

S. HRG. 114-307

**FINANCIAL AND ECONOMIC CHALLENGES  
IN PUERTO RICO**

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**HEARING**

BEFORE THE

**COMMITTEE ON FINANCE  
UNITED STATES SENATE**

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

—————  
SEPTEMBER 29, 2015  
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## **FINANCIAL AND ECONOMIC CHALLENGES IN PUERTO RICO**

**TUESDAY, SEPTEMBER 29, 2015**

U.S. SENATE,  
COMMITTEE ON FINANCE,  
*Washington, DC.*

The hearing was convened, pursuant to notice, at 10:11 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Present: Senators Grassley, Crapo, Thune, Toomey, Wyden, Schumer, Stabenow, Nelson, Menendez, Bennet, Casey, and Warner.

Also present: Republican Staff: Chris Campbell, Staff Director; Tony Coughlan, Tax Counsel; Preston Rutledge, Tax Counsel; and Jeff Wrase, Chief Economist. Democratic Staff: Michael Evans, General Counsel; Elizabeth Jurinka, Chief Health Policy Advisor; Todd Metcalf, Chief Tax Counsel; Joshua Sheinkman, Staff Director; and Tiffany Smith, Senior Tax Counsel.

### **OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The committee will come to order.

Good morning, and welcome to today's hearing to consider the various financial and economic challenges in Puerto Rico. We have all watched with great interest as the debt situation in Puerto Rico has unfolded.

Whenever we talk about this issue, there are a number of interested parties, including policymakers here in Washington, bondholders, and of course the people of Puerto Rico.

According to the statements from the Puerto Rican government, the territory's debt of more than \$72 billion is, quote, "not payable." Some of that debt includes General Obligation bonds which have a constitutional first priority, and some includes debt of public corporations. In all, we are talking about roughly 17 different debt-issuing entities in Puerto Rico.

Puerto Rico's debt has more than doubled since 2000, despite the billions of dollars infused into its coffers from the Federal stimulus enacted in 2009 and from health care funding increases included in the Affordable Care Act. Even with those boosts in Federal funding and the related increases in Commonwealth spending, all we see is added Commonwealth debt. Moreover, there is a lack of reliable data indicating what Puerto Rico has to show in return in terms of infrastructure, efficiencies, and improved economic performance.

One reason we are having this hearing today is to give us a chance to gather additional information. As Senator Grassley, a former chairman of the Finance Committee, can attest, this panel has done a great deal over the years to clarify the interplay between issues like Federal tax and health care policy and the impact they have on Puerto Rico and other territories.

I know that Ranking Member Wyden is committed to working with me to update and improve our understanding of this situation so that Congress can make decisions using the best available information. I think it would be extremely difficult to ask Congress to make important decisions and appropriately allocate resources without first understanding what the facts are and what problems need to be fixed.

Accompanying today's hearing, we have made available an updated overview of Federal tax policy and its interplay with Puerto Rico. This document was produced by our friends at the Joint Committee on Taxation.\*

We also have several other reports addressing Federal health care policies in Puerto Rico, provided by the Congressional Research Service. And I have made public the responses that I received from inquiries I made to the Department of Health and Human Services on this issue.

In the days leading up to this hearing, I have heard from many interested parties, virtually all of whom have their own ideas about what needs to be done here. Some of these proposals have been helpful, others not so much.

For example, I have heard that we can expect to see increased strains on Puerto Rico's health care system, especially given the demographic and economic realities on the island. One source of this stress seems to stem from the Affordable Care Act, which contains future cliffs where funding will be pared down and, according to some, the cliffs will hit Puerto Rico particularly hard. Of course, for me it is not surprising to learn that there are inequities and financial harms resulting from the health care law.

Even so, these problems and any proposed solutions are multi-dimensional and extremely complicated. Questions of funding and resource allocation are always difficult, and they implicate a number of issues.

It is not as simple as just deciding to give more health funds to Puerto Rico, because doing so would necessarily mean reduced funding for other priorities, increased taxes, or even more Federal debt. That is the unpleasant budget arithmetic that we face. There are no easy answers.

For a long time, the people of Puerto Rico have suffered under a weak economy, including double-digit unemployment rates, very low labor force participation rates, and a bloated public sector. With many residents of the island facing a lack of opportunity or any expectations of a brighter future, Puerto Rico has increasingly seen out-migration. All of this contributes to the fiscal challenges the territory now faces.

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\*For more information, *see also*, "Federal Tax Law and Issues Related to the Commonwealth of Puerto Rico," Joint Committee on Taxation staff report, September 28, 2015 (JCX-132-15), <https://www.jct.gov/publications.html?func=startdown&id=4840>.

According to independent analysts, there are significant barriers to job creation and labor force participation in Puerto Rico. Some of these barriers stem from Federal entitlement programs. Others can be attributed to the application of other Federal laws and regulations. In other words, I do not think we can just lay all the blame on Puerto Rico.

For example, analysts across the political spectrum agree that Federal laws have increased the cost of energy in Puerto Rico and that the island's regulatory processes and bureaucratic red tape stifle business activity. And sadly, for the children in Puerto Rico, its education system, to quote Secretary of Education Duncan, "has been plagued by a revolving door of leaders and political patronage."

In short, and to put it mildly, Puerto Rico faces enormous fiscal and economic challenges. While the government of Puerto Rico has taken some steps in recent years to address these matters, many more changes, significant and fundamental changes, need to be made.

Fortunately, Puerto Rico has a number of advantages to its credit, and we have seen successful turnarounds from over-indebtedness elsewhere, such as here in the District of Columbia and in New York City. I hope to see Puerto Rico join the list of successful turnaround experiences, and I know that everyone here wants the people of Puerto Rico to experience a future with increased economic opportunity and growth.

Before I conclude, I just want to make sure that we acknowledge the negative long-term impact Puerto Rico's unsustainable debt has had, and will continue to have, on the island's residents and what lessons we should take from their experience. As the Congressional Budget Office has repeatedly warned over the past several years, despite some recent declines, our Federal deficits under current law will soon rise again, and Federal debt will grow, as it has in Puerto Rico, to beyond 100 percent of the size of our economy.

According to CBO, if we do not change course, we will increasingly have less fiscal flexibility, and we will run the risk of a fiscal crisis at the Federal level. Absent some kind of fundamental correction, it is not hard to imagine the devastating effects from unsustainable debt that are now being felt by Americans living and trying to work in Puerto Rico also being felt throughout the entire country.

Now I will close by noting that this is the Finance Committee, with broad areas of jurisdiction, including Federal tax policy and health care policy. There are, of course, many other aspects of Federal policy that are also relevant to Puerto Rico's situation but fall into other committees' areas of jurisdiction, including Federal labor policies, Federal laws governing shipping vessels, bankruptcy law, and others. However, I ask that our witnesses keep their focus on areas of the Finance Committee jurisdiction. This is not, for example, a hearing on chapter 9 of the Bankruptcy Code, or a hearing on Puerto Rico's status as a territory.

And let me just say that I am concerned about Puerto Rico very much. I do not think this country has done its job either in helping Puerto Rico in doing some of the things that should be done. Then again, Puerto Rico has brought a lot of these calamities on itself.

But I think there is blame enough to push around on a lot of people.

[The prepared statement of Chairman Hatch appears in the appendix.]

The CHAIRMAN. And with that, I wish to welcome all of our witnesses, and I will now recognize our ranking member, Senator Wyden, for his opening statement.

**OPENING STATEMENT OF HON. RON WYDEN,  
A U.S. SENATOR FROM OREGON**

Senator WYDEN. Thank you very much, Mr. Chairman, and thank you for holding this hearing.

There are more than 3 million United States citizens living in the Commonwealth of Puerto Rico, where long-standing economic challenges have developed into a real and very immediate crisis. No single policy or harsh austerity platform is going to save the day. The solutions in Puerto Rico must be focused first and foremost on helping its millions of American citizens get ahead in the private economy and putting that system on solid ground.

In order to accomplish that task, policymakers in Washington and San Juan need to take a hard look at the origins of the crisis. To move forward, you need an understanding of what is holding you back.

The core of Puerto Rico's challenge is simply that the Commonwealth, its public corporations, and other entities issued more debt than they are now able to pay back. Without a process for restructuring that debt, the problem does not go away on its own. But just solving the immediate crisis is not a long-term solution. You have to find ways to modernize and grow the economy, or you find yourself right back here again.

For example, the Commonwealth's electric utility, which is responsible for the largest share of Puerto Rico's debt, still burns diesel fuel to generate power. By converting archaic generators to use lower-cost, cleaner-burning natural gas, the utility could make more money on the power itself. But that type of conversion requires up-front investment, and Puerto Rico cannot attract that investment without addressing the immediate financial crisis.

Many engaged in this debate blame Puerto Rico's economic struggles on the ending of an old tax policy that gave corporations tax-free income in the Commonwealth. But in my view, the history is a lot more complicated than that, especially when it comes to taxes.

Companies based in Puerto Rico are foreign in the eyes of the IRS, the same as if their headquarters were in Mexico, China, or the U.K. But there is a major benefit that no other foreign companies get, which is access to American incentives for investments in research and development and manufacturing. There are a lot of people who view Puerto Rico as a tax haven tucked within the United States, and that is one reason why.

There are also other special breaks that are unavailable in the mainland. For example, there is a longstanding policy known in the tax world as the rum cover-over, which for decades provided a big economic boost to Puerto Rico. But in recent years, instead of being invested in roads or schools or health care, the proceeds from the rum cover-over have mostly gone straight to the large distillers.

And the Commonwealth's own tax policy has been less than helpful as well. By some estimates, Puerto Rico collects less than half of its sales tax. It recently put in place a program to attract certain Americans and their firms by zeroing out local taxes on capital gains, with no requirement that there be a contribution to the economy. Under a local tax break known as Act 20, service providers who move to the Commonwealth have their corporate tax rate drop from 30 percent to 4 percent.

These strategies may appeal to some companies and attract some wealth, but there is not a lot of evidence to suggest that they are steering Puerto Rico's economy towards sustainable prosperity. Scaling back or eliminating overly generous or ineffective tax breaks ought to be on the table as part of any long-term financial recovery plan.

Now in this debate, some have argued that Puerto Rico's safety net programs are too generous and need to be rolled back. For example, there is a belief among some that Puerto Rico needs a lower minimum wage. But changing the law to cut people's pay makes hardly any sense when American citizens in Puerto Rico already make less than half as much, on average, as those in the mainland United States. In addition, lowered wages and putting new tatters in the safety net are going to drive more young workers to the mainland, and you want those young workers as an important and vital engine of future economic growth.

The Medicaid program in Puerto Rico is less generous than in the mainland U.S., and its capped funding system means that it continues to face harsh spending limits that undermine the ability to meet the health care needs of the lowest-income American citizens. In addition, Puerto Rico is locked out of one of the most successful pieces of the Medicare Prescription Drug Program, which is the Part D low-income subsidy. The people this hurts are already dealing with very limited means on a daily basis.

A better funding system for Medicaid and improvements to Medicare also ought to be on the table. Puerto Rico could adopt an Earned Income Tax Credit to help raise incomes and encourage employment. The Child Tax Credit could be a bigger help to more families, and the Commonwealth could change its own tax policies to make sure it is able to invest in education and infrastructure in the years ahead.

It is important to move ahead with policies that amount to more than what might be the policy equivalent of a momentary sugar high. The bottom line is that the solutions have to help Puerto Rico and its millions of American citizens build a stronger economic future, or else this debt cycle will continue and continue and continue.

Mr. Chairman, I want to also thank our witnesses. I am going to have to be a little bit in and out this morning. I hope to be able to hear our witnesses.

But I thank you, and my hope is that, here on the Finance Committee, we can come up with a practical, bipartisan set of policies to address these issues.

Thank you.

[The prepared statement of Senator Wyden appears in the appendix.]

The CHAIRMAN. Well, we are going to count on your help, Senator, and help from both sides to try to resolve this problem. It is in the best interests of Puerto Rico and our country.

I would like to take a few minutes to introduce our distinguished panel of witnesses. Our first witness is Congressman Pedro Pierluisi. The Resident Commissioner of Puerto Rico since January 2009, Congressman Pierluisi has served as Puerto Rico's sole member of Congress. He currently sits on the House Judiciary and Natural Resources Committees and, in the past, served on both the House Ethics and Education and the Workforce Committees.

Congressman Pierluisi was born in San Juan and has 24 years of legal experience in the private and public sectors, including 4 years as the Attorney General of Puerto Rico. He is a graduate of both Tulane University and George Washington University Law School.

Our second witness is Ms. Melba Acosta, President of the Government Development Bank for Puerto Rico. Ms. Acosta has previously served as the Secretary of the Treasury Department, Chief Public Financial Officer, Director of the OMB, and Chief Information Officer of Puerto Rico, as well as the Chief of Staff of the Municipality of San Juan.

She is a certified public accountant as well as an attorney. Ms. Acosta earned a bachelor's degree in accounting from the University of Puerto Rico, an MBA from the Harvard Business School, and a J.D. from the University of Puerto Rico School of Law.

Our third witness is Dr. Douglas Holtz-Eakin. We are always happy to welcome him back to the committee. He is president of the American Action Forum. Dr. Holtz-Eakin's long resume includes his recent service as Commissioner of the congressionally chartered Financial Inquiry Commission, Director of the non-partisan Congressional Budget Office, and Chief Economist of the President's Council of Economic Advisers.

He first began his career at Columbia University and later worked at Syracuse University, where he became the trustee professor of economics at the Maxwell School, chairman of the Department of Economics, and associate director of the Center for Policy Research. Dr. Holtz-Eakin currently serves on the boards of the Tax Foundation, National Economists Club, and the Research Advisory Board for the Center for Economic Development.

Last but certainly not least, we will hear from Mr. Sergio M. Marxuach. He is public policy director at the Center for a New Economy. Prior to his current post, Mr. Marxuach served as Deputy Secretary of Commerce and Economic Development for Puerto Rico. Before that, he was an associate at the New York law firm of Curtis, Mallet-Prevost, Colt, and Mosle, where he worked in Latin American and international corporate transactions.

Mr. Marxuach has a bachelor's degree in economics and political science from Yale University, as well as a J.D. and master's degree in foreign service from Georgetown University.

I really want to thank each of you for your participation and your diligent work and service, as well as your comments here today. I ask that each of you keep your initial remarks to 5 minutes. And

we will start with you, Congressman Pierluisi, and go from there. Is that all right?

Mr. PIERLUISI. Yes, thank you.

**STATEMENT OF HON. PEDRO R. PIERLUISI, RESIDENT COMMISSIONER OF PUERTO RICO, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC**

Mr. PIERLUISI. Chairman Hatch, Ranking Member Wyden, and members of the committee, the crisis in Puerto Rico is not new. The 3.5 million U.S. citizens I represent have endured it for many years. Based on any metric, Puerto Rico's economy has lagged behind the States' for decades. The Puerto Rico government spends more than it receives, leading to deficits and debt.

My constituents are becoming your constituents in unprecedented numbers. Between 2004 and 2014, Puerto Rico's population declined by over 7 percent. The exodus is changing the character of Puerto Rico and the composition of the American electorate. To tackle the crisis, we must act with boldness and vision. If we are faint-hearted, we will fail.

The core economic problem is lack of growth. So Puerto Rico must implement a strategy to increase capital investment. Government reform is essential. Puerto Rico has an inefficient central government whose competence and credibility are questioned by prospective investors. The government has stifled, rather than unleashed, the private sector's potential.

Fiscal reform is also required. The Puerto Rico government must live within its means and cut spending. It must modernize its tax system, which requires some companies to pay 39 percent and others to pay under 5 percent. Recently the government increased taxes to support its excess spending. These taxes must be repealed or refashioned.

Once Puerto Rico has an equitable tax policy, the government must collect what it imposes, something it now does poorly. Furthermore, the Puerto Rico government must ensure access to affordable electricity, a modern transportation system, and other basic infrastructure. Many of these services are provided by public corporations that are in financial distress, carry significant debt, and require reform.

The Governor of Puerto Rico has asserted that if Puerto Rico continues on its present course, its \$71 billion debt is unpayable. But this course can and must change. With sound economic and fiscal policies, the debt will become easier to manage. Puerto Rico's Constitution provides that debt service on bonds issued or guaranteed by the central government take priority over other expenditures. These bonds must be paid, period.

There are 18 government entities in Puerto Rico that issue bonds. Each is in a different financial condition and has different legal terms governing its bonds. Contrary to the Governor's strategy, each should be considered on a case-by-case basis.

Finally, the Governor has portrayed the debate about whether Puerto Rico will meet its obligations to creditors as "us versus them." The countless men and women from Puerto Rico who own our bonds know better.

Like the people of Puerto Rico, Congress is right to expect more from the government of Puerto Rico, but it would be the height of hypocrisy for this committee to criticize Puerto Rico without acknowledging the Federal Government's shared responsibility for this crisis. The crisis is rooted in Puerto Rico's undemocratic and undignified territory status.

Congress treats Puerto Rico in discriminatory fashion, under numerous programs within this committee's jurisdiction. My Senate allies and I have filed bills to address these disparities, and the committee should act on them. Otherwise, spare us the lectures about Puerto Rico's own failings.

This is not just a Puerto Rico problem; it is an American problem requiring an American solution. If you treat us like second-class citizens, do not expect us to have a first-class economy. If you treat us in appalling fashion under Medicaid and Medicare, do not claim surprise that our health care system is in dire condition. If you exclude us from tax credits that encourage individuals to work, do not add insult to injury by attributing our low labor participation rate to generous welfare benefits or urging our exemption from the minimum wage. If you do not extend the SSI program to Puerto Rico and you treat us unequally under TANF, do not express disbelief that one in four Puerto Rico residents lives in extreme poverty.

I look forward to the day when my constituents have the exact same rights and responsibilities as your constituents. For Puerto Rico to prosper, it must be treated equally, and to be treated equally, it must become a State. Until then, there is much this committee can do to empower Puerto Rico. I urge you to act.

Thank you.

The CHAIRMAN. Thank you so much.

[The prepared statement of Mr. Pierluisi appears in the appendix.]

The CHAIRMAN. Ms. Acosta, thank you.

**STATEMENT OF MELBA ACOSTA, PRESIDENT, GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO, SAN JUAN, PR**

Ms. ACOSTA. Thank you, Mr. Chairman, Ranking Member Wyden, and members of the committee.

The fiscal, economic, and liquidity crisis in Puerto Rico has passed the tipping point. The legislature has declared an emergency. Puerto Rico has no access to the capital markets on sustainable terms, and it endures a crisis beyond what any jurisdiction in the United States has faced in generations.

The crisis threatens the health, safety, and welfare of the 3.5 million American citizens in Puerto Rico. It did not develop overnight, but is the culmination of decades of ill-advised policies both in San Juan and Washington, coupled with a stagnating economy, seemingly unlimited access to easy credit, and a market willing to lend.

Puerto Rico's economy was disproportionately impacted by the financial crisis, and growth continues to pose a significant challenge. In fact, unemployment remained above 15 percent for many years following the financial crisis, and is currently at 11 percent. With today's labor participation rate at only 40 percent, Puerto Rico's

unprecedented economic difficulties have contributed to rising budget deficits and deficit financing.

Today, Puerto Rico has amassed \$73 billion in debt and over \$45 billion in unfunded pension liabilities. Governor García-Padilla took office in 2013 and has been honest and forthcoming about this crisis. He has forcefully responded to these unprecedented challenges.

Since taking office, he has reduced the budget deficit by raising revenues and cutting expenses; reduced general fund expenses by almost 20 percent; imposed labor reforms across the entire government, including freezing wages and salaries and reducing payroll; imposed unprecedented cost-control measures at the central government and public corporations; implemented comprehensive pension reform to address Puerto Rico's unfunded pension liabilities; pursued public-private partnerships to promote investment on the island; and approved and overseen ongoing debt restructuring negotiations at the Puerto Rico Electric Power Authority, just to name a few.

Notwithstanding these difficult efforts, Puerto Rico faces an immediate liquidity crisis. Earlier this year, it became apparent that additional measures were needed, and Puerto Rico commissioned a team of economists led by Dr. Anne Krueger, former deputy managing director of the IMF, to undertake a comprehensive analysis of Puerto Rico's challenges. Dr. Krueger and her team identified a number of economic shocks that have contributed to economic stagnation, recommended measures to reverse negative economic trends, and highlighted the need for debt relief.

In light of the report's findings, our Governor ordered the creation of a working group to develop a Plan for Economic Development and Fiscal Institutional Reform. The plan calls for significant and challenging reforms across nearly all aspects of the economy and government, including comprehensive private-sector labor reform and dramatic cuts to expenditures and operating subsidies.

It proposes legislation to create an independent control board appointed by the Governor, with jurisdiction over government entities in Puerto Rico to ensure compliance with the plan. In addition, it also calls on the Federal Government to act. This includes treating Puerto Rico equally in terms of Medicare and Medicaid funding and providing Puerto Rico with tax treatment that encourages investment and growth. And finally, the plan recognizes that widespread debt relief across the island is required, and proposes a voluntary exchange offer to give Puerto Rico much-needed debt relief.

Achieving economic growth and avoiding a more chaotic situation in Puerto Rico will likely depend on obtaining access to a legal framework to address our liabilities in an orderly manner.

In conclusion, I would like to reiterate that Puerto Rico has passed the tipping point and faces an immediate liquidity crisis. We have taken the important step of developing a clear roadmap to address these challenges.

Reasonable minds may differ as to specific measures that must be taken. However, the fact remains that Puerto Rico faces immediate challenges that require Federal action. Most importantly, Puerto Rico needs equal Medicare and Medicaid funding and a

legal framework through which it can adjust its debts and address its financial difficulties.

I thank the committee for recognizing the urgency of the situation and for giving Puerto Rico the opportunity to participate in today's hearing.

The CHAIRMAN. Well, thank you very much.

[The prepared statement of Ms. Acosta appears in the appendix.]

The CHAIRMAN. Dr. Holtz-Eakin?

**STATEMENT OF DOUGLAS HOLTZ-EAKIN, Ph.D., PRESIDENT,  
AMERICAN ACTION FORUM, WASHINGTON, DC**

Dr. HOLTZ-EAKIN. Chairman Hatch, Ranking Member Wyden, members of the committee, thank you for the privilege of appearing today. You have my written statement; let me make a few brief main points.

The first, as has been pointed out, is that Puerto Rico has a serious growth problem. Its GDP is expected to decline over the next 10 years. Its unemployment rate is expected to remain elevated in most forecasts. The population will continue to decline, and those population losses are concentrated in the skilled and prime-age working population. Their work participation is low, and overall employment is expected to be flat at best. And fundamentally, Puerto Rico is still operating on a 1960s-style, government-led economic strategy, and that needs to change.

Coupled with this, Puerto Rico has a deep fiscal problem. It has run chronic deficits and is expected to continue to do so in the future. Its borrowing costs, as a fraction of revenue, have risen sharply and are now nearly double the 10 percent that most people consider a point of alarm.

It has a high level of debt relative to GDP, especially when one compares it to other States. But its debt-to-GDP ratio does not look high when compared to other sovereign debt crises in the countries that got into them. And that, I think, is instructive, because what it says is, we can look to the experience of the IMF and other international bodies in working out sovereign debt crises, and the experience particularly of Latin America and South America, for guidelines on how to be successful in Puerto Rico. And we know that the rough playbook for success in situations of poor economic growth and very high debt has some key components.

