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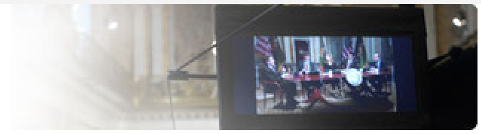

Remarks by Counselor Antonio Weiss at the Peter G. Peterson Institute for International Economics

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As prepared for delivery

WASHINGTON - I am here to speak with you today about a top priority for the Obama Administration: ending Puerto Rico's financial crisis and setting the Commonwealth on a path toward economic growth.

There should be no doubt that Puerto Rico is already in distress. The Commonwealth has lost access to credit markets, even the costliest ones, and has started to default on its debt. Tax refunds and vendor payments are being withheld. With each passing month, revenue estimates are revised downwards. More than a dozen hospitals have closed floors and curtailed services because the central government and its health care agencies cannot pay their bills.

Businesses are leaving the Island. The second largest shipping company serving Puerto Rico recently pulled out because of continuing losses and an uncertain return to profitability. In the last year, General Electric, Pfizer, Merck, Novartis, Micron, and Procter & Gamble all reduced or terminated operations in Puerto Rico. Businesses that stay, or are solely local, face mounting pressures. Rising taxes – from a fivefold increase in the petroleum tax to a near doubling of the sales tax to 11.5 percent, the highest in the country – have eroded profits and discouraged investment.

Nowhere, however, is the crisis more apparent than in the record rate at which Puerto Ricans are leaving the Island. 2.5 percent of the population left last year, and more than 1,500 residents continue to depart each week. Many are young, working-age citizens in search of economic opportunity. Their departure has long-term, devastating effects, both for economic growth and the tax base of the Commonwealth.

Inaction is no longer an option.

Let me further describe Puerto Rico's fiscal challenges and present the Administration's proposed response.

PUERTO RICO'S FISCAL CHALLENGES

Last June, the Governor of Puerto Rico warned that he would soon be forced to choose between paying Puerto Rico's debts and providing essential services.

In the intervening months, the Commonwealth has started making those difficult decisions. Essential services remain intact only because the Governor authorized more than $1.0 billion in emergency liquidity actions. Puerto Rico deferred payment of $300 million in tax refunds to citizens, failed to make required pension contributions, and borrowed $400 million in emergency loans from the workers' compensation, automobile insurance, and other disability funds. The next interest payment on constitutionally backed, general obligation debt is at risk because $300 million in monthly set-aside payments have not been made.

These emergency measures are immensely harmful to the economy and to the people of Puerto Rico, and contributed to the $600 million shortfall in current-year revenues. They have also proven to be insufficient. As a result, on December 1st, the Governor signed an executive order requiring the "clawback" of bonded revenues to pay general obligation debt and essential services. This action puts the payment of $7.0 billion in other debts on a path to likely default.

Finally, liquidity at the Government Development Bank is at dangerously low levels. As the entity responsible for holding government deposits, managing the Commonwealth's finances, and clearing payments, the GDB is at the heart of Puerto Rico's financial system. Its solvency and uninterrupted operation are critical to the functioning of the economy.

This crisis could further escalate in many ways. But make no mistake; it is already upon us.

THE ADMINISTRATION'S RESPONSE

My colleagues across the Administration have worked tirelessly for years to help the residents of Puerto Rico. As the situation deteriorated, the National Economic Council and Treasury also convened a broad, Administration-wide effort to encourage federal agencies to ensure Puerto Rico has ready access to congressionally appropriated funds and to develop the most effective policy response to the crisis.

This inter-agency effort has already produced tangible results, and we will not relent. But, it has become clear that resolving Puerto Rico's crisis requires Congressional action.

To that end, the Administration has called on Congress to act on a comprehensive legislative package that includes a debt restructuring mechanism, appropriate fiscal oversight, healthcare funding, and tax incentives to encourage work. Our proposals have drawn strong support from business and labor leaders. And we are grateful to those members of Congress who recognize the severity of the problem and the urgent need for action.

