Mr. Antonio Weiss
Counselor to the Secretary
United States Department of the Treasury
House Committee on Natural Resources
"The U.S. Department of the Treasury's Analysis of the Situation in Puerto Rico"
February 25, 2016

Chairman Bishop, Ranking Member Grijalva, and Members of the Committee:

Thank you for inviting Treasury to testify today. We commend this Committee for its leadership in response to the March timetable for action set by Speaker Ryan. We look forward to working together on a responsible solution to this crisis. There is a growing recognition that we need to act now, and we are encouraged by the positive, bipartisan discussions taking place.

This is a Puerto Rican crisis, which means it is an American crisis.

Puerto Rico is home to 3.5 million Americans whose economic well-being and safety are at stake. In the many months we have been traveling to Puerto Rico and meeting with Government officials, business leaders and workers, there is a growing sense of fear and a more urgent call to action.

Action is needed now

Puerto Rico is already in distress. What started as a recession has turned into a fiscal and liquidity crisis that shows signs of becoming a humanitarian one as well.

The Commonwealth has begun defaulting on its debt. Puerto Rico no longer has access to the credit markets, even the costliest ones. Health, education, and public safety services have been curtailed because the government cannot pay all of its bills. Hospitals are closing floors and businesses are leaving the Island.

The government remains open only because the Governor authorized more than $1 billion in onerous and unsustainable emergency liquidity actions. Tax refunds have been withheld from citizens. Pension assets, already severely depleted, are being sold to fund government operations. Money dedicated to one group of creditors is being taken to pay other creditors. The inevitable defaults and lawsuits have already begun.

Without action, this crisis will escalate. The Government Development Bank, which is at the heart of Puerto Rico's financial system, is dangerously undercapitalized. Debt payments in May and July, including nearly $800 million of constitutionally prioritized debt, are unlikely to be made. Mounting litigation will flood the courts. And the central government itself could be forced to shut down entirely.

There is no room for error in this economy. 57 percent of children live in poverty. Unemployment is 12.2 percent, more than twice the national average. At $19,000, median annual household income in Puerto Rico is approximately one-third the U.S. median.

This crisis has sparked the largest wave of outmigration from Puerto Rico since the 1950's. The population has dropped by nearly 10 percent in the past decade - and 2.5 percent last year alone - as young, working age Puerto Ricans leave the Island with their children in search of opportunity. Since World War II, no U.S. state has posted such a large 10-year drop in population.

Puerto Ricans are leaving from across the socioeconomic spectrum. Their departure leaves behind an aging population and further erodes Puerto Rico's long-term growth prospects. Seniors already represent more than 23 percent of the population, one of the highest ratios in the country, and the number of children under five years of age has decreased 37 percent since 2000.[1] Only an end to the crisis and a return to growth can stop this vicious cycle.

The debt is not sustainable

Under any realistic scenario, Puerto Rico's $70 billion of debt is not sustainable. Markets know this. Puerto Rico bonds trade between 10 and 70 cents on the dollar. Debt service consumes one-third of all central government revenues, more than five times the average state. A balanced budget would require a primary surplus of five percent of Gross National Product (GNP), significantly above the level that any distressed entity can reasonably sustain.

In addition, the Commonwealth has a $46 billion pension liability funded by only $2 billion in net assets, the lowest level of any major pension system in the country. More than 330,000 current and future beneficiaries rely on the public pension system as their primary source of retirement security. Average payments in the largest system are less than $1,200 per month. A failure to protect those payments would irreparably harm retirees and add greater stress to Puerto Rico's economy.

A comprehensive response is needed

The depth and complexity of Puerto Rico's financial challenges led the Administration to release a comprehensive legislative roadmap last October to stem the crisis and restore growth. The plan includes a debt restructuring authority paired with fiscal oversight, healthcare transformation, and tax incentives to reward work.[2] Our proposals have drawn strong support from business, religious and labor leaders as well as conservative economists and the Wall Street Journal.

While we believe all elements of our plan are essential to Puerto Rico's recovery and long-term growth, the most time-sensitive components are debt restructuring and fiscal oversight.

