizable impact of tax incentives. Tax incentives comprise two thirds (67.7%) of Puerto Rico’s general fund spending. Economic incentives created under Act 135 of 1997 and Act 73 of 2008 cost Puerto Rico upwards of \$15 billion. The Puerto Rican think tank Espacios Abiertos has called for a cost-benefit analysis of these tax incentives for individuals and corporations to determine if they yield any tangible social or economic benefits.¹⁹³ The Board has only recently turned its attention to this matter.¹⁹⁴

In addition to ignoring sizable tax incentives, the Board’s fiscal plans also tend to prioritize a significant fiscal surplus. This serves Wall Street but hurts average Puerto Ricans. That fiscal surplus could be used to invest in social services and public investments, support struggling families, and boost Puerto Rico’s economy. Instead, it will likely be used to repay Wall Street hedge funds and bondholders.¹⁹⁵

While the Board pushes austerity on Puerto Rican communities, it is leading a debt restructuring process that will cost Puerto Rican taxpayers an estimated \$1.6 billion through FY2026.¹⁹⁶

Why Austerity Doesn't Work

The Board's emphasis on extreme budget cuts ignores credible research that has consistently shown that austerity does not support robust economic recovery or growth. A review of International Monetary Fund (IMF) data after the 2008 financial crisis found that between 2009 and 2013, countries with the least austerity saw better economic growth while those pushing austerity, like Greece, saw the greatest contraction in their economies.¹⁹⁷ Economists have consistently raised the alarm on the assumptions underlying the Board's fiscal plans. According to the Center for Economic and Policy Research, the fiscal approach "is based on overoptimistic macroeconomic assumptions, downplays the negative impacts of continued austerity, and fails to address many of the structural problems at the core of Puerto Rico's lost decade, all while mandating a significant erosion of worker rights and reductions in public services."¹⁹⁸

The Board's fiscal plans have faced widespread criticism. In 2018, 26 world-renowned economists, including Nobel Prize winning economist Joseph Stiglitz, issued a public letter outlining the failings of the plan. They argued the plan, "proposed by the Governor and certified by the [Board], 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."¹⁹⁹ These economists also argued that a new fiscal plan would need to be "fundamentally different than the previous one if Puerto Rico is to have a chance for recovery."²⁰⁰ Critics note that the Board is following a similar model to that of the IMF, which pushes harsh "structural adjustment" policies in places like Greece. This playbook involves cutting local taxes, undermining labor protections, and slashing social programs under the guise of attracting businesses and investors and fueling economic growth. This only exacerbates inequality and prolongs recessions while padding the pockets of investors and consultants.²⁰¹ It is also important to note that the Board is following an IMF-style austerity playbook in a colonial context, further amplifying the harmful effects of austerity.²⁰²

The Puerto Rican government has repeatedly pushed back on sweeping austerity measures proposed by the Board.²⁰³ At moments, even members of the Board have warned against austerity. Board member Ana Matosantos cast the only dissenting vote against the board's April 2018 Fiscal plan, saying that "austerity measures that generate near-term surpluses but may very well lead to another fiscal cliff are not in the best interest of Puerto Rico, its retirees, creditors, or its future." Matosantos continued, "I cannot support too much pain with too little promise." This was echoed by former US Treasury Department economist Brad Setser, who said, "I am suspicious that structural reforms will have a bigger impact than the austerity and fall-off in projected disaster spending."²⁰⁴



PART IV

Debt Restructuring: Wall Street Rakes in Huge Profits While Local Communities Resist Cuts

- Restructuring Sales Tax-Backed 'COFINA' Bonds: A Great Deal for Wall Street and a Terrible Deal for Puerto Rico
- Central Government Debt Restructuring: Wall Street and the Board Play Tug of War with Puerto Rico



Pension holders from Construyamos Otro Acuerdo and el Frente en Defensa de las Pensiones take over UBS Bank in Puerto Rico to protest the Fiscal Control Board.

Debt Restructuring

In addition to granting the Board sweeping authority to adopt fiscal plans, PROMESA designated the Board as the representative of Puerto Rico in the debt restructuring proceedings, with the ability to negotiate with creditors through a court-supervised process (under Title III of PROMESA) or a process similar to some sovereign debt procedures (under Title VI of PROMESA). The Title III process involves a legal framework that incorporates some provisions from Chapter 9 (municipal bankruptcies) and Chapter 11 (corporate bankruptcies) of the US Bankruptcy Code. District Court Judge Laura Taylor Swain supervises the Title III debt restructuring proceedings, under which only the Board is empowered to propose debt restructuring plans.

Puerto Rico's debt falls into four main categories: general obligation (GO) bonds and other debt payable through Puerto Rico's central government; sales-tax-backed debt known by its Spanish acronym COFINA and other revenue-backed debt; debt of public corporations such as the Puerto Rico Electric Power Authority (PREPA); and debt issued by local governments.²⁰⁵ The Board is empowered to decide the order in which to seek the restructuring of these different types of debt.

In January 2018, three prominent economists—Pablo Gluzmann, Martin Guzman, and Joseph Stiglitz—published an analysis of Puerto Rico's debt, concluding that in order for Puerto Rico's debt to become sustainable, all interest would need to be cancelled and the face value of the debt cut by 50-80%.²⁰⁶ Unfortunately, the many debt restructuring plans the Board has presented in court ignore this critical analysis.

Additionally, the Title III debt restructuring process has proven to be too easily co-opted by wealthy hedge funds, which have made billions of dollars in the process while local creditors—including small businesses, government workers, small investors, credit unions, and retirees—have borne the brunt of the cuts proposed by the Board.²⁰⁷ This dynamic of wealth extraction, in which the Board has been complicit, depresses the local economy, as it decreases the spending power of local residents in favor of profits for those who will not reinvest in the local economy.²⁰⁸

Puerto Rico has four primary types of public debt

General obligation (GO) bonds, and other debt payable through Puerto Rico's Treasury;

Debt from Puerto Rico's public corporations, including the Puerto Rico Electric Power Authority (PREPA); and

Sales tax-backed debt known as COFINA bonds and other revenue-backed debt;

Debt that was issued by localities and smaller entities.⁶⁵

PROMESA TIMELINE

Puerto Rico's credit rating is downgraded to junk status. Puerto Rico loses access to capital markets after its COFINA and GO bonds are downgraded and total debt outstanding grows to the same size as gross national product.

Then-governor Alejandro García Padilla declares Puerto Rico's debt unpayable.

2014

2015

2016

2017

2019

2020

2021



Congress passes **PROMESA** and establishes the Financial Oversight and Management Board.

- Puerto Rico is hit by many earthquakes, with pronounced effects in the southern part of the island.
- Allegations of insider trading by hedge funds arise in the context of a confidential mediation ordered by the judge, resulting in public calls for an investigation.

- Puerto Rico's unfunded pension system owes current and future retirees \$55 billion as of 2021.

- After increasing pressure from organized pension holders, the Puerto Rico legislature unanimously passes the Dignified Retirement Act to protect pensions and essential services.

