

Addressing Puerto Rico's Economic and Fiscal Crisis and Creating a Path to Recovery: Roadmap for Congressional Action

The Commonwealth of Puerto Rico is in the midst of an economic and fiscal crisis, and without Congressional action the situation could become a humanitarian crisis. Puerto Rico's government has a responsibility to the 3.5 million residents. The Commonwealth must take additional steps to strengthen its finances, including tough reforms, stronger fiscal governance, and credible budget controls. But Puerto Rico cannot reverse a decade of economic decline on its own. The United States Government also has a responsibility to those same 3.5 million American citizens, and without Congressional action their well-being is at stake. Today's [fact sheet](#) documents this crisis in detail.

The 3.5 million Americans living in Puerto Rico have endured a decade of economic stagnation. Since 2006, Puerto Rico's economy has shrunk by more than 10 percent and shed more than 250,000 jobs. More than 45 percent of the Commonwealth's residents live in poverty – the highest poverty rate of any state or territory – and its 11.6 percent unemployment rate is more than twice the national level. These challenges have sparked the largest wave of outmigration since the 1950's, and the pace continues to accelerate. More than 300,000 people have left Puerto Rico in the past decade; a record 84,000 people left in 2014.

Puerto Rico's government is out of cash and is running out of options. The Commonwealth ran out of the cash to fund normal operations earlier this year. Government services and debt payments have only continued because Puerto Rico is deploying onerous and unsustainable emergency liquidity actions. Despite these actions, the Commonwealth projects it will completely run out of liquidity before year-end. Once that happens, Puerto Rico will face the unenviable and difficult choice between repaying its debts and maintaining vital public services. The latest reliable estimates reveal that, without further steps, Puerto Rico will not have resources to pay for both.

Puerto Rico must further strengthen its fiscal discipline. Additional fiscal adjustment is needed, together with stronger governance. While the Commonwealth has already taken significant action, its efforts have been stymied by Puerto Rico's long history of insufficient fiscal oversight and failure to achieve revenue and expense targets. Puerto Rico has proposed important reforms, such as increasing tax collection, as well as significant additional revenue and expense measures. To be successful, Puerto Rico will need to implement sufficient fiscal controls and oversight to make these measures credible. Puerto Rico must ensure it does its part by adopting tighter fiscal discipline and transparency.

However, Puerto Rico cannot solve this crisis alone. Austerity alone is not a path to recovery. While Puerto Rico needs to do more, there are limits to the scale and pace of additional fiscal adjustment that can be achieved. Puerto Rico projects it will face a \$28 billion fiscal shortfall over the next five years and has identified additional actions it can

take, through revenue and expense proposals, to partly close that gap. However, full implementation of Puerto Rico's proposed actions, including a return to economic growth, only reduces the five-year gap to \$14 billion. The remaining shortfall must be filled, in no small part, through the restructuring of Puerto Rico's large and complex debt burden. The federal government must also do its part to address this crisis and help restart growth, which will require Congressional action, as detailed below.

The Administration is committed to continuing to work with Puerto Rico, but Congress must act to resolve this crisis. The Administration has been working with officials from Puerto Rico to stimulate investment and support economic growth, ensure a steady flow of previously obligated federal funds to the Island, and provide our technical and financial expertise wherever appropriate. We have dedicated a team to closely monitor the crisis and provide financial expertise. But existing administrative authorities are not enough. There is no set of administrative authorities that can fully address and resolve this crisis. The administration has been clear that no one is contemplating a federal bailout for Puerto Rico, and the legislative proposals below are not a bailout. They are the reforms that Puerto Rico needs to effectively manage through its crisis. Only Congress can provide the critical tools Puerto Rico needs to restructure its debt, enhance its fiscal governance, fix its healthcare system, and help jumpstart its economy.

Without action by Congress and further fiscal discipline by Puerto Rico, the crisis will escalate. All stakeholders, including bondholders, need to be part of the solution. Without a comprehensive solution, which requires Congressional action, Puerto Rico and its creditors risk a long, difficult, and disorderly crisis. In the interim, delaying action will result in continued uncertainty, which will drive additional economic contraction, outmigration, and suffering. This will inevitably lead Puerto Rico's government to an impossible choice between fulfilling its financial obligations and providing essential services to the 3.5 million Americans living in Puerto Rico.