Component number one is to keep taxes as low as possible and avoid sharp tax increases, which are detrimental to long-term growth, and reform them, as the Congressman pointed out, where appropriate, to be more pro-growth. That is part of the playbook. And address the chronic deficits, largely on the spending side, if at all possible.

But not all spending is created equal. You have to preserve core functions of government, the investments and the education that are central to long-term economic growth, and instead focus on transfer programs as the mechanism for reining in excess spending.

It is also important to liberalize labor and product markets and to remove onerous regulations. I think there is a good case to be made for that in Puerto Rico. And while I am sympathetic to Ranking Member Wyden's concerns over the social safety net, the min-

imum wage does stand out as an economic impediment in Puerto Rico.

The ratio of the minimum wage to the median wage—so, sort of how the minimum wage is relative to wages in the States and territories—Puerto Rico is at about 77 percent. In all the other States and territories, the next highest is 59 percent. That is South Dakota and Guam, tied.

If you wanted to just get down to that 59 percent, you would have to have the minimum wage go from \$7.25 to about \$5.50. If you wanted to get Puerto Rico into the middle of the pack of all States and territories, the minimum wage would have to be \$4.50. And so, as a matter of labor-market policy, I think it has to be something that people think about.

And then lastly, you need to privatize where necessary. And the key from the perspective of the near-term outlook is, if one puts in place this kind of a credible program, access to capital markets can be restored, bridge financing can materialize, and you can pursue the rest of the reforms as you go.

So those reforms—economic reforms, budgetary reforms—I think, should be the centerpiece of discussions, and they dominate any legal or process reforms that others might want to pursue. You have to change the fundamentals on the economy and on the budget.

And I thank you for the chance to be here today, and I look forward to your questions.

[The prepared statement of Dr. Holtz-Eakin appears in the appendix.]

The CHAIRMAN. Mr. Marxuach?

**STATEMENT OF SERGIO M. MARXUACH, POLICY DIRECTOR,  
CENTER FOR A NEW ECONOMY, OLD SAN JUAN, PR**

Mr. MARXUACH. Good morning, Chairman Hatch, Ranking Member Wyden, and members of the United States Senate Committee on Finance.

For the record, my name is Sergio Marxuach. I am the policy director at the Center for a New Economy, Puerto Rico's only not-for-profit, independent, and nonpartisan think tank. I thank you for the opportunity to appear today before this committee to discuss Puerto Rico's financial and economic challenges.

Puerto Rico, usually invisible to the U.S. media, has been in the news recently, especially since the Governor announced that the island's public debt of around \$72 billion, equivalent to 103 percent of its GNP, was "unpayable" and needs to be restructured.

The island, a U.S. territory since 1898, has experienced severe economic problems for several years now. Its economy has been contracting, or stagnant, at least since 2006, and unemployment, poverty, and inequality levels are extremely high, especially in comparison with the 50 States in the mainland.

Furthermore, decades of fiscal and economic mismanagement have engendered an economy characterized by chronic primary deficits, high debt-to-GNP ratios, low employment levels in the formal economy, an enlarging formal economy encompassing both legal and illegal activities, significant government corruption and predatory rent-seeking behavior in both the public and private sec-

tors, substantial tax evasion, a hollow productive base, and high levels of private consumption and indebtedness enabled by having access to a stronger currency than its economic fundamentals would warrant.

In our opinion, the parallels with Greece are quite evident for all to see and none to misunderstand. Notwithstanding this dismal economic situation, the island managed to triple its public debt from \$24 billion in 2000 to \$72 billion in 2015. Indeed, during this period, Puerto Rico's public indebtedness grew at a compounded annual growth rate of 7.6 percent, while its income, measured by GNP, grew at a nominal rate of only 3.6 percent.

Given that Puerto Rico's indebtedness grew at an average annual rate two times faster than the growth rate of its income during the past 15 years, it should not be surprising that Puerto Rico's public debt currently exceeds its GNP. To be fair however, for decades the borrowed money was put to good use, to finance the construction of public schools, hospitals, highways, and other essential infrastructure. The problem is that, during the last 20 years or so, a large portion of the money borrowed by issuing long-term debt was issued to finance budget deficits, operating expenses, and classic borrowed spending.

We at CNE had warned for years—since 2006, actually—that Puerto Rico's levels and rates of indebtedness were not sustainable. In February 2014, the three principal rating agencies ratified our analysis by downgrading the Commonwealth's debt as well as the debt issued by several of its agencies and instrumentalities to a speculative or non-investment grade.

The rating downgrades had a material adverse effect on the Commonwealth's finances, because they essentially shut down its access to capital markets, at least capital at reasonable rates. This at a time when the central government is still running a sizable budget deficit, several of the Commonwealth agencies and instrumentalities face significant maturities in the near term, the economy is contracting at an estimated annual rate of 1.2 percent, liquidity is running extremely tight, and net out-migration has increased to levels not seen since the 1960s.

Given the magnitude and multiplicity of challenges faced by Puerto Rico, it should be obvious that there are no quick fixes to solve the island's fiscal and economic problems. In our opinion, what is needed in the short term is a two-pronged action program, both at the Federal level and in Puerto Rico.

In Washington, Congress needs to implement a comprehensive program, remove some of the disadvantages imposed on Puerto Rico under the current political arrangement, and eliminate some longstanding discriminatory policies. The current situation simply does not allow for piecemeal action by Washington. A wide-ranging plan is needed. Specifically, this committee could introduce legislation on two issues that could have a positive and significant short-term impact on both the fiscal and economic growth parts of the problem.

On the fiscal side, the cost of the government health plan is one of the principal drivers of Puerto Rico's budget deficit. Providing Puerto Rico equal treatment under Federal health programs such as Medicare, Medicaid, and the Affordable Care Act would provide

the Commonwealth with some much-needed fiscal space to address a long-standing injustice inflicted on Puerto Ricans. For the truth of the matter is that Puerto Rican workers and employers pay the same payroll taxes as workers and employers in the United States, yet benefits to Puerto Rico are unfairly rationed by Federal legislation.

On the economic growth side of the equation, we recommend extending the Federal Earned Income Tax Credit program to Puerto Rico. The Federal EITC is the most effective anti-poverty program in the United States. Recent research also shows that it encourages work, promotes savings, helps poor families smooth out the effect of unexpected financial shocks, and builds a strong sense of future orientation among recipients. Extending this program to Puerto Rico, which would provide a significant wage supplement to Puerto Rican working families, could be expected to stimulate aggregate demand in the short term.

Outside the scope of this committee's jurisdiction, a Federal comprehensive package could include approving legislation to authorize the Puerto Rican government to allow distressed agencies and municipalities to file for bankruptcy under chapter 9, exempting Puerto Rico from coast-wide shipping laws which require the use of relatively expensive U.S. vessels for trade within Puerto Rico and the U.S. mainland, and approving legislation to relax the overly binding income and asset limits that apply to recipients of certain social assistance programs in Puerto Rico.

This Federal assistance would be conditioned on Puerto Rico in turn agreeing to increase tax revenues by improving enforcement efforts, closing down ineffective tax loopholes and modernizing its property tax system, cracking down on government corruption, significantly improving its Byzantine and unduly opaque financial reporting, reforming an unnecessarily complicated permitting and licensing system that stifles innovations, undertaking affirmative actions to materially lower energy and other costs of doing business in the island, and finally, substantially improving educational standards.

In addition to all of the above, Puerto Rico unfortunately also needs to obtain some debt relief. After years of relying on accounting gimmicks, forward refundings, back-loaded "scoop and toss" refinancings, capitalized interest payments, and other short-term expensive liquidity fixes, the Commonwealth has finally admitted that its debt is unsustainable.

While it is true—and I agree with Dr. Holtz-Eakin on this—that Puerto Rico's capacity to repay its debt ultimately depends on restoring economic growth in the island, there can be no economic recovery without debt sustainability. And that in turn is not possible without significantly restructuring at least some of its debt.

In my written testimony, I mention some recent findings about why that is necessary, but I am running—actually, I am over time. I am going to skip that one.

Basically, a recent study by Carmen Reinhart finds that softer forms of crisis resolution such as debt rescheduling, temporary payment standstills, and bridge lending operations were generally not followed by higher growth and better ratings. And these crisis resolution tools were in general ineffective in solving a debt crisis that

has been dragging on for years. Therefore, obtaining significant debt relief for Puerto Rico appears to be a necessary condition to restore economic growth on the island.

On the other hand, it should be obvious that obtaining debt relief is not sufficient in and of itself to jump-start economic growth. The important point in the case of Puerto Rico is that any savings derived from a reduction in debt service be used exclusively to advance and implement a renewed industrial policy, broadly defined, based on horizontal policies such as the ones described above; discovering new sectorial opportunities through a process of dialogue and consultation with key stakeholders in the island, both in the private and civic spheres; and identifying spillovers, externalities, and other areas where society could learn more.

This new learning, in turn, will lead to new investment in research and development, increased productivity, identifying new areas of comparative advantage for Puerto Rican firms, higher economic growth, and the creation of high-quality jobs which, at the end of the day, is what will categorically end Puerto Rico's economic stagnation. We at the Center for a New Economy are currently working with experts from Columbia, Brown, MIT, and Brookings, among other institutions, to develop this medium- and long-term industrial policy for Puerto Rico.

Finally, I would be negligent if I did not raise the question of whether Puerto Rico has reached the limits of what it can do to improve the quality of life of its people within the constraints imposed by its subordinate political status. Neither a sovereign country nor a State of the Union, Puerto Rico has no authority to negotiate international treaties, no access to emergency financing from multilateral institutions, no monetary policy instruments, limited fiscal policy tools, nominal representation in Congress, and the U.S. Supreme Court has determined that it is constitutionally permissible for Congress to discriminate against Puerto Rico in the application of Federal programs as long as there exists a rational basis for doing so.

Thus, Puerto Rico lives in a state of permanent limbo, a status that is both humiliating to Puerto Ricans and unworthy of the United States. Simply stating that it is up to Puerto Ricans to decide their political status, while true, is insufficient, because the U.S. Congress has longstanding legal and moral obligations with respect to Puerto Rico that it has failed to honor.

Congressional failure to act not only highlights a shameful lack of political will, it also weakens the United States' moral standing and jeopardizes its ability to effectively utilize its soft power in the international arena when it argues, for example, for better treatment for Hong Kong by China, for the Palestinians by Israel, or for Greece by members of the Eurozone. In this context, I would like to quote from the remarks made just a few days ago by an extraordinary man who came to this magnificent building to address a rare joint session of Congress.

Drawing from a deep well of wisdom that has accumulated for over 20 centuries, he stated, and I quote, "Your own responsibility as members of Congress is to enable this country, by your legislative activity, to grow as a Nation. You are the face of its people, their representatives. You are called to defend and preserve the

dignity of your fellow citizens in the tireless and demanding pursuit of the common good. For this is the chief aim of politics. A political society endures when it seeks as a vocation to satisfy common needs by stimulating the growth of all its members, especially those in situations of greater vulnerability or risk. Legislative activity is always based on care for the people. To this, you have been invited, called, and convened by those who elected you.”

In conclusion, Mr. Chairman, I thank you and the committee once again for the opportunity to participate in this important public policy debate, and I look forward to answering any questions that you or committee members may deem appropriate to ask.

Thank you.

[The prepared statement of Mr. Marxuach appears in the appendix.]

The CHAIRMAN. Well, thank you, sir. The ranking member needs to leave, so I am going to turn to him for his questions first, then I will turn to Senator Grassley.

Senator WYDEN. Mr. Chairman, thank you for the courtesy.

And let me ask the witnesses a question this way. It is not exactly an atomic secret that it is a big challenge around here to get bipartisan solutions to major issues.

Now, you all heard me say in my opening statement that I do not believe that cutting large new holes in Puerto Rico’s safety net is part of a strategy for a long-term plan for prosperity. I outlined that in my statement.

So I think I would like to go down the row and ask each of you four distinguished witnesses to give an example in your view of what Puerto Rico could work on with this committee, on a bipartisan basis, to help move ahead. And let us just go right down the row.

Congressman, I am very glad to have you here. I watched your very fine work in the House, and we have talked. But you understand the challenge. The challenge is to see if we can find a way to move forward in a bipartisan fashion, the government of Puerto Rico and colleagues on this committee, where there are obviously different views. Let us start with the Congressman.

Mr. PIERLUISI. As you all know, I fight for equal rights for the American citizens of Puerto Rico, equal political rights and equal treatment in Federal programs. But I will be very specific, to answer your question.

Something concrete you could do is to improve the treatment of Puerto Rico under both the Medicaid and the Medicare programs. And let me explain the impact that it would have. Just changing the Medicaid program as it applies to Puerto Rico so that it would cover our constituents up to 100 percent of Federal poverty level, would give Puerto Rico, the government of Puerto Rico, at least \$1.5 billion more to deal with the health needs of our population.

That would help Puerto Rico in terms of its liquidity issues. It would help Puerto Rico in terms of balancing its budgets. Because you have to understand, when you are talking about Puerto Rico, you are not talking about Costa Rica or the Dominican Republic. You are talking about American citizens who can hop on a plane from one day to the next and move to the States, if you are not

treating them adequately, if they do not have a decent quality of life. So that is being concrete.

The other program that you can deal with is Medicare. It is atrocious that we have the same payroll taxes in Puerto Rico, and there are disparities in the way the Medicare program applies. Hospitals do not get paid the same. Medical providers do not get paid the same, and Advantage Plans in Puerto Rico do not get paid the same.

That money, hundreds of millions of dollars—more than that—would be flowing through our economy, and it should. And it would help the economy to grow, particularly the health sector.

Senator WYDEN. And as the Congressman and all of you heard, I did talk specifically in my opening statement about Medicaid and Medicare reforms. For purposes of this question, put yourself in the position of trying to find support on that side of aisle and this side of the aisle for the kind of reform that will move us forward.

Ms. Acosta?

Ms. ACOSTA. Thank you. I think, in many important matters, we—even with our political differences—can agree. And I really would like to think that that is true. I totally agree with the statement just made by Congressman Pierluisi.

The health matters in Puerto Rico, and not only the fiscal matters, certainly, as he mentioned, would have a direct impact on the finances of the government. But it is also a humanitarian matter.

Right now there are physicians in Puerto Rico leaving the island, there are elderly people not having the services. And because of certain reductions, certain costs are going to happen in January, more people are going to enter into the government-sponsored program. That means we are going to have an even larger deficit of \$200 to \$300 million.

In addition to that, when the ACA funds expire, that means to Puerto Rico an additional \$1 billion deficit of funds that Puerto Rico is going to have, and we have to find them. So certainly I totally agree with the Congressman's statements.

And I have to say, the problem in Puerto Rico is not necessarily that we have too much debt, it is that we have too much debt and we do not have growth. We need growth. We need to create the growth, to increase the economy. We need to create the jobs so people stop going out of Puerto Rico and actually stay in Puerto Rico.

So certainly when we have talked about having a structure, a regime, that could help us restructure our debt, what I mean is that the debt is literally suffocating Puerto Rico. I mean, people say that we have more expenses now. No, we are paying more debt now than before.

Right now, our debt consumes our \$1.5 billion in payments. Years and years before, it was less than \$600 million. So we need a regime that could help us move forward, and that is why we have been asking for chapter 9. And we agree, again, with H.R. 870, which was another way in which we can agree, with differences.

Senator WYDEN. I am already over my time. Still, take the lodestar as something that can be bipartisan with my colleagues.

Dr. HOLTZ-EAKIN. I can count on you to ask hard questions, Senator, thanks. [Laughter.]

I think the number-one thing in solving a problem is to actually be able to identify it, measure it, and track it. And I think one of the very troubling aspects of this situation is that there are not good, high-quality budgetary documents prepared according to some sort of international standard that provide a transparent way to see the financing problem. And there has never been, to my knowledge, out of the various reforms that have been proposed, a genuine debt-sustainability analysis.

Those are things that this committee and Puerto Rico both need, and I do not think those should be partisan issues. Let us get better information, and let us guide the reform process using standard tools of debt sustainability, not snapshots on deficits and things like that, because that is the fundamental problem.

And if a program is put in place that provides sustainable debt, as I mentioned, the record is that that instills a lot of confidence in investors. It opens capital markets. It will bring in fixed investment into Puerto Rico. That is the growth issue. Without that, there is no success.

So I know it is a process answer, but I think it is a really important one.

And on the substance, just avoid the errors of the past, right? Section 936, targeted tax breaks, triple tax exemptions—those are not broad-based economic policies that generate growth.

Senator WYDEN. All right. One last witness.

Mr. MARXUACH. Thank you. I think there is one Federal program that has broad bipartisan support outside of defense and security appropriations. It is the Earned Income Tax Credit. I cannot think of any other Federal legislation since the mid-1970s that has been both adopted and improved by both Republican and Democratic Presidents and Congresses.

In terms of the impact it would have in Puerto Rico, it would provide a significant wage supplement to Puerto Rican workers, to the hardest-hit poor families in Puerto Rico, and that would have a short-term stimulus on aggregate demand.

It is not a fix-all-be-all, but in the short term, it is one of the few things that I think would both obtain support from both sides of the aisle and help the Puerto Rican economy in the short term.

Senator WYDEN. One of the reasons I mentioned it in my opening statement—and I thank Chairman Hatch for his courtesy—is because that program, of course, had Republican roots. That is something that clearly does fit this kind of litmus test.

Mr. Chairman, again, thank you for your courtesy, and I look forward to working with all our colleagues to try, as my question suggests, to work on a bipartisan basis to actually get something done.

Thank you, Mr. Chairman.

The CHAIRMAN. Thanks, Senator.

Next, Senator Grassley, and then I will ask my questions.

**OPENING STATEMENT OF HON. CHUCK GRASSLEY,  
A U.S. SENATOR FROM IOWA**

Senator GRASSLEY. Thank you for your courtesy, and thank you for holding a very important hearing, Mr. Chairman.

During the summer, I have had several meetings with people with different points of view on Puerto Rico, including the political

leadership of the community. And I would prefer to just make a statement now so you know kind of where, as chairman of the Judiciary Committee, I am coming from. I will continue to be open to discussions in the future as well. So I will take a few moments to make these points.

Puerto Rico's debt crisis did not happen overnight. It has been years in the making. Puerto Rico now has one of the largest deficits of all municipal governments in the United States.

The Krueger report explains that the root cause of this problem is decades of stimulus spending and economic stagnation. Instead of making difficult decisions to cut spending and balance its budget, the government kept borrowing to finance its operations using tax-exempt bonds to roll over debt coming due.

Finally, as we know and we have been discussing here, the game is up. As the Governor has said, debt is not payable and must be restructured. Now Congress is asked to step in and address Puerto Rico's debt situation.

No doubt a comprehensive approach is needed to restore fiscal balance and economic growth. Puerto Rico's debt is not sustainable without growth, and growth is not possible without local and Federal structural reforms. The government's fiscal and economic growth plan aims to provide a roadmap that achieves these goals. The plan asks Congress for meaningful help to restore economic development.

One proposal is to extend chapter 9 bankruptcy to Puerto Rico so that its municipalities can restructure their debt. Chapter 9, though, would only affect certain debt, as it is not applicable to the sovereign constitutional debt, constitutionally protected General Obligation bonds.

As with any single proposal, chapter 9 alone will not solve Puerto Rico's financial problems. Therefore, if we agree with the experts that structural reforms are critical to growth, then Congress should work to help Puerto Rico help itself.

We should consider exempting Puerto Rico from the Jones Act, which limits competition and raises the cost of living for island residents. Congress could also exempt Puerto Rico from the Federal minimum wage, which *New York Times* columnist Paul Krugman has stated is too high for Puerto Rico. Full-time employment at the minimum wage is equivalent to 77 percent of per capita income versus 28 percent here on the continent. Thus, eliminating the Federal minimum wage mandate would help grow Puerto Rico's economy.

However, congressional help without meaningful reform by the Puerto Rican government will not work. Puerto Rico needs to tackle difficult problems as part of any serious growth policy reform. Critics, however, of the government's plan argue that proposals do not go far enough. There is no mechanism to ensure that the proposals are ever implemented, and a local control board, if one is ever created, will be ineffective due to local politics and pressure.

Perhaps then a Federal financial control board should be part of a comprehensive approach to remove obstacles to certain fiscal reform, like the fact that the government employs almost 25 percent of Puerto Rico's workers.

Historically, these oversight and control boards—which Congress created, for instance, in New York City probably 35 years ago, the District of Columbia more recently—have shown success.

At the end of the day, it is likely that neither Congress nor Puerto Rico alone can solve this crisis, but now is the time for Puerto Rico to have the will and the courage needed to make difficult decisions so that this debt cycle is never again repeated, or otherwise anything that Congress might do would be of little avail if things do not change where the problem was created.

I yield the floor.

The CHAIRMAN. Thank you, Senator.

I think I will claim my time now, at this point.

Dr. Holtz-Eakin, this question is for you. I have heard frequently from a number of people that employers and workers in Puerto Rico pay the same Federal payroll taxes that are paid in the States, and that Puerto Rico's Medicare beneficiaries pay the same premiums, yet at the same time, the Medicare program treats hospitals, insurance providers, doctors, and patients in Puerto Rico differently than they are treated in the States.

Now many, including a number of Senators, have claimed that this is unfair and should be rectified. Given your knowledge of our health care laws and rules and the various Federal health programs, do you agree with the claim that people in Puerto Rico pay the same taxes as in the States with respect to Medicare, but are treated in an unequal fashion?

Dr. HOLTZ-EAKIN. Well fairness, obviously, is in the eye of the beholder, but I will just point out that Medicare Part B, Part C, and Part D are 75-percent financed out of general revenue and not out of payroll taxes or premiums. And that means that they are financed by income taxes. So Puerto Ricans do not pay income taxes, and so they do not contribute fully to the financing of the Medicare program.

There is no dedicated payroll tax for Medicaid, and so it is all out of general revenue at the Federal level. The same situation arises there, so there are not equal contributions in, and then it is up to the Congress to set the rules for what the support levels will be going out.

The CHAIRMAN. Well, let me ask you—maybe you and Mr. Marxuach—another question.

Looking at Puerto Rico's economy, analysts at the Federal Reserve Bank of New York have identified a number of challenges and recommended that Puerto Rico take a number of steps to promote growth and improve the overall health of the island's economy. These steps include reducing barriers to job creation and labor force participation, reforming the island's energy industry, lowering the cost of doing business, and partnering with industry in promoting independent policy evaluation by producing better data.

And like most reasonable people, I believe that Puerto Rico faces a number of specific economic challenges, and that these challenges will not go away if the strategy is simply to shave obligations to debtors and obtain more Federal tax incentives or funds for various benefit programs.

So, in looking for pro-growth policies that can promote economic activity in Puerto Rico, I wonder if you could tell me, both you and Mr. Marxuach, what you believe are the comparative advantages in Puerto Rico that should be built upon to stimulate growth, and what ideas you might have to accomplish this goal.

Dr. HOLTZ-EAKIN. Go ahead.

Mr. MARXUACH. Well, we are actually working on that right now, Senator, as I mentioned in my testimony, with a group of experts at Columbia University and Brown and other places.