- The plan to privatize Puerto Rico's power utility takes effect. Days later, over a million people are affected by power outages and blackouts. The private operator is now embroiled in legal and political battles as it faces public oversight by both the US Congress and the government of Puerto Rico.

- The Board pushes a central government debt restructuring plan that would cut pensions, slash claims from local businesses, workers, and civil rights claimants, and give challenged bonds a large return.

- Hurricane Maria devastates the island.
- The Board recommends labor reforms, higher taxes, and spending cuts, leading to mass protests.

- The court overseeing Puerto Rico's debt restructuring confirms the Board's plan to restructure sales tax-backed COFINA bonds, resulting in estimated profits of over \$1 billion for a handful of hedge funds while Puerto Rican residents pay the highest sales tax in the United States.

- After public pressure, the Board and the Unsecured Creditors' Committee (UCC) argue that billions of dollars in bonds were issued illegally and file hundreds of lawsuits against some owners of the challenged bonds, as well as Wall Street banks and firms that participated in the issuances of the challenged bonds.

- Hundreds of thousands of Puerto Ricans take to the streets to demand the resignation of then-governor Ricardo "Ricky" Rosselló, chanting "Ricky renuncia, y llévate a la Junta" (Ricky, resign and take the Board with you).

- The legislature of Puerto Rico unanimously passes a joint resolution opposing pension cuts.

- Puerto Rico's population decreased by 620,000 between 2005 and 2019, largely due to out-migration — a loss of 16.4% of the island's total population.

Restructuring Sales Tax-Backed COFINA Bonds: A Great Deal for Wall Street and a Terrible Deal for Puerto Rico

COFINA is the Puerto Rico Sales Tax Financing Corporation, which was created in 2006 to avoid the Constitutional debt limit.²¹² COFINA bonds are backed by a sales and use tax (SUT), which started at 7% but increased to 11.5%, the highest in the United States.²¹³ The COFINA bonds are split into two major categories: senior bonds, which have a higher priority for repayment, and subordinated bonds, which have a lower priority for repayment. The senior bondholders are mostly hedge funds that bought debt at steep discounts, while subordinated bondholders are disproportionately Puerto Rican residents, including local businesses, small investors, credit unions, and public-sector pension funds.²¹⁴

On February 5, 2019, Judge Swain approved the restructuring of \$17.5 billion in COFINA bonds.²¹⁵ While the plan cut the principal amount to \$11.9 billion, the total to be paid over forty years still comes to a staggering \$32.3 billion, including interest.²¹⁶ Capital appreciation bonds, the frequently deceptive and dangerous financial instruments discussed in part I of this report, are part of this plan. “Balloon payments” of these bonds would be due in future decades, the last ones ending in 2058.²¹⁷ The restructuring plan gives the holders of the senior bonds (primarily hedge funds) 93 cents on the dollar, while only giving subordinated bonds (primarily Puerto Ricans and small investors) 54 cents on the dollar.²¹⁸

It is estimated that this plan will result in over \$1 billion in profits for the handful of hedge funds that brokered the debt restructuring deal.²¹⁹ Baupost Group and GoldenTree are two examples of hedge funds that profited greatly from the COFINA deal. In August 2015, Baupost bought more than \$900 million in senior bonds and incorporated ten shell companies to hold the debt in an attempt to hide its identity.²²⁰ If Baupost bought the debt at the price bonds were trading for at the time—around 55 cents on the dollar—they stand to make \$170 million in profits from those investments alone.²²¹ GoldenTree bought subordinated bonds after Hurricane Maria, when their prices plummeted to 15 cents on the dollar.²²² If GoldenTree bought them for this amount, they stand to make \$160 million in profits from those investments.²²³ Meanwhile, Puerto Rican residents will foot the bill through a sales tax (commonly understood to be one of the most regressive forms of taxation) higher than any other in the United States.²²⁴

While economists had originally estimated that all interest would need to be cancelled and the face value of the debt cut by 50–80% for Puerto Rico to achieve debt sustainability, in light of the COFINA plan's extreme generosity with hedge fund bondholders, economists found that the rest of Puerto Rico's debt must be slashed by 85–95% to avoid another debt restructuring in the coming years. In a report commissioned by the Puerto Rican advocacy group Espacios Abiertos, economists Martin Guzman and Pablo Gluzmann, found that:

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%.²²⁵

In summary, the plan to restructure COFINA bonds benefited Wall Street, harmed most local Puerto Rican creditors, sent the Puerto Rican economy into an even steeper decline, and significantly increased the chances that Puerto Rico's debt would again become unpayable in a few years.





THE BOARD'S **QUESTIONABLE CENTRAL GOVERNMENT FISCAL PLAN**

Although not front and center in the COFINA restructuring process, a questionable central government fiscal plan certified by the Board played an important role in the confirmation of the COFINA restructuring plan.

When confirming the COFINA restructuring plan, the Center for a New Economy asserts that the Judge assumed COFINA's fiscal plan was "sound because it is based on the 'reasonable' assumptions regarding economic growth, consumption, the flow of stimulus funds, and the effects of structural reforms, that underlie the Commonwealth's [central government's] Fiscal Plan."²²⁶ However, as the Center for a New Economy notes, these assumptions are not reliable: federal funds could be delayed, cut back, and/or spent mostly on contracts with firms based in the United States.²²⁷ Also, structural reforms to Puerto Rico's economy could be ineffective and lead to net migration increases.²²⁸ The Center for a New Economy suggests that uncritically accepting the fiscal and economic forecasts of the fiscal plan can amount to "magical thinking."²²⁹

Notably, the certified central government fiscal plan the Judge discussed had a predecessor that estimated a cash flow deficit of \$28 billion when including COFINA debt service payments—but assuming no debt payment to central government creditors, an unrealistic assumption.²³⁰ The Unsecured Creditors' Committee (UCC)—an entity created for the Title III proceedings to represent the interests of local businesses, workers, and winners of civil rights claims—warned of the implications of this fiscal plan on the central government's ability to pay their expenses.²³¹ Instead of addressing the issue with deeper debt relief in the COFINA restructuring plan, the Board certified a new central government fiscal plan that wiped out the previously-projected \$28 billion-deficit.²³² It remains unclear why the Board drastically changed the central government's fiscal plan assumptions and projections.

Central Government Debt Restructuring: Wall Street and the Board Play Tug of War with Puerto Rico

In 2019, after the COFINA plan was in place, the Board pivoted to restructuring the GO bonds of the central government, pension obligation bonds, and bonds issued by the Public Building Authority, an entity that constructs buildings that are leased to government agencies.²³³

This restructuring is of particular importance—and particularly ripe for controversy—because it involves the central pot of money the government uses to provide services to Puerto Rico's residents, billions of dollars' worth of debt of questionable legality held by hedge funds, debts owed to local businesses and government workers, and pensions.