Roadmap for Congressional Action:
Four Immediate Steps to Address the Crisis in Puerto Rico

Only Congress has the power to provide Puerto Rico with the tools needed to address this economic and fiscal crisis in a comprehensive manner while creating the foundation for recovery. The Administration is presenting these concepts as principles and stands ready to work with Congress on legislation. There are four key elements to the Administration's plan:

- 1. Provide tools for Puerto Rico to comprehensively address its financial liabilities.** Congress should provide Puerto Rico with the necessary tools to restructure its financial liabilities in a fair and orderly manner under the supervision of a federal bankruptcy court. Pending legislation to extend Chapter 9 protection to Puerto Rico's municipalities as already provided to municipalities across the country is an important first step. But with the escalating crisis, bankruptcy protection is now needed for the Commonwealth as well. Congress should authorize a broader legal framework that allows for a comprehensive restructuring of Puerto Rico's debts. This framework should be reserved exclusively for U.S. territories. As under current law, states would remain ineligible to file for bankruptcy under this or any other bankruptcy regime.
- 2. Enact strong fiscal oversight and help strengthen Puerto Rico's fiscal governance.** Puerto Rico must reform its fiscal governance in a credible and transparent way while implementing the fiscal adjustments and reforms needed to achieve financial stability. To strengthen reform, Congress should provide independent fiscal oversight while respecting Puerto Rico's autonomy. Such oversight would provide sufficient safeguards to ensure Puerto Rico adheres to its plan and fully implements proposed reforms. Congress should also support Puerto Rico's government in making the critical investments needed to bring the Commonwealth's accounting and disclosure practices into the 21st century.
- 3. Provide a long-term solution to Puerto Rico's historically inadequate Medicaid treatment.** Under federal law, Puerto Rico's 3.5 million American citizens are left without access to routine healthcare treatments considered standard in the rest of the nation. There are more than 1.6 million Medicaid enrollees in Puerto Rico's healthcare system, of which 600,000 people living in Puerto Rico could lose their healthcare coverage when one-time Medicaid funds run out. Congress should reform Puerto Rico's Medicaid program to increase access to coverage, raise the standard of care and prevent Medicaid's unstable financing from worsening Puerto Rico's fiscal crisis.

4. Reward work and support growth. The decade-long recession has taken its toll on Puerto Rico's finances, its economy, and its people. To reward work and break this vicious cycle, Congress should enact proven, bipartisan tools for stimulating growth and rewarding work to people living in Puerto Rico. This should include providing access to an Earned Income Tax Credit (EITC), which is already available to Americans living in the fifty states and the District of Columbia. An EITC would create incentives for work and increase participation in the formal economy. An expanded Child Tax Credit (CTC) could supplement this effort.

Four Immediate Steps to Address the Crisis in Puerto Rico

1) Provide tools for Puerto Rico to comprehensively address its financial liabilities

Only Congress can grant access to a federal restructuring mechanism. Puerto Rico does not have access to the federal bankruptcy courts to restructure its financial obligations. Puerto Rico's officials tried to address this shortfall on their own by passing a law to provide a bankruptcy-like process, but a federal appeals court held that federal law preempts the local legislation. Further, the court held that only Congress may grant Puerto Rico access to bankruptcy protection.

Shared sacrifice is needed. All stakeholders have an interest in Puerto Rico's economic recovery. Puerto Rico must take additional steps to close its fiscal gap, building on the measures it has already taken. However, austerity alone is not a path to recovery. While Puerto Rico needs to do more, there are limits to the scale and pace of additional fiscal adjustment that can be achieved. Against this backdrop, any additional fiscal adjustment must be measured against its potentially adverse effects on Puerto Rico's economy and people.

Puerto Rico's liabilities are unsustainable and need to be restructured. As currently structured, Puerto Rico's debt load is unsustainable. Tax-supported debt service consumes approximately one-third of annual revenues and total liabilities exceed 160 percent of GNP – a greater burden than likely can be supported even if economic growth resumes. Long-term, Puerto Rico projects it will face a \$28 billion fiscal shortfall over the next five years and has identified additional actions it can take, through revenue and expense proposals, to partly close that gap. However, full implementation of Puerto Rico's proposed actions, coupled with economic growth, only reduces the five-year gap to \$14 billion. The remaining shortfall must be filled, in no small part, through the restructuring of Puerto Rico's large and complex debt burden.

Puerto Rico's pension systems are at serious risk. Monthly pension payments are the only source of steady income for many of the pension systems' 163,000 retirees. An additional 167,000 workers, who represent nearly 20 percent of Puerto Rico's workforce, are also counting on the pension systems for retirement income. For much of the past decade, Puerto Rico has failed to pay its annual required contributions. As a result, system administrators are currently being forced to sell pension assets to pay current benefits. Once those assets are depleted – likely by 2019 – all future pension benefits will need to be paid directly from the Commonwealth's General Fund. Given Puerto Rico's fiscal constraints, it is unclear how the Commonwealth will find the resources to deliver promised pension benefits, make full payment on its debt, and operate essential public services. Any restructuring of Puerto Rico's financial liabilities should account for the promises the Commonwealth has made to its public servants.