Puerto Rico does have some advantages in having a fairly highly educated workforce, a bilingual workforce. Our geographic position traditionally has been an asset that I think has been under-utilized by Puerto Rico.

There are opportunities in areas like research and development of new medicines that we are undertaking right now. We need to do a lot more there, especially drugs that affect certain population groups, especially Hispanics and Latinos, in our case.

Also, there is a lot more that can be done in terms of research and development of green energy initiatives. Puerto Rico has a great engineering school. Again, that has been greatly under-utilized. We lose a lot of graduates from those schools to, basically, Fortune 500 companies.

There is a lot more we could be doing in tourism, believe it or not. Tourism as a share of the economy is still a relatively low part of our GNP. The problem there is that we cannot compete on a cost basis. Of all the low-income Caribbean islands, we have to target—and to be fair, some efforts have been done in this area—more high-end kind of tourists who are looking for a different experience.

So we do have some advantages. What we are lacking is a comprehensive strategy to implement it over the medium to long term, with specific milestones and objectives that we can measure along the way. And also, to be fair, we in Puerto Rico have in some sense created this problem by not following up or following through on what past administrations have done.

We do suffer from what—it is in the literature—I will call a re-founding syndrome. Every party, or every new Governor who comes in, seems to believe that whatever was done by the previous administration is illegitimate or in some way invalid. So they take it upon themselves basically to destroy whatever was contracted by the previous administration. And obviously this has hurt our ability to grow.

But yes, there are areas we can exploit and—

The CHAIRMAN. My time is up, but let me have Dr. Holtz-Eakin's answer.

Dr. HOLTZ-EAKIN. I would be happy to get back to you with a longer answer, but just to pick up on some of the key items, first of all, the New York Fed has it exactly right on the need for reforms.

And I think an emphasis on tourism is entirely appropriate, given the location and other advantages. The complaint will be that those are not high-wage jobs, but you cannot support high-wage jobs, given what is going on in Puerto Rico right now.

The areas that have the opportunity to grow those are in medical science and health, where there are already existing footprints; in

aerospace, which has a footprint. And in general, Puerto Rico needs to build on all of those and have a diversified strategy and not one that is pinned on a single policy or industry.

The CHAIRMAN. Senator Schumer, you are next.

Senator SCHUMER. Yes, thank you, Mr. Chairman. I want to thank you and Ranking Member Wyden for holding this hearing to discuss the dire economic and financial situation in Puerto Rico.

There are 3.5 million Puerto Ricans living on the island today, another 5.2 million in the United States, including over 1 million in my home State of New York. Sadly, as the economic situation in Puerto Rico has deteriorated, residents have felt the need to flee their homeland.

This population shift from the island to the mainland will continue as long as their economic situation worsens, until the only ones left are those who do not have the resources or ability to move. And at that point, we will have a humanitarian crisis on our hands as well, if not before.

We have a basic American responsibility to aid all American citizens in times of crisis, regardless of where they live. And beyond that basic imperative, if we fail to offer Puerto Rico assistance now, this problem will not be contained to the island.

We need to be concerned with these issues not only because Puerto Ricans are part of the American family and deserve the quality of life that we all expect, but because a failure now would ultimately result in a Puerto Rican financial crisis that could become a drag to our entire economy.

So I have introduced legislation to address several of the most pressing issues facing the people of Puerto Rico, including the legislation to allow Puerto Rico to access chapter 9 bankruptcy protections. I did it along with my colleague, another chief sponsor, Senator Blumenthal of Connecticut.

Because there are many factors that have and continue to contribute to the economic situation, I have some questions for our panelists.

First, I want to ask—

Senator NELSON. Would the Senator yield for 10 seconds?

Senator SCHUMER. Sure.

Senator NELSON. The statement that the Senator from New York has made applies to the State of Florida as well. A million Puerto Ricans, if we do not solve this problem, will move to New York and Florida. So I thank the Senator for raising this issue.

Senator SCHUMER. Thank you. Frankly, I have been disappointed by the lack of urgency of many of my colleagues in taking up and supporting this important piece of legislation.

I have heard a lot of excuses and justifications for this inaction. I have heard others say the legislation will not solve a fiscal crisis in Puerto Rico and we must come up with other solutions. Well, I agree. It is not the only solution.

I have never said that this one piece of legislation is the salve that cures all of Puerto Rico's wounds, and I believe we must continue to work towards finding the policy solutions that will help Puerto Rico address economic issues in the long term, and I have introduced other bills to do that. But providing Puerto Rico with access to chapter 9 bankruptcy protections is not only the equitable

thing to do, it is an incredibly important resource that can help Puerto Rico address its current fiscal crisis in the near term. It is not a silver bullet, but it helps and is needed dramatically. This is not an esoteric debate. The Puerto Rican people cannot wait any longer.

So today I am sending a letter with colleagues to Chairman Grassley of the Judiciary Committee urging Mr. Grassley at the very least to hold hearings on the upcoming piece of legislation. We have to move the process forward and hold a hearing and, hopefully, a markup shortly thereafter.

And one other issue before I ask my questions: health care is another great issue affecting us.

As was mentioned, Puerto Rico is treated differently in several key health care programs: Medicare, Medicaid, and under the ACA. Some examples are, Part B: beneficiaries in Puerto Rico are not automatically enrolled in Part B; they have to opt in. Part D: low-income beneficiaries in Puerto Rico cannot afford to pay for their medicines, and they do not get assistance through the low-income subsidy program. Physician payments under Medicare: Puerto Rico has the lowest payments of all the States, even though they do not have the lowest cost of living. Medicaid: Federal funding for Medicaid in Puerto Rico is capped. And so I, along with Representative Pierluisi, have introduced a bill that would address all these inequities.

The bill is called Improving the Treatment of U.S. Territories Under the Federal Health Care Programs, and it has four co-sponsors whom I am proud to have on the bill: Senators Menendez and Nelson, who are here today, and Senators Blumenthal and Gillibrand.

So these are my two questions to, particularly, our two representatives of Puerto Rico who are here today, and we welcome them. Can you explain how access to chapter 9 would be a particularly useful tool to deal with some of the issues facing Puerto Rico in the near term? And just talk a little bit about how the people of Puerto Rico feel about the unfair and inequitable medical treatment under Medicare and Medicaid and our other programs—to both Representative Pierluisi and Ms. Acosta.

And I am finished.

Mr. PIERLUISI. Senator Schumer, thank you; thank you so much for introducing both pieces of legislation. I have counterpart legislation in the House, as you know.

I previously addressed the Medicaid and Medicare issue, so I will now address, for the sake of time constraints, the chapter 9 issue.

It is not a panacea. I have never proposed it that way. In fact, I do not like talking about bankruptcy insofar as Puerto Rico is concerned. I do believe that our debt is payable. You might need to restructure, of course, where we have to, in particular cases.

One example is the Puerto Rico Electric Power Authority, the public utility. It has been under an indulgence agreement with its creditors for now a bit more than a year. So clearly it has not been able to pay its debts as they become due. Now, negotiations are ongoing, but there is no chapter 9 available.

Perhaps you do not need to use chapter 9, but you should have it available. There is no principled basis for not giving access to

Puerto Rico to chapter 9 of the Bankruptcy Code. We had it for 45 years, and then for no reasons explained in the Congressional Record, we were left out. The life of a territory—

And since then, now that we could be using it, now that our Legislative Assembly could be saying the Power Authority should be eligible to go to Bankruptcy Court and seek to reorganize itself, we are helpless. It would assist even in the process of negotiations, because it would foster fair negotiations to have chapter 9 as a backup.

So it is a very practical thing to propose. Not that I am proposing bankruptcy, simply that we should have the same treatment as the States do in the mainland.

Senator SCHUMER. Ms. Acosta?

Ms. ACOSTA. Yes. Certainly having a mechanism to deal with our debt—it is an extremely urgent matter. And you mentioned that it is an urgent matter.

I mean, Puerto Rico is having a liquidity crisis. We have been able to run the government by taking one-time measures that cannot be repeated. So we are in the process right now, as you know, of asking our creditors to sit down at the table and do a consensual agreement with us, because we do not have chapter 9.

The example of the restructuring of the electric company is just the best one. We have reached an agreement with almost half of the creditors, but there is another half that has not come to the table.

The problem here is timing. We need to have a solution soon, because we are running out of money. As the Governor mentioned, we are starting this process, and the idea is to respect the differences between the General Obligation bonds and COFINA.\* So that process is going to take some time. But if we had chapter 9, it could be a faster process.

And I agree, maybe we do not have to use chapter 9, but just having the tool is going to really, really help us. As I was saying before, Puerto Rico has a large amount of debt, but Puerto Rico has no growth. So every year a larger amount of our budget is going to pay debt. We pay more money to pay debt, we put in more money to the pension plans, more money to the health care, and then the operations of the government are actually being reduced.

There is a point at which we have to decide whether to provide basic services to our citizens—security, health, education—or to pay our debt. And what we are saying is, come to the table, bondholders, sit with us and try. It is best for everybody, even for them, for Puerto Rico to move forward and have growth.

So certainly, having a regime, a chapter 9 regime, is going to really help us. And as I said, I want to mention that we have a liquidity crisis. We are keeping the government open, but it certainly is taking some time.

In regard to the health matter that you mentioned, I totally agree. In both cases, in chapter 9, on the Medicare and Medicaid issue, it is a matter of fairness. It is a matter of saying, why do all the States have access to chapter 9 and Puerto Rico does not?

\*Corporación del Fondo de Interés Apremiante, also known as the Puerto Rico Sales Tax Financing Corporation.

Why do the American citizens living in the States not have caps on Medicare and Medicaid, and Puerto Rico has those caps on?

It is not only a fiscal matter. It is also, as I mentioned before, a humanitarian matter. So thank you.

Senator SCHUMER. Thank you.

The CHAIRMAN. We will turn to Senator Menendez.

Senator MENENDEZ. Well, thank you, Mr. Chairman, and I appreciate you holding this hearing on a critical issue—as we just heard, a crisis—that affects 3.5 million American citizens.

And I like to keep reminding everyone that Puerto Rico is not a foreign country. Because I was shocked, when I was in the House of Representatives, that I would have members of the House of Representatives come and ask me whether they needed a passport to visit Puerto Rico. That is true. That is true.

And that mentality is appalling, considering the fact that Puerto Ricans have fought and shed blood for American ideals and values in every war since World War I. Among the most decorated in the military history of the United States was an all-Puerto Rican division during the Korean War, the 65th Infantry Division.

So it is amazing to me that we have this attitude as if Puerto Rico is some foreign country and this is about foreign assistance. This is about—if the 3.5 million citizens of the United States who happen to call Puerto Rico home came to the United States, they would be able to vote. They would have all of the obligations, but also all of the benefits, of American citizenship, certainly in their health care, among other things.

And unfortunately, we are seeing a significant number of them. I see them in my home State of New Jersey. We have a long history of a sizable Puerto Rican population in our State, but they are coming in significant numbers because there is not, in many of their minds, a light at the end of the tunnel.

So they are citizens of this great country, just as much as you and I, Mr. Chairman, and therefore that means we have a responsibility of not turning it from a crisis into a full-blown tsunami.

Now certainly, identifying the causes of the problem are important. There is no question in my mind that local fiscal decisions over many administrations have created a part of the challenge. They played a significant role, and I recognize that.

I also recognize this crisis did not happen overnight. I believe the current administration inherited many of these problems and has taken a number of significant steps to improve the situation. And I believe—as I have worked with Congressman Pierluisi, who has done such an outstanding job in this regard—that the inequities at the Federal level have significantly contributed to the problem we face today, as he eloquently spoke of.

So we have not only a role but a responsibility to help meet this challenge.

Now, I think there is no good reason why Puerto Rico should not have equal access to chapter 9. I do not believe it is a panacea, but to the extent that you can get people to come negotiate with you in good faith, if they know chapter 9 is available, then all of a sudden we have a process to negotiate which would enable them to restructure a portion of their debt in an orderly, legal, and efficient manner.

Puerto Rico is included in nearly every other aspect of the Bankruptcy Code, and only lost access to chapter 9 after an obscure and non-debated provision was slipped into a larger bill in 1984. Now, I do not have the time here to get into why that happened, but there were reasons.

Now, I am a sponsor of the legislation that Senator Schumer talked about to correct this inequity. And I understand that is outside of the committee's jurisdiction, but so many of the things that we are talking about here, without the ability to orderly reorganize, are going to be virtually impossible, at the end of the day. So I think that is incredibly important.

I think there are enormous inequities in health care, and I have been dealing with that on this committee for some time. I have offered several efforts here. We skipped over the Puerto Rican hospitals in terms of health care technology, and everybody admits it was a mistake. But we have not helped them correct the mistake, despite our efforts to do so.

You know there are several bills that I have introduced to address these health care inequities, most recently with the Improving the Treatment of U.S. Territories Under Federal Health Programs Act of 2015, which is S. 1961. This is a comprehensive bill that includes provisions ranging from ensuring the island has equitable and sustainable Medicaid funding to changes to Medicare to ensure equity to hospitals, physicians, and seniors on this island.

I think, Dr. Holtz-Eakin, when asked a question about how do we get growth, one of the things you said was, having a more significant, sustainable health industry in the island. Well, it is going to be difficult to achieve that if you cannot be reimbursed in an equitable way.

And several of the bill's provisions do not even require a legislative fix, which is what is really alarming here. If we wanted to help Puerto Rico, CMS is capable of finding an alternative way to calculate Medicare Disproportionate Share Hospital payments to account for the fact that Puerto Ricans do not have access to SSI, and to adjust payments in Medicare Advantage rules to more accurately reflect the situation facing plans on the island. That could be done by CMS. Those policy changes do not require any new legislation and would have a substantial impact on the health care system in Puerto Rico.

Another area where U.S. citizens living in Puerto Rico are treated unfairly is in the refundable tax credits. As the Resident Commissioner noted in his testimony, Puerto Rico is partially excluded from the Child Tax Credit and completely prohibited from receiving the Earned Income Tax Credit. With a labor participation rate that is significantly below the mainland's, we should be doing everything we can to incentivize work, which is exactly what the EITC does.

And it makes no sense that an American citizen living in Puerto Rico is ineligible for the EITC, yet if the same citizen moved to the mainland, they would be able to benefit, even though they would have an identical Federal tax liability.

And taken together, I think these common-sense steps would help pull Puerto Rico back from the brink of collapse. They would

create an opportunity to set the stage for economic growth and give the government a fighting chance to dig out of this hole.

Now, finally, Mr. Chairman, I have heard some other suggestions, such as driving down the wages for Puerto Rican workers. I believe these suggestions are shortsighted and counterproductive. They will only exacerbate the problem.

The poverty rate in Puerto Rico is approximately 45 percent—45 percent—and the per capita income is one-third of the mainland average, with 37 percent of the population relying on nutritional assistance just to eat. Just to eat. It seems to me that the last thing Puerto Rican workers need right now is a pay cut.

I know that people look at section 936 and say that that was a mistake. Well, we have Enterprise Zones; we have Empowerment Zones. States all across the country are offering tax breaks in order to create investment and growth.

So we have to look at all of this in the totality for the 3.5 million citizens who have served this country, who still serve this country. If you go with me, Mr. Chairman, to visit the Vietnam Memorial, you will see a disproportionate number of Latino names and a disproportionate number of Puerto Rican names on that wall.

So this is about doing the right and moral thing by 3.5 million American citizens, and I will look forward, beyond this hearing, to some action, both by this committee and, hopefully, the Judiciary Committee, as we work together to ensure a greater future for the people of Puerto Rico.

And my questions were answered by members of the panel. I appreciate their testimony.

The CHAIRMAN. Thank you, Senator.  
Senator Nelson?

Senator NELSON. If you boil this down, it is a matter of right and wrong. It is a matter of fairness.

All along the last decade or so, Puerto Rico has suffered economically as a result of policies of the United States Government: the loss of the major military installations and the financial boost that they gave to the island, the loss of some of the pharmaceutical companies because of that position expiring, and now a change in the law that has been on the books since 1984 with regard to the crisis that we are facing. And it is simply not fair.

I think Senator Menendez and Senator Schumer, who have preceded me in their comments, have spoken of things that I would associate myself with. And of course, my State of Florida has a huge population, estimated at a million, of puertorriqueños all over Florida, but a lot who are concentrated in the Orlando area.

Now I wonder, if we do not solve this problem, whether it is the health care problem—Medicaid, Medicare Advantage—if we do not solve the bankruptcy problem and things just rock along like they are, how many more American citizens residing in Puerto Rico are going to move to the mainland?

And you know what that means. They are coming to places like New York and Florida, and, of course, we are glad to have them. But what degree of expertise and educational population is going to move from the island to the mainland? That is not good for Puerto Rico.

Congressman, do you want to comment on that?

Mr. PIERLUISI. Very much so. See, there is consensus here, Mr. Chairman, that the worst problem Puerto Rico is facing is lack of economic growth. And a related aspect of that is the loss of population.

It is very hard, if not impossible, to grow if you are losing population, and we are losing population to the tune of about 1.5 percent net per year now, for more than 10 years. They are leaving, yes, to places like Florida. And why? That is the question. They leave because of lack of good quality of life. They are leaving because of lack of jobs. They are leaving because of lack of good-paying jobs.

And for some to suggest that we should have a lower minimum wage does not make sense to me. If you lower the minimum wage in Puerto Rico, you will be giving the people of Puerto Rico an additional incentive to leave. The cost of living in Puerto Rico is comparable to the one in Florida. If you lower the minimum wage in Puerto Rico, you are basically giving people an incentive to simply rely on welfare benefits. It makes no sense.

We should stop treating Puerto Rico differently. We should treat Puerto Rico equally. That is a long-term plan that would make sense.

And I have to react to Dr. Holtz-Eakin's comment about Puerto Ricans paying payroll taxes but the Medicare program being 75 percent funded by general revenues. Well, let me remind the members of this committee as well as Dr. Holtz-Eakin that close to one-half of U.S. households in the mainland do not owe Federal income taxes, and nobody is suggesting removing them from programs like Medicare, Medicaid, and so on.

It is a policy reason why we are not paying Federal income taxes, but at the same time there is a policy reason for excluding us from a lot of Federal programs.

So we have to be smart about this. We have to make sure that in Puerto Rico we have a decent quality of life, and that involves health programs. That involves having, for example, participation in the Earned Income Tax Credit and Child Tax Credit programs, like Mr. Marxuach was suggesting.

Because when you look at them all, what you are doing is improving the quality of life in Puerto Rico. They are fellow American citizens. You should not be looking the other way. You should not be ignoring us. If you do so, you do it at your own peril.

The CHAIRMAN. Well, thank you. Thank you, Senator Nelson.

Dr. Holtz-Eakin, you have heard these comments from a variety of people here. Do you have any comments you would care to make to help us to understand this better and what we should be doing about the inequities that appear to exist that have been made in formal complaints?

Dr. HOLTZ-EAKIN. So on health spending, it has many dimensions, and it is important to think clearly about what additional spending would do. Additional health spending by the Federal Government into Puerto Rico is not a pro-growth strategy. You do not generate long-term economic growth by having health spending. It is a desire to consume something, not to generate saving investment.

The CHAIRMAN. It may be good, but it does not necessarily create jobs.

Dr. HOLTZ-EAKIN. It is not going to do that. It might relieve some budgetary pressure, but so would Federal checks of any type. So the real question is, as a matter of health policy—objectives in population health, objectives in reimbursement rates for providers and others, on hospitals—do you want to modify these programs? That is the issue.

But do not confuse it as sort of solving the budgetary and growth problems, which are the core problems in Puerto Rico. So that is, I think, something just to be very clear about when you analyze the problem and the solutions you come up with.

The CHAIRMAN. All right. Ms. Acosta, let me ask you—I have a couple of questions. They are asked for good purposes, but I would like to have your response.

I understand that there are roughly 17 or 18 different debt-issuing entities involved in Puerto Rico's indebtedness, and some have put the amount of indebtedness at around \$73 billion. It has also been reported that the debt has roughly doubled over the last 15 years or so. In fact, you have kind of indicated that, some of you here today.

And we have been told that some of Puerto Rico's debt could be restructured, and that some of it involves General Obligation bonds with certain protections under Puerto Rico's constitution, as well as some debts of municipalities.

Now, I have several questions about the scale and scope of this debt. I will read through them all first and then give you a chance to respond.

First, what is the best and most accurate source we can go to in order to find a clear and perhaps audited picture of Puerto Rico's government or government-backed indebtedness: who the debtors are, how much debt each of them has issued? I would like to know that. Maybe I should ask these separately. What about that? Where do we go to get the clear and perhaps audited picture, preferably an audited picture, of Puerto Rican debt?

Ms. ACOSTA. Yes, the Government Development Bank, which is the entity that I preside over, is the fiscal agent for the government. And we issue actually a quarterly document that we file with our legislature which contains all the debt that Puerto Rico has.

As you very well mentioned, we have, just to give an example, GOs, the General Obligation debts. We have guaranteed debts; they are not GOs, but they are guaranteed, which is similar to GOs. We have the debt from all the public corporations, the ones that we know and even others that I, no doubt, would know. We have COFINA pay for sales tax, municipalities' debt, GDB's own debt. So actually we issue a report quarterly with all the different issuers, all the debt.

The CHAIRMAN. I would like you to help the committee and send us material, if you can, on the debt so that we at least understand that.

Ms. ACOSTA. Sure. Sure.

The CHAIRMAN. This has to be done right away, because you have been indicating that you are going insolvent in November, I guess.

Ms. ACOSTA. We are. We are. Definitely, I will be more than happy to send you the information.

The CHAIRMAN. Thank you.

Ms. ACOSTA. Yes, certainly.

The CHAIRMAN. Number two, what is there to show for the resources that were borrowed, coupled with nearly \$3 billion Puerto Rico received from the Federal stimulus and more than \$6 billion of Medicaid relief funding provided in the Affordable Care Act?

Ms. ACOSTA. Yes, the monies provided by the Affordable Care Act actually reduced the amount that the Puerto Rican government was basically putting in the budget from our own monies. The amount coming from the general fund, which is our own funds, was reduced when we received the ACA, and certainly ACA has been a huge relief for Puerto Rico. That is why the cliff that is coming in 2018 is going to create a large budget problem.

In regards to the American Recovery and Reinvestment Act funds, ARRA funds were—

The CHAIRMAN. Let me get that right. You merged those funds with your general funds?

Ms. ACOSTA. No, no, no. We do not merge.

The CHAIRMAN. I did not think that—

Ms. ACOSTA. We have the health plan that is provided by the government to the citizens of Puerto Rico.

The CHAIRMAN. So that is where you put the monies?

Ms. ACOSTA. It helped to pay the health plan, exactly. It helped to pay the health plan that we provide to the citizens, along with general funds, monies from the Governor of Puerto Rico.

The CHAIRMAN. All right. The third question I have is, do you and others associated with the government in Puerto Rico intend to improve the transparency and availability of financial and economic data related to Puerto Rico's government finances and the health of its economy? If we do not get really well-audited figures, it is going to be pretty hard to help here. I want to help you; I do not think Puerto Rico is treated fairly, for the most part.

So my goal is to help you, but we are going to have to have real figures. We are going to have to have really good information from you in order to help you.

Ms. ACOSTA. Yes. We totally agree with you that our information is not the best information it can be, and certainly that is why the fiscal plan that we put together actually is investing money in changing our system.