While Puerto Ricans are fighting hard to prevent a result like the COFINA restructuring which enriched hedge funds and hurt Puerto Ricans—hedge funds continue to co-opt the debt restructuring process to make billions in profits. The Board has largely been complicit in this co-optation even though, under PROMESA, it is supposed to represent the interests of Puerto Rico. The Board has been complicit vwby: 1) proceeding with a debt restructuring process without a debt audit, which could have helped invalidate bonds held by hedge funds; 2) engaging in extensive negotiations with hedge funds without offering local creditors a seat at the table; 3) backing away from a legal challenge to bonds held by hedge funds; 4) largely turning a blind eye to allegations of insider trading; and 5) suing the government of Puerto Rico when it tried to push back against unsustainable deals that would hurt its most vulnerable communities.

How the central government debt restructuring plan is unfolding reveals that the playing field created by Title III is tilted in favor of hedge funds and against Puerto Ricans. It also demonstrates that the Title III process opens the door for hedge funds to distort the process to gain an even greater advantage and shows that the Board is unwilling to hold them accountable. These proceedings—along with the fight for a just restructuring agreement that would allow Puerto Rico to get on a path to economic recovery and growth—are ongoing as of the date of this publication.

Initial Victory for Puerto Rican Activists

Besides calling for an audit of the debt, activists in Puerto Rico and the diaspora pressured the Board to challenge bonds that they argued exceeded the debt limit in Puerto Rico's constitution, and to sue the banks responsible for those issuances.²³⁴ On January 14, 2019, the Board filed an objection to more than \$6 billion in GO bonds issued in 2012 and 2014.²³⁵ The Board filed this objection with the Unsecured Creditors' Committee (UCC). In April and May 2019, the Board and the UCC filed hundreds of lawsuits against some owners of the challenged bonds, as well as Wall Street banks and firms that participated in the debt issuances of the challenged bonds.²³⁶ In the lawsuits, they argued that \$9 billion in debt is invalid.²³⁷

Changes in Bond Trading Prices and Restructuring Plans Raise Suspicion of Hedge Fund Malfeasance

After the Board and the UCC challenged the legality of billions of dollars of debt, the Board attempted to negotiate a deal with hedge funds. In June 2019, the Board entered into an agreement with some bondholders that provided the basis for a restructuring plan that was filed a few months later.²³⁸ The plan gave holders of the challenged bonds two options: either accept a haircut (a reduction in the face value of the bonds), or continue litigating the validity of the bonds with the risk of losing everything if a court found them to be invalid.²³⁹ Later that summer, Judge Swain paused the litigation challenging the validity of the bonds and ordered mediation,²⁴⁰ which began in the fall. Following the mediation, in early 2020 the parties announced a new agreement that would rescind the legal challenges to the bonds and give the holders of the challenged bonds a much higher return.²⁴¹

Changes in trading prices between when the Board and UCC first challenged the bonds and when the new plan was announced on February 9, 2020, combined with the substance of that plan, raised suspicions that some of the hedge funds involved may have traded on the basis of nonpublic information learned through the confidential mediation. After the Board challenged the legality of general obligation bonds issued in 2012 and 2014, GO bonds issued in 2014 fell to 48 cents on the dollar.²⁴² By contrast, between July 2019 (when the court stayed litigation challenging the validity of certain bonds and ordered mediation) and February 9, 2020 (when the proposed restructuring plan was announced), trading prices of the challenged GO bonds—especially the 2014 bonds—increased dramatically.²⁴³ This market spike occurred even though there was no public information suggesting that the Board's challenge to those bonds would be withdrawn. The market also reacted when, just a few days before the plan was announced, the Wall Street Journal published that the Board agreed to a higher payment for the later-issued bonds.²⁴⁴ Bonds issued in 2014 jumped to trading between 72 and 76 cents on the dollar.²⁴⁵

Concerns were raised that hedge funds may have traded using nonpublic information learned through confidential mediation.

In light of these trends, the UCC and bond insurance companies asked the judge to order the hedge funds to release more detailed disclosures of their bond holdings.²⁴⁶ The judge agreed.²⁴⁷ The disclosures, filed on July 3, 2020, revealed that some hedge funds increased their holdings of 2014 bonds by almost 400%, from \$16,960,000 on August 30, 2019 to \$83,945,000 on January 6, 2020.²⁴⁸ During this same time period, those hedge funds were engaging in confidential mediations and their official position was that the 2014 bonds were issued illegally. Indeed, on January 8, 2020, these hedge funds reaffirmed their challenge to the 2014 bonds.²⁴⁹ Some creditors expressed concern that some hedge funds may have used the Title III proceedings to drive down the prices of 2014 bonds, purchase those bonds at a steep discount, and then negotiate a new settlement which assigned those bonds a higher recovery than the one in the proposed restructuring plan filed in the fall of 2019—all while trading these bonds using nonpublic information.²⁵⁰ Some hedge funds sold off substantial portions of the challenged bonds just as prices jumped considerably as a result of their treatment in the new agreement.²⁵¹ Hedge funds have denied all allegations of insider trading.²⁵²

Even if hedge funds did not trade using confidential information, the fact that some hedge funds were at the negotiating table when their public position was against the legality of challenged bonds—while at the same time holding a vested interest in their return—could have distorted the process. For example, it is possible that some hedge funds used the proceedings to drive down the prices of 2014 bonds, purchase those bonds at a steep discount, and then negotiate a new settlement that gave those 2014 bonds a higher recovery even without using any confidential information for trading. All of this could mean that Puerto Rico missed out on a chance to cancel, or at least significantly cut, payments for legally challenged debt.

Hedge Fund Trades that Occurred During Court-Ordered, Confidential Mediation Spark Calls for Insider Trading Investigation

In the wake of the court-ordered hedge fund disclosures, members of Congress and some creditors called for an insider trading investigation. On August 5, 2020, Congresswoman Alexandria Ocasio-Cortez and four other members of Congress sent a letter to New York Attorney General Letitia James voicing concerns about insider trading allegations and calling on her to launch an investigation. On October 5, 2020, the National Public Finance Guarantee Corporation, a bond insurance company, filed a motion asking Judge Swain to order an investigation into whether hedge funds violated mediation confidentiality and engaged in insider trading.²⁵³ Shortly thereafter, Congressman Raúl Grijalva, Chair of the House Committee on Natural Resources, along with six other members of Congress, sent a letter to the Board requesting that it support an independent investigation and imploring them to halt negotiations with bondholders until such an investigation is completed.²⁵⁴ Additionally, Puerto Rico Resident Commissioner Jenniffer González sent a letter to the Securities and Exchange Commission demanding an investigation into the allegations.²⁵⁵

On October 28, 2020, Judge Swain denied the request for an investigation.²⁵⁶ While the Board responded to the letter led by Chair Grijalva acknowledging the public referrals of the matter and stating their intention to make a referral to the Department of Justice,²⁵⁷ it proceeded with business as usual, continuing to negotiate with the hedge funds and not using their position as the representative of Puerto Rico in the Title III proceedings to meaningfully push for an investigation or continue litigating the validity of the challenged bonds.