Bankruptcy provides a fair process and a comprehensive solution. The Commonwealth and its creditors need a fair and orderly mechanism to restructure Puerto Rico's financial liabilities. Bankruptcy protection is not a federal bailout. Allowing Puerto Rico to resolve its liabilities under the supervision of a bankruptcy court involves no federal financial assistance. Puerto Rico's debt stock is highly complex. More than 20 creditor committees have already formed around Puerto Rico's 18 different debt issuers, each with its own competing interests. This will make it very difficult for Puerto Rico to negotiate a voluntary restructuring on a timely basis. A court-supervised process would help ensure fair treatment to all parties. The alternative – an untested and potentially disorderly process with numerous creditor lawsuits and years of litigation – would depress the local economy, increase costs, and make long-term recovery harder to achieve. Absent an orderly process, all stakeholders stand to lose in the face of continued deterioration of Puerto Rico's economic and financial conditions and ongoing uncertainty.

Congress should take the following actions to provide a fair and orderly restructuring mechanism built on the tested principles of the federal bankruptcy code:

- Congress should move swiftly to pass pending legislation that provides Chapter 9 protection to municipalities of the Commonwealth of Puerto Rico in the same manner it is currently provided to municipalities in the fifty states. This legislation would cover approximately one-third of Puerto Rico's debt.
- Congress should also authorize a broader legal framework that goes beyond the scope of Chapter 9 to allow for a comprehensive restructuring of Puerto Rico's liabilities.
 - The restructuring regime should be reserved exclusively for U.S. territories. As under current law, states would remain ineligible to file for bankruptcy under this or any other bankruptcy regime.
 - The restructuring regime should provide the basic protections of bankruptcy: a stay on creditor collection actions, priority for new private short-term cash flow financing, and voting by creditor classes on any proposed restructuring. Such an approach would, among other things, provide breathing space for consensual negotiations and ensure the uninterrupted provision of essential public services.
 - The restructuring regime should fairly balance the interests of Puerto Rico and all its creditors.

2) Implement strong fiscal governance and oversight

Puerto Rico's efforts have been hampered by a long-standing lack of fiscal oversight and transparency. Historically, Puerto Rico's budgets relied on unrealistic revenue estimates, and, as a result, annual budgets masked recurring structural deficits. Moreover, proposed revenue and expense measures have fallen short because Puerto Rico lacks important fiscal controls to ensure discipline. Financial disclosure is opaque and deadlines have repeatedly been missed, impairing the ability to track progress against proposed reforms.

Independent and credible fiscal oversight is needed. Congress should enact independent and credible fiscal oversight only as part of a comprehensive legislative package that fully equips Puerto Rico with the tools it needs. The oversight should provide sufficient safeguards to ensure Puerto Rico adheres to its recovery plan and fully implements proposed reforms. This would help restore confidence among all stakeholders. Access to the broader restructuring regime should be conditioned on this oversight. The Administration is ready to work with Congress on the details of how to develop the powers of this oversight body and its proposed membership, according to the following principles:

- The oversight body should have broad representation from Puerto Rico's stakeholders. Care must be taken to structure the fiscal oversight in a way that respects Puerto Rico's autonomy.
- The oversight body's powers should include the authority to ensure that annual budgets and expenditures are in conformance with Puerto Rico's multi-year fiscal plan. There are also some authorities, like the ability to impose new taxes and raise fees, which should remain solely within the control of democratically-elected officials.

Puerto Rico needs to improve its fiscal accounting. While the historical inadequacies of Puerto Rico's governance systems are undeniable, there can be no doubt about the realities of Puerto Rico's current fiscal crisis. The Commonwealth recently commissioned an independent and exhaustive forensic accounting of its financial books that for the first time revealed the true extent of Puerto Rico's fiscal crisis. This rigorous and thorough accounting is available publicly on the Government Development Bank's website for all to see. But, more steps must be taken to improve fiscal transparency and management.

- Congress should provide funding and authorization for technical assistance to help Puerto Rico make the critical investments needed to bring its accounting and disclosure practices into the 21st century.

