

Policy Brief

PROMESA: A Failed Colonial Experiment?

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San Juan, PR | Washington, DC

June 2021



INTRODUCTION

On June 30, 2016, President Obama signed into law the Puerto Rico Oversight and Management Economic Stability Act (“PROMESA”). At that time, the Puerto Rican economy had stopped growing for approximately a decade; the central government had incurred in chronic budget deficits for years; the island’s total bonded debt of \$72 billion exceeded its gross national product; the government pension system was insolvent, adding an extra \$55 billion in unfunded liabilities to Puerto Rico’s long-term obligations; and the governor had declared the island’s debt to be “unpayable” in 2015.

Five years after the enactment of PROMESA, an unelected financial oversight board still controls Puerto Rico’s fiscal policy, two-thirds of its central government bonded debt of approximately \$53 billion has not yet been restructured, and its economy is still stagnant, even as the island is in the midst of a complex process to recover from Hurricane Maria and the COVID-19 pandemic.

In this policy brief, we take a look at the events leading up to the enactment of PROMESA and how it has been implemented. As we look back and take stock of the events that have taken place since 2016, the unavoidable conclusion is that the territorial bankruptcy regime set up by that law has failed to achieve most of the goals set forth by its authors.

THE PRELUDE TO PROMESA: THE CHAPTER 9 SAGA

In June of 2015 the Commonwealth government publicly admitted that its debt burden was unsustainable, after years of: (1) overstating tax revenues; (2) understating or disguising expenditures; (3) running concealed budget deficits; (4) widespread government corruption; and (5) relying on accounting gimmicks, forward refundings, back-loaded “scoop and toss” refinancings, assorted swaps, capitalized interest payments, and other short-term, expensive liquidity fixes.

While it is true that Puerto Rico’s capacity to repay its debt ultimately depended on restoring economic growth in the island, its government realized that there could be no economic recovery without debt sustainability and that, in turn, was not possible without significantly restructuring at least some of its debt. At that time, however, Puerto Rico did not have access to an orderly mechanism, either local or federal, to restructure its public indebtedness.

In order to accomplish that restructuring, both the Obama administration and the Puerto Rican government lobbied Congress seeking the enactment of legislation to authorize the Puerto Rican government to allow its distressed agencies, instrumentalities, and municipalities to file for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code.

However, obtaining Chapter 9 protection for Puerto Rico became politically impossible because lobbyists for bondholders had already closed-off access to the Judiciary Committees, both in the House and in the Senate, which have primary jurisdiction over bankruptcy issues. [[Read More.](#)]

THE ENACTMENT OF PROMESA

So, if Puerto Rico was to receive some relief from its creditors it would have to be done working through other Congressional committees. The obvious candidates were the House Committee on Natural Resources and the Senate Committee on Energy and Natural Resources, which have primary jurisdiction over Puerto Rico pursuant to Article IV, Section 3 of the Constitution of the United States, **which grants Congress the power to dispose of and make all needful rules and regulations for its territories.**

Acting under this broad grant of power, Congress created a territorial bankruptcy regime that consists, broadly speaking, of two elements: (1) the establishment of an oversight board with ample powers to impose fiscal discipline on the territory, in this case, Puerto Rico, and (2) a court-supervised process for the orderly adjustment of the territory's debts and obligations. This two-pronged approach to territorial bankruptcy is what the late Judge Torruella called the "PROMESA experiment". **A legal experiment inflicted on the Puerto Rican body politic that was possible only because of Puerto Rico's colonial status.**

In general, the origins of the PROMESA experiment can be traced to the establishment of financial control boards by state governments to manage financial crises at the city, municipal, and county level, most notably in the cases of the City of New York, Philadelphia, Washington, D.C., and Detroit, among other jurisdictions.

These boards usually take over the fiscal and financial policymaking functions of cities or municipalities, with the objective of making the "politically difficult decisions" necessary to get out of the crisis and that, presumably, democratically elected politicians were unwilling or unable to make. **Needless to say, these boards are extremely unpopular and are frequently accused of anti-democratic practices.**

However, in a paper entitled, [Dictatorships for Democracy: Takeovers of Financially Failed Cities](#), published in 2014, Professor Clayton Gillette, of the New York University School of Law argued that

Takeover boards with near-dictatorial powers, including those that coerce or displace the authority of elected local officials, may be the most effective means of addressing the shortfalls and consequences of normal politics...The more contentious model that I propose here... would permit extensive takeover board restructuring of governance to extricate the locality from an entrenched pattern of costly and defragmented decision making.

Professor Gillette then expanded his [Schmittian](#) thesis in the publication, with Professor David Skeel of the University of Pennsylvania Law School and currently a member and chairman of the Financial Oversight and Management Board for Puerto Rico, of [Governance Reform and the Judicial Role in Municipal Bankruptcy](#), in which the authors argue that municipal bankruptcy proceedings should not be limited to debt restructuring but should also reform the debtor's governance structure, given that, in their view, fiscal distress is usually a product of governance dysfunction. In short, they advocated for a sort of "cram-down" of governance reforms on financially distressed governments.

Finally, on March 15, 2016, these advocates of authoritarian governance in the name of fiscal prudence published a white paper entitled "[A Two-Step Plan for Puerto Rico](#)", which outlined the main elements of what eventually came to be known as PROMESA. According to Professor Skeel in an interview with [The Nation](#) magazine, what Congress "did looks quite a bit like what we were proposing."

PROMESA, then, was enacted as a political compromise between the Democratic administration and the Republican majority in Congress ostensibly to address Puerto Rico's fiscal and economic troubles. In the short term, the law sought to stay creditor lawsuits seeking payment on Puerto Rico's indebtedness; provide a mechanism for the speedy and orderly restructuring of the island's obligations; and afford Puerto Rico some breathing room to reorganize its finances while still providing services to the people of Puerto Rico.

Over the medium term, PROMESA provided a mechanism for Puerto Rico to regain access to the capital markets at reasonable rates and to implement new budgeting controls that would eliminate chronic budget deficits, while allowing the expedited approval and implementation of "critical projects" for economic growth.

In exchange for that, Congress exacted its pound of flesh: the island's fiscal policy would be exercised by an undemocratic, unelected Financial Oversight and Management Board ("FOMB") appointed by the president of the United States from a list of candidates submitted by the Congressional leadership. That was the deal offered by Congress to its colonial subjects: debt restructuring in exchange for the loss of political control over government spending, taxation, and indebtedness.

Back in 2016, [CNE did not endorse](#) the bill that eventually became PROMESA because "we believe[d] the political costs associated with the oversight part of the bill [were] extremely high and quite definite, while any benefits to be derived from debt restructuring [were] fairly uncertain and contingent on the successful implementation of a complicated, new territorial debt restructuring process, which combines principles drawn from both the U.S. Bankruptcy Code and the realm of sovereign debt restructuring."

FIVE YEARS LATER

After five years of PROMESA and the FOMB, time has proven, unfortunately, that our initial assessment was essentially correct. To be fair, **Puerto Rico has had a respite from bondholder claims** and has been able to spend money that otherwise would have gone to debt service. However, the stay on litigation did not apply to other legal (nonpayment) claims while **the debt restructuring process, although orderly, has been extremely slow and expensive**. With respect to the longer-term goals of PROMESA, we are still a long time away from regaining access to the capital markets and balancing our budgets. All the while an unelected "dictatorship for democracy" keeps making decisions crucial to Puerto Rico's future.

While a lot has happened since 2016, and though the FOMB may reasonably argue that some of the events that have transpired since June 2016 were beyond their control, their actions to date reinforce the argument made by CNE back then, that PROMESA would not provide the platform to achieve political, economic and social stability. If PROMESA was drafted, as some government officials stated back in 2016, to chart a sustainable path forward, then the bottom line is that **the current track is far from sustainable**. Worse yet, a whole host of proposals made by the financial body in its most recent Fiscal Plan suggests that FOMB members themselves don't quite understand how **their sequester-like cuts across the government will continue to hinder any chances of success** for the island.

THE TROIKA PRECEDENT

At the outset, we must recognize that not a few countries and jurisdictions have faced similar situations. Impositions of collection regimes, debt adjustments, and claims for "fiscal discipline" have been expressed since ancient times and under various political systems. From the non-payment of Greek municipalities in the fourth century before the Christian era, to the United States takeover of the Dominican customs in 1904, and the bankruptcy of Detroit in the 21st century, the episodes of waste, muddle, and moneylenders adjusting accounts abound.

In that context, the experience of Greece offers us an analytical scaffolding to evaluate PROMESA and the work of the FOMB. In 2015, after years of negotiations with European institutions and the International Monetary Fund — the infamous Troika — that resulted in loans in exchange for the implementation of cruel austerity policies and the presence of European technocrats in key ministries, the Greeks decided to break forty years of bipartisanship by electing Syriza leaders to parliament.

According to John Galbraith, advisor to the famous former finance minister, Yanis Varoufakis, in his book entitled, *"Welcome to the Poisoned Chalice: The Destruction of Greece and the Future of Europe"*, the negotiations between the Troika and the Syriza government focused on four key issues: how much austerity, what to do with public pensions, how to deal with problems in the labor markets, and how privatizations should proceed. For Syriza leaders, these were issues that raised a red flag when considering concessions.

From the outset, however, the Troika called for more cuts in all areas and more privatizations. In the jargon of the European technocrats, the Greeks had to: (1) generate a primary surplus of 4.5% in order to meet their credit obligations and to be able to borrow again in global markets; (2) cut excessive benefits to public pensioners; (3) reduce the minimum wage to restore competitiveness; (4) and privatize key, but expensive to manage assets, such as ports and other public companies. The underlying logic was simple: following this recipe implied acting with fiscal wisdom to leave behind the good times of champagne and roses. **Any similarity to our case is not a coincidence.**

What the Troika plan did not articulate or reveal explicitly was **the political dimension and ideological leanings of the proposals**. The primary surplus — which implies a positive balance between government revenues versus expenditures, without considering the debt — would ensure payment to creditors, but it would serve to ruin the economy through a contraction in economic activity, thanks to budget cuts and increases in taxes that would be necessary. On the other hand, the amount of the debt would remain intact. Every last drop would be squeezed out of the people, to avoid

a renegotiation. The proposal clearly demonstrated that the interests of the creditors outweighed the socio-economic well-being of 11 million Greeks. In sum, each of the ostensibly sensitive and modest proposals of the Troika was marked with the bleak stain of neoliberal ideology.

WHAT HAS PROMESA DELIVERED? - A TROPICAL TROIKA

Operating under the authoritarian presumption that an independent body would make the “hard” decisions necessary to put the “fiscal house in order”, the FOMB has essentially followed the Troika formula in a colonial context, pushing for big budget cuts, relatively small tax increases, “structural reforms” in key areas such as energy, education, and labor laws, while agreeing to debt restructuring transactions that many analysts consider to be unsustainable.

The colonial context is important here for two reasons. First, as Judge Torruella pointedly argues in an essay published in the [Harvard Law Review Forum](#) in 2018, the United States government has carried out four major governance experiments on the island through various legal mechanisms: the Foraker Law at the beginning of the 20th century, then the Jones Act in 1917, the creation of the Commonwealth in 1952 and the adoption of the PROMESA law in 2016.

Torruella argues that these moves have served to perpetuate an asymmetric colonial relationship that violates the human rights of residents of the island and underlies our economic decline. Thus, the most recent governance experiment developed with PROMESA is based on a logic similar to that applied to (majority Black) Washington D.C. during its fiscal crisis: Puerto Ricans cannot govern themselves, so the federal government must impose itself and appoint a small group of technocrats to put the house in order. In this sense, PROMESA is based on the same colonial mindset adopted by Congress after the Spanish-American War and ratified by the Supreme Court in the *Insular Cases*: Puerto Ricans are an “alien” and “uncivilized” race, unfit to govern themselves in accordance with “Anglo-Saxon principles of governance.”

Second, the imposition of International Monetary Fund (“IMF”)-like austerity policies makes absolutely no sense in a colonial context (setting aside the question of whether it ever does make sense) because, in contrast with other jurisdictions that could complement those policies with either a currency devaluation to boost exports or loans from emergency liquidity facilities negotiated with international multilateral institutions, **Puerto Rico, due to its colonial status, cannot devalue its currency nor does it have access to such emergency liquidity facilities.** Therefore, the FOMB has insisted on imposing on Puerto Rico an IMF-like austerity policy straitjacket without providing any of the scant benefits that usually accompany IMF conditionality programs.

According to Mark Blyth, a professor of International Political Economy at Brown University, “austerity is a form of voluntary deflation in which the economy adjusts through the reduction of wages, prices, and public spending to restore competitiveness, which is (supposedly) best achieved by the state’s budget, debts, and deficits.” Since its inception, **the Board has pursued an austerity agenda in Puerto Rico to no avail.**

This austerity agenda also happens to be quite inconsistent. For example, while it orders downsizing in nearly all government agencies, it has awarded a bevy of contracts to outside consultants and

lobbyists. The Board also argues that federal disaster aid will provide a great stimulus to Puerto Rico's economy, yet the aid is only meant to compensate for what was damaged or destroyed and it continues to be severely delayed. The Board, however, has **consistently ignored warning signs that its austerity-based measures are failing to deliver.**

Furthermore, when PROMESA was being drafted in 2016, there was broad concern about the detrimental effects of government agencies' high turnover rates on their institutional memory. Thus, the FOMB was created under the notion that it would hire staff and develop its technical capacity internally. But the FOMB never followed suit. While on one end of the equation, the FOMB has been gutting government capacity; on the other end, they have projected expenses for legal and financial advisor fees between fiscal years 2018-2026 to exceed \$1.5 billion, well in excess of the Congressional Budget Office cost estimate of \$370 million between fiscal years 2017-2026. As such, **Puerto Rico is poised to become one of the most expensive municipal bankruptcies ever.**

In addition, because a lot of the gaps left by cuts to government personnel are filled by outside consultants, what **we have now is essentially a parallel government with a whole new set of wasteful expenses.** Instead of employing local, in-house personnel as a way to build long-lasting technical expertise in Puerto Rico and nurture local talent, the FOMB has opted to spend on outside consultants, lobbyists and advisors, **further eroding Puerto Rico's ability to ever get rid of the financial control body and to successfully implement a long-term recovery program.** We must remember that Puerto Rico is the only jurisdiction, to the best of our knowledge, that is going through both a fiscal/debt crisis (like Detroit) and a complicated reconstruction after a major natural disaster (like New Orleans after Katrina), **at the same time.**

Finally, **the Title V process to identify and implement high-value "critical projects" appears to have been discarded by the FOMB.** Back in 2016, economic growth under this rubric was one of the three central pillars of PROMESA, in conjunction with debt restructuring and balanced budgets. Yet, it appears the FOMB has substituted the capital investment that was supposed to be generated using the Title V procedures for its "structural reforms". If so, the payoff of that trade remains to be realized.

THE LONG AND WINDING ROAD TO GOODBYE

Section 209 of PROMESA states the following:

An Oversight Board shall terminate upon certification by the Oversight Board that—

- (1) the applicable territorial government has adequate access to short-term and long-term credit markets at reasonable interest rates to meet the borrowing needs of the territorial government; and
- (2) for at least 4 consecutive fiscal years—
 - (A) the territorial government has developed its Budgets in accordance with modified accrual accounting standards; and
 - (B) the expenditures made by the territorial government during each fiscal year did not exceed the revenues of the territorial government during that year, as determined in accordance with modified accrual accounting standards.

The FOMB has broken down these statutory requirements into several operational steps it deems necessary to achieve the legal requirements for its termination, **but five years after the enactment of PROMESA progress toward achieving those objectives has been slow.** The chart below sets forth these operational steps and the progress in their implementation:

EXHIBIT 8: PROGRESS TOWARDS ACHIEVING KEY REQUIREMENTS FOR THE TERMINATION OF THE OVERSIGHT BOARD

Requirement	Detail	● Not started ● Some Progress ● Completed	Current Progress
Complete Sustainable Debt Restructuring	Exchanged/ New Debt	<ul style="list-style-type: none"> Exchanged / new bonds trading well in the public markets 	●
	Muni bond market/ buyers	<ul style="list-style-type: none"> Interest from traditional, institutional municipal bond buyers 	●
	Investors	<ul style="list-style-type: none"> Evidence investors ready to invest in Puerto Rico again 	●
Timely Financial Reporting	Timeline and Action Plan	<ul style="list-style-type: none"> Provide detailed timeline and implementation plan for issuance financial statements 	●
	Financial reporting division	<ul style="list-style-type: none"> Adequately position Hacienda's financial reporting division to oversee completion of all financial reporting, including component units 	●
	Multiyear master audit contract	<ul style="list-style-type: none"> Secure multi-year contracts with auditors and other essential contractors in conformance with best practices 	●
	Implement monthly closing procedures	<ul style="list-style-type: none"> Short-term: Implement / monitor a rigorous process for circular letters, administrative determinations, procedures, and regulations (manual closings) Medium-term: Implement ERP system (quarterly closing procedure) Longer-term: ERP system fully implemented (monthly closing procedures) 	●
	Strict monitoring and publish delays	<ul style="list-style-type: none"> Set up strict monitoring and escalation procedures with consequences and published schedules noting agency and component unit delays 	●
Budgets in accordance with modified accrual accounting standards	Accrual Budgeting	<ul style="list-style-type: none"> Adopt policies and train employees to book budget and book expenses Adjusting entries are communicated and coordinated across agencies Accruals and interagency reconciliations automated 	●
	Revenue/Expenses	<ul style="list-style-type: none"> Incorporate a periodic review of revenues and expenditures against the forecast to respond to changes Detailed resolution certifications and expense system registration 	●
	Payroll Systems	<ul style="list-style-type: none"> Appropriations for termination of payroll accruals Integrate systemwide payroll system into a financial reporting system 	●
	Accounts Payable	<ul style="list-style-type: none"> Maintain government wide monthly accounts payable procedures Automate process and journal entries 	●
	Purchase Orders	<ul style="list-style-type: none"> Book encumbrances for entire year when contract is approved Multi-year contract encumbered at the beginning of subsequent years 	●
	Other Funds	<ul style="list-style-type: none"> Eliminate as many special revenue funds as possible; better maintained through annual General Fund appropriation procedures Track and record all expenses and standardize chart of accounts 	●
Implementing a balanced budget	Payroll spending	<ul style="list-style-type: none"> Connect time and expense to payroll systems 	●
	Closing of books	<ul style="list-style-type: none"> Reconcile bank balances and monies held outside of the TSA Issue consistent systemwide guidance 	●
	Real time spending reports	<ul style="list-style-type: none"> Perform quarterly budget to actual review by senior leadership Issue public reporting and strategic guidance to stay within means 	●
	Visibility into all funds	<ul style="list-style-type: none"> Gain visibility into special revenue funds and federal funds Require reporting and sweep back unused general fund appropriations 	●
	Financial accounting systems	<ul style="list-style-type: none"> Integrate financial systems Ensure reporting is consistent across all agencies 	●

Source: FOMB, Certified Fiscal Plan for the Commonwealth of Puerto Rico, April 23, 2021

With respect to debt restructuring, which is imperative to achieve a sustainable debt burden over the long term, there has been partial progress. According to [the most recent Fiscal Plan for the Commonwealth](#), “the restructuring of more than a third of the outstanding debt has already been completed, totaling \$27 billion, Plan Support Agreements have been announced for \$35 billion in claims and over \$50 billion in pension liabilities.” **Thus, after five years there has been some progress on this front—slow, but progress nonetheless.**

However, in order to regain access to the capital markets at reasonable rates Puerto Rico needs to be up to date on its financial reporting. Back in 2016, there was much gnashing of teeth in Congress and by then candidates Ricardo Rossello and Pedro Pierluisi about Puerto Rico's delays in publishing its audited financial statements. Well, five years later, the FOMB reports that "the Government of Puerto Rico has yet to produce long past due Annual Comprehensive Financial Report ("ACFRs") for FY2018-FY2020." **In plain English, this means that Puerto Rico has yet to publish audited financial statements for the past three fiscal years. On this issue, therefore, progress has been null.**

Prior to PROMESA, Puerto Rico had a long history of overstating revenues and understating, misstating, or not stating all of its expenditures in a given year. The widespread use of accounting gimmicks allowed governments to present budgets that appeared to be balanced, but in fact, generated consistent budget deficits and forced the use of deficit financing.

In order to avoid a return to the old budgetary shenanigans, PROMESA requires Puerto Rico to develop and implement a budget in accordance with "modified accrual accounting standards for four consecutive years". According to the FOMB, this accounting method "is more conservative since it requires recognition of revenues when measurable and promised payments when liabilities are incurred. Consequently, the books and records will present a more realistic picture of spending and help Puerto Rico avoid overspending and present an accurate financial picture to Government managers, taxpayers and other stakeholders."

However, as shown in the table above, **"the Government has unfortunately not yet demonstrated meaningful progress in many of the key requirements for the termination of the Oversight Board."** We believe it is disingenuous, though, for the FOMB to blame the government of Puerto Rico for its lack of progress on this issue, when, at the same time, **it is implementing policies that limit the same government's capacity to satisfy this requirement.** The change from a cash basis to a modified accrual accounting method requires employee training, the acquisition of new information technology, and the implementation of new compliance methods, operations, and procedures. All that, in turn, requires the allocation of new resources.

CONCLUSION

Five years after the enactment of PROMESA we find that it has **failed to accomplish most of the objectives** set forth by its authors. On the positive side, Puerto Rico has benefited from the stay on litigation and the moratorium on debt payments, while PROMESA has also provided some control, transparency, and visibility over government expenditures. Yet, **five years in, about 2/3 of the bonded debt has not been restructured; no critical projects for economic development have been approved; audited financial statements are still three years in arrears; the shift to budgeting on a modified accrual accounting basis is a work in progress; and the government's budget is still out of balance.**

Furthermore, the FOMB's insistence on expenditure cuts relative to, say, the elimination of tax breaks and loopholes, has generated undue anxiety and uncertainty among the population and may have permanently damaged institutions important to Puerto Rico's economic development, such as the University of Puerto Rico. **Thus, as we stated in 2016, the economic, political, and social costs**

associated with the colonial PROMESA experiment have been extremely high and explicit, while any benefits we may have derived from it have been small and most remain quite uncertain and contingent.

In sum, PROMESA has been, in the words of Judge Torruella, “Congress’s fourth try at cutting through the Puerto Rican Gordian knot in its interminable attempt to colonially rule Puerto Rico and its people” **and, in our opinion, it has failed.** Perhaps it is time for the United States “to accept that its relationship with its citizens who reside in Puerto Rico is an egregious violation of their civil rights. The democratic deficits inherent in this relationship cast doubt on its legitimacy, and require that it be frontally attacked and corrected ‘**with all deliberate speed**’”.



The Center for a New Economy (CNE) is Puerto Rico's first and foremost policy think tank, an independent, nonpartisan group that advocates for the development of a new economy for Puerto Rico. For more than 20 years, CNE has championed the cause of a more productive and stable Puerto Rico through its offices in San Juan, Puerto Rico, and Washington, D.C. We seek to inform current policy debates and find solutions to today's most pressing and complex economic development problems by rigorously analyzing hard data and producing robust empirical research. CNE is organized as a 501(c)(3) nonprofit that does not solicit or accept government funding. It relies solely on funding by individuals, private institutions, and philanthropic organizations.