Part of the plan is that—the systems that we have are very old, and the Treasury Department, which is the entity in charge of all the expenses and revenues, actually right now is acquiring a totally new system.

We are putting in new data and different data. For example, when we show the fiscal adjustment plan, we also issue a new report that has never been issued, so a report prepared by Conway MacKenzie, and it has to do with the cash flow of the whole government, not only the central government, but all the other agencies.

The CHAIRMAN. But you are going to have to provide that to us.

Ms. ACOSTA. I am more than happy to.

The CHAIRMAN. We will need that as soon as we can get it, now.

Ms. ACOSTA. Certainly. Certainly. I will send that.

The CHAIRMAN. Let me ask you some questions about Puerto Rican pension liabilities, because this is something that is bothering a lot of members of Congress. And this is, again, a question for you, Ms. Acosta.

You mention in your written testimony that Puerto Rico's public pension plans represent \$45 billion in liabilities. That is in addition to the \$73 billion that has been discussed.

Ms. ACOSTA. That is right.

The CHAIRMAN. So you are talking about a lot of money here. From what I understand, approximately \$18 billion of the roughly \$73 billion of the Puerto Rican debt that we hear a lot about is General Obligation debt backed by the full faith and credit of the Commonwealth.

Now, I wonder if you can tell me whether the pension liabilities are also backed by the full faith and credit of the Commonwealth and how Puerto Rico plans to deal with its public pension debt. Because I understand that is a very, very big problem right now.

Ms. ACOSTA. No, the pension obligation bonds are not backed by the full faith. There is around \$3 billion of debt, and certainly it is a big problem. You mentioned it is a big problem. Both of the largest systems, the teachers and the general employees, are running huge deficits. Most of the \$45 billion is coming from those two.

And the problem is that those systems are running out of assets. For both, actually, the assets are depleted by 2018, so that means that there are no assets to pay the pension, and that means that the money to pay the pensions of Puerto Ricans who have retired is going to come from the general fund.

So we have to find almost another \$900 million to put into the pension plan so we can keep paying the pensions.

This is one of the reasons, Congressman, that we are saying that we need to restructure debt and we need some time. We need some time to adjust our finances. And that time, if our creditors actually give us what we probably will be requesting, which is some time with no payment of principal and probably no interest payment, the idea is to just borrow the money to actually put it into the pension plans, because they badly need that.

The CHAIRMAN. All right. We have Dr. Holtz-Eakin here, who ran our Congressional Budget Office in this country, and who of course is a person we rely on rather heavily. And both sides do. He is totally honest.

You have listened to these answers; what are your suggestions?

Dr. HOLTZ-EAKIN. Well, I would echo the importance of having a set of transparent, audited financials that are comprehensible.

The CHAIRMAN. I think we have those now.

Dr. HOLTZ-EAKIN. But I think the nature of the analysis is also very important. As I mentioned earlier, I have never seen a debt sustainability analysis. As you know, the Congressional Budget Office puts out a long-term budget outlook on a regular basis that contains a debt sustainability analysis. The U.S. Federal Government flunks that analysis.

And we have not seen anything like that for the current policy in Puerto Rico, nor have we seen it for the proposed reforms, such as the Governor's Work Group, for example.

Those proposed reforms and anything this committee does should contain a real sustainability analysis to find out whether the measures are sufficient to solve the problem that Puerto Rico faces.

The CHAIRMAN. So you would recommend that we have to get this type of material before we really can solve the problem.

Ms. ACOSTA. The Anne Krueger report is a debt sustainability analysis, and we can happily provide that to you too.

Mr. PIERLUISI. Mr. Chairman, if you allow me, I would like to comment on a couple of these issues you have raised.

The CHAIRMAN. All right.

Mr. PIERLUISI. I will be brief.

The CHAIRMAN. Well, let me just preface this. One thing that bothers me is that I know the government has swelled there tremendously, and I presume the pension plans have swelled as well.

And sooner or later, somebody is going to have to get these things under control before the American people as a whole, including Puerto Ricans, really want to do something about this.

But go ahead. I just want to hear some—

Mr. PIERLUISI. I will be brief. In terms of ARRA funding, stimulus funding, it was spent in Puerto Rico in accordance with the legislation approved by Congress. I, for one, wanted to see more infrastructure project funding, but that was not the will of Congress.

The CHAIRMAN. Well, I think you should keep fighting for that.

Mr. PIERLUISI. Yes. In terms of Medicaid, the program, I remind you that in Puerto Rico the FMAP we have, it is 55/45. So we are assuming 45 percent of the expense, whereas if we were treated as a State, we would be assuming less than 20 percent of the expense. And we are not covering anything close to 100 percent of Federal poverty level.

The CHAIRMAN. Part of the reason is, you do not pay taxes. How do you answer that?

Mr. PIERLUISI. I already discussed, as a matter of policy, that that really should not be an issue, because you do help people, regardless of their ability to pay Federal taxes. You do it nationwide now.

In terms of financial information, to me there is no excuse for the government of Puerto Rico to have failed to publish audited financial statements for the last 2 fiscal years. And you are definitely entitled to get that information.

With respect to the budget—

The CHAIRMAN. Let me interrupt. On that point, unless you get those to us, I do not see how we can solve any problems here. So that has to be the first thing we get, and they have to be accurate financials. Let's face it, we have two houses of Congress and 535-plus people who are going to have to vote on this, and we had better have the right tools and we had better have the right information and we had better have the best possible economic information, or nothing is going to be done.

Ms. ACOSTA. Yes. We now have many financial reports that have never, ever been prepared by the government, like the quarterly report.

The CHAIRMAN. Well, I am counting on you.

Ms. ACOSTA. I will be sending those to you.

The CHAIRMAN. All right.

Keep going.

Mr. PIERLUISI. In terms of our budgeting system, definitely we have to revise the way we budget. We should adopt a zero-based budgeting system, because we have no margin for error. We do not have—

The CHAIRMAN. Well, I understand that you are government-heavy down there.

Mr. PIERLUISI. Exactly. And I have been criticizing the level of spending from day one. The first thing the current administration did was to increase spending by about 9 percent, by \$850 million the first year in office. And I said, “Do not do that.” They ended up adopting a slew of new taxes that affected our ability to grow, affected the private sector.

But I am not going to belabor that point. We do have to change the budgeting system, because we need to justify every penny we are spending. In addition, we need to make sure that it is not a fictitious budget, that we include in the central government budget everything that we are spending on, including subsidies to government-owned entities.

And finally, on your pension liabilities concern, which I share, let me just tell you that back in the year 2000, there was massive reform of the pension system in Puerto Rico. We changed it from an earned pension system to a contribution system, back in the year 2000.

In year 2013, there was another round of reform. And in terms of the legal liability here in question, there is Supreme Court case law in Puerto Rico recognizing the property and contractual rights of pension holders in Puerto Rico, to the extent that they are vested, to the extent that they are already getting a pension. And there is, I believe, also Federal case law along those lines.

So that is why I share your concern. To the extent those liabilities will affect the general revenues of the central government of Puerto Rico, it will be hard to deal with, but we will be legally obligated to do so.

Ms. ACOSTA. Can I just comment quickly on something that the Congressman mentioned?

The CHAIRMAN. Sure.

Ms. ACOSTA. I think it is important, Congressman, that we understand our budget and the changes that have happened from, let us say, 2011, 2012, to today.

The current budget that has been approved for both 2015 and 2016 contains the total amount of debt that has to be paid. The debt service is included.

The CHAIRMAN. We are pretty sure about the debt.

Ms. ACOSTA. I know, but in comparison—the Congressman keeps saying that we are increasing our budget. The budget has increased only in the amount of debt service and the amount that we are allocating to the pension because of the program that you just mentioned.

Just to give you an example, in 2012 the budget was \$9.2 billion. But you know what? There was \$870 million of debt payment, GO and PBA,\* government guaranteed debt, that was not paid. It was

\*The Puerto Rico Public Buildings Authority.

refinanced. And year after year, as Mr. Marxuach mentioned, that was commonly known as the “scoop and toss.” They would scoop the debt and throw it to the future.

So that budget of 2012 of \$9.2 billion, if you add the \$800 million that was not being paid, it would take you up to over \$10 billion.

The current budget is lower. When you look at the operational expenses, it is lower. But there is a big chunk of debt that we are putting in that was not being paid in the past, debt and retirement.

So no, that is not correct that we have been increasing our expenses. We are paying the debt that did not used to be paid, and we are taking all the measures. If you look at everything—services, contracts, professional services—everything is going down. The only amounts that are going up are debt and the amount that is put in the retirement system.

It is easy to play with the numbers, but when you look at the detail, you can actually understand that we have been decreasing the expenses.

The CHAIRMAN. All right.

Mr. MARXUACH. Mr. Chairman, can I add one more thing, since you are asking for information?

The CHAIRMAN. Yes.

Mr. MARXUACH. I submitted for the record an analysis of Puerto Rico’s fiscal balance. I actually did look at the audited financials we had available from 1998 to 2013. And I provided the committee for the record a summary of both the revenue and expenditures sides, including interest pending, so the committee could have an idea from that summary that I prepared, at least for those 15 years, how spending has developed.

We do not have audited financials for 2014, so that is why I had to end my analysis in 2013.

The CHAIRMAN. All right, I will accept that.

Now, let us finish with Dr. Holtz-Eakin. I am sorry to make you the skunk at the picnic, but—

Dr. HOLTZ-EAKIN. It has happened before, Senator. [Laughter.]

The CHAIRMAN. It sure has up here.

But I would like you to summarize what we ought to do here, or at least give us what your recommendations are and bring some realism into this so that my fellow members of Congress can say, “All right, we have the facts. Let us see what we can do.”

Dr. HOLTZ-EAKIN. As I emphasized—

The CHAIRMAN. It is a big job I am giving you.

Dr. HOLTZ-EAKIN. Yes. As I emphasized, the primary focus should be on policies that restore economic growth.

The CHAIRMAN. Right.

Dr. HOLTZ-EAKIN. So, for example, the Governor’s Work Group put out a proposal. If you look at it, whatever you might think of the policy merits on the tax and the spending side, and I have some reservations, it does not change the growth trajectory. So it does not work.

So you have to have a fundamental focus on better long-term economic growth. Without that, nothing gets solved.

The CHAIRMAN. Well, let me interrupt you for a second. Do you think chapter 9 would be a useful tool?

Dr. HOLTZ-EAKIN. So, there may be a place somewhere down the road for chapter 9, but I have deep reservations about the inordinate focus on it in dealing with the current crisis. As a lesson of life, changing the rules in midstream generates unintended consequences, and that is something to worry very much about.

I am not a legal scholar, but I think you should consult legal scholars about the applicability of chapter 9 to all the institutions that are in Puerto Rico. My understanding is, that is an issue.

It is also important to do the analysis and find out where those bonds are. I think roughly 30 percent of the bonds are held by Puerto Ricans. And a one-sided haircut, which is what chapter 9 provides—it is not a creditor/debtor negotiation; this is one-sided by the debtor—that haircut imposed on Puerto Ricans is not going to help them.

So I have been confused by the focus on chapter 9. I do not think it is a place that the Judiciary committee should go and then just stop. There are much bigger problems that have to be dealt with.

The CHAIRMAN. There is a reason why chapter 9 has not been supposed to apply. I should say reasons. But I share some of your skepticism there.

Keep going.

Dr. HOLTZ-EAKIN. I think you have the growth imperative. It has to be a growth that builds off the island's inherent capabilities. It cannot be something that is a sugar high, force-fed by Federal policies.

I have spent a long time in my tax policy career looking at section 936, and it did not serve the island well in the long run. And this is an underperforming economy, not for the past 5 years, the past 10 years, the past 20 years. It has been underperforming for a long, long time. It does not match growth rates of its Caribbean neighbors. It does not match growth rates of the U.S. States.

So there really has to be a rethinking of it. It is too government-centric; there is not enough room for the private sector to grow. Puerto Rico has to do its part on some of those things.

But the Congress has to take care of issues like the Jones Act, and there really are things that can be helpful to the island.

I am not a big fan of the health spending as growth policy or a fix for the budget, but there is a place to make sure, for example, that an 11-percent cut in Medicare Advantage in Puerto Rico, which is how the vast majority of Medicare recipients are served, does not endanger the sustainability of Medicare Advantage. Medicare Advantage is one of our better health programs, and that is an 11-percent cut when most MA plans are getting something that looks like a 2-percent, maybe a 3-percent increase. I would worry about that.

So you need to avoid going in the wrong direction on some of the social safety net programs while you are building the economic growth aspects.

And there is going to be, I think, no substitute for dealing with the budgetary problems within the context of Puerto Rico's legislative process and political process. I am, again, somewhat skeptical of the applicability of control boards, which are meant to circumvent the legislature and politics as the solution to this problem. A successful control board has to be independent enough and have

authority enough to impose the desired budgetary remedies. A control board independent enough would have to be basically imposed on Puerto Rico and infringe on its sovereignty. And I think that is a problematic thing for the Federal Government to do.

A control board that is not of that nature is probably not going to be independent enough to be effective.

So I think a focus on core budgetary solutions through the regular order is the way to go, and I do not think Puerto Rico is analogous to DC or New York, for that reason. I think it is a different animal.

The CHAIRMAN. Well, thank you. This has been a helpful hearing to me, and all I can say is, get us the facts and figures and let me see what our colleagues on both sides of the aisle want to do.

I am not for doing things that are just going to continue the problems—just extend them out. And then we have to find some way of having this operate on a fair basis, and we have to have a way of showing that as citizens of the United States of America, you are going to be treated fairly.

I would like to see that happen. The question is how, and I am not sure we have enough information to really make these earthshaking decisions up here. And besides, it is more than one committee too. So we will see what we can do.

I would love to resolve this problem, because I care a great deal for the Commonwealth and want you to succeed in every way. But I know one thing: it is very government-centric and very government-heavy. And that occurred too easily, probably.

All I can say is, help us to know what we can do. This hearing is helpful. I am still not sure what to do. If there is a board, it probably would have to be independent. If we modify title XI to put you in there, there are other factors there that militate against that.

So we could use whatever professional advice you can give us up here as to how best to do this and still have Puerto Rico rebound upwards, rather than downwards, just keeping programs going that literally are not justified.

So I am open, and I think others on this committee are open. I do not think anybody wants to see you suffer or be mistreated or not treated fairly, so help us to know what to do. And I do think that Dr. Holtz-Eakin is right on a number of items here that you should take to heart and see what you can do to resolve them.

Well, with that, I will recess until further notice, and we thank all of you for appearing here today. It means a lot to me personally. And we will recess until further notice.

Ms. ACOSTA. Thank you very much.

[Whereupon, at 12:05 p.m., the hearing was concluded.]



## APPENDIX

### ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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PREPARED STATEMENT OF MELBA ACOSTA-FEBO, PRESIDENT, GOVERNMENT  
DEVELOPMENT BANK FOR PUERTO RICO, SAN JUAN, PR

Chairman Hatch, Ranking Member Wyden, and members of the Committee:

My name is Melba Acosta-Febo, and I am the President of the Government Development Bank for Puerto Rico (the “GDB”). Before assuming this position in October 2014, I was the Secretary of Treasury of the Commonwealth of Puerto Rico.

I want to thank the Committee for giving the Commonwealth of Puerto Rico (“Puerto Rico”) and the GDB the opportunity to participate in this hearing. The GDB is charged with safeguarding the long-term fiscal stability of Puerto Rico and promoting its economic competitiveness. The GDB is also charged with serving as the fiscal agent and financial advisor for Puerto Rico and all of its instrumentalities. The GDB has a significant interest in and knowledge of the subject matter of this hearing.

#### THE CRISIS IN PUERTO RICO

The fiscal, economic, and liquidity crisis in Puerto Rico has passed the tipping point. The Legislative Assembly has declared a state of emergency, Puerto Rico has lost access to the capital markets on sustainable terms, and Puerto Rico faces an economic and liquidity crisis beyond what any jurisdiction in the United States has faced in generations. This crisis threatens the health, safety and welfare of the 3.5 million Americans living in Puerto Rico, many of whom are moving to the mainland—notably to Florida—at a rate of almost 100,000 per year. As I describe below, this crisis did not develop overnight, and it is not the result of any one factor, political decision or political party. Rather, this crisis is the culmination of decades of ill-advised public policy—both in San Juan and in Washington—coupled with a persistent stagnating economy, seemingly unlimited access to easy credit, and a market willing to lend.

While the United States economy as a whole has recovered from the recent financial crisis, Puerto Rico’s economy never came out the other side of that crisis, having contracted more than 20 percent in real terms over the last 8 years, which few countries in the world have experienced. Federal policy towards Puerto Rico has, if anything, exacerbated the situation. For example, the repeal and phase-out by Congress of Section 936 of the U.S. Internal Revenue Code, which provided tax benefits for certain businesses (including large pharmaceutical companies) operating in Puerto Rico, has led to a significant contraction in employment in Puerto Rico’s manufacturing sector. By some estimates, between 1996–2014 the phase-out of Section 936 itself caused the loss of 270,000 jobs when its total effect is calculated. Chairman Hatch, to his credit, worked with Puerto Rico and introduced a replacement to Section 936 in 2001. Had that legislation been enacted, the crisis we find ourselves facing today may well have been avoided.

Puerto Rico’s fragile fiscal state and the breakdown of its healthcare system have also been adversely affected by chronic underfunding of Medicare and Medicaid. Under Medicaid, for example, Congress both caps the amount of Medicaid funding that the Federal Government provides annually to Puerto Rico (\$329 million in 2015) and limits the share of Federal matching funds (known as Federal Medical Assistance Percentage (FMAP) at a fixed percentage (55 percent)). The Patient Protection and Affordable Care Act (ACA) provided some relief from these formulaic

limitations but those funds are scheduled to be depleted in fiscal year 2017. Several members of this Committee introduced S. 1961, which would address many of the inequities in how Federal healthcare programs are applied to Puerto Rico.

The contraction of Puerto Rico's economy has resulted in rising budget deficits at all levels of government, including at Puerto Rico's municipal or "public" corporations. Historically, to close unanticipated operating deficits, Puerto Rico and its public corporations relied on debt financing, and the credit markets had been willing to supply the funds. So while the economy has contracted by more than 20 percent over the past 8 years, outstanding public debt has increased by more than 60 percent. Today, Puerto Rico and its public agencies, divisions, instrumentalities and public corporations collectively have amassed approximately \$73 billion in public debt. In addition, Puerto Rico's public pension funds, although subject to a major overhaul in 2013 that reduced future accruals, still face significant unfunded actuarial accrued liabilities—approximately \$45 billion by some estimates—and will run out of funds altogether to pay benefits to their 166,000 beneficiaries by 2018 without substantial additional governmental contributions, contributions that will put further strain on Puerto Rico's budget.

Beyond these economic and fiscal constraints, Puerto Rico's labor and demographic characteristics are bleak. Unemployment has remained at elevated levels since the financial crisis: Puerto Rico's unemployment rate as of June 2012 was 14.6 percent but has since dropped to 11.6 percent as of June 2015 while unemployment in the rest of the United States has dropped to 5.1 percent. While the labor participation rate in the United States was 62.6 percent as of July 2015, the labor participation rate in Puerto Rico was 39.5 percent as of July 2015, which is a symptom of deeper structural problems and a combination of local and Federal policies that often incentivize individuals not to work. In 2014 there were 660,500 non-farm jobs in Puerto Rico, which is approximately 100,000 fewer jobs than in 2005 or a 13 percent decline over the period; an economy with a total labor force of about 1.2 million persons lost more than 100,000 jobs in less than a decade. By contrast, the number of non-farm jobs in the mainland increased by 4 percent over the same period. Poverty levels are also extremely high. Indeed, the median annual household income is \$19,000, which is only 36.7 percent of the median income in the United States. Moreover, due to outmigration to the mainland, Puerto Rico's population has declined every year since 2006; the same year of the phase-out of Section 936.

Puerto Rico's demographic trends are also deeply troubling. The remaining population is becoming increasingly elderly and outside the labor force. Persons 60 years and older represent more than 20 percent of the population (the highest in the United States) and children aged 5 years or less have decreased from approximately 295,406 in 2000 to approximately 187,371 in 2014, a reduction of 37 percent. This means Puerto Rico will have fewer people participating in the economy going forward, shrinking the tax base and making it more challenging to service its outstanding debt and finance necessary public services.

#### ACTIONS TAKEN BY PUERTO RICO TO ADDRESS THE CRISIS

Puerto Rico's Governor, the Hon. Alejandro García-Padilla, took office in 2013. Governor García-Padilla has been honest and forthcoming about the crisis that Puerto Rico faces and has forcefully responded to these unprecedented challenges in an effort to achieve fiscal sustainability and to place Puerto Rico on a path for long-term success. Since taking office, the Governor and the Legislature have materially reduced budget deficits by raising revenues and cutting expenses; imposed unprecedented cost-control measures at the central government and public corporations (including suspension of economic clauses of collective bargaining agreements, across-the-board freezes of wages and salaries, prohibiting extraordinary labor bonuses); established strict limits on government payroll (as of May 2015, there were 116,000 Central Government employees, compared to 158,000 in May 2008, a 27 percent reduction in central government employment); eliminated subsidies to public corporations such as the Puerto Rico Water and Sewer Authority; implemented comprehensive pension reform that sought to shift all government employees from defined benefit to defined contribution pension plans, and increased employee contributions to the retirement systems; enacted a law known as the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act") to create an orderly process to restructure the debt of Puerto Rico's public corporations; approved and overseen ongoing debt restructuring negotiations at the Puerto Rico Electric Power Authority ("PREPA"); prohibited GDB from providing deficit-financing loans; completed and is actively exploring public-private partnerships for state-owned assets and operations; and reformed rates at certain public corporations.

These measures build on the work of successive administrations that have tried to address Puerto Rico's stagnant economy through a mix of policies that have increased taxes, reduced the size of the public sector, reduced pensions to current employees, and increased water rates and highway tolls. In each case, however, economic growth has failed to materialize, and budget deficits have persisted as Puerto Rico's tax base has shrunk, creating an even greater dependence on deficit financing. As a result of persistent economic stagnation, more than half a million Puerto Ricans have left the island in the last 10 years seeking better opportunities on the mainland. This is a trend that does not augur well for our future.

Notwithstanding 10 years of tax and rate increases and the reduction of the government's workforce and reform of government wages and benefits, Puerto Rico faces an immediate liquidity crisis resulting from its inability to access the credit markets on sustainable terms to refinance upcoming debt-service obligations. In recent months, Puerto Rico has been forced to implement emergency "one time" measures to keep the government functioning, including borrowing from the State insurance companies, terminating monthly set-aside payments for debt service on the central government debt, delaying payment of tax refunds to residents and further stretching payment of accounts payables to vendors and third parties. While these emergency measures have temporarily avoided a shutdown of the Government of Puerto Rico, without access to the capital markets to refinance maturing debt, Puerto Rico may run out of emergency measures by the end of this year (and before a large general obligations payment due in January 2016), threatening the ability of the Government to continue to provide essential services to its residents and to pay its debts when due. In order to protect the 3.5 million citizens of the United States living in Puerto Rico, immediate action is required.