It is not known whether any law enforcement agency is investigating allegations of insider trading. Leaving these allegations uninvestigated and continuing to offer such a high return to holders of challenged debt, could mean that legal challenges to bonds ended up benefiting hedge funds while Puerto Ricans lost out on what could have been meaningful debt relief. It could also put the integrity of the municipal bond market in jeopardy and set a dangerous precedent for future municipal debt restructurings.

Timeline of Mediation Between **THE BOARD AND HEDGE FUNDS**



2019

January

- The Board and the UCC challenged the legality of general obligation bonds issued in 2012 and 2014.
- GO bonds issued in 2014 fell to 48 cents on the dollar.

February

March

April

- The Board entered into an agreement with some bondholders that gave holders of the challenged bonds two options:

May

...Either accept a haircut, or

June

...Continue litigating the validity of their bonds with the risk that they would lose everything if a court found them to be invalid.

July

- Judge Swain paused the litigation challenging the validity of the bonds and ordered mediation.

August

September

- Confidential mediations began, with participants including the Board and some hedge funds.

October

November

December

- 8th — • Some hedge funds reaffirmed their challenge to the 2012 and 2014 bonds.

2020

January

- 13th — • Agreement in principle was reached between the Board and the hedge funds.
- 15th

February

- 2014 bonds jumped to trading between 72 and 76 cents on the dollar.
- A new deal between the Board and hedge funds was announced that would rescind the legal challenge to the 2012 and 2014 bonds and give some hedge funds a much higher return on their speculative investments.

*Shortly
Thereafter*

- Some hedge funds sold off substantial portions of the challenged bonds.

Hedge funds that argued 2014 bonds were invalid increased their holdings of 2014 bonds from \$16,960,000 to \$83,945,000 — a 395% increase.

Challenged bonds increased in market value at a faster rate than unchallenged bonds.

JUL.

AUG.

JAN. 6

FEB.

Most Recent Restructuring Plan

The debt restructuring plan that was announced on February 9, 2020 was put on hold and revisited in light of the COVID-19 pandemic. The most recent plan of adjustment, filed in court in July 2021, is unsustainable and, based on the Board's own estimates, would result in deficits as early as 2036.²⁵⁸ As noted above, after the COFINA restructuring plan was confirmed, economists concluded that an 85–95% cut in the remaining debt would be necessary for debt sustainability.²⁵⁹ However, a plan that the Board filed in March 2021 would only cut the debt by an estimated 23%.²⁶⁰ The most updated plan filed in July 2021, which the Board is currently seeking to get confirmed, includes deals it made with additional creditors for a more favorable recovery.²⁶¹ The plan would give central government bondholders \$7 billion in cash up front and \$7.4 billion in new bonds.²⁶² Capital appreciation bonds, the frequently deceptive and dangerous financial instruments discussed in part I of this report, are part of the plan.²⁶³ These payments would, in part, go to holders of bonds the Board itself challenged as illegal and which are the subject of the insider trading allegations discussed above. The plan could result in even greater returns for bondholders if revenue from the sales and use tax exceeds projections.²⁶⁴ Meanwhile, many unsecured creditors, including local small businesses, public sector workers, and individuals who had won civil rights claims against the government, would be forced to take an estimated cut of 80%.²⁶⁵

A significant point of contention between the Board on one side, and the government and residents of Puerto Rico on the other, is the possibility of cuts to pension payments for former public-sector workers. The plan would cut pensions payments of more than \$1,500 per month by 8.5% and would freeze all pension benefit accruals for teachers and judges.²⁶⁶ These cuts and benefit freezes would amount to a 19.3% reduction in pension payments by 2058.²⁶⁷ It should be noted that retirees had already suffered significant cuts to their pensions before PROMESA's enactment; indeed, the ballooning of the unfunded pension liability was partly attributable to underfunding of the pension funds to pay off bondholders.²⁶⁸ These cuts—which resulted in benefits reductions of up to 82% for some²⁶⁹—included increases in retirement age and a freeze to cost of living allowance (COLA) since 2007.²⁷⁰ Seeing their livelihoods on the chopping block, pensioners organized to push back against these cuts.

Ley para un Retiro Digno / Dignified Retirement Act

Pension holders started organizing to protect their livelihoods two years ago through the *Construyamos Otro Acuerdo* (Build Another Agreement) campaign. In October 2019, they achieved their first significant victory: the legislature unanimously passed a joint resolution opposing pension cuts.²⁷¹ Pensioners built upon that success and, in February 2020, organized a large pensioner convention attended by over 1,000 public sector retirees. Pensioners pushed for the *Ley para un Retiro Digno* (Dignified Retirement Act), which creates a policy against the Puerto Rican government taking the actions necessary to implement a restructuring plan if that plan would include cuts to pensions. It also includes a model plan of adjustment that would: (1) keep pensions intact; (2) discharge legally challenged debt; and (3) protect essential government services. This landmark bill also expands pension benefits to private sector workers. Notably, employees of private companies hired by the Government of Puerto Rico, as well as employees of companies with Puerto Rican government investments and grants, are all newly eligible.²⁷² The bill passed both legislative chambers unanimously and was signed into law by the Governor of Puerto Rico on June 9, 2021.²⁷³

Ever since the Dignified Retirement Act was introduced in the Puerto Rican legislature in March 2020, the Board has antagonized the government, writing a series of public letters disparaging the legislation and alleging that it violates federal law. The Board even sought to have the local government repeal the law after it had passed unanimously.²⁷⁴ However, the legal underpinning of its basic premise is clear: PROMESA § 314(b)(5) conditions confirmation of a restructuring plan on obtaining “any legislative, regulatory, or electoral approval necessary under applicable law in order to carry out any provision of the plan.” As noted by the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF) in an objection to the court, legislation is necessary to issue debt instruments backed by the full faith and credit of the Commonwealth, a key part of the plan of adjustment.²⁷⁵ AAFAF also provided a non-exhaustive list of three other securities-related provisions and five pension reform measures of the restructuring plan that would require Puerto Rico legislation.²⁷⁶

Before creditors can vote on a plan of adjustment, a disclosure statement with information about the proposed restructuring plan, as well as Puerto Rico’s finances, must be approved by the court as sufficient for creditors to make an informed decision when deciding whether to vote for or against the plan. Seeing many objections to the sufficiency of the disclosure statement—including AAFAF’s, which noted that the Board had not explained how it intended to implement the plan without the cooperation of the Puerto Rican government—Judge Swain asked a mediation judge to certify that parties have made their “best efforts” at consensual deals before she considers approving the disclosure statement.²⁷⁷

Even though the Board is supposed to represent the interests of Puerto Rico in the Title III proceedings, the Board, after many threats to sue the Puerto Rican government to invalidate the Dignified Retirement Act, did so on July 2, 2021.²⁷⁸ It is unclear how, even if the law is overturned, the Board could implement the plan of adjustment if the government of Puerto Rico refuses to pass the legislation necessary for implementation.