We consider all components of our legislative package to be essential. I would like to highlight two of the critical elements today: restructuring and oversight.

Restructuring

The restructuring of Puerto Rico's debts is inevitable. The financial markets know this. Puerto Rico's debt has traded at distressed levels for more than two years.

Under current law, Puerto Rico would have to restructure its liabilities without access to a tested, orderly framework to resolve competing legal claims. Puerto Rico's debt is unusually complex, with eighteen different but inter-related issuers. There are an even larger number of creditor groups with conflicting interests, and the legal remedies under existing contracts are untested.

We cannot predict the outcome of the complex litigation that would inevitably follow a disorderly default. But we know that it would be contentious and protracted – both among competing creditor classes and against the Commonwealth. This could impede the pursuit of restructuring negotiations and stand in the way of Puerto Rico's economic recovery.

There is real risk of another lost decade, this one more damaging than the last.

The attempted restructuring of Puerto Rico's own power authority, PREPA, provides a cautionary tale. After 18 months of negotiations, PREPA and its creditors have yet to reach a binding agreement. And, compared to the Commonwealth and its numerous tax-supported instrumentalities, the structure of PREPA's indebtedness is relatively straightforward.

So what is the alternative?

A federally legislated restructuring regime would bring all of the Commonwealth's financial liabilities into a coordinated, court-supervised process.

Such an authority offers obvious benefits. It would provide a stay on litigation, protect the provision of vital public services, and enable Puerto Rico to obtain third-party cash-flow financing. It would also provide a comprehensive framework for the adjustment of all debts under the supervision of the federal courts and a process for creditors to vote on a plan of adjustment.

Most importantly, it would cost taxpayers nothing.

The choice is stark: an orderly restructuring process that allows Puerto Rico to put its debt crisis in the past and begin the hard work of economic redevelopment; or, a disorderly and chaotic default that risks the economic safety and well-being of the 3.5 million Americans living in Puerto Rico.

Oversight

The restructuring authority must be conditioned on independent and credible fiscal oversight. Puerto Rico's economy has long suffered from a lack of fiscal discipline and transparency. Historically, budgets have relied on unrealistic revenue estimates. Revenue and expense adjustments have fallen short due to a lack of fiscal controls. Financial disclosure is opaque, and accounting deadlines are missed repeatedly.

Independent and credible oversight would guarantee Puerto Rico corrects these practices. It would also ensure that the Commonwealth's annual budgets, determined by its Government, adhere to the long-term recovery plan. And it would help Puerto Rico fully implement fiscal reforms, restoring confidence among all stakeholders.

At the same time, any fiscal oversight must be structured in a way that respects Puerto Rico's autonomy and preserves its self-governance. The oversight body should have relevant expertise, true independence and strong representation from Puerto Rico.

Pairing restructuring and oversight is a tried and true combination to resolve debt crises, both domestically and abroad. In Chapter 9, states often provide oversight to manage their municipalities in distress. Restructuring and oversight, appropriately adapted to the Commonwealth, would put Puerto Rico on a path to fiscal balance and renewed economic growth.

MYTHS AND REALITIES

Now, several myths have emerged about the crisis that I would like to take a moment to dispel.

Myth #1 – We need to see audited financials before we can act

Even without fiscal year 2014 audited financials, the magnitude of Puerto Rico's problems, and the need for action, are clear.

The latest Commonwealth report, released last month, disclosed the dire state of Puerto Rico's current cash position. The local Treasury account is overdrawn by $370 million, with $543 million in checks that have been written, but remain, as they say, "in the mail."

Puerto Rico's recent audited financial statements through fiscal year 2013 also reveal persistent, large deficits. And, a series of recently commissioned independent reports confirm that those deficits will continue far into the future.

Puerto Rico has a long history of delinquent audited financials. Their unavailability in March 2014, however, did not dissuade investors from buying Puerto Rico's $3.5 billion general obligation bonds, or keep sophisticated investors from buying and selling debt in secondary markets. The delay in these 18-month old financials should not prevent the Federal Government from acting now.