#### THE KRUEGER REPORT

After it became apparent that the difficult fiscal adjustment measures taken by Puerto Rico in 2013 and 2014 were not having the desired result of restarting economic growth and stabilizing public finances, the Governor commissioned a team of economists led by Dr. Anne Krueger, the former Chief Economist at the World Bank and First Deputy Managing Director of the International Monetary Fund (IMF), to undertake a comprehensive analysis of Puerto Rico's fiscal and economic challenges with the goal of identifying a course of action that could return the island to fiscal health and economic growth.

In June 2015, Dr. Krueger published her findings in a report entitled *Puerto Rico—A Way Forward*, which is commonly referred to as the Krueger Report. I have attached a copy of the Krueger Report, for inclusion in the hearing record, as Exhibit A,<sup>1</sup> which I hereby incorporate into my testimony. The Krueger Report identified a number of economic shocks—including the phase-out of section 936 noted above, a sharp decline in home prices during the recent financial crisis, and the Great Recession, among others—that have contributed to Puerto Rico's economic stagnation. The Krueger Report further identified a number of supply side factors contributing to the weak state of the economy, including relatively high labor costs, complex labor regulation and structural disincentives to work, outmigration of 1 percent annually (roughly 10 times the rate of West Virginia, the only State currently experiencing subzero growth), and the high costs of energy and transportation, among others. In addition to economic factors, the Krueger Report also identified a number of fiscal problems that have contributed to Puerto Rico's unsustainable debt-load. Specifically, the Krueger Report indicates that Puerto Rico's revenue projections have historically contained extremely optimistic assumptions, leading to an annual revenue shortfall of roughly \$1.5 billion.

Beyond identifying the cause of Puerto Rico's crisis, the Krueger Report identified prescriptive measures to reverse these trends and created a model to project future financing gaps after implementing the recommended measures. The Krueger Report's recommendations included items that must be implemented by Puerto Rico itself, as well as items that require assistance and policy change at the Federal Government. Critically, the Krueger Report found that even after implementing many of the recommended economic and fiscal measures, large residual financing gaps would persist well into the next decade, implying a critical need for debt relief from a significant proportion of the principal and interest falling due in Puerto Rico over the next 6 years.

<sup>1</sup>The Krueger Report, "Puerto Rico—A Way Forward" can be found on the Senate Committee on Finance website, or at <http://www.gdbpr.com/documents/PuertoRicoAWayForward.pdf>.

## THE FISCAL AND ECONOMIC GROWTH PLAN

Promptly after the Krueger Report's release, Governor García-Padilla ordered the creation of the Working Group for the Fiscal and Economic Recovery of Puerto Rico (the "Working Group") and charged it with developing a plan for economic growth and fiscal and institutional reform. The Working Group, in conjunction with its advisors, conducted extensive due diligence on various Commonwealth funds, agencies and public corporations that are supported by taxes and appropriations and that have contributed to the fiscal deficits identified in the Krueger Report, in order to create a holistic projection of Puerto Rico's finances and to examine various measures that could be implemented to address ongoing financing gaps. I serve on the Working Group in my capacity as President of GDB, and I have intimate familiarity with its diligence and findings.

On September 9, 2015, the Working Group released its conclusions and recommendations in a document titled the *Puerto Rico Fiscal and Economic Growth Plan*. I have attached a copy of the Fiscal and Economic Growth Plan, for inclusion in the hearing record, as Exhibit B,<sup>2</sup> which I hereby incorporate into my testimony. The Fiscal and Economic Growth Plan reviews the historical measures taken to increase taxes and reduce expenses; analyzes the current liquidity and fiscal position of Puerto Rico; recommends certain fiscal and economic reform and growth measures, including measures that require action by the U.S. Government; proposes a new law known as the Fiscal Responsibility and Economic Revitalization Act that authorizes the Governor to establish and appoint members, from a list provided by third parties, to a financial control board in Puerto Rico; and identifies significant projected financing gaps, even assuming the implementation of the recommended fiscal reform and economic growth measures.

Although I have already touched on the historical measures and current liquidity and fiscal position of Puerto Rico, I would like to highlight briefly certain key portions of the Fiscal and Economic Growth Plan for the benefit of the Committee.

*First*, the Fiscal and Economic Growth Plan calls for significant—and in many cases, painful—local reforms across nearly all aspects of the economy and government. The Fiscal and Economic Growth Plan includes reforms to labor and welfare laws, tax and permitting simplification and reform, consolidation of schools and the elimination of municipal and higher education subsidies. It also proposes the adoption of a new accounting systems, a new budgetary process, and reforms to the structure of Puerto Rico's Treasury Department in particular and fiscal decision-making processes more generally. These "structural reforms" are aimed at spurring economic growth while new revenue and expense measures are aimed at restoring Puerto Rico's long-term fiscal health.

*Second*, the Fiscal and Economic Growth Plan proposes legislation to be adopted by Puerto Rico's Legislative Assembly that would create an independent control board with jurisdiction over most government entities in Puerto Rico so as to assure budgetary discipline. Like control boards in other jurisdictions, Puerto Rico's control board will consist of qualified individuals who have knowledge and expertise in finance, management, and the operation of government. The control board will have the ability to monitor and ensure compliance with budgetary targets.

*Third*, the Fiscal and Economic Growth Plan calls on the U.S. Government to support Puerto Rico's effort to ensure long-term fiscal sustainability and growth. Specifically, the Fiscal and Economic Growth Plan calls on Congress to allow Puerto Rico access to a legal framework to restructure its liabilities in an orderly process; to provide equitable Medicare and Medicaid treatment and funding to address the humanitarian concerns tied to the healthcare crisis in Puerto Rico; to exempt Puerto Rico from the Jones Act to reduce costs and improve the ease of doing business; to modify Federal minimum wages rules, welfare programs, and labor laws applicable to Puerto Rico to incentivize people to work and increase the labor participation rate; and to provide Puerto Rico with a tax treatment that encourages U.S. investment and job growth on the island. With respect to this last item, the chairman and other members of the committee, as well as our Resident Commissioner, the Hon. Pedro Pierluisi, have moved forward legislation that would have helped Puerto Rico compete against foreign countries and attract manufacturing investment. These pro-growth measures could include amending the U.S. Internal Revenue Code to add a new Section 933A to permit U.S.-owned businesses in Puerto Rico to elect to be

<sup>2</sup>The Working Group for the Fiscal and Economic Recovery of Puerto Rico report, *Puerto Rico Fiscal and Economic Growth Plan*, can be found on the Senate Committee on Finance website, or at <http://bgfpr.com/documents/PuertoRicoFiscalandEconomicGrowthPlan9.9.15.pdf>.

treated as U.S. domestic corporations; enacting an economic activity tax credit for U.S. investment in Puerto Rico designed as a targeted, cost-efficient version of former Section 936 of the Internal Revenue Code; and exempting Puerto Rico from base erosion and/or minimum tax measures in the event the U.S. moves towards a territorial taxation system.

*Finally*, like the Krueger Report, the Fiscal and Economic Growth Plan recognizes that, notwithstanding implementation of key measures to restore growth in Puerto Rico, significant financing gaps will remain over the next decade necessitating debt relief across the Commonwealth's many different credits. The Working Group's advisors have already begun discussions with creditors that own significant amounts of Puerto Rico's debt. The goal of these discussions is to achieve, through consensual negotiations, an agreement with creditors to amend the payment terms of the Commonwealth's debt so as to avoid widespread defaults and to give Puerto Rico the breathing room necessary to implement the Fiscal and Economic Growth Plan.

#### DEBT RELIEF AND THE NECESSITY OF A RESTRUCTURING REGIME FOR PUERTO RICO

Notwithstanding Puerto Rico's best efforts to adjust its debts in a consensual manner as contemplated and discussed above in the context of the Fiscal and Economic Growth Plan, the likelihood of success would be materially improved if Puerto Rico had a legal framework within which to do so. The unavailability of any feasible legislative option to adjust debts has created an overall environment of uncertainty that makes it more difficult to address Puerto Rico's fiscal challenges and further threatens Puerto Rico's economic future. I would like to explain why this is so important for Puerto Rico, and how the lack of such a framework has already had significant adverse consequences in our ongoing restructuring efforts at PREPA.

As many of you may know, I testified in February before the Subcommittee on Regulatory Reform, Commercial, and Antitrust Law of the Committee on the Judiciary of the U.S. House of Representatives about the harmful effects associated with having no legal regime for debt restructuring in the context of a hearing on a bill to extend the protections of Chapter 9 to Puerto Rico. I described Puerto Rico's attempt to fill a statutory gap left by Congress in the Bankruptcy Code through the passage of the Recovery Act. The Recovery Act permits Puerto Rico's public corporations to adjust their debt in an orderly process—with creditor input and court supervision—much like the U.S. Bankruptcy Code while ensuring the continued provision of essential public services to residents in the event of a fiscal emergency at one of the public corporations.

Unfortunately, the Recovery Act has been held unconstitutional by the U.S. Court of Appeals for the First Circuit on the theory that the Recovery Act is preempted by section 903 of the Bankruptcy Code, which it held prohibits Puerto Rico from passing a law allowing for the adjustment of debt through a method of composition (Puerto Rico has filed a petition for *certiorari* with the Supreme Court of the United States). The practical and unfortunate result of this decision is that no legal regime is currently available for Puerto Rico to adjust debts through a court-supervised process.

#### THE LACK OF A RESTRUCTURING FRAMEWORK ALREADY HAS CONSEQUENCES, AS DEMONSTRATED BY PREPA

The consequence of this predicament has already shown its impact in recent and ongoing debt restructuring discussions between PREPA and its creditors. I believe it is helpful to give the committee context as to why this is so important. Specifically, PREPA has been able to reach a consensual agreement with a substantial group of its bondholders (both original and secondary market purchasers) and all of its fuel line lenders, which collectively hold nearly \$4 billion of PREPA's outstanding obligations. However, a consensual restructuring has been held up by a few institutions that, in the absence of an effective debt-restructuring regime, can try to hold up or opt out of a comprehensive restructuring. The Recovery Act was specifically designed to avert this free rider situation.

What is more, even if all of the major institutional creditors with whom PREPA is currently negotiating were to agree to a consensual debt restructuring plan, the unavailability of a court to oversee the restructuring process and, ultimately, approve and validate the plan, adds complexity, cost, and delay to the process, none of which is in the interests of creditors, consumers, or PREPA's other stakeholders. Indeed, parties will be hesitant to lend new money, or buy new securities, without the finality offered by the approval of an adjustment plan by a court of competent jurisdiction as contemplated in Chapter 9 or the Recovery Act. In addition, without

such a framework, even if PREPA reaches a consensual agreement with all of its key creditor groups, in the absence of an ability to bind “holdouts” such as could be achieved through a process like Chapter 9 or the Recovery Act, there is a built-in incentive for “free riders” to sit on the sidelines while other creditors bear the burden of the debt adjustment. The cost of dealing with such “free riders” is ultimately borne by the creditors that participate in the restructuring. In a worst-case scenario, free-riders can drive up the costs of a restructuring to the point where no deal can be consummated, even with creditors who would otherwise be willing to participate, because the cooperative creditors are unwilling to subsidize the recoveries of the holdouts. This problem would not exist under Chapter 9 or a Recovery Act framework where a supermajority of creditors willing to compromise can bind a dissenting minority looking for a free ride.

Finally, it is worth emphasizing two of the primary benefits of a bankruptcy regime. The first is the availability of interim or “Debtor-in-Possession” financing while negotiations with creditors ensue, which has the critical benefit of avoiding a liquidity crisis. Such financing is not available under current law. With no court empowered to approve and supervise such financing, the Commonwealth and its instrumentalities will continue to deplete much-needed resources until a consensual restructuring is consummated. Access to such interim financing would help ensure that the Commonwealth and its instrumentalities can continue to provide basic government services to its residents while debt adjustments are implemented and a resolution to the debt restructuring discussions is achieved. Second, in the event that efforts to reach a consensual agreement fail, there would be a stay against creditor suits that would help protect the residents of Puerto Rico and the island’s economy from the legal morass that would ensue.

In the case of PREPA, if negotiations continue for any lengthy period of time (as they have so far), or an event beyond PREPA’s control occurs (such as a hurricane that generates unanticipated costs), PREPA could be left unable to provide power to millions of Americans. I need not explain the health and humanitarian consequences in such a scenario.

To be clear, I discuss PREPA only as one example of the difficulty of restructuring debts in the absence of a clear legal regime. And while PREPA is making progress towards a consensual restructuring, PREPA has been in negotiations for well over a year and a number of significant creditors continue to hold out, hoping to free ride on those creditors who have already agreed to the deal. But for Puerto Rico, PREPA is only one of the nearly 17 Puerto Rico issuers that may need to adjust their debt as contemplated by the Fiscal and Economic Growth Plan. The absence of a legal regime to restructure the Commonwealth’s liabilities in an orderly process may potentially doom the ability of the Commonwealth and its creditors to achieve a comprehensive debt restructuring that will allow Puerto Rico to jump start its stagnant economy.

#### CONCLUSION

In conclusion, I would like to reiterate that the situation in Puerto Rico has passed the tipping point, and that Puerto Rico, in the face of an immediate liquidity crisis, has no access to the capital markets on sustainable terms and faces significant financing gaps over the next decade. Puerto Rico has taken the important step of developing a clear roadmap to address these challenges, which roadmap requires the implementation of difficult and painful measures, including the creation of a control board to monitor spending and compliance with the fiscal and economic growth plan.

I stress that while reasonable minds may differ as to the propriety of the specific measures that need to be taken—both at the local and Federal levels—the fact remains that Puerto Rico faces significant liquidity and financing shortfalls that require the U.S. Government to act. Congress must act now because the failure to act is not an option for the 3.5 million Americans living in Puerto Rico. Indeed, Federal action is essential, as outlined in the Krueger Report and the Fiscal and Economic Growth Plan and discussed in detail above, including parity for Medicaid and Medicare funding. Puerto Rico also speaks in unison in seeking access to a legal regime to adjust its debts as one necessary and critical step to achieving the objectives of the Fiscal and Economic Growth Plan.

The current crisis in Puerto Rico has been long in the making; it is the byproduct of a now decade-long stagnation in economic activity on the island, stagnation that threatens the ability of Puerto Rico to meet the essential needs of its residents and to avoid a disorderly default on its \$73 billion of indebtedness. But, as part of the

United States and subject to its laws and regulations, Puerto Rico can only do so much for itself to mitigate the crisis and avoid these devastating results. It needs the assistance of the U.S. Government to get out of this crisis, to achieve equitable funding in important Federal programs such as Medicaid and Medicare, to eliminate discrimination against it (versus the Virgin Islands, for example) in the application of the Jones Act and to give it access to an insolvency regime to facilitate an orderly restructuring of its debts. These areas in which we need immediate changes in Federal law and policy can help to facilitate an orderly resolution of Puerto Rico's current crisis. We have been unable to forestall a more chaotic situation by executing "one time" emergency measures; however, without an insolvency regime there will be greater losses to our creditors, our economy and our people.

I thank the Committee for recognizing the urgency of these matters by holding this hearing, and for giving the Puerto Rico and the GDB the opportunity to participate here today. I look forward to working with all of the members of the Committee to ensure that the health, safety and well-being of 3.5 million United States citizens is safeguarded and to making common cause with you in creating a better future for all the residents of Puerto Rico.

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PREPARED STATEMENT OF HON. ORRIN G. HATCH,  
A U.S. SENATOR FROM UTAH

WASHINGTON—Senate Finance Committee Chairman Orrin Hatch (R-Utah) today delivered the following opening statement at a hearing to examine Puerto Rico's current economic conditions and long-term fiscal health:

Good morning and welcome to today's hearing to consider the various financial and economic challenges in Puerto Rico.

We've all watched with great interest as the debt situation in Puerto Rico has unfolded. Whenever we talk about this issue, there are a number of interested parties, including policymakers here in Washington, bond holders, and, of course, the people of Puerto Rico.

According to statements from the Puerto Rican Government, the territory's debt of more than \$72 billion is "not payable." Some of that debt includes General Obligation bonds which have a constitutional first priority, and some includes debt of public corporations. In all, we're talking about roughly 17 different debt-issuing entities in Puerto Rico.

Puerto Rico's debt has more than doubled since 2000, despite the billions of dollars infused into its coffers from the Federal stimulus enacted in 2009 and from health care funding increases included in the Affordable Care Act. Even with those boosts in Federal funding and the related increases in Commonwealth spending, all we see is added Commonwealth debt. Moreover, there is a lack of reliable data indicating what Puerto Rico has to show in return in terms of infrastructure, efficiencies, and improved economic performance.

One reason we're having this hearing today is to give us a chance to gather additional information. As Senator Grassley—a former Chairman of the Finance Committee—can attest, this panel has done a great deal over the years to clarify the interplay between issues like Federal tax and health care policy and the impact they have on Puerto Rico and other territories.

I know that Ranking Member Wyden is committed to working with me to update and improve our understanding of this situation so that Congress can make decisions using the best available information. I think it would be extremely difficult to ask Congress to make important decisions and appropriately allocate resources without first understanding what the facts are and what problems need to be fixed.

Accompanying today's hearing, we have made available an updated overview of Federal tax policy and its interplay with Puerto Rico. This document was produced by our friends at the Joint Committee on Taxation. We also have several reports addressing Federal health care policies and Puerto Rico provided by the Congressional Research Service. And I've made public the responses that I received from inquiries I made to the Department of Health and Human Services on this issue.

In the days leading up to this hearing, I have heard from many interested parties, virtually all of whom have their own ideas about what needs to be done here. Some of these proposals have been helpful; others, not so much.

For example, I have heard that we can expect to see increased strains on Puerto Rico's health care system, especially given the demographic and economic realities on the island. One source of this stress seems to stem from the Affordable Care Act, which contains future cliffs where funding will be pared down and, according to some, these cliffs will hit Puerto Rico particularly hard.

Of course, for me it is not surprising to learn that there are inequities and financial harms resulting from the health care law. Even so, these problems and any proposed solutions are multidimensional and extremely complicated. Questions of funding and resource allocation are always difficult, and they implicate a number of issues. It isn't as simple as just deciding to give more health funds to Puerto Rico, because doing so would necessarily mean reduced funding for other priorities, increased taxes, or even more Federal debt.

That is the unpleasant budget arithmetic that we face. There are no easy answers.

For a long time, the people of Puerto Rico have suffered under a weak economy, including double-digit unemployment rates, very low labor force participation rates, and a bloated public sector. With many residents of the island facing a lack of opportunity or any expectations of a brighter future, Puerto Rico has increasingly seen out-migration.

All of this contributes to the fiscal challenges the territory now faces.

According to independent analysts, there are significant barriers to job creation and labor force participation in Puerto Rico. Some of these barriers stem from Federal entitlement programs. Others can be attributed to the application of other Federal laws and regulations.

For example, analysts across the political spectrum agree that Federal laws have increased the cost of energy in Puerto Rico and that the island's regulatory processes and bureaucratic red tape stifle business activity. And sadly, for the children in Puerto Rico, its education system, to quote Secretary of Education Duncan, "has been plagued by a revolving door of leaders and political patronage."

In short, and to put it mildly, Puerto Rico faces enormous fiscal and economic challenges. While the government of Puerto Rico has taken some steps in recent years to address these matters, many more changes—significant and fundamental changes—needed to be made.

Fortunately, Puerto Rico has a number of advantages to its credit, and we have seen successful turnarounds from over-indebtedness elsewhere, such as here in the District of Columbia and in New York City. I hope to see Puerto Rico join the list of successful turnaround experiences and I know that everyone here wants the people of Puerto Rico to experience a future with increased economic opportunity and growth.

Before I conclude, I just want to make sure we acknowledge the negative long-term impact Puerto Rico's unsustainable debt has had and will continue to have on the island's residents and what lessons we should take from their experience.

As the Congressional Budget Office has repeatedly warned over the past several years, despite some recent declines, our Federal deficits under current law will soon rise again and Federal debt will grow, as it has in Puerto Rico, to beyond 100 percent of the size of our economy. According to CBO, if we don't change course, we will increasingly have less fiscal flexibility and we run the risk of a fiscal crisis at the Federal level. Absent some kind of fundamental correction, it is not hard to imagine the devastating effects from unsustainable debt that are now being felt by Americans living and trying to work in Puerto Rico also being felt throughout the entire country.

Now, I will close by noting that this is the Finance Committee, with broad areas of jurisdiction, including Federal tax policy and health care policy. There are, of course, many other aspects of Federal policy that are also relevant to Puerto Rico's situation but fall into other committees' areas of jurisdiction, including Federal labor policies, Federal laws governing shipping vessels, bankruptcy law, and others. However, I ask that our witnesses keep their focus on areas of Finance Committee jurisdiction.

This is not, for example, a hearing on chapter 9 of the bankruptcy code or a hearing on Puerto Rico's status as a territory.

With that, I wish to welcome all of our witnesses, and I will now recognize Ranking Member Wyden for his opening statement.

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PREPARED STATEMENT OF DOUGLAS HOLTZ-EAKIN, PRESIDENT,  
AMERICAN ACTION FORUM\*

INTRODUCTION

Chairman Hatch, Ranking Member Wyden, and members of the Committee, I am pleased to have the opportunity to appear today. In this testimony, I wish to make three basic points:

- Puerto Rico's economic outlook is poor, reflecting a continuation of past, steady declines in output and employment. This trajectory could be stabilized or substantially improved with policy reforms.
- Puerto Rico's budget outlook is dire, but is not beyond being put on a sustainable trajectory with sound policies that do not defer difficult choices.
- The policy choices arrayed before Puerto Rican and Federal policymakers should be evaluated based on the degree to which they address root causes of the Commonwealth's budget challenges. The most widely discussed change, Chapter 9 bankruptcy protection for Puerto Rican governmental entities, would not improve economic growth, would not change the budget trajectory, and is not something that should be pursued at this time.

I will discuss each in additional detail.

ECONOMIC OUTLOOK

The Puerto Rican economy has been in steady decline for over a decade, which has and will continue to exacerbate the Commonwealth's fiscal challenges. The strict mathematical and practical reality is that any sustainable solution to Puerto Rico's must involve an economic growth component that boosts output, employment rolls, and income.

*Economic Output*

Puerto Rico has seen real output plummet since 2005, while Moody's predicts essentially stagnant territorial income for the next decade. This growth assumption incorporates an expectation of the inability of the Commonwealth to strike the proper balance between fiscal consolidation and economic growth. Pure austerity—poorly targeted tax increases and indiscriminate cessation of services—would have anti-growth effects and could contribute to tepid growth in the future, while more innovative fiscal consolidation approaches could be buttressed by enhanced revenues from stronger growth.

Unemployment peaked in 2010, with an increase of nearly 50 percent from 2005. While this high rate of joblessness has attenuated, it is projected to remain at persistently high levels—averaging nearly 13 percent over the next 10 years.

