

U.S. House of Representatives
Committee on Natural Resources

Additional Questions from Republican Members
Hearing on Puerto Rico—“Lessons Learned Three Years Later,” May 2, 2019

Answers from
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Questions from Rep. Jody Hice (GA-10) for Alex Pollock, Distinguished Senior Fellow, R Street Institute, Washington, D.C.

1. As you reference in your testimony, \$41 billion in aid has so far been approved for Puerto Rico. And the Oversight Board estimates that this figure will reach \$81 billion while the President has estimated a top end of \$91 billion. My understanding is that is due to potential liabilities over the life of the disaster that would need to be committed via the Disaster Relief and Emergency Assistance Act of 1988 (Stafford Act). For instance, over the life of the disaster recovery, CRS reported in 2014 that, "Congress provided roughly \$120 billion for Hurricane Katrina."

You remark that this acts as a short-term stimulus. Would you agree that in the wake of this crisis that now more than ever it is vital the Puerto Rican government gets its fiscal house in order? Do you have any recommendations?

Answer: I fully agree that is essential to improve the transparency, control and reliability of the Puerto Rican government’s fiscal affairs. As discussed in my written testimony, I believe the financial powers of the Oversight Board should be strengthened if the opportunity arises, in particular by structuring an Office of the Chief Financial Officer which reports to the Board, on the Washington DC model.

Disaster aid of any of the amounts mentioned in the question will be very large relative to the Puerto Rican economy, with its GNP of about \$70 billion. As the Oversight Board has discussed, this inflow of funds will create a short-to-intermediate term stimulus directly to the local economy and indirectly to government revenues, which may reduce the government's motivation for fiscal reform. The challenge is to separate the temporary effects of the stimulus from the weak underlying economic and fiscal trends. Moreover, a high level of effective financial control is required to effectively manage the magnitude of the funds involved with the disaster aid.

Questions from Rep. Rob Bishop for Mr. Alex Pollock, Distinguished Senior Fellow, R Street Institute, Washington, D.C.

1. How important to the financial recovery of the island is fiscal transparency? How would you rate Puerto Rico's government thus far in regard to achieving and demonstrating fiscal transparency? Could an increase in the powers of the Oversight Board help achieve more success in this regard?

Answer: I believe fiscal transparency is critical and necessary (though not sufficient) for financial recovery. You cannot fix the problems until you know what the financial situation really is, until the problems can be accurately measured and reported, and progress likewise accurately tracked.

In my view, significantly more progress is required than has been made. I suggest the financial powers of the Oversight Board should be increased, whenever that may be possible, by giving it authorities more like those of the control boards which were so successful in Washington DC and New York City. In particular, the Office of the Chief Financial Officer should be restructured on the Washington model.

2. Compared to the control boards for Washington DC, New York City and other cities, how would you rate the Oversight Board's success for Puerto Rico? When considering the success that the control boards of DC and New

York had, are there ways you think the Oversight Board for Puerto Rico could be improved?

Answer: We have the advantage of looking back in time on the Washington DC and New York City insolvencies, so we know how they turned around. History shows that the control boards of Washington and New York were very successful. This is generally agreed upon. Of course, they both entailed plenty of disputes, complaints and protests along the way. I believe this is inevitable in such situations-- in Puerto Rico as in other financial failures of local governments.

The Oversight Board for Puerto Rico is still in in the midst of its work with important uncertainties ahead. It has made progress, but it is clear that the Washington and New York boards had more power as *financial control* boards. As part of the PROMESA political compromise, this was not the design of the Oversight Board. In my opinion, if the occasion arises to amend the legislation, the Oversight Board should be moved more in the direction of the successful Washington and New York models. In particular, reporting to it should be an Office of the Chief Financial Officer, which is independent of the Governor.

3. How important is it for Puerto Rico to fix their unfunded pension system? Do you think the Puerto Rican government will be able to achieve success in fixing their broken pension system alone or do you see this as an area where the local government could work together with the Oversight Board to achieve success?

Answer: As this question suggests, the Puerto Rican government's employee pension plans are not only "underfunded," as so many other plans are; they are basically *unfunded*. This is, in my view, a political and moral default by the government of Puerto Rico. Puerto Rico's government pension plans have an aggregate deficit of an estimated \$60 billion, making them a huge unsecured creditor of the insolvent government, representing about 45% of the total pre-reorganization claims. They inevitably compete for available funds with bondholders in the debt reorganization.

Nothing is clearer, both in general and in this particular case, than that pension fund deficits are a problem very difficult for local governments to deal with. I believe it is essential for the Puerto Rican government to work with the Oversight Board to address this huge issue in its insolvency.

4. How important would you say achieving fiscal reforms within the Government of Puerto Rico are towards helping the island recover? In your view, can the local government accomplish these necessary reforms on their own or could the Oversight Board be instrumental in helping the island achieve this goal?

Answer: All experience of insolvent local governments shows that substantial reforms are very difficult for local politicians to achieve on their own. Hence the roles of bankruptcy judges in Chapter 9, of control boards in many municipalities, of the emergency manager in the City of Detroit, and of the Oversight Board in Puerto Rico. The Oversight Board, in this as in parallel other cases, can certainly be instrumental in helping the government of Puerto Rico achieve the needed reforms.

5. How effective is debt restructuring IF the island's government does not also achieve fiscal reforms?

Answer: I believe debt restructuring and fiscal reforms must go together. That is the fundamental logic of PROMESA, which seems to me entirely correct.