[1] Puerto Rico Fiscal and Economic Growth Plan, released September 9, 2015. Page 9. Available at: http://www.gdb-pur.com/documents/PuertoRicoFiscalandEconomicGrowthPlan9.9.15.pdf

[2] "Addressing Puerto Rico's Economic and Fiscal Crisis and Creating a Path to Recovery: Roadmap for Congressional Action." Dated October 21, 2015. Available at: https://www.whitehouse.gov/sites/default/files/roadmap_for_congressional_action___puerto_rico_final.pdf

Puerto Rico needs tools to restructure all of its financial liabilities

Puerto Rico has already defaulted on its debt and is facing a likely series of future defaults of unprecedented magnitude in the municipal bond market. The debt is unusually complex with eighteen different issuers and twenty creditor committees with competing claims. There is currently no way to forestall litigation or conclude a voluntary agreement supported by a majority of creditors.

We propose a restructuring authority, pursuant to the territorial clause of the U.S. Constitution, that would apply to all of the Commonwealth's liabilities. This would give Puerto Rico the tools it needs to reach a resolution with creditors and adjust its debts to a sustainable level. Importantly, this authority would expressly not apply to states, who have an entirely different relationship with the federal government under the 10^{th} Amendment. Accessing this territorial restructuring authority would be conditioned on acceptance of strong, independent federal oversight.

A territorial restructuring framework would consist of: (1) a temporary stay on litigation to protect the provision of vital public services and allow time for voluntary negotiations; (2) a voting mechanism to prevent a few hold-outs from blocking a reasonable compromise; and (3) if negotiations fail, a court-supervised structure to assure an orderly resolution.

Without a comprehensive restructuring framework, Puerto Rico will continue to default on its debt, and litigation will intensify. It will be contentious and protracted – both among competing creditor classes and against the Commonwealth – while the economy worsens and Puerto Rico's capacity to repay creditors collapses further. As the cascading defaults and litigation unfold, there is real risk of another lost decade, this one more damaging than the last.

In our view, all creditors must be at the table to reach a comprehensive and sustainable solution. But we are not advocating a "one size fits all" approach; restructuring legislation can be designed to consider existing priorities and claims. We would also favor allowing for an initial period of voluntary negotiations with creditors, facilitated by a stay on litigation.

Any viable solution will require restructuring Puerto Rico's liabilities to a level its economy can safely and reasonably afford.

Effective oversight is also required to strengthen Puerto Rico's fiscal governance

We propose strong, independent federal oversight to address the Commonwealth's longstanding history of fiscal mismanagement and inadequate financial disclosure. Accounting and payroll systems are antiquated and insufficiently integrated. Disclosure remains opaque and financial reporting deadlines are repeatedly missed.

Strong, independent oversight is needed. But, to be effective, oversight should be structured in a way that respects Puerto Rico's self-governance while assuring implementation of required reforms.

We believe federal legislation can be crafted to achieve this balance.

Pairing restructuring and oversight is a tried and true combination to resolve debt crises, both domestically and abroad. However, these two proposals must be enacted together. One without the other will not work. Oversight and restructuring, appropriately adapted to Puerto Rico, would put the Commonwealth on a path to fiscal recovery and renewed economic growth.

Importantly, these two provisions would cost U.S. taxpayers nothing.

Congress must also fix Puerto Rico's healthcare inadequacies and reward work

The Medicaid programs in Puerto Rico and the other the U.S. territories are fundamentally different from the Medicaid program in the States. Medicaid funding in the territories is capped; beneficiaries are offered fewer benefits; and the federal government contributes less on a per-capita basis than it does to the rest of the nation.

The Commonwealth provides health insurance coverage to approximately 1.5 million Medicaid beneficiaries, representing nearly half of Puerto Rico's total population.

When one-time Affordable Care Act funds are exhausted in Puerto Rico, as early as June 2017, up to 600,000 Americans living in Puerto Rico could lose their healthcare coverage. To avoid this calamity, Congress needs to reform Puerto Rico's Medicaid program to raise the standard of care and prevent Medicaid's unstable financing from exacerbating Puerto Rico's fiscal crisis.