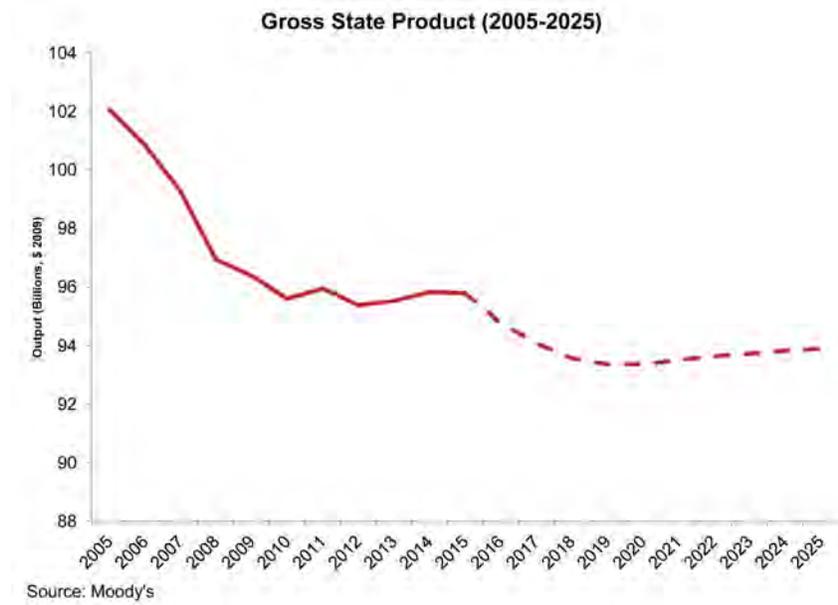
A key contributor to Puerto Rico's economic challenge has been net emigration. Over 300,000 Puerto Ricans have left since 2005, with net emigration and population decline expected to persist for the next decade, albeit at a slower pace. This has significantly curtailed the Commonwealth's labor force as a whole. Despite a declining population, the labor force participation rate has declined apace, highlighting structural weakness in labor markets beyond net emigration.

Echoing other indicators of the labor markets, payrolls have declined precipitously in the past 10 years, while a policy-agnostic outlook assumes flat employment levels over time. Stable payrolls however, compared to recent experience, are a positive sign and could provide policymakers with a predictable wage and tax base in the contemplation of future fiscal policies.

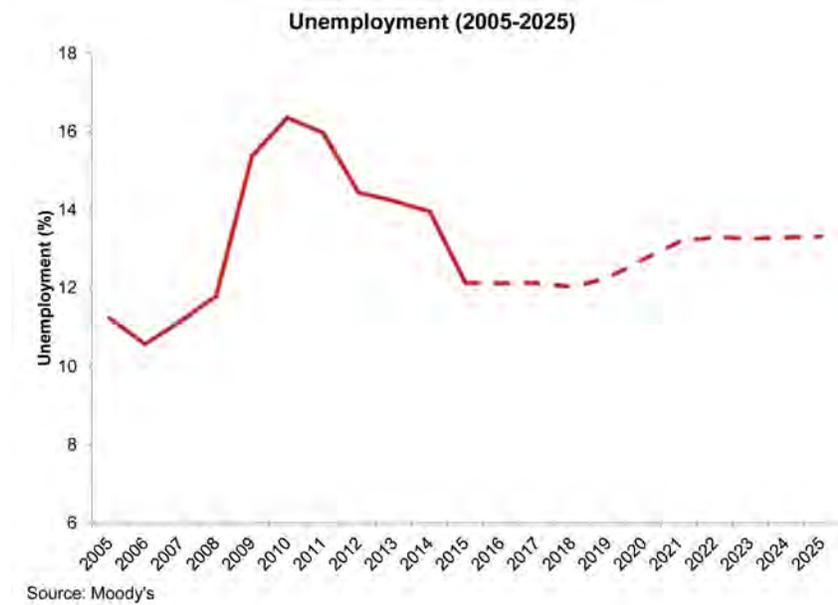
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\*The opinions expressed herein are mine alone and do not represent the position of the American Action Forum. I thank Gordon Gray, Sarah Hale, and Curtis Arndt for their assistance.

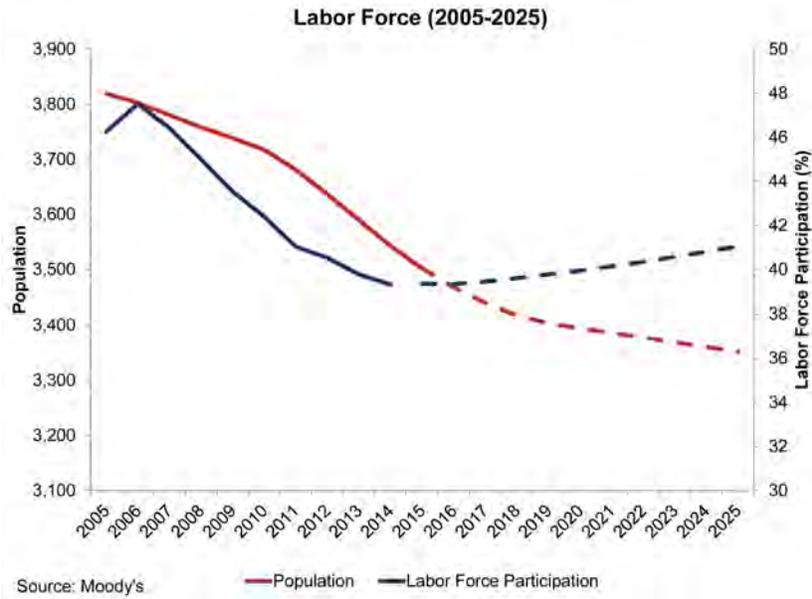
**Figure 1: Historical and Projected Output**



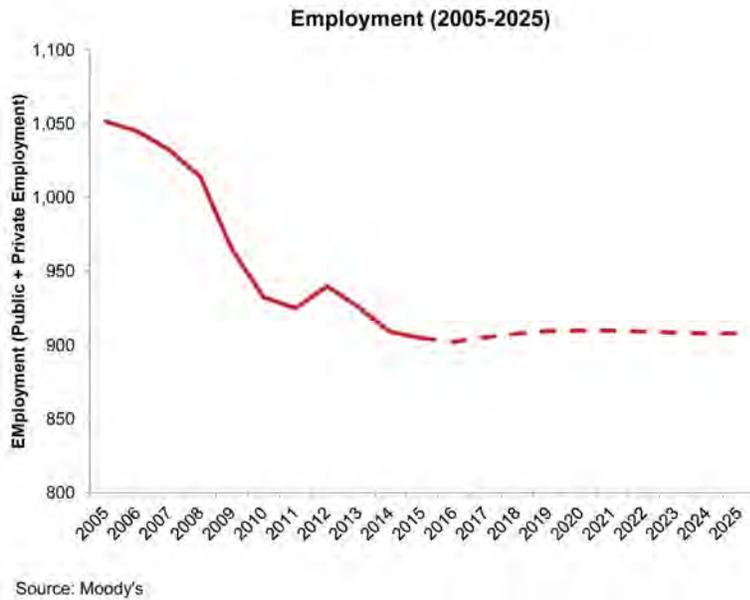
**Figure 2: Unemployment**

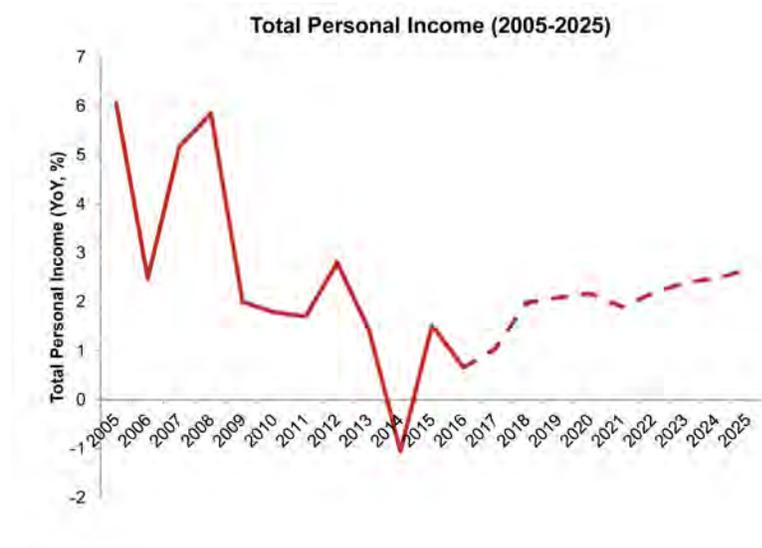


**Figure 3: Labor Force Trends**



**Figure 4: Employment**



**Figure 5: Total Personal Income**

Source: Moody's

Personal Income growth has remained under 3 percent since 2008 and is projected to average about 2 percent over the next 10 years. While far from ideal, stable income growth paired with steady payrolls could again provide a predictable wage and tax base around which to design pro-growth, fiscal consolidation.

#### SUMMARY OF ECONOMIC OUTLOOK

Every major economic indicator of Puerto Rico's economic well-being shows a Commonwealth in a protracted retrenchment. However, there are indications that major emigration flows and steep economic declines may have passed, leaving a trajectory of tepid though predictable growth. How Puerto Rico addresses its fiscal challenges, however, could radically alter this outlook for good or for ill.

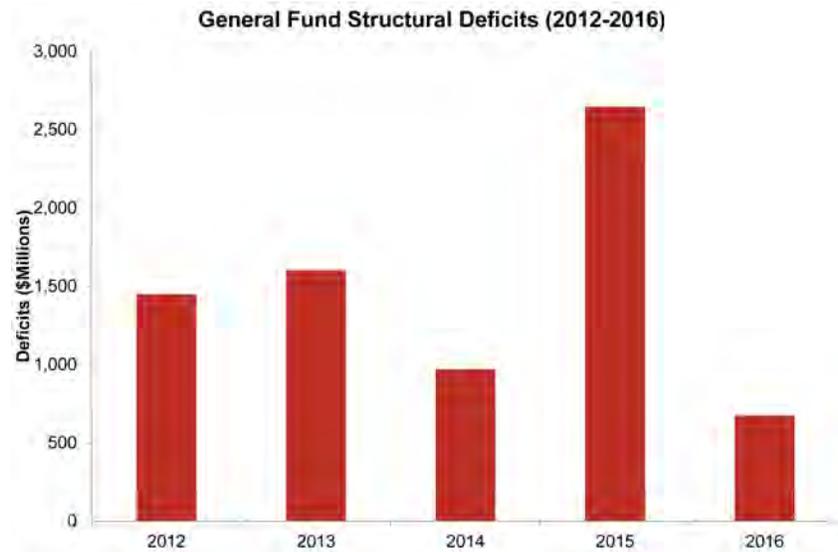
#### BUDGET OUTLOOK

By any objective measure, the budget outlook for Puerto Rico is troubling. The Commonwealth, through policy choices compounded by economic difficulty, has seen its debt obligations grow inexorably over the past decade and is projected to continue. Addressing these dual challenges is essential to an improved budgetary trajectory. This necessity must also reconcile immediate concerns over liquidity with the need for longer-term structural reforms.

#### *Historical and Recent Developments*

Puerto Rico has maintained structural deficits for some time, driven by economic conditions, policy choices, and unrealistic revenue and expenditure estimates.<sup>1</sup> Accounting for timing shifts and non-recurring budget events, structural deficits have been and will remain considerable.

<sup>1</sup><http://www.bgfpr.com/documents/puertoricoawayforward.pdf>.

**Figure 6: Structural Deficits**

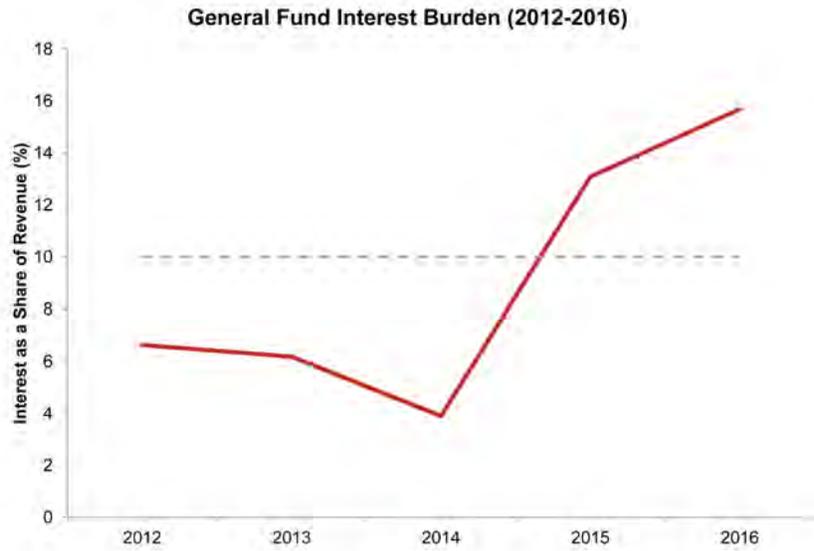
Source: CNE

The analysis by the Center for a New Economy of Puerto Rico's finances is instructive here.<sup>2</sup>

With persistent borrowing, debt service has grown as a share of general fund expenditures. More indicative of a borrower's ability to repay debt however, is debt service as a share of revenues. This simple metric incorporates many elements that signal a borrower's wherewithal to manage debt: interest reflects not only past borrowing, but the terms and credit worthiness of the borrower demonstrated by the interest rate underlying debt service costs; revenue reflects the strength of the economy and the ability of a government to harness national resources through tax policy. A common bright-line for identifying distressed sovereign borrowers is when interest exceeds 10 percent of revenues. The Commonwealth reached this level as of March 2015.

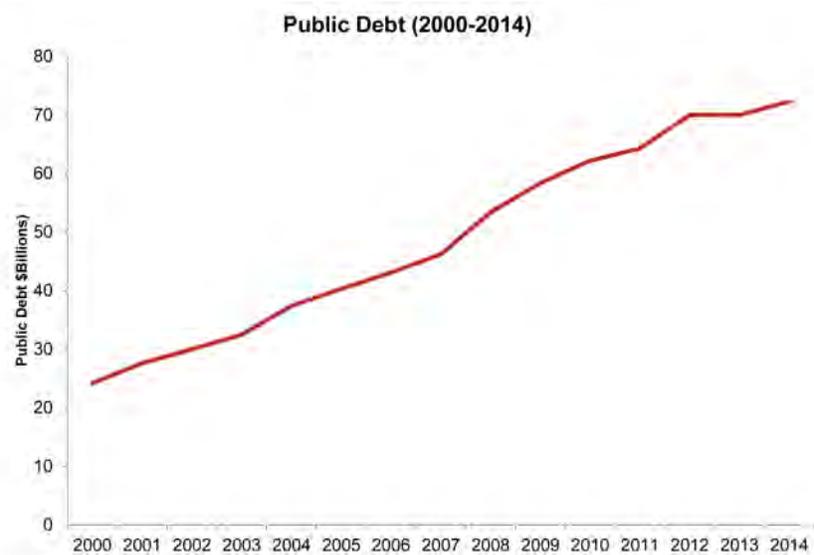
<sup>2</sup> <http://grupocne.org/2015/06/16/fiscal-situation-update-analysis-of-the-governors-budget-request-for-fiscal-year-2016/>.

**Figure 7: General Fund Debt Service Burden**



Source: CNE

**Figure 8: Public Debt**



Source: National Public Finance Guarantee

General fund debt has risen rapidly, but is only part of the problem. Puerto Rico's debt portfolio is largely driven by entities other than the central government. The Commonwealth's public sector debt has more than tripled over the last 15 years,

rising to over \$72 billion today.<sup>3</sup> The composition of this debt however, is instructive, and reveals the complicated nature of financing the Commonwealth's expenditures.

**Table 1: Composition of Public Debt**<sup>4</sup>

Year	Commonwealth	Municipalities	Public Corporations	Total
2009 .....	9,939	2,997	40,044	52,980
2010 .....	10,303	3,231	43,289	56,823
2011 .....	10,363	3,537	45,284	59,184
2012 .....	11,844	3,872	49,045	64,760
2013 .....	12,329	3,882	48,746	64,957
2014 .....	14,336	4,193	48,744	67,273
2015 .....	15,050	4,114	48,079	67,244

Source: Quarterly Report of the Commonwealth of Puerto Rico.

As of June 2015, the public sector debt for Puerto Rico stood at \$71.1 billion. Over \$48 billion of this total is attributed to debt issued by Puerto Rico's public corporations.<sup>5</sup>

**Table 2: Debts of Public Corporations**

Public Corporation	Total Bonds and Notes
Aqueduct and Sewer Authority .....	4,779
Convention Center District Authority .....	554
Electric Power Authority .....	9,054
Highways and Transportation Authority .....	6,530
Housing Finance Authority .....	263
Industrial Development Company .....	262
Infrastructure Financing Authority .....	2,184
Port of the Americas Authority .....	235
Ports Authority .....	275
Public Buildings Authority .....	4,316
Public Finance Corporation .....	1,091
Sales Taxes Financing Corp. (COFINA) .....	15,224
University of Puerto Rico .....	556
Others .....	2,757
<b>Total .....</b>	<b>48,079</b>

Source: Quarterly Report of the Commonwealth of Puerto Rico

These entities provide public and business-like services to Commonwealth residents, with the bulk of the indebtedness comprised of debt of the Sales Tax Financing Corp (COFINA), which in itself was originally created to finance existing debts; the Island's power utility (PREPA), which has recently agreed to a restructuring of some of its mature obligations; the Highway and Transportation Authority (PRHTA); the Aqueduct and Sewer Authority (PRASA); and the Public Buildings Authority (PBA). The major ratings agencies have continuously downgraded the general obligations of the Commonwealth as well as issuances of Puerto Rico's principal public corporations, which are rated below investment grade by Fitch, Moody's and S&P.<sup>6</sup>

#### *Near Term Challenges and Outlook*

Prospectively, the Commonwealth faces significant challenges in both the near and long term. Of most immediate concern is the claim that Puerto Rico is facing a liquidity crisis, and will be unable to meet its payment obligations beginning in

<sup>3</sup> <http://www.bgfpr.com/documents/CommonwealthQR-5-7-15.pdf>.

<sup>4</sup> This reflects most of what comprises the Commonwealth's debt. For specific exclusions, see footnotes 1 and 2 on page 63 of: <http://www.bgfpr.com/documents/CommonwealthQR-5-7-15.pdf>.

<sup>5</sup> <http://www.bgfpr.com/documents/PuertoRicoFiscalandEconomicGrowthPlan9.9.15.pdf>.

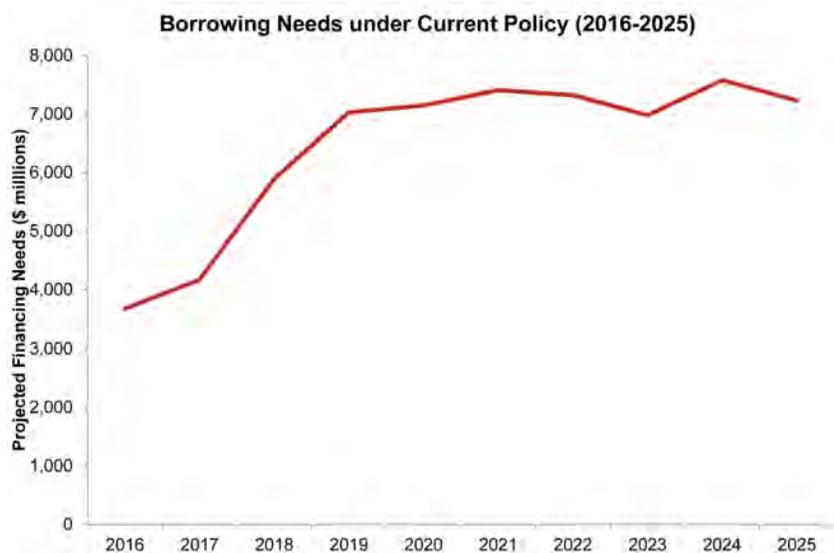
<sup>6</sup> <http://www.bgfpr.com/documents/SupplementoQuarterlyReport6-30-15.pdf>.

November of this year.<sup>7</sup> The financial advisor to the Government Development Bank for Puerto Rico estimates that this cash constraint will persist through December before improving until June. At that point Puerto Rico is again expected to face a liquidity challenge. It is important to note that this advisor also expects that the Commonwealth will be able to manage the immediate challenge. Moreover, the June challenge does not appear insurmountable, as the cash flow analysis that underpins the June shortfall assumes certain payments that should not take priority over existing obligations such as deferred tax refunds and “economic development fund” expenditures.

#### *Longer Term Challenges*

As noted above, the GDP outlook is poor, with growth remaining depressed over the foreseeable future. The Commonwealth’s future financing gap is also a source of serious concern.

**Figure 9: Projected Borrowing Needs**



Source: Krueger, et al.

According to a recent estimate by former first deputy managing director of the International Monetary Fund, Anne Krueger and others, under current policy and accounting for other factors, the Commonwealth faces a financing gap of over \$64 billion over the next 10 years.<sup>8</sup> Under current conditions, capital markets are highly unlikely to supply this financing to the Commonwealth. Accordingly, long-lasting and meaningful policies must be pursued to confront the dual challenge of tepid growth and an unsustainable fiscal outlook.

Any approach to altering Puerto Rico’s budget trajectory must improve the employment outlook. These should include lowering the Federal minimum wage to levels appropriate for the island’s wage scale. The Federal minimum wage is quite high relative to wages in the Commonwealth—the ratio of the minimum wage to the median wage is 77 percent, the highest of any State or territory. The next highest (South Dakota and Guam) is 59 percent, which would require a minimum wage of \$5.55 in Puerto Rico. Lowering the minimum wage to put Puerto Rico in the middle of the rankings of States and territories would require a minimum wage of \$4.50. The minimum wage is simply too high for Puerto Rico.

<sup>7</sup> <http://www.bgfpr.com/documents/150825ConwayMacKenzieLiquidityUpdateReport.pdf>.

<sup>8</sup> <http://www.bgfpr.com/documents/puertoricoawayforward.pdf>.

At the same time, the Commonwealth should undertake reforms of its labor market to bring employment practices into closer alignment with the rest of the United States. Some degree of these approaches was recognized in the “Fiscal and Economic Growth Plan,” but reforms should go farther than the plan pursues.<sup>9</sup> For example, the Governor’s plan would seek to exempt Puerto Rico from future minimum wage increases rather than reduce the current wage and would maintain, albeit with eased exemption, mandatory December bonuses.

Additional reforms should be pursued to reduce regulatory impediments and other burdens on business. These efforts should include addressing concerns for shipping costs by reforming the application of the Jones Act to Puerto Rico. While the Government Accountability Office did not make a conclusive determination of what overall effect this might have, limited exemptions, such as for natural gas, could be beneficial.<sup>10</sup>

Beyond these measures, Puerto Rican policy makers should address reforms at root causes, rather than defer these challenges. This includes measures to enhance economic growth, as well as the key drivers of the Commonwealth’s budget challenges. This should include structural reforms aimed at Puerto Rico’s major public sector corporations, as well as pensions. Some of the reforms to the public-sector corporations pursued in the “Fiscal and Economic Growth Plan,” such as depoliticizing PREPA, are worthwhile but insufficient. In the cases of some of these large public-sector corporations, PREPA in particular, a privatization should be considered, both from the standpoint of the Commonwealth’s balance sheet, as well as efficient delivery of services. Addressing unneeded municipal expense should form part of a budget plan. In some municipalities, 98 percent of budgets are payrolls, which suggests that these entities could be consolidated without diminishing services.<sup>11</sup> Puerto Rico has undertaken important pension reforms in the past several years, but with public pension liabilities of \$43.5 billion, this area of Commonwealth finance must also be further reformed.<sup>12</sup> While additional tax collection should be part of the Commonwealth’s budget reforms, it should not reflect the bulk of the solution, which must be found among the key drivers of Puerto Rico’s debt.

