

U.S. DEPARTMENT OF THE TREASURY

Press Center



Remarks by Counselor Antonio Weiss on Puerto Rico Before the National Tax Association

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As Prepared for Delivery

Thank you for the kind introduction and for inviting me to participate in today's conference. Before I begin and in observance of Veteran's Day, I would like to recognize the veterans in our audience and thank you for your service to our country.

There is another group of veterans who have participated in every major United States military engagement since World War I, our fellow citizens in Puerto Rico. This long history of service includes the exceptional heroism and gallantry of Puerto Rico's 65th Infantry Regiment, known as the Borinqueneers, who served in the Korean War. Since 9/11, more than 25,000 active duty Puerto Rican soldiers have served across all branches of the armed forces, carrying out more than 38,000 deployments. A recent survey showed that more than half of the Island's residents have either served in the military or have a family member who has served. Nine Puerto Ricans have been awarded Medals of Honor. This history of service is remarkable.

The commitment of these veterans should remain at the forefront of our minds as we seek to resolve a severe fiscal crisis that has been a threat to the economic security and well-being of the 3.5 million Americans living in Puerto Rico.

My remarks this afternoon will focus on the federal government's response to this crisis, including the passage of the Puerto Rico Oversight, Management, and Economic Stability Act, known as PROMESA. I will discuss the human impact of the crisis, and the Administration's legislative plan for arresting it and restoring economic growth. I will also review the powerful restructuring tools that PROMESA provides and how they can be used to address the Island's unsustainable debt burden. I will conclude by reflecting on the important work that remains to be done both in Puerto Rico, through the local government and Oversight Board, and in Washington.

THE PROBLEM

For many, the problems facing the Island appeared to emerge from nowhere. In reality, Puerto Rico fell into recession in 2006 and its GNP has contracted by 18 percent since then without recovery. The recession was exacerbated by years of excessive borrowing, as the government of Puerto Rico grew increasingly reliant on deficit financing. Debt service grew to roughly a third of central government receipts. This past spring, the Commonwealth declared a debt moratorium and was forced to resort to emergency measures to provide sufficient cash to keep essential services running. Competing claims among the holders of 18 different issuers of Puerto Rico's \$70 billion debt complicated negotiations. Lawsuits flooded the courts.

The fiscal crisis threatened to set off a humanitarian crisis. More than a dozen hospitals closed floors and curtailed services because the central government and its health care agencies could not pay their bills.

Nowhere is the human impact of 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 in the greatest wave of outmigration since the 1950s. Many are young, working-age citizens seeking economic opportunity. As they depart, the population ages, and the future revenue base erodes.

There is no room for error in this economy. 58 percent of children live in poverty. Unemployment stands at 11.9 percent, more than twice the national average, and labor force participation is just 40 percent. And, at less than \$19,000, the median household income in Puerto Rico is approximately one-third the U.S. median, though the cost of living is comparable.

The crisis did not arise overnight, and a sustainable solution was needed to address each layer of the problem decisively.

First, the Island urgently needed a stay of litigation to provide relief from creditor lawsuits so that it could continue to provide essential services. Second, Puerto Rico needed a process to restructure its debt to a sustainable level. Third, the Commonwealth needed to restore fiscal discipline through improved governance, and modernizing accounting and tax systems to ensure greater efficiency and transparency. It also needed a comprehensive solution to address long-standing health care inequities that have created an impending healthcare crisis. Finally, Puerto Rico would need to return to economic growth by attracting long-term investment and increasing workforce participation.

PROMESA

The Obama Administration released a legislative roadmap in October 2015 designed to give lawmakers a path forward on each of these issues. The plan centered on four key elements: First, a territory-wide debt restructuring regime that would, among other things, stay all litigation facing the Island.

Second, independent oversight to work with the Puerto Rican government to address its economic and fiscal challenges. Third, healthcare funding to ensure proper care for Puerto Ricans. And fourth, a path to economic growth through enactment of federal measures such as the Earned Income Tax Credit, EITC, to incentivize workforce participation to revitalize the economy.

Following a concerted effort by the Administration and many committed stakeholders, Congress responded by enacting PROMESA in late June. Like any bipartisan legislation, PROMESA was a product of compromise. No party or stakeholder got exactly what it wanted. Many pushed for an alternative approach with limited restructuring tools and carve-outs for individual classes of creditors.

Instead, we won broad support from Republicans and Democrats for a central Administration priority; a powerful restructuring authority covering all Puerto Rico's debt with no exceptions for specific financial interests and an automatic stay on litigation. This stay removes the damaging uncertainty of protracted litigation and provides Puerto Rico with the breathing space it needs to provide essential services while designing a viable long-term fiscal plan.

The legislation also established an oversight board to provide independent review of Puerto Rico's long-term plan, annual budgets, and debt restructuring process. On August 30, the President, in consultation with Republican and Democratic leadership in Congress, appointed the seven board members, four of whom are Puerto Rican.

PROMESA IN ACTION

So where does this leave us? With much urgent work to do on many fronts.

First, I encourage everyone to watch with care as the process unfolds in the coming weeks and months, during a period of transition in San Juan and Washington. The Board has asked the Governor to produce a fiscal plan that includes all of the tax-covered entities on the Island. The Governor submitted his plan to the Board on October 14, and it is currently under review.

This plan lays out a set of guiding principles that, combined with PROMESA's requirements, serve as the framework for the Commonwealth's policy choices. Several of these principles and requirements reflect the Treasury Department's view of key lessons learned from our experience with other debt crises. First, the plan asserts that austerity alone is self-defeating and will only lead to further economic contraction. Next, the plan commits to protecting the most vulnerable populations, including the elderly, young, disabled, and low-income residents. We strongly support the Commonwealth's commitment to ensuring that residents receive the services they need.