Myth #2: The debt is sustainable and can be paid in full

If Puerto Rico's $45 billion in unfunded pension liabilities were added to its $50 billion in tax-supported debt, government liabilities would exceed 120 percent of Gross National Product (GNP). Moreover, paying debt service on all $50 billion in tax-supported debt would require a sustained primary surplus of around five percent of GNP. This is a significantly higher primary surplus than what any distressed entity can reasonably achieve.

Measuring tax-supported debt service relative to government's taxing power also shows the debts are unsustainable. Rating agencies have always evaluated the fiscal health of states and municipalities using this methodology. On that basis, debt service totals one-third of Puerto Rico's revenues, straining capacity to support essential services and critical investments in economic development.

Some investors consider only debt service disclosed in the General Fund. That approach, however, does not include debts paid out of the Commonwealth's sales tax and those paid by public agencies like the GDB, the Public Finance Corporation, and the University of Puerto Rico, which depend on the central government for funding but are not included in the general fund budget.

Whichever method you use, Puerto Rico's debt service is more than five times that of the average state and more than twice that of the next most indebted.

Myth #3: Puerto Rico can manage this crisis through austerity alone

Puerto Rico has already made significant fiscal adjustments, but these efforts have failed to arrest the crisis or restore economic growth. The Commonwealth has enacted over $1.5 billion in tax increases since 2012. Government spending, net of debt service, is at its lowest level since 2005, both in nominal terms and as a share of GNP. Public employment has been cut by more than 20 percent since 2008. Today, more than 70 percent of remaining government employees are teachers, police officers, firefighters, and nurses.

Puerto Rico must put its fiscal house in order, and there are undoubtedly further cost efficiencies to be gained.

But after ten years of recession, the purported benefits of additional austerity must be weighed against the potential costs to economic growth.

Myth #4: A restructuring framework for Puerto Rico would be bad for the municipal market

Traditional, investment grade municipal bond investors tell us that a quick and orderly resolution to Puerto Rico's financial distress is imperative and would be the best outcome for markets.

Moreover, the vast majority of Puerto Rico's creditors should stand to benefit from an orderly restructuring framework. It would eliminate fiscal deficits, remove legal uncertainties, compress the timeline for recovery of claims, and, ultimately, increase the Commonwealth's capacity to repay its debts.

We do not anticipate a broad restructuring framework would have a spillover effect on the municipal bond market. Puerto Rico's financial distress has remained isolated in the eyes of municipal bond investors for the past two years.

Importantly, the restructuring framework would be reserved exclusively for U.S. territories. Under the Constitution, the Commonwealth and the territories have a fundamentally different relationship with the federal government than do states. As under current law, states would remain ineligible to file for bankruptcy under this or any other restructuring regime.

I should note that non-traditional municipal bond investors who voice concerns about "changing the rules in the middle of the game," have already been put on notice.

The bond prospectus from 2014 included an explicit risk factor stating, and I quote: "in the future,… new legislation could be enacted by the United States Congress or by [Puerto Rico's] Legislative Assembly that would entitle the Commonwealth to seek the protection of a statute providing for restructuring, moratorium and similar laws." This could not be more clear.

THE PATH FORWARD

Puerto Rico lacks the tools required to resolve this crisis effectively and faces an uncertain and perilous future. The question is not whether the Commonwealth will restructure its debts, but when, and at what cost to the economic safety and well-being of its citizens.

Puerto Rico can and will emerge from the current crisis and return to growth. But there are two paths in front of us. The first gives Puerto Rico the tools it needs to repair its finances and quickly move to the hard work of economic redevelopment. In the second, Puerto Rico does not receive the tools it needs, and the fiscal crisis turns into a humanitarian one.

We must take the first path. The Obama Administration stands ready to work with Congress to get the job done.

Thank you.

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