I am less optimistic regarding the appointment of a control board with the authority to institute meaningful budget reforms. Control boards were involved in addressing budget challenges in New York and Washington DC. Unfortunately, it is hard to imagine a board that simultaneously respects the sovereignty of the Commonwealth and has sufficient political independence to be successful. For example, the board proposed in the “Fiscal and Economic Growth Plan,” would be relatively limited in its scope and authority.

What the Commonwealth should not be pursuing, and what Congress should not entertain, is extension of Chapter 9 bankruptcy law to the government corporations. Chapter 9 would not increase economic growth. Chapter 9 would not alter the fundamental fiscal trajectory. For these reasons, it should not be pursued, at least at this time.

Moreover, it could hinder future well-being in the Commonwealth. First, while Puerto Rico will face challenges seeking financing in capital markets, Chapter 9 would enshrine these challenges with perpetually higher borrowing costs at such time that Puerto Rico is even able to access external financing. Chapter 9 would not address the root causes of Puerto Rico’s ills, but rather defer them to future generations.

#### CONCLUSION

The economic and budgetary outlook for Puerto Rico is dimmed by past experience. If meaningful policy reforms are not put in place to address the persistently low growth, outmigration and high unemployment, then the budgetary outlook will remain distressed. As a complement, if the major institutions and elements of Puerto Rico’s debt growth are left unreformed, then the economic outlook will be further damaged by a debt crisis and resulting diminished investment. Both facets of Puerto

<sup>9</sup><http://www.bgfpr.com/documents/PuertoRicoFiscalandEconomicGrowthPlan9.9.15.pdf>.

<sup>10</sup><http://www.ny.frb.org/outreach-and-education/puerto-rico/2014/Puerto-Rico-Report-2014.pdf>.

<sup>11</sup>[http://www.caribbeanbusinesspr.com/prnt\\_ed/municipalities-can-save-money-and-be-more-efficient-with-county-system-11093.html](http://www.caribbeanbusinesspr.com/prnt_ed/municipalities-can-save-money-and-be-more-efficient-with-county-system-11093.html).

<sup>12</sup><http://grupocne.org/2015/06/16/fiscal-situation-update-analysis-of-the-governors-budget-request-for-fiscal-year-2016/>.

Rico's challenge must be addressed simultaneously, an effort that would dramatically improve the Commonwealth's future.

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QUESTIONS SUBMITTED FOR THE RECORD TO DOUGLAS HOLTZ-EAKIN

QUESTIONS SUBMITTED BY HON. ORRIN G. HATCH

*Question.* Would you recommend any changes in federal tax policy that would affect Puerto Rico and, if so, what specific changes would you recommend and why?

*Answer.* Puerto Rico is in part dependent on federal reimbursements of rum excise taxes. These reimbursements are currently based on an enhanced, "temporary" basis that is routinely renewed in Congress's annual tax "extenders" package. If this package is not renewed, Puerto Rico (and the U.S. Virgin Islands) would receive lower reimbursements—a combined \$168 million in subsidies.<sup>1</sup> As part of broader tax reform measures, Congress should regularize its tax policies to improve predictability and stability of provisions like the extenders.

*Question.* We've all heard the argument that the so-called Affordable Care Act provided streams of elevated health care funding for Puerto Rico that came with cliffs, where the ramped up spending will, under the law, be lowered down the road. Now, some people—including more than a few outspoken proponents of the Affordable Care Act—are telling us that those cliffs will cause undue harm to the people of Puerto Rico and must be either eliminated or delayed. As I said in my opening statement, it is no surprise to me that the Affordable Care Act imposes harm on Americans.

My question is whether you agree with me that, if the funding cliffs written into that law are simply removed by effectively increasing federal health care funding to Puerto Rico, we will necessarily see reduced healthcare funds for states, fewer available funds for other federal programs, higher taxes, expanded debt, or some combination of all of these outcomes. Do you share that view? Why or why not.

*Answer.* I agree. Increasing federal outlays for Puerto Rico involves either higher taxes or borrowing by the Treasury. Alternatively, it would be possible to avoid this by cutting spending elsewhere—either state-based health programs or other priorities.

As an aside, there is no compelling case to remove the sunset. As was made clear by Melba Acosta in her responses to your questions, when the ACA funding was provided Puerto Rico cut its spending on health and directed it elsewhere. Obviously a higher level of health spending was not desired or Puerto Rico would have kept its funding in place. When the ACA cliff occurs, the same sequence can simply be run in reverse.

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PREPARED STATEMENT OF SERGIO M. MARXUACH, POLICY DIRECTOR,  
CENTER FOR A NEW ECONOMY, SAN JUAN, PR

"The paths of progress in history have proved to be more devious and unpredictable than the putative managers of history could understand."

—Reinhold Niebuhr, "The Irony of American History" (1952)

Good morning, Chairman Hatch, Ranking Member Wyden, and members of the United States Senate Committee on Finance. For the record, my name is Sergio Marxuach, and I am the Policy Director at the Center for a New Economy, Puerto Rico's only, not-for-profit, independent, and non-partisan think tank. I thank you for the opportunity to appear today before this Committee to discuss Puerto Rico's financial and economic challenges.

Puerto Rico, usually invisible to the U.S. media, has been in the news recently, especially since the governor announced that the island's public debt of \$72 billion, equivalent to 103 percent of its GNP, was "unpayable" and needs to be restructured.<sup>1</sup>

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<sup>1</sup><https://www.jct.gov/publications.html?func=startdown&id=4677>.

<sup>1</sup>In Puerto Rico, GNP, which measures income earned by residents or by locally owned production factors, is a more accurate measure of economic activity than GDP, due to distortions induced by the transfer pricing practices of multinational companies operating in the island. For a technical analysis of the GNP/GDP gap in Puerto Rico, see "Economic Growth" by Barry P.

The island, a U.S. territory since 1898, has experienced severe economic problems for several years now. Its economy has been contracting or stagnant at least since 2006, and unemployment, poverty, and inequality levels are extremely high, especially in comparison with the 50 States in the mainland.<sup>2</sup>

Furthermore, decades of fiscal and economic mismanagement have engendered an economy characterized by: (1) chronic primary deficits; (2) high debt-to-GNP ratios; (3) low employment levels in the formal economy; (4) a large informal economy, encompassing both legal and illegal activities; (5) significant government corruption and predatory rent-seeking behavior in both the public and private sectors;<sup>3</sup> (6) substantial tax evasion; (7) a hollow productive base; and (8) high levels of private consumption and indebtedness enabled by having access to a stronger currency than its economic fundamentals would warrant. In our opinion, the parallels with Greece are quite evident for all to see and none to misunderstand.

Notwithstanding this dismal economic situation, the island managed to *triple* its public debt from \$24 billion in 2000 to \$72 billion in 2015. Indeed, during this period Puerto Rico's public indebtedness grew at a compound annual rate of 7.6 percent, while its income (GNP) grew at a nominal rate of only 3.6 percent.

Given that Puerto Rico's indebtedness grew at an average annual rate two times faster than the growth rate of its GNP during the past 15 years, it should not be surprising that Puerto Rico's public debt currently exceeds its GNP. To be fair, however, for decades the borrowed money was put to good use to finance the construction of public schools, hospitals, highways, and other essential infrastructure. The problem is that during the last 20 years or so, a large portion of the money borrowed by issuing long-term debt was used to finance budget deficits, operating expenses, and classic pork-barrel spending.

We at CNE had warned for years that Puerto Rico's levels and rates of indebtedness were not sustainable.<sup>4</sup> In February 2014, the three principal rating agencies ratified our analysis by downgrading the Commonwealth's debt, as well as debt issued by several of its agencies and instrumentalities, to speculative or non-investment grade. Since then, the Commonwealth and its agencies and instrumentalities have been downgraded further by the three main rating agencies.

The rating downgrades had a material adverse effect on the Commonwealth's finances because they essentially shutdown its access to the capital markets, at least at reasonable rates. This, at a time when the central government is still running a sizeable budget deficit, several of the Commonwealth's agencies and instrumentalities face significant maturities in the near term, the economy is contracting at an estimated annual rate of 1.2 percent, liquidity is running extremely tight, and net outmigration has increased to levels not seen since the 1960s.

Given the magnitude and multiplicity of challenges faced by Puerto Rico, it should be obvious that there are no quick fixes to solve the island's fiscal and economic problems.

In our opinion, what is needed in the short-term is a two-prong action program, both at the Federal level and in Puerto Rico. In Washington, Congress needs to implement a comprehensive program, remove some of the disadvantages imposed on Puerto Rico under the current political arrangement, and eliminate some long-standing discriminatory policies. The current situation simply does not allow for piecemeal action by Washington, a wide-ranging plan is needed.

Specifically, this Committee could introduce legislation on two issues that could have a positive and significant short-term impact on both the fiscal and economic growth parts of the problem.

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Bosworth and Susan M. Collins in *The Economy of Puerto Rico: Restoring Growth* (Brookings Institution Press: Washington, DC, 2006), p. 17–81.

<sup>2</sup>To put the situation in perspective, consider that Puerto Rico's per capita income is one third of the United States' and close to one half of the poorest State, Mississippi; its poverty rate is 46 percent in comparison with 15 percent in the United States as a whole; and 38 percent of its population receives nutritional assistance, while only 13 percent of the population in the 50 States receives such assistance.

<sup>3</sup>"Rent-seeking" can be defined as the pursuit of uncompensated value from other economic agents, in contrast with profit-seeking, where economic agents seek to create value through mutually beneficial economic activity.

<sup>4</sup>See, for example, CNE's Policy Brief—Municipal Fiscal Crises in the United States: Lessons and Policy Recommendations for Puerto Rico, published in April 2006.

On the fiscal side, the cost of the Government Health Plan is one of the principal drivers of Puerto Rico's budget deficit.<sup>5</sup> Providing Puerto Rico equal treatment under Federal health programs, such as Medicare, Medicaid, and the Affordable Care Act would provide the Commonwealth with some much-needed fiscal space and address a long-standing injustice inflicted on Puerto Ricans. For the truth of the matter is that Puerto Rican workers and employers pay the same payroll taxes as workers and employers in the mainland, yet benefits to Puerto Rico are unfairly rationed by Federal legislation.<sup>6</sup>

On the economic growth side of the equation, we recommend extending the Federal Earned Income Tax Credit (EITC) program to Puerto Rico. The Federal EITC is the most effective anti-poverty program in the United States. Recent research also shows that it encourages work, promotes savings, helps poor families smooth out the effect of unexpected financial shocks, and builds a strong sense of future orientation among recipients.<sup>7</sup> Extending this program to Puerto Rico, which would provide a significant wage supplement to Puerto Rican working families, could be expected to stimulate aggregate demand in the short-run.

Outside the scope of this Committee's jurisdiction, a Federal comprehensive policy package could include approving legislation to authorize the Puerto Rican Government to allow its distressed agencies and municipalities to file for bankruptcy under Chapter 9 of the U.S. Bankruptcy Code; exempting Puerto Rico from coast-wise shipping laws (Jones Act), which require the use of relatively expensive U.S. vessels for trade between Puerto Rico and the U.S., and approving legislation to relax the overly binding income and asset limits that apply to recipients of certain social assistance programs.

This Federal assistance would be conditioned on Puerto Rico agreeing to (1) increase tax revenues by improving enforcement efforts, closing down ineffective tax loopholes, and modernizing its property tax system; (2) crack down on government corruption; (3) significantly improve its Byzantine and unduly opaque financial reporting; (4) reform an unnecessarily complicated permitting and licensing system that stifles innovation; (5) undertake affirmative actions to materially lower energy and other costs of doing business in the island; and (6) substantially improve educational standards.

In addition to all of the above, Puerto Rico also needs to obtain some debt relief. After years of relying on accounting gimmicks, forward refundings; back-loaded "scoop and toss" refinancings, capitalized interest payments, and other short-term, expensive liquidity fixes, the Commonwealth has finally admitted that its debt is unsustainable.

While it is true that Puerto Rico's capacity to repay its debt ultimately depends on restoring economic growth in the island, there can be no economic recovery without debt sustainability and that, in turn, is not possible without significantly restructuring at least some of the debt.

According to a recent paper by Carmen Reinhart and Christoph Trebesch, "kicking the can down the road" via cash flow relief and debt rescheduling does not facilitate economic recovery in debtor countries. In protracted crises, growth only picks up after deeper debt relief, such as after the Brady plan."<sup>8</sup>

Analyzing 35 debt relief episodes in 30 middle and high-income countries during period between 1978 and 2010, these researchers found (1) that "sovereign debt re-

<sup>5</sup> *Commonwealth of Puerto Rico Quarterly Report*, dated May 7, 2015, p. 20–21 and 37–40.

<sup>6</sup> See United States Government Accountability Office, *U.S. Insular Areas: Multiple Factors Affect Federal Health Care Funding*, GAO–06–75 (October 2005), and *Puerto Rico: Information on How Statehood Would Potentially Affect Selected Federal Programs and Revenue Sources*, GAO–14–31 (March 2014).

<sup>7</sup> See Bruce D. Meyer, "The Effects of the Earned Income Tax Credit and Recent Reforms" in *Tax Policy and the Economy*, Volume 24, Jeffrey R. Brown, ed. (University of Chicago Press, 2010); Sara Sternberg Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair*, New York University Law Review, Vol. 88, No. 2, May 2013; V. Joseph Hotz, Charles H. Mullin, and John Karl Scholz, *Examining the Effect of the Earned Income Tax Credit on the Labor Market Participation of Families on Welfare*, NBER Working Paper 11968 (National Bureau of Economic Research: Cambridge, MA, 2006); and Chuck Marr, Chye-Ching Huang, and Arloc Sherman, *Earned Income Tax Credit Promotes Work, Encourages Children at School, Research Finds* (Center on Budget and Policy Priorities: Washington, DC, 2014), among others.

<sup>8</sup> Carmen M. Reinhart and Christoph Trebesch, *Sovereign Debt Relief and Its Aftermath*, Faculty Research Working Paper Series, John F. Kennedy School of Government, RWP 15–028 (June 2015), p. 33.

lief averaged . . . 16 percent of GDP and 36 percent of external debt in the middle-high-income emerging markets [crises]" during that period and (2) emerging market countries that received significant debt relief reported, on average, an 11 percent increase in per capita income during the 5 years following "decisive debt relief."

They conclude that "softer forms of crisis resolution, such as debt rescheduling, temporary payment standstills, and bridge lending operations were not generally followed by higher growth and better ratings;" and, "These crisis resolution tools were ineffective in solving debt crises that had been dragging on for several years."<sup>9</sup> Therefore, obtaining significant debt relief for Puerto Rico appears to be a necessary condition to restore economic growth in the island.

On the other hand, it should be obvious that obtaining debt relief is not sufficient, in and of itself, to jumpstart economic growth. The important point in the case of Puerto Rico, is that any savings derived from a reduction in debt service be used exclusively to advance and implement a renewed industrial policy, broadly defined, based on horizontal policies such as the ones described above, discovering new sectorial opportunities through a process of dialogue and consultations with key stakeholders in the private and civic spheres, and "identifying spillovers, externalities, and other areas where society could learn more."<sup>10</sup>

This new learning, in turn, would lead to: new investment in R&D, increased productivity, identifying new areas of comparative advantage for Puerto Rican firms, higher economic growth and the creation of high-quality jobs, which at the end of the day is what will categorically end Puerto Rico's economic stagnation. We at the Center for a New Economy are currently working with experts from Columbia, Brown, MIT, and Brookings, among other institutions, to develop this medium to long-term industrial policy for Puerto Rico.

Finally, I would be negligent if I did not raise the question of whether Puerto Rico has reached the limits of what it can do to improve the quality of life of its people within the constraints imposed by its subordinate political status. Neither a sovereign country nor a State of the union, Puerto Rico has no authority to negotiate international treaties, no access to emergency financing from multilateral institutions, no monetary policy instruments, limited fiscal policy tools, nominal representation in Congress, and the U.S. Supreme Court has determined it is constitutionally permissible for Congress to discriminate against Puerto Rico in the application of Federal programs as long as there exists a "rational basis" for doing so.

Thus, Puerto Rico lives in a state of permanent limbo, a status that is both humiliating to Puerto Ricans and unworthy of the United States. Simply stating that it is up to Puerto Ricans to decide their political status, while true, is insufficient because the United States' Congress has long-standing legal and moral obligations with respect to Puerto Rico that it has failed to honor. Congressional failure to act not only highlights a shameful lack of political will, it also weakens the United States' moral standing and its ability to effectively utilize its "soft power" in the international arena, when it argues for better treatment for Hong Kong by China, for the Palestinians by Israel, or for Greece by members of the Eurozone.<sup>11</sup>

In this context I would like to quote from the remarks made just a few days ago by an extraordinary man who came to this magnificent building to address a rare joint session of Congress. Drawing from a deep well of wisdom that has accumulated for over twenty centuries, he stated:

"Your own responsibility as members of Congress is to enable this country, by your legislative activity, to grow as a nation. You are the face of its people, their representatives. You are called to defend and preserve the dignity of your fellow citizens in the tireless and demanding pursuit of the common good, for this is the chief aim of all politics. A political society endures when it seeks, as a vocation, to satisfy common needs by stimulating the growth of all its members, especially those in situations of greater vulnerability or risk. Legislative activity is always based on care

<sup>9</sup>Id. at p. 34.

<sup>10</sup>Joseph E. Stiglitz and Bruce C. Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress* (Columbia University Press: New York, 2014), p. 489.

<sup>11</sup>See Joseph S. Nye, Jr., *Soft Power: The Means to Success in World Politics* (Public Affairs: New York, 2005)

for the people. To this you have been invited, called and convened by those who elected you.”<sup>12</sup>

In conclusion, Mr. Chairman, I thank you and the Committee once again for the opportunity to participate in this important public policy debate and look forward to answering any questions that you or Committee Members may deem appropriate.

*See also*, “Puerto Rico Fiscal Balance, 1998–2013,” Sergio M. Marxuach, Center for a New Economy, September 29, 2015 and “Analysis of the Governor’s Budget Request for Fiscal Year 2016,” Sergio M. Marxuach, Center for a New Economy, June 2015, <http://www.finance.senate.gov/imo/media/doc/Senate%20Finance%20Testimony%20-%20Sergio%20Marxuach.pdf>.

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QUESTIONS SUBMITTED FOR THE RECORD TO SERGIO M. MARXUACH

QUESTION SUBMITTED BY HON. ORRIN G. HATCH

*Question.* Would you recommend any changes in federal tax policy that would affect Puerto Rico and, if so, what specific changes would you recommend and why?

*Answer.* We recommend extending the federal Earned Income Tax Credit (“EITC”) program to Puerto Rico. The federal EITC is the most effective anti-poverty program in the United States. Recent research also shows that it encourages work, promotes savings, helps poor families smooth out the effect of unexpected financial shocks, and builds a strong sense of future orientation among recipients.<sup>1</sup> Extending this program to Puerto Rico, which would provide a significant wage supplement to low-income Puerto Rican working families, could be expected to stimulate aggregate demand in the short-run.

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QUESTIONS SUBMITTED BY HON. MARIA CANTWELL

*Question. Paired federal-local action:* You say that what is needed for Puerto Rico in the short term is “a two-prong action program, both at the federal level and in Puerto Rico.” On the Federal side you recommend: equal treatment under federal health programs; extending the EITC; allowing municipalities access to Chapter 9 of the Bankruptcy Code; an exemption from the Jones Act; and relaxing income and asset limits on certain social assistance programs. This federal assistance, you say, should be conditioned on Puerto Rico agreeing to: increasing tax revenues by improving enforcement, closing loopholes and reforming property taxes; cracking down on corruption; improving financial reporting; reforming permitting and licensing; lowering energy costs; and improving educational standards.

Assuming Congress is prepared to enact some of the Federal actions you recommend provided Puerto Rico agrees to some of the conditions you recommended, what do you recommend as a mechanism to monitor and enforce Puerto Rico’s implementation of the conditions you have recommended?

*Answer.* See our answer to the question on partnership below.

*Question.* Would you describe in a bit more detail the six conditions you have recommended that Puerto Rico agree to, and describe for each whether the Puerto Rico government has developed a plan and taken meaningful steps to implement each recommendation?

*Answer.* In general, tax revenues are a function of (1) compliance and enforcement; (2) legislation; and (3) economic growth.

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<sup>12</sup> Pope Francis, remarks before the Congress of the United States of America, September 24, 2015.

<sup>1</sup>See Bruce D. Meyer, “The Effects of the Earned Income Tax Credit and Recent Reforms” in *Tax Policy and the Economy*, Volume 24, Jeffrey R. Brown, ed. (University of Chicago Press, 2010); Sara Sternberg Greene, *The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair*, New York University Law Review, Vol. 88, No. 2, May 2013; V. Joseph Hotz, Charles H. Mullin, and John Karl Scholz, *Examining the Effect of the Earned Income Tax Credit on the Labor Market Participation of Families on Welfare*, NBER Working Paper 11968 (National Bureau of Economic Research: Cambridge, MA, 2006); and Chuck Marr, Chye-Ching Huang, and Arloc Sherman, *Earned Income Tax Credit Promotes Work, Encourages Children at School, Research Finds* (Center on Budget and Policy Priorities: Washington, DC, 2014), among others.

Tax evasion in Puerto Rico is widespread, and tax enforcement traditionally has been lax and fairly slipshod. To put it diplomatically, there is certainly room for improvement in this area.

In terms of legislation, the Puerto Rico tax code is chock-full of credits, deductions, exclusions, exemptions, and special rates that have been enacted in a scatter-shot manner to promote “economic growth.” Part of the problem is that the Puerto Rico Department of the Treasury has no instruments to measure the effectiveness of these tax expenditures in generating either growth or employment and they significantly erode the tax base, resulting in a tax system with relatively high statutory rates applied to a relatively small base. That is precisely the opposite of the mainstream consensus among tax economists who favor low rates applied to a relatively large tax base to in order to minimize economic distortions.

Furthermore, the property tax system in Puerto Rico has not been thoroughly overhauled since the 1950s. This has resulted in a situation that can be charitably characterized as dysfunctional.

Finally, economic growth has been stagnant at least since 2006, so there has been little revenue growth generated from economic activity.

To be fair, the Government of Puerto Rico hired KPMG in 2013 to carry out an extensive analysis of the Treasury Department’s operations, to propose changes to the tax code and other improvements to the tax collection system. Unfortunately many of these recommendations have not been implemented.

Second, the corruption of government institutions is particularly harmful to economic growth as it engenders social mistrust, has a chilling effect on investment, and leads to the inefficient allocation of scarce resources. From an economic perspective, good institutions ensure at least two desirable outcomes: first, they guarantee that there is relatively equal access to economic opportunity, what is commonly referred to as a “level playing field;” and second, they ensure that those who provide labor and capital are appropriately rewarded and their property rights are protected.

Puerto Rico may be reaching the outer limits of its government institutional framework, as the economic playing field is increasingly tilted in favor of those with political connections *and the providers of both labor and capital are concerned about the protection of their respective rights*. Simply put, reforming our institutions and eradicating corruption from the system is a necessary condition, but not sufficient, to reignite economic growth in the island.