In addition, the plan sets out a path to shore up Puerto Rico's fragile pension systems. Public pension have over 330,000 members, and serve as the primary source of income for over 150,000 retirees. And the average benefit in the largest plan is just \$1,100 a month.

The pensions have endured years of underfunding by successive governments. As a result, if left unfunded, they would run out of cash within three years. One of PROMESA's requirements for the fiscal plan is to provide adequate funding for public pension systems, and we firmly support this requirement on economic and societal grounds.

Once a Fiscal Plan is agreed, it will determine the extent of restructuring needed to place Puerto Rico's debt at a sustainable level. The Board should make full use of the powers provided to it by Congress to pursue consensual negotiations and, if unsuccessful, file a petition for a court-supervised restructuring process before the expiration of PROMESA's automatic stay. As such, timely certification of the Fiscal Plan, a prerequisite to these negotiations, should be the Board's top priority.

Time is of the essence. The automatic stay established by PROMESA is set to expire on February 15, 2017. And nearly \$2 billion in bond payments will come due as Puerto Rico's debt moratorium expires on January 31, 2017.

CONGRESSIONAL TASK FORCE

While we believe PROMESA, properly utilized, has the power to definitively arrest Puerto Rico's fiscal crisis, the law itself acknowledges that more must be done to return the Island to economic growth.

PROMESA created an eight-member Congressional Task Force on Economic Growth in Puerto Rico. This bipartisan Task Force was charged with identifying Federal laws and programs that impede Puerto Rico's growth and recommending changes that could spur sustainable economic development.

The Administration has relayed our recommendations to the Task Force. While we support new and creative solutions, the Administration has found that the policies we proposed last October, including healthcare equity, the EITC, and an expanded Child Tax Credit, CTC, provide the most powerful and fiscally responsible tools to support growth and long-term stability.

HEALTHCARE

As I noted earlier, PROMESA was designed to stem the immediate crisis and address the most urgent aspects of the problems facing the Island. PROMESA does not, however, provide the Island with the tools it needs to prevent another crisis when federal healthcare funding is exhausted next year. Puerto Rico's healthcare system is already under severe strain and the government's fiscal condition will limit its ability to cope with the urgent demand for health services among the Island's poor. Already, over the past decade, a third of the doctors on the Island have left for the mainland.

Puerto Rico provides health insurance coverage to more than 1.6 million Americans through Medicaid and the Children's Health Insurance Program, covering nearly half of its population. When one-time additional funds provided by the Affordable Care Act are exhausted, which could happen by the end of next year, up to 900,000 Americans living in Puerto Rico could lose coverage, including the most vulnerable populations on the Island.

This deterioration in services is especially troubling given the public health threat from Zika. As of November 9, the Centers for Disease Control and Prevention has recorded 30,439 Zika cases in Puerto Rico. And, financial constraints have impaired the local government's response. Congress must act to eliminate the healthcare funding gap in order to protect the well-being of the Island's 3.5 million residents.

STIMULATING GROWTH

Next, Congress needs to help Puerto Rico build a viable path to economic growth. While greater local investment in infrastructure and other projects is critically needed, the Island cannot achieve this goal entirely on its own. Through proven tax measures, the federal government can play a critical role.

Puerto Rico has a unique tax system. Most Puerto Rican residents do not pay federal income taxes on locally earned income. However, Puerto Rican earnings are subject to federal payroll taxes and local income taxes comparable to federal rates.

Puerto Ricans can also file a federal income tax return to be eligible for the refundable portion of the CTC, but only if they have three or more children. Within the context of this complex system, there is a significant opportunity for federal tax reforms to stimulate growth and increase labor force participation.

As this audience knows, the EITC is a tax credit available to workers in low-income families in the states – but not the territories. The credit is refundable. Eligibility for, and the size of, the EITC is based on income, age, residence, and the presence of qualifying children.

Expanding EITC would be particularly powerful in Puerto Rico because of its low labor force participation rates, 23 percentage points below that on the mainland.

This type of tax credit is also well-targeted to stimulate the economy and reduce poverty.

We estimate that adopting a locally-administered EITC consistent with the President's budget proposal would pull 54,000 Puerto Ricans out of poverty and increase Puerto Rico's GNP by over \$1 billion. The EITC would likely also increase tax compliance and tax revenues, improving Puerto Rico's fiscal position.

Expanding eligibility of the CTC would supplement this effort. 58 percent of children in Puerto Rico live beneath the poverty line. Currently, underserved families with two or fewer children do not qualify. Extending the credit to all families would improve the lives of roughly 650,000 additional families.

The EITC and CTC expansion in Puerto Rico would bring the credit to more than 400,000 additional children.

CONCLUSION

We have come a long way in tackling Puerto Rico's fiscal crisis but there is much work ahead. The bipartisan principles of PROMESA will continue to guide this process forward.

We all have a role to play in the coming months: the current and future Governor, the Oversight Board, local legislature, Congress, and the current and future administrations in Washington. At Treasury, this is a top priority and we are committed to ensuring a smooth transition to the next administration.

But let me be clear – additional action is needed without delay. The Commonwealth and Oversight Board must reach consensus on a Fiscal Plan as soon as possible. Restructuring negotiations to reduce Puerto Rico's unsustainable debt load must commence. Congress must act to address Puerto Rico's critical health care challenges and provide targeted incentives to reinvigorate the economy. Any delay in achieving these crucial objectives will simply prolong the state of crisis.

The 3.5 million Americans in Puerto Rico – many of whom have served our country – deserve our urgent attention. And I remain confident that Puerto Rico can and will come out of this crisis and return to growth.

Thank you.

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