These constraints on Puerto Rico's Medicaid program also limit Puerto Rico's capacity to respond to emergent healthcare threats like the Zika virus. That is why the Department of Health and Human Services recently requested a supplemental appropriation from Congress to enact a temporary one-year increase in the territories' federal Medicaid share.

In addition to fixing Puerto Rico's inadequate healthcare treatment, Congress must also enact some of the most proven, bipartisan tools for stimulating economic growth and rewarding work. A large body of economic research, including Treasury's own analysis, has found the Earned Income Tax Credit (EITC) is one of the strongest, most powerful policy tools to meet those objectives. As a result, Congress should grant Puerto Rico access to an EITC.

Questions from the Chairman

I would now like to respond to four thoughtful questions Chairman Bishop and his staff have raised as they work to design a responsible legislative solution.

For those who support authorizing restructuring authority for Puerto Rico, will the Commonwealth ever be able to access the markets again?

Yes. An orderly restructuring framework paired with effective oversight would help remove legal uncertainties, improve fiscal governance and return Puerto Rico to the kind of economic growth that attracts market capital.

Numerous U.S. cities have regained market access after fiscal restructuring and oversight, including New York City, Washington, D.C., Cleveland and Philadelphia. Notable companies such as General Motors, Delta, and Texaco, have also undergone restructuring and emerged stronger and better than before. Debt investors understand restructuring can lead to better outcomes for all parties. Puerto Rico should expect to achieve the same result.

Puerto Rico has not had access to the municipal market for more than two years. Municipal bond investors tell us that an orderly restructuring under clear federal guidelines is also the surest way to restore Puerto Rico's market access. And, it is the best outcome for municipal markets – far preferable to a protracted, disorderly series of defaults of unprecedented magnitude and complexity. A post-restructured Puerto Rico that can pay its debts, invest in infrastructure and support economic growth should attract traditional investors to consider new investment.

For those who oppose authorizing restructuring authority, will recalcitrant creditor holdouts ever seriously negotiate without restructuring authority?

No. Without access to territorial restructuring authority that brings all creditors to the table, it is overwhelmingly likely that holdouts will prevent voluntary negotiations from reaching a successful conclusion.

In addition, proposals that only provide access to Chapter 9 of the Bankruptcy Code will not resolve this crisis. Less than one-third of Puerto Rico's debt would be clearly eligible for adjustment under Chapter 9. The remaining debt is either ineligible or, like many other recent Chapter 9 cases, would likely go through protracted litigation regarding eligibility for restructuring. The litigation could take many years to resolve, pushing the Commonwealth further into a downward economic spiral. Additionally, because Chapter 9 is limited to certain public corporations and municipalities, it leaves Puerto Rico's central government liabilities, including general obligation bonds and employee pensions, outside the reach of restructuring.

Chapter 9 was carefully designed for states, in conformance with the 10^{th} Amendment of the U.S. Constitution, to enable municipalities to adjust their liabilities. Puerto Rico is neither a state nor a municipality. What we need here is a tailored solution permitted under the U.S. Constitution to address the complex, inter-connected liability structure of an entire territory.

For those who support establishing just a federal advisory board without fiscal enforcement powers, will Puerto Rico ever make the necessary reforms to improve their fiscal governance?

An advisory board is not adequate to do the job. But, there are various ways to create a strong, independent oversight board while simultaneously preserving Puerto Rico's self-governance.

First, Puerto Rico's access to restructuring authorities, including an automatic stay on litigation, should be strictly conditioned on the Commonwealth's acceptance of federal oversight.

Second, the board should provide independent revenue forecasts and recommend improvements to budgetary and fiscal management practices. This includes regular, multi-year fiscal plans and budgets that are balanced pursuant to generally accepted accounting principles. The board should also have adequate enforcement tools to ensure necessary adjustments are made if the government falls short of its targets.

Third, while the oversight board should not be responsible for direct negotiations with creditors, it should support the Commonwealth's restructuring efforts. For example, the board should certify that any voluntary restructuring agreements between the Commonwealth and its creditors meet certain criteria. In addition, authorization from the board should be required before Puerto Rico gets access to territorial restructuring authorities.