Third, the Commonwealth has had longstanding problems with its accounting, financial and fiscal controls, and thus, with its financial reporting in general. According to the most recent Commonwealth Report:

The Commonwealth’s accounting, payroll and fiscal oversight information systems have deficiencies due to obsolescence and lack of compatibility that have adversely affected the Commonwealth’s ability to supervise and control expenditures. Agencies often incur expense overruns that are not detected in time to permit the implementation of corrective measures during the same fiscal year. At the present time, three of the Commonwealth’s agencies which are responsible for over 50% of the General Fund expenses have separate accounting systems that are unable to interact on a timely basis with the Commonwealth’s central accounting system. In addition, the Commonwealth’s central accounting system still relies *on various manual processes* for recordkeeping that are only reviewed and updated at the end of the fiscal year in connection with the issuance of the audited financial statements. These deficiencies also affect the Commonwealth’s ability to timely and accurately report financial information to the market, and to complete its audited financial statements in a timely manner. (emphasis is ours)

A committee named by the Secretary of Treasury to evaluate and submit recommendations with respect to the Commonwealth’s accounting systems has concluded its work and presented its findings and recommendations to the Secretary of Treasury. Such findings and recommendations are being evaluated to determine next steps. Some of the proposed changes are ex-

pected to improve the Commonwealth's ability to monitor, control and forecast expenses.<sup>2</sup>

Fourth, for decades the government of the Commonwealth has unsuccessfully tried to reform an unnecessarily complicated permitting and licensing system that stifles innovation. The permitting process—whereby the government oversees construction and real estate development projects, the commercial use of equipment and facilities, and the periodic renewal of various business licenses—suffers from several serious problems. These problems raise the costs of doing business, undercut the drive for employment growth, and retard economic development.

Puerto Rico's regulatory environment deters business entry, hampers job creation, and erodes competitive pressures in many ways. Occupational licensing requirements create artificial entry barriers, restricting the supply of services and raising prices to consumers. Government oversight of business entry and location decisions raises entry costs and affords commercial rivals the opportunity to block entry. "Buy local" laws insulate business interests from foreign competition and raise prices for consumers. Like many provisions of the tax code, these aspects of the regulatory environment serve special business interests at the expense of the general welfare. They reflect and promote a business culture focused on rent seeking.

Fifth, the Puerto Rico Electric Power Authority ("PREPA") supplies substantially all of the electricity consumed in the Commonwealth. PREPA owns all transmission and distribution facilities and most of the generating facilities that constitute Puerto Rico's electric power system.

Notwithstanding its state-sanctioned monopoly status, PREPA managed to sustain net losses of \$267 million during fiscal year 2014, compared with net losses of \$283 million during fiscal year 2013 and net losses of \$346 million during fiscal year 2012.

PREPA's operating results have been adversely affected in recent years by a decrease in electric energy demand caused in part by a declining population and a prolonged recession, high fuel costs which result from reliance on oil for energy generation, high capital expenditure requirements associated with ageing generating facilities, and a high level of debt. As of September 30, 2015, PREPA's debt included \$8.229 billion of outstanding revenue bonds and \$696 million under bank working capital lines of credit. PREPA also owed GDB approximately \$35 million under a line of credit.

During the past year or so, the Government of Puerto Rico has taken several steps to restructure PREPA. For example:

- On May 27, 2014, the Governor signed into law Act No. 57 of 2014 ("Act 57–2014"), known as "The Energy Transformation and Relief of Puerto Rico Act." Act 57–2014 provides that two entities will oversee the new law's implementation. The Puerto Rico State Office of Energy Policy ("SOEP") (formerly the Energy Affairs Administration), will be responsible for developing and promoting the Commonwealth's energy policy, and the Puerto Rico Energy Commission ("PREC"), will be responsible for overseeing and regulating the implementation of the Commonwealth's energy policy. Among its duties, PREC will be responsible for approving the electricity rates proposed by PREPA.
- In August 2014, PREPA initiated negotiations with its principal creditors, including bondholders, bank lenders, monoline insurers, and the GDB to restructure its debt.
- In September 2015, PREPA announced it had reached agreements "in principle" to restructure its debt with an Ad Hoc Group of Bondholders that own approximately 35% of PREPA's outstanding bonds and with a group of bank lenders.
- The effectiveness of those agreements, however, is contingent on the Puerto Rico legislature approving the so-called PREPA Revitalization Act. According to the most recent Commonwealth Report: "The PREPA Revitalization Act sets forth a framework for PREPA to execute on the agreements with creditors reached to date. Among other things, the PREPA Revitalization Act would (1) enhance PREPA's governance processes; (2) adjust PREPA's practices for hiring and managing management personnel; (3) change PREPA's processes for collecting outstanding bills from public and private entities; (4)

<sup>2</sup> Commonwealth of Puerto Rico, *Financial Information and Operating Data Report*, November 6, 2015, p. 42.

improve the transparency of PREPA's billing practices; (5) implement a competitive bidding process for soliciting third party investment in PREPA's infrastructure; (6) allow for the refinancing of existing PREPA bonds through a securitization that would reduce PREPA's indebtedness and cost of borrowing; and (7) set forth an expedited process for the Energy Commission to approve or reject PREPA's proposal for a new rate structure that is consistent with its recovery plan."<sup>3</sup>

As of the date of this document, however, it is not clear whether (1) García-Padilla has the votes to enact the PREPA Revitalization Act or (2) a final agreement will be reached with PREPA's creditors. Nor has the Administration put forth an estimated date of when all these reforms will have a positive net effect on rates paid by PREPA's customers.

Sixth, a dramatic gain in educational attainment stands out as a major contributor to Puerto Rico's past economic growth. However, there is evidence that this area of former strength is now encountering significant problems. Families that can afford to do so are abandoning the public school system in response to problems of violence, perceptions of declining quality, and a lack of accountability at all levels. These problems are similar to those faced by many large urban systems on the mainland, but the rate of deterioration seems more rapid in Puerto Rico.

The Puerto Rico Senate recently passed a bill for major education reform in Puerto Rico. As of this writing, however, the Puerto Rico House of Representatives has not acted on this bill. If enacted and signed into law by the governor, it is probable that different interest groups within the Puerto Rico Department of Education Bureaucracy will oppose the implementation of this reform.

*Question. Case studies:* On page 6, you write about an analysis of 35 debt relief episodes in 30 countries.

Did this analysis include an examination of monitoring and control mechanisms that were used to ensure implementation of financial and policy reforms?

Answer. No. Most, though not all, of the debt relief episodes analyzed in that paper occurred in the context of negotiating a structural reform package as a predicate for obtaining short-term liquidity from the International Monetary Fund. The IMF usually monitors the progress of the implementation of financial and policy reforms in countries that have agreed to undertake the implementation of structural adjustment policies.

*Question.* What advice would you give the Committee regarding mechanisms to ensure implementation of reforms?

Answer. See our answer to the question on partnership below.

*Question. Partnership:* Currently, the U.S. Treasury has a Puerto Rico Working Group that is providing technical assistance to the Puerto Rico Government. In addition, the Governor is recommending the establishment of a local Control Board to implement elements of his 5-year plan.

Do you have any suggestions on ways that the local Control Board and the Treasury Working Group could be brought more closely together in partnership to better assure positive outcomes?

Answer. This is really a political economy problem. On the one hand, if the Treasury Working Group takes over the fiscal oversight function completely it may suffer from a lack of legitimacy and representation. On the other hand, the proposed Commonwealth's Control Board, as structured right now, may suffer from a lack of credibility with the capital markets and, it may fail, due to political pressures, to impose adequate accountability standards on other agencies of the Puerto Rican government. The problem therefore is to identify the proper tradeoff between these two options.

In this case we recommend the Committee analyze the option of establishing a fiscal council with representatives from both the Federal and the Commonwealth governments and from the private sector. According to the International Monetary Fund:

Fiscal councils are independent public institutions aimed at promoting sustainable public finances through various functions, including public assess-

<sup>3</sup> Commonwealth of Puerto Rico, *Financial Information and Operating Data Report*, November 6, 2015, p. 197–198.

ments of fiscal plans and performance, and the evaluation or provision of macroeconomic and budgetary forecasts. By fostering transparency and promoting a culture of stability, they can raise reputational and electoral costs of undesirable policies and broken commitments.<sup>4</sup>

These councils have been used, with mixed success to be honest, in several countries to stabilize government finances and oversee the implementation of fiscal and economic reforms.

*Question. Industrial Policy:* On page 7, you mention the CNE's work with experts at Columbia, Brown, MIT, Brookings and others to develop a medium to long-term industrial policy for Puerto Rico.

Can you outline the general approach that this research is taking and when you expect that a formal paper on this work will be available?

Answer. What Puerto Rico needs the most is to grow its economy. Short-term fixes will not work and short sightedness by the government on matters pertaining to economic development is partly to blame for our current situation. It is important to understand that the comparable situation here is not that of a two-year business cycle. A more realistic time horizon for registering significant economic gains in a country could be up to 10 years.

Crafting development and growth strategies is an endeavor best suited to academics and economic development experts. It should also stem from a country dialogue process to insure legitimacy and sustained acceptance by civil society. A project like this is already underway and led by CNE. The project is identified as the *Roundtable for a New Economy*, and in it, CNE and its partners—Professor Joseph Stiglitz and the Initiative for Policy Dialogue at Columbia University (IPD), the Brookings Institution (BI), and the Watson Institute for International Studies and Public Affairs at Brown University—aim to create a transformation agenda based on well-thought policy solutions that command the support of a broad group of key stakeholders. This novel project combines top-notch research and civic engagement to transcend the current juncture and restructure the island's outdated economic model.

Unique in resources, structure and processes, this bold initiative will inspire first-class actionable research and policy making as the foundation for a series of dialogues that will engage a wide swath of Puerto Rican stakeholders in considering, discussing, crafting and implementing the optimal policy solutions to current challenges. We are working within a three-year time horizon to produce and divulge specific research products and policy proposals, but are currently accelerating the project's timeline due to the urgency of Puerto Rico's situation.

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PREPARED STATEMENT OF HON. PEDRO R. PIERLUISI, RESIDENT COMMISSIONER OF  
PUERTO RICO, U.S. HOUSE OF REPRESENTATIVES

Chairman Hatch, Ranking Member Wyden, and members of the committee:

Thank you for holding this hearing and inviting me to testify.

Puerto Rico, a U.S. territory home to 3.5 million American citizens, is experiencing the most severe crisis in its history. At the outset, it is important to emphasize that the crisis in Puerto Rico is not new; it has been simmering for years without attracting much attention. Now that it has reached a particularly acute stage, the press and the public have taken notice. My testimony will outline the nature of the crisis and then recommend concrete steps that can be taken at the local and Federal level to resolve it.

My constituents are understandably weary of studies, reports, plans and working groups. They are tired of empty promises and ill-informed proposals. They want, and they deserve, action on the part of political leaders in San Juan and Washington, DC. They seek smart policies, swiftly implemented, that will have a tangible impact on their lives.

Accordingly, my testimony will focus less on explaining how bad things are and more on how we as policymakers can make them better. I will look backward only to the extent it helps delineate a path forward.

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<sup>4</sup>International Monetary Fund, *The Functions and Impact of Fiscal Councils*, IMF Policy Paper, July 16, 2013, p. 1.

## THE NATURE OF THE CRISIS

The current crisis has three main components.

First, the crisis is *economic*. Puerto Rico is a U.S. jurisdiction, so the 50 States—not foreign nations—serve as the proper point of comparison. By any economic metric, the performance gap between the States and the territory is large. Puerto Rico's economy has lagged behind that of the States for at least four decades. Except for one year of slight growth in fiscal year 2012, Puerto Rico's economy—as measured by the territory's gross national product—has contracted every year since fiscal year 2007.<sup>1</sup> The Puerto Rico Government Development Bank's Economic Activity Index (GDB-EAI), which is highly correlated with GNP, has fallen by 20 percent since 2005.<sup>2</sup> Since the Federal Government began collecting state-by-state statistics in the 1970s, Puerto Rico's unemployment rate has always been far higher and its labor participation rate—the share of adults in a jurisdiction working or seeking work—has always been far lower than those of any State. Puerto Rico's current unemployment rate is 11.6 percent, compared to a U.S. national average of 5.1 percent. Approximately 995,000 individuals are employed in Puerto Rico, about 220,000 (22 percent) of whom are employed by the central government, its public corporations, or one of the island's 78 municipal governments. The number of people currently working in Puerto Rico—995,000—is nearly 250,000 (or 20 percent) less than the number of people who were working on the island a decade ago in August 2005. Meanwhile, over 130,000 individuals are presently seeking, but cannot obtain, employment.<sup>3</sup> Many other individuals have stopped searching for work altogether. The territory's labor participation rate is under 40 percent, compared to a U.S. national average of over 62 percent.<sup>4</sup> The number of island residents living at or below the Federal poverty level exceeds 46 percent, compared to a national average of about 16 percent.<sup>5</sup>

Second, Puerto Rico's crisis is *fiscal*. Although it is difficult to paint a completely accurate historical picture of Puerto Rico's public finances, because statistics published by the government of Puerto Rico are often unavailable, incomplete or inconsistent with other official sources of information, there is no dispute that the central government's annual expenditures have exceeded its annual revenues for many years. Moreover, Puerto Rico has numerous bond-issuing public corporations that provide a variety of essential services, and several of these corporations are in severe financial distress and have accumulated significant debt over the last 15 years. Puerto Rico's total public sector debt has steadily grown since the mid-1980s, with the sharpest increase taking place in the period since 2001, when the government of Puerto Rico began to shift from borrowing for capital investment to borrowing to fund government operations, to compensate for declining revenue resulting from economic weakness, and to cover increased spending. The debt was less than \$20 billion in 1985, approximately \$22.5 billion in 1995, over \$42 billion in 2005, approximately \$56.5 billion in 2008, and \$71 billion in 2015—which is roughly equal to Puerto Rico's GNP.<sup>6</sup>

Puerto Rico's debt structure is complex. Approximately 18 government entities have bonds outstanding. For example, there are \$18.6 billion in bonds issued (\$13.1 billion) or guaranteed (\$5.5 billion) by the central government; \$15.2 billion in bonds issued by the Puerto Rico Sales Tax Financing Corporation—COFINA—that are backed by sales tax revenue; and bonds issued by public corporations like the electric power authority (PREPA; \$8.1 billion), the highways and transportation authority (PRHTA; \$6 billion), and the water and sewer authority (PRASA; \$3.7 billion).

<sup>1</sup>See "An Update on the Competitiveness of Puerto Rico's Economy," Federal Reserve Bank of New York (July 31, 2014), at page 3, available at [www.newyorkfed.org/outreach-and-education/puerto-rico/2014/Puerto-Rico-Report-2014.pdf](http://www.newyorkfed.org/outreach-and-education/puerto-rico/2014/Puerto-Rico-Report-2014.pdf). Gross national product is generally considered a more accurate measure of Puerto Rico's economy than gross domestic product.

<sup>2</sup>See Puerto Rico Fiscal and Economic Growth Plan, Working Group for the Fiscal and Economic Recovery of Puerto Rico, at page 8 (September 9, 2015), available at [www.bgfpr.com/](http://www.bgfpr.com/); see also GDB-EAI (June 2015), at page 7, available at [www.bgfpr.com/documents/2015-Jun-GDB-EAI.pdf](http://www.bgfpr.com/documents/2015-Jun-GDB-EAI.pdf).

<sup>3</sup>See Bureau of Labor Statistics, U.S. Department of Labor, available at [www.bls.gov/eag/eag.pr.htm](http://www.bls.gov/eag/eag.pr.htm) and [data.bls.gov/timeseries/LASST720000000000003](http://data.bls.gov/timeseries/LASST720000000000003).

<sup>4</sup>See Puerto Rico Institute of Statistics (July 2015), at page 3, available at [www.estadisticas.gobierno.pr/iepr/Estadisticas/InventariodeEstadisticas/tabid/186/ctl/viewDetail/mid/775/report\\_id/2b640ee2-d186-45b9-84a1-765e7345c188/Default.aspx?f=1.3.1.4.2](http://www.estadisticas.gobierno.pr/iepr/Estadisticas/InventariodeEstadisticas/tabid/186/ctl/viewDetail/mid/775/report_id/2b640ee2-d186-45b9-84a1-765e7345c188/Default.aspx?f=1.3.1.4.2) (citing a labor participation rate of 39.5 percent).

<sup>5</sup>See U.S. Census Bureau, 2014 American Community Survey, available at [www.factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?\\_afpt=table](http://www.factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?_afpt=table).

<sup>6</sup>See D. Andrew Austin, "Puerto Rico's Current Fiscal Challenges: In Brief," Congressional Research Service, at page 1, available at [www.fas.org/sgp/crs/row/R44095.pdf](http://www.fas.org/sgp/crs/row/R44095.pdf).

The terms, source of repayment and level of legal protection for each class of bonds are different. For instance, Puerto Rico's constitution, which was authorized and approved by Congress in the 1950s, provides that debt service payments to owners of bonds issued or guaranteed by the central government are to be prioritized over all other expenditures. There has typically been high demand for bonds issued by U.S. territories, because the yields are high relative to bonds issued by States and because Congress enacted legislation decreeing that the interest income generated on territory (and District of Columbia) bonds is not taxable at the Federal, State or local level—regardless of where the investor resides. Currently, nearly all bonds issued by government entities in Puerto Rico are classified as non-investment (junk) grade by the credit rating agencies. Puerto Rico's ability to issue new bonds at a reasonable interest rate is highly uncertain and, as a result, the territory government faces severe liquidity challenges.<sup>7</sup> The fiscal challenges confronting Puerto Rico are compounded by the massive underfunding of its government pension systems.<sup>8</sup>

Finally, the crisis is *demographic*. My constituents are relocating to the States in extraordinary numbers, which—as U.S. citizens—they can do for the price of a one-way plane ticket. According to the U.S. Census Bureau, in 2000, Puerto Rico's population was a little over 3.8 million. By 2014, it had fallen by almost 7 percent to 3.5 million. In 2014, an estimated 84,000 individuals moved from Puerto Rico to the States, while 20,000 residents of the States moved to Puerto Rico, for a net population loss of 64,000.<sup>9</sup> In both degree and duration, this level of migration from a single jurisdiction appears to be unprecedented in modern American history. There are now over 5.2 million individuals of Puerto Rican birth or descent living in the 50 States, compared to 3.5 million individuals residing on the island (3.4 million if individuals born outside of Puerto Rico are not included in the calculation).<sup>10</sup>

Clearly, the three components of the crisis are interconnected. As Puerto Rico's economy deteriorates, migration to the U.S. mainland increases. As migration increases, consumer spending and government tax collections decrease. The government may respond by raising taxes or reducing spending on public services, which tend to spur further migration. Assuming it has access to the markets, the government also borrows to finance the deficit at high interest rates, a short-term measure that compounds Puerto Rico's long-term problems, adding to its overall debt burden and crowding out government investments in health, safety, education, infrastructure and other priorities that are (by necessity) subordinated to the repayment of principal and interest.

#### SOLUTIONS TO THE CRISIS

To break this cycle, both the Puerto Rico Government and the Federal Government must make fundamental changes. If the crisis has taught us a single lesson, it is that a "business as usual" approach in San Juan and Washington, DC will fail.

##### *Solutions at the Puerto Rico government level*

The core economic problem in Puerto Rico is the lack of growth, and so the Puerto Rico government must—first and foremost—craft and implement a comprehensive pro-growth strategy. (Historically, Puerto Rico's problem is not the inability to devise economic plans, but the inability to execute those plans.) If a government policy or program inhibits growth, it should be discarded, unless there is a compelling reason to retain it. To generate growth, the government must work relentlessly to at-

<sup>7</sup> See Conway MacKenzie, Commonwealth of Puerto Liquidity Update (August 25, 2015), available at [www.bgfpr.com/documents/150825ConwayMacKenzieLiquidityUpdateReport.pdf](http://www.bgfpr.com/documents/150825ConwayMacKenzieLiquidityUpdateReport.pdf).

<sup>8</sup> See Michelle Kaske, "Puerto Rico's Bonds Overshadow Pension Fund Poised to Go Broke," *Bloomberg Business* (September 25, 2015), available at [www.bloomberg.com/news/articles/2015-09-25/puerto-rico-s-bonds-overshadow-pension-fund-poised-to-go-broke](http://www.bloomberg.com/news/articles/2015-09-25/puerto-rico-s-bonds-overshadow-pension-fund-poised-to-go-broke); see also Mary Williams Walsh, "Fierce Debt Puts Pensions at Risk in Puerto Rico," *N.Y. Times* (November 26, 2012), available at [www.nytimes.com/2012/11/27/business/puerto-rico-races-to-rescue-its-pension-fund.html?hpw&r=1&pagewanted=print](http://www.nytimes.com/2012/11/27/business/puerto-rico-races-to-rescue-its-pension-fund.html?hpw&r=1&pagewanted=print).

<sup>9</sup> See [www.census.gov/hhes/migration/data/acs/state-to-state.html](http://www.census.gov/hhes/migration/data/acs/state-to-state.html). Of the 84,000, 28,000 (33 percent) moved to Florida, where over one million individuals of Puerto Rican birth or descent now reside; 7,400 moved to Pennsylvania; 6,300 moved to Texas; 4,000 to 5,000 moved to New York, Massachusetts, California, Connecticut, and New Jersey; and 1,000 to 2,000 moved to Virginia, Ohio, Mississippi, South Carolina, Georgia, North Carolina, Illinois, and Maryland. Up to 1,000 moved to 26 other States.

<sup>10</sup> See U.S. Hispanic Origin Groups, by Population, 2013, available at [www.pewhispanic.org/2015/09/15/the-impact-of-slowing-immigration-foreign-born-share-falls-among-14-largest-us-hispanic-origin-groups/ph\\_2015-09-15\\_hispanic-origins-02-2/](http://www.pewhispanic.org/2015/09/15/the-impact-of-slowing-immigration-foreign-born-share-falls-among-14-largest-us-hispanic-origin-groups/ph_2015-09-15_hispanic-origins-02-2/); see also "It's Official: One Million Puerto Ricans in Florida! And the South Keeps Growing," Center for Puerto Rican Studies, Hunter College, CUNY (September 2015), available here.

tract job-creating capital investment in Puerto Rico from local and external sources in all sectors of the economy, including manufacturing, retail, agriculture, tourism, professional services, aviation, health and construction. This diversified approach is the only way to meaningfully address the severe unemployment problem in Puerto Rico, which is structural in nature. Individuals who are working in the formal economy are less likely to leave Puerto Rico. They will spend more money on goods and services, pay more in consumption and income taxes, and require less support from the Federal and territory governments. These men and women must earn a living wage to support themselves and their families, however, and so I strenuously oppose any effort to exempt Puerto Rico workers (of any age) from the Federal minimum wage of \$7.25 per hour. This ill-conceived proposal would dramatically increase migration, create a disincentive to work, and widen—rather than close—the gap between Puerto Rico and the states.

In theory, Puerto Rico should be an attractive location for capital investors, particularly relative to foreign jurisdictions in the region. The island is blessed with natural beauty, a rich history, and a vibrant culture. As a U.S. territory, Puerto Rico provides would-be investors with all of the benefits associated with the world's most stable and trusted banking, currency, and legal systems. Although Puerto Rico's public education system requires major reforms, there is no shortage of skilled, industrious