- This includes taking action to fund information technology upgrades, improve economic forecasting capabilities and provide federal technical assistance around budgeting, cash management and spending controls. Agencies in Puerto Rico use different financial systems that are incompatible with one another, making it difficult to provide consistent, timely financial reporting and visibility into expenses.
- The funding involved would be small, but the benefits would be great.

3) Provide a long-term solution to Puerto Rico's historically inadequate Medicaid treatment

Puerto Rico's residents deserve a higher standard of care. Given the current treatment of Puerto Rico and the other territories under federal law, the 3.5 million Americans in Puerto Rico are left without access to healthcare treatments considered standard in the rest of the nation. There are currently more than 1.6 million Medicaid enrollees, representing nearly one-half of Puerto Rico's population.

Insufficient and unstable funding for Medicaid has contributed to Puerto Rico's fiscal challenges and endangered access to coverage. Despite the significant one-time funding increase provided in the Affordable Care Act, as many as 600,000 Americans living in Puerto Rico could lose their healthcare coverage when those funds run out. Moreover, Puerto Rico's Medicaid program is fundamentally different from the Medicaid program that serves Americans in the 50 states and the District of Columbia. Medicaid funding in Puerto Rico is capped; U.S. citizens in Puerto Rico are offered fewer benefits; and the federal government contributes less on a per-capita basis in Puerto Rico than in the rest of the nation.

Congress can take action today to reform Puerto Rico's Medicaid program to raise the standard of care in Puerto Rico and prevent Medicaid's unstable financing from worsening Puerto Rico's fiscal crisis. The Administration stands ready to work with Congress on reform that advances the following principles:

- Provide access to Medicaid and key health care services that better aligns with what their fellow Americans receive on the mainland, including by:
 - Protecting Medicaid coverage for needy individuals in Puerto Rico during these difficult times, and avoiding a drop in coverage when one-time funds from the Affordable Care Act expire.
 - Improving the quality of Medicaid coverage in the Commonwealth by offering access to additional core services Medicaid beneficiaries would receive if they were living on the mainland.

- In a fiscally responsible manner, move toward a permanent and stable funding partnership that would alleviate some of the fiscal challenges and risks created by the current insufficient and unstable federal funding.
- Ensure an adequate transition period needed for Puerto Rico to upgrade its healthcare system required to offer new benefits and strengthen its internal accountability, financial management, and program integrity controls to prevent fraud, waste and abuse.
- Remove the cap on Puerto Rico’s Medicaid program and increase the federal support Puerto Rico receives through the federal Medicaid match, after a sufficient transition period.

4) Reward work and support growth

Any credible plan for resolving Puerto Rico’s fiscal crisis must recognize the importance of restoring economic growth. The decade-long recession has taken its toll on Puerto Rico’s finances, its economy, and its people. To break this vicious cycle and establish a solid foundation for renewed growth, Congress should extend some of the most proven, bipartisan tools for stimulating growth and rewarding work to the citizens of Puerto Rico.

The Earned Income Tax Credit (EITC) is one of the strongest policy tools for rewarding work and supporting economic growth. At forty percent, Puerto Rico has the lowest labor market participation in the United States and the territories – participation rates are about two-thirds the U.S. average. Low participation in the formal economy stunts economic growth and undermines Puerto Rico’s economic reform efforts. A large body of economic research has found that the EITC in the fifty states and the District of Columbia has increased work. Studies have documented the impact of the mainland EITC enacted in the 1980s and 1990s, which induced more than half a million people to enter the labor force. The existence of an EITC should also increase employment in the official sector relative to the informal economy by providing higher incomes to workers who file taxes.

The EITC would strengthen formal participation in Puerto Rico’s economy. This added incentive for formal participation in Puerto Rico’s economy should increase tax compliance and tax revenues and likely improve the fiscal position in Puerto Rico. As a result, Congress should provide Puerto Rico access to an earned income tax credit (EITC), which is already available to Americans living in the fifty states and the District of Columbia. An EITC would encourage work in the formal economy and boost Puerto Rico’s low level of labor market participation. Puerto Rico does not have an EITC today.

The EITC is a time-tested, bipartisan job creation tool that has garnered broad support. The EITC has historically long garnered broad bipartisan support in Congress. President Reagan proposed a major EITC expansion that was included in his 1986 Tax Reform Act, which he argued was “the best antipoverty, the best pro-family, the best job creation measure to come out of Congress.”

Congress should also consider other proven measures, in addition to an EITC, that reward work and support growth, such as the Child Tax Credit. Puerto Rico should support federal action by taking its own steps to enhance incentives for labor force participation, encourage job creation and make it easier to do business in Puerto Rico.