Fourth, the oversight board should be based in San Juan and have a majority representation of Puerto Ricans, but retain the independence that would result from appointments pursuant to federal law. Members must have relevant expertise and no conflicts of interest. The board should be granted flexibility to hire professional staff with the skills and experience to make this effort successful.

Lastly, an oversight board should remain in place until the necessary fiscal reforms are carried out, budgets are balanced, and market access returns.

For those who prefer a dominant federal control board, how will you get the needed buy-in to make lasting reforms that will ensure Puerto Rico does not find itself in this position again?

Respecting Puerto Rico's heritage and self-governance is critical for any oversight function to be accepted and effective. If that core tenant is not observed, it will be impossible to adopt and sustain sufficient reforms over the long-term. At the same time, the oversight board should have sufficient powers to assure stakeholders that necessary reforms will be implemented.

The Administration's response to the crisis

I will conclude by sharing more information on the Administration's response to the crisis.

Secretary Lew created a dedicated team within Treasury to evaluate Puerto Rico's fiscal outlook and share our expertise with the officials that oversee the Commonwealth's economic policies.

Since its formation, the team has visited Puerto Rico regularly to review Puerto Rico's financial data, offer our perspectives on how other entities have managed through similar crises, and discuss options Puerto Rico could pursue to restore economic growth. We interact regularly with the Governor, members of Puerto Rico's legislature, business leaders and workers as well as creditors. We also speak every day with the officials managing Puerto Rico's fiscal response.

In December, Congress also provided Treasury with the authority to offer technical assistance to Puerto Rico in specialized areas such as revenue collections and budgeting. Since then, we have worked with the Commonwealth to assess its capacity to receive technical assistance, identified high priority needs, and already deployed the first set of technical advisors.

Technical assistance, while necessary, is not a solution for Puerto Rico's fiscal challenges. These tools will benefit the financial structure of the Island in the long-term, but Puerto Rico needs an immediate solution to address its unstable financial outlook today.

The White House National Economic Council and Treasury are also leading the Administration-wide effort to address the immediate crisis and take steps to put in place a foundation for economic growth and recovery. This long-standing effort includes the support of the White House Task Force on Puerto Rico, the Office of Management and Budget, the Department of Health and Human Services, the Department of Justice, and a number of other federal agencies that interact with Puerto Rico on critical needs. Through this effort, the Administration has already facilitated significant steps to strengthen the Island's healthcare delivery, improve infrastructure, and attract new job-creating investments.

Secretary Lew also traveled to Puerto Rico last month as part of the Administration's continued engagement with Puerto Rico, meeting with elected officials, labor and community leaders, and the business community on the Island. The trip was the first of five scheduled visits by Cabinet Secretaries to Puerto Rico, with more to come.

And, today, Secretary Foxx is in San Juan to sign an agreement with Puerto Rico's transportation authority. The agreement will provide Puerto Rico with technical assistance to accelerate $400 million of available infrastructure funds. During their visits, Cabinet Secretaries will work with Puerto Rico on the reforms needed to support growth, including transportation infrastructure investments, strengthening primary and secondary education, expanding agricultural production, and addressing the impacts of drought.

While the Administration will continue to implement actions that strengthen Puerto Rico, Congressional action is needed for Puerto Rico to fully address its crisis.

Conclusion

Puerto Rico lacks the tools required to resolve this crisis on its own. The question is not whether the Commonwealth will restructure its debts, but when, and at what cost to the 3.5 million Americans on the Island.

The Administration will leave no stone unturned and bring all of our capabilities to bear in support of our fellow citizens in Puerto Rico. But only Congress can provide the comprehensive solution Puerto Rico requires.

There is a justifiable expectation the Administration and Congress will work together and that Congress will ultimately act as it has always done when there is a crisis that affects Americans. Our fellow citizens in Puerto Rico expect Congress to do what is necessary to stem the crisis, to protect the people of Puerto Rico, and to allow the economy to return to a path towards growth.

We look forward to working with this Committee on legislation that will protect our fellow citizens in Puerto Rico.