THE BOARD IS FAILING BY ITS OWN METRICS

Five years after PROMESA was passed, \$53 billion (a full two-thirds of Puerto Rico's bonded debt) has still not been restructured. Under the unelected Board's watch, there has been a slow and expensive unsustainable debt restructuring process involving a bevy of high-paid consultants and lobbyists. Puerto Rico's economy is faltering as the island deals with the continued fallout of both natural disasters and the COVID-19 pandemic.²⁷⁹

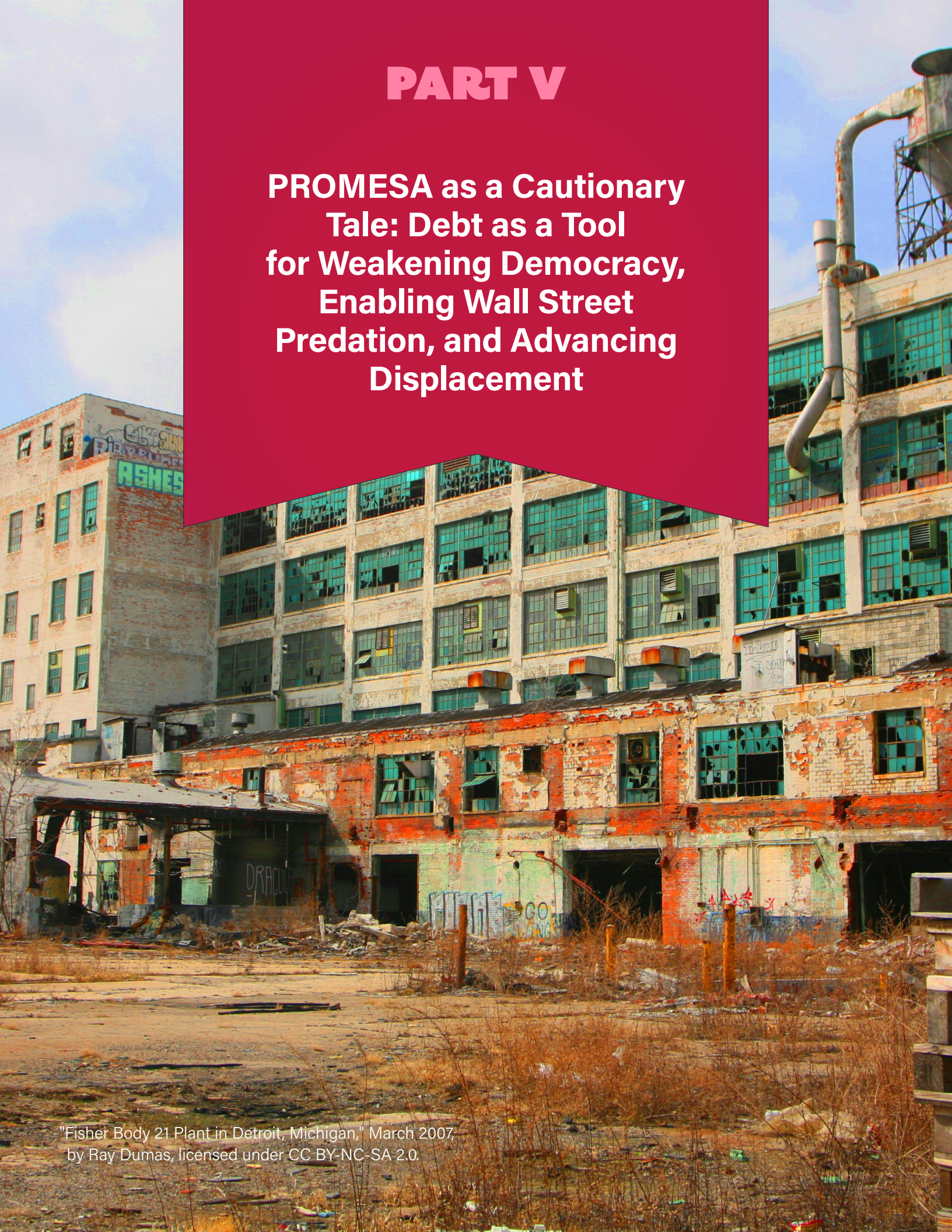
PROMESA requires the Board to achieve fiscal responsibility before the Board can be dissolved. This is defined as four consecutive years of balanced budgets and regaining access to capital markets at reasonable rates.²⁸⁰ None of PROMESA's longer-term goals—including regaining access to capital markets and a balanced budget—are currently within reach.²⁸¹ Instead, "the debt policies that [the Board] is implementing are leaving a legacy of debt and risk that may undermine the future of Puerto Rico's economy" according to Espacios Abiertos.²⁸²

By its own analysis, the Board is woefully behind on its major objectives. The Board has defined a set of operational steps required in order to meet the legal requirements necessary before it can be dissolved. Of those 19 steps, the Board reports that 13 have not been started as of April 2021, only 6 have seen "some progress," and none have been completed.²⁸³

Even among the debt that the Board has restructured, critics are raising the alarm on the lack of sustainability of those deals and the long-term implications for Puerto Rico. Many argue the Board's COFINA restructuring is unsustainable and will burden Puerto Rico with increasing debt payments over the next 20 years. There are growing concerns that Puerto Rico will inevitably default again in the future if the Board follows this same playbook for the GO bond restructuring.²⁸⁴ Additionally, the restructuring plans largely send profits abroad while imposing significant cuts on local creditors and a high tax burden on local residents. This formula will likely depress the economy further by decreasing the spending power of local residents in favor of profits for those who will not reinvest in the local economy.

PART V

PROMESA as a Cautionary Tale: Debt as a Tool for Weakening Democracy, Enabling Wall Street Predation, and Advancing Displacement



"Fisher Body 21 Plant in Detroit, Michigan," March 2007,
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The Board's Rhetoric Stands in Stark Contrast to the Realities on the Ground—Both in Puerto Rico and in Detroit



PROMESA as a Cautionary Tale: Debt as a Tool for Weakening Democracy, Enabling Wall Street Predation, and Advancing Displacement

What is happening in Puerto Rico is not happening in a vacuum. The Puerto Rican debt crisis followed closely in the wake of the Detroit bankruptcy, and the precedents set by both Detroit and Puerto Rico will likely become the blueprint for how public officials and Wall Street can use debt crises to undermine local democracy, impose harsh and unpopular austerity measures, and ultimately displace people of color from the communities in which they have lived for generations.

Using debt to dictate public policy is not new. In developing countries, the IMF and World Bank have long required financially distressed governments to enact painful cuts in order to obtain financing. Similarly, during New York City's fiscal crisis in the 1970s, banks refused to continue extending credit to the city and then forced harsh austerity measures.²⁸⁵ Detroit and Puerto Rico are only the latest examples of what this model can look like in the United States.

Both Detroit and Puerto Rico faced structural issues that they did not have the legal authority to address themselves, which put them into an economic tailspin. Detroit's economic crisis was originally rooted in the decline of the US auto industry amid trends of globalization and

deindustrialization, which caused the city to hemorrhage 60% of its population. The debt crisis that led to the city's bankruptcy in 2013 was triggered by a set of actions undertaken by the State of Michigan in the aftermath of the 2008 financial crisis to cut state revenue sharing with the city and limit its ability to raise taxes at the local level.²⁸⁶ Governor Rick Snyder was elected alongside sweeping Republican majorities in both houses of the Michigan Legislature during the Tea Party wave of 2010, and the state set out to weaken the overwhelmingly Black, Democratic base in the City of Detroit.

The structural roots of Puerto Rico's economic crisis trace all the way back to 1898, when the island became a colony of the United States. Since then, it has been subject to laws enacted by the federal government in Washington, DC, which Puerto Ricans have practically no say in electing. Puerto Rico's inability to determine its own economic policy, or to access financing from international organizations like the IMF, have left it vulnerable to predatory Wall Street schemes.

Wall Street predation was a driving factor in the largest ever bankruptcy in the US municipal bond market.

In both Detroit and Puerto Rico, local communities of color have been scapegoated as irresponsible deadbeats living beyond their means. This characterization has been used as an excuse to justify dismantling local democracy and taking decision-making power out of the hands of local residents.

- **In Detroit**, in 2013, the governor installed an emergency manager who could override the elected city council and rule by decree.²⁸⁷ The person chosen for that task, Kevyn Orr, was a lawyer who had previously worked at Jones Day, a law firm that represented Bank of America and other Wall Street banks that had been involved with selling Detroit predatory financial deals.²⁸⁸
- **In Puerto Rico**, the federal government appointed an unelected fiscal control board. Two of the original seven members of the PROMESA Board were former executives of Santander, one of the banks that had underwritten predatory financial deals to the island.²⁸⁹ In both cases, decision-making power was usurped from local elected officials and handed over to unelected and unaccountable emergency managers and fiscal control board members with ties to Wall Street.

In both places, an emergency management regime was put in place to oversee a restructuring of debt, in Detroit through bankruptcy under Chapter 9 of the US Bankruptcy Code and in Puerto Rico under Title III of PROMESA. In both cases, the emergency manager and control board have chosen to protect the interests of creditors by instituting painful austerity measures that elected officials would have had a hard time enacting because of broad popular opposition. Just as Puerto Rico's Board initially refused to challenge the validity of some bonds despite obvious legal issues, so too did Detroit's emergency manager have to be pressured by the federal bankruptcy judge to challenge the legality of \$1.4 billion of the city's debt.²⁹⁰

Finally, in Detroit we have seen the post-bankruptcy era marked by a period of gentrification that has displaced large swaths of Black communities, which have lived there for decades, and replaced them with wealthier white residents.²⁹¹ Puerto Rico appears to be headed in a

similar direction, with a population decrease of 16.4% between 2005 and 2019,²⁹² in large part due to out-migration because the economic conditions have made it impossible for Puerto Ricans to remain on the island between the lack of good jobs, the high cost of living, and the cuts to public services like education, healthcare, and public utilities. Meanwhile, Puerto Rico has been offering tax incentives to entice stateside billionaires to move there. Hedge fund manager John Paulson, who has bought more than a billion dollars in real estate on the island, has even said that the island has “the potential to become the Singapore of the Caribbean.”²⁹³

Prior to the Detroit bankruptcy in 2013, municipal bankruptcy within the United States was primarily seen as a way for governments to obtain debt relief in order to maintain public services at a level needed to spur economic recovery and get the municipality back on its feet in the long run. It was believed that bankruptcy gave public officials the leverage they needed to force creditors to take haircuts, so that the city could get back to its core purpose of serving residents. Detroit created a different kind of precedent, with federal bankruptcy law being used to get around state constitutional protections for city workers’ and retirees’ pensions, and for the state to wrest control of city assets like the Detroit Water and Sewerage System and Belle Isle Park away from the people of Detroit. Governor Snyder appeared to be more interested in forcing cuts on workers and retirees than on creditors. Since then, municipal bankruptcy has been invoked in cities across the country by public officials looking to get out of union contracts and constitutionally protected pensions as part of an austerity regime.²⁹⁴

Similarly, the restructuring of Puerto Rico’s debt could become the model for a modified version of bankruptcy at the state level. The US Bankruptcy Code does not permit states or territories like Puerto Rico to file for bankruptcy. That is partly why Congress had to create a process for restructuring Puerto Rico’s debt through PROMESA. Title III of the law creates a bankruptcy-like process for restructuring the territory’s debt. We cannot allow the PROMESA model, which has been devastating for the people of Puerto Rico, to be exported to other territories and states.



PART VI

Policy Recommendations



"Philly-Puerto Rico Solidarity Brigade - Scenes"
Series: Nov 1-7 of 2017, by Joe Piette, is licensed under
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We Recommend

Puerto Ricans have suffered from the failures of PROMESA for the last five years, and it is time to change course. Below are recommendations which, if adopted, would help put Puerto Rico on a path toward fiscal and economic health.

1. Ensuring Puerto Rico debt is restructured to sustainable levels by:

- Eliminating the Financial Oversight and Management Board;
- Passing the Territorial Relief Act;
- Protecting pensions and local creditors;
- Addressing the undue power and distorting effects of hedge funds in the debt restructuring process;
- Preventing federal relief funds from being used to pay existing debt; and;
- Providing the resources necessary to establish local, centralized, accountable, and transparent public financial management systems.

2. Removing structural barriers to fiscal health and employing tools for economic development and growth by:

- Undoing Board-imposed austerity measures;
- Addressing the economy's dependence on multinational corporations; and;
- Ensuring federal funds are used in accordance with federal policies that promote moving away from fossil fuels and advancing use of renewable energy.

3. Investing in environmental cleanup and healthcare by:

- Investing in public health infrastructure;
- Passing Medicare for All and in the meantime, providing full Medicaid parity; and;
- Ensuring thorough environmental cleanups.

4. Strengthening the municipal bond market by:

- Having the Federal Reserve offer loans with favorable terms to public sector borrowers;
- Investigating underwriting fraud; and;
- Creating an opt-in program for public issuers to obtain SEC review before issuing securities.

5. Advancing a process of decolonization by passing the Puerto Rico Self-Determination Act.



RESTRUCTURING DEBT TO SUSTAINABLE LEVELS

Puerto Rico needs to restructure its debt to sustainable levels as soon as possible to stand a chance of achieving financial and economic recovery and growth. As explained by leading economists, “debt sustainability is a necessary condition for economic recovery, because there is no possibility of implementing the policies needed for macroeconomic recovery when debt is unsustainable.”²⁹⁵ Restructuring debt to sustainable levels is necessary for Puerto Rico to be able to provide services to its residents, develop and maintain the infrastructure necessary to sustain economic activity and withstand natural disasters, and invest in developing and growing its economy.

Even though PROMESA provided tools for Puerto Rico to restructure its debt, the law has failed to facilitate a process for restructuring its debt to sustainable levels.

As noted above, economists estimated that in order for Puerto Rico’s debt to be sustainable, all interest would need to be cancelled and the face value of the debt cut by 50–80%.²⁹⁶ After the COFINA restructuring plan was finalized, economists found that the rest of the debt would have to be slashed 85–95% if Puerto Rico hoped to avoid another debt restructuring in the coming years.²⁹⁷ However, the Board has proposed a plan that would only cut the debt an estimated 23%,²⁹⁸ and has continued to amend the plan based on deals it made with additional creditors for a more favorable recovery.²⁹⁹

Additionally, the restructuring plans largely send profits abroad while imposing significant cuts on local creditors and a high tax burden on local residents.

This formula will likely depress the economy further by decreasing the spending power of local residents in favor of profits for those who will not reinvest in the local economy.³⁰⁰

1. To achieve a sustainable debt restructuring, we recommend:

- a) Eliminating the Financial Oversight and Management Board. We recommend amending PROMESA to eliminate the Board. The Board has negotiated unsustainable debt restructuring deals and has been ineffective in leading Puerto Rico to fiscal health and access to capital markets. Besides being ineffective, the Board has been costly; even though Board members are not compensated, Puerto Rican taxpayers are stuck with a hefty bill for the generous compensation received by their staff and their army of consultants.

Importantly, while the Board is supposed to represent Puerto Rico's interests in the restructuring litigation, it has long suffered from conflicts of interest and has no legitimacy in Puerto Rico, further eroding its ability to achieve its purpose. Economists Gluzmann, Guzman, and Stiglitz predicted, "If the government presents a [restructuring] plan that is aligned with the development goals of the territory and the Board supports it, PROMESA will help. But if the Board demands a plan that intends to squeeze as much as possible to satisfy creditor demands at the expense of the Puerto Rican people, PROMESA will hurt."³⁰¹ Unfortunately, the Board chose the latter course and is now in a standoff with the Puerto Rican government over pension cuts with no end in sight.

- b) Passing the Territorial Relief Act. This legislation would: 1) give territories the option to terminate their non-pension debt obligations if they meet certain criteria; 2) make funds available to compensate certain creditors; and 3) create a commission to audit Puerto Rico's debt.³⁰² If able to address the debt that is yet to be restructured through this Act, Puerto Rico would be much more likely to move forward without facing another insolvency crisis in the coming years. This bill was introduced by Senator Elizabeth Warren in 2019. In 2020, it was included in a set of amendments to PROMESA that Congressman Raúl Grijalva, Chair of the House Natural Resources Committee, introduced.
- c) Protecting pensions and local creditors. The restructuring plan that the Board is currently trying to get confirmed would dramatically cut pensions, debt owed to public sector workers and small businesses, and civil rights claims, while giving much more generous recoveries to outside creditors.³⁰³ This is the exact inverse of what economists Gluzmann, Guzman, and Stiglitz recommend for economic growth. They write, "The expansionary effects of the restructuring will be increasing in the fraction of the write-off that falls on external bondholders, rather than on domestic bondholders, as far as the marginal propensity to spend in Puerto Rico's economy is lower for external than for domestic bondholders."³⁰⁴ More specifically, they say that "cuts in pensions will more likely deepen the recession."³⁰⁵
 - a. Congress should support the Dignified Retirement Act's refusal to cut pensions and pass the Territorial Relief Act, which would establish a compensation fund that would help pay creditors with a larger impact on the local economy.
- d) Addressing the undue power and distorting effects of hedge funds in the debt restructuring process. Many hedge funds bought Puerto Rico's debt at steep

discounts and became prominent players in the debt restructuring process, making billions of dollars in profits while residents of Puerto Rico faced austerity measures and a crumbling infrastructure ill-equipped to withstand natural disasters.

- a. Congress should pass legislation to require hedge funds to disclose the amount they paid for government debt, and consider capping the profits they can receive from government debt restructuring. This stands to benefit not only Puerto Rico, but other government entities facing fiscal distress.
- b. The Securities and Exchange Commission (SEC) and/or the Department of Justice should investigate the insider trading allegations detailed above. If they find that hedge funds broke the law, these hedge funds should be prosecuted and face steep financial penalties and any other penalties applicable through the US Bankruptcy Code provisions incorporated into PROMESA. Additionally, any agreements reached with the Board involving illegally traded bonds should be rescinded.
- c. If law enforcement agencies find that hedge funds did not break the law, they should nonetheless study the effects that trades conducted by hedge funds during active restructuring litigation and confidential mediation had in the restructuring process and recommend laws or regulations to prevent adverse effects hedge funds could have in future government debt restructurings.
- e) Preventing federal relief funds from being used to pay existing debt. When Congress appropriates money to rebuild infrastructure after natural disasters, Medicaid, or other purposes, this money should not be used to pay down existing debt. Unfortunately, wealthy outside creditors often argue that the infusion of these funds should result in a bigger recovery for them. Federal agencies should implement an interagency rule that prohibits any potential secondary effects the funds may have on the local economy from being used to service legacy debt held by wealthy creditors outside the island who will not reinvest in the local economy.
- f) Providing the resources necessary to establish local, centralized, accountable, and transparent public financial management systems. The main challenges to effective public financial management systems within the Puerto Rican government are decentralization and lack of transparency. The United States should invest in the centralization and transparency of Puerto Rico's public financial management system so that Puerto Rico can develop the tools necessary for long-term, sustainable fiscal self-management.

Additionally, the legislature recently passed important legislation that would require the local government to publish information about tax exemptions every year, as well as a detailed cost-benefit analysis of every tax exemption every three years.³⁰⁶ As of the date of this publication, the governor has not yet signed the legislation into law.³⁰⁷ Federal investment in a centralized, transparent financial management structure will help Puerto Rico fully implement this law, which will help the local government make informed decisions about tax exemptions to maximize economic development while minimizing loss of tax revenue.

2. Removing structural barriers to fiscal health and employing tools for economic development and growth

Economists Gluzmann, Guzman, and Stiglitz note that “the debt restructuring will not be a sufficient but just a necessary condition for economic recovery. Puerto Rico needs more than just the restoration of debt sustainability: it needs a new economic growth strategy that replaces the old one that has clearly failed.”³⁰⁸ In order for Puerto Rico to implement a new economic growth strategy, the federal government needs to address structural barriers that have stood in the way of Puerto Rico’s fiscal health and economic development. The United States can also use tools available at the federal level to help spur economic development. We recommend:

- a) Undoing Board-imposed austerity measures. Research has shown that austerity does not support robust economic recovery or growth. A review of International Monetary Fund data after the 2008 financial crisis found that between 2009 and 2013, countries with the least austerity saw better economic growth while those pushing austerity, like Greece, saw the greatest contraction in their economies.³⁰⁹ Economists have consistently expressed grave concern regarding the assumptions underlying the Board’s fiscal plans. According to the Center for Economic and Policy Research, the fiscal approach “is based on overoptimistic macroeconomic assumptions, downplays the negative impacts of continued austerity, and fails to address many of the structural problems at the core of Puerto Rico’s lost decade, all while mandating a significant erosion of worker rights and reductions in public services.”³¹⁰
- b) Addressing the economy’s dependence on multinational corporations. A significant structural barrier to Puerto Rico’s economic development is its economic dependence on tax breaks designed to keep foreign manufacturing in Puerto Rico and compete with other tax havens. In its pursuit of large multinational corporations, the federal and Puerto Rican governments have stifled the development of the local business economy.³¹¹ The United States must help facilitate a shift towards a fairer tax system in Puerto Rico. As a starting point, the federal government should work with Puerto Rico’s government to maximize the use and effectiveness of existing federal programs intended to foster small and medium-sized businesses. These include programs of the Small Business Administration such as loan guarantees and the Small Business Innovative Research program, which provides grants to small businesses at the start-up and development stages.³¹²
- c) Ensuring federal funds are used in accordance with federal policies that promote moving away from fossil fuels and advancing the use of renewable energy. Transitioning to publicly-owned renewable energy would benefit Puerto Rico’s finances and economy, as it would provide electricity at a lower cost *and* cut consumer costs. A report by the Institute for Energy Economics and Financial Analysis found that “Puerto Rico could cost-effectively and reliably generate 75% of its total electricity from renewables within 15 years” and “[knock] electricity prices from the current 21 cents per kilowatt-hour (kWh) to less than 15 cents/kWh.”³¹³

The LUMA contract, which privatizes Puerto Rico’s power provision operations, sets Puerto Rico on the opposite path and does not align with Executive Order 14008, *Tackling the Climate Crisis at Home and Abroad* (Jan. 27, 2021), or Executive Order 13990, *Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis* (Jan. 25, 2021).³¹⁴ FEMA funds should be withheld until the LUMA contract is changed to be in compliance with these federal policies and set Puerto Rico on a path toward renewable energy.³¹⁵

3. Investing in environmental cleanup and healthcare

Both direct actions by the federal government and lack of robust environmental regulations and enforcement at the federal level have resulted in environmental devastation in Puerto Rico, with significant adverse health effects. For example, for over six decades the Navy tested biochemical weapons and explosives with heavy metals, both of which caused extraordinarily high rates of cancer, hypertension, and asthma.³¹⁶ Although massive popular protests finally forced the Navy to leave Puerto Rico in 2003, the military's cleanup has been insufficient.³¹⁷ Another example is the coal-fired plant run by the multinational corporation Applied Energy Systems that contains levels of heavy metals that may "exceed up to 9,000 times federal safety standards upon contact with liquids and soil," according to a US Environmental Protection Agency Report.³¹⁸ This poses a significant health risk to local communities. The burden of addressing these negative human health effects has impacted Puerto Rico's fiscal health as well.

Even though the federal government has directly caused and contributed to environmental degradation, and is therefore responsible for the devastating health effects that resulted, its investment in healthcare in Puerto Rico has been woefully inadequate. For example, while states receive funding that covers a specified share of Medicaid costs based on per capita income, Puerto Rico and other US territories receive a block grant. If Puerto Rico's federal matching rate were determined using the same formula as states, it would be 83%.³¹⁹ However, its rate is stuck at 55% by law, while the effective rate has been as low as 15–20% in some years.³²⁰ This has meant that Puerto Rico has not been able to invest in program improvements or cover seven of Medicaid's seventeen mandatory services, including nursing home care.³²¹ Almost half of Puerto Rico's residents receive healthcare through Medicaid.³²²

To remedy past harms caused by the United States that have negatively impacted Puerto Rico's fiscal health, we recommend:

- a) Investing in public health infrastructure. Puerto Rico needs robust, upfront investments in public health infrastructure. Nowhere is this need more evident than in Vieques, an island-municipality that was the site of Navy training for many years and suffers high rates of cancer and other serious health conditions as a result. Since Hurricane Maria, Vieques has not had a hospital, a fact that has likely contributed to preventable deaths.³²³
- b) Passing Medicare for All and, in the meantime, providing full Medicaid parity. Medicare for All would ensure everyone has access to high-quality health insurance regardless of ability to pay. In the meantime, the United States should provide full Medicaid parity to Puerto Rico.
- c) Ensuring thorough environmental cleanups. The federal government should complete a thorough environmental cleanup of former Navy training sites. This cleanup should comply with international standards, which exceed the weaker US protections. Additionally, the federal government should ensure that multinational and US corporations clean up environmental devastation caused by their operations through enforcement of strong environmental regulations.

4. Strengthening the municipal bond market

There are lessons to be learned from Puerto Rico's debt crisis with implications for the municipal bond market as a whole. The federal government should take these lessons to heart and implement changes to prevent future municipal debt crises. To do so, we recommend:

- a) Having the Federal Reserve offer loans with favorable terms to public sector borrowers. State and local governments pay more than \$160 billion in interest payments every year.³²⁴ Additionally, some banks make predatory loans which, as in the case of Puerto Rico, have meant facing a 785% interest rate as well as billions of dollars in fees.³²⁵ One solution to this problem is for the Federal Reserve to offer zero-interest, long-term loans to all public sector borrowers.³²⁶
- b) Investigating underwriting fraud. Municipal bonds are subject to antifraud provisions of the federal securities laws. Questions have been raised about the validity of Puerto Rico bond issuances that took place in 2012 and 2014, resulting in the Board suing financial institutions that underwrote the bonds for alleged fraud and misrepresentations. The SEC should invest resources in investigating and prosecuting underwriting fraud to deter financial actors from engaging in these practices.
- c) Creating an opt-in program for public issuers to obtain SEC review before issuing securities. The Tower Amendment prohibits the SEC and the Municipal Securities Rulemaking Board from requiring municipal securities issuers to submit information to them prior to the sale of securities.³²⁷ The SEC, however, could create a program whereby public issuers could opt into a review process prior to the sale of securities. This program could detect attempted underwriting fraud before it happens and serve as a deterrent to predatory lending practices.

5. Advancing a process of decolonization

A root cause of Puerto Rico's economic and fiscal crises lies in its colonial relationship to the United States. The Center for Economic and Policy Research notes that: "both the Board and legal proceedings have failed to adequately address the underlying causes and consequences of Puerto Rico's debt crisis, some of which are unique to the island due to its special political status. If Puerto Rico is going to have a chance to avoid a continued deterioration of living standards and loss of population, either the policies imposed from outside will have to change, or Puerto Rico will have to change its political status."³²⁸ Any comprehensive approach to Puerto Rico's debt crisis would necessarily have to include a decolonization process. Therefore, we recommend:

- a) Passing the Puerto Rico Self-Determination Act. This Act outlines a democratic and inclusive process for Puerto Rico and the United States to negotiate a non-colonial relationship and transition period that could result in statehood, independence, or free association. This process can provide a just transition for Puerto Rico to emerge from its colonial status and debt crisis having the autonomy and tools it needs to foster economic growth and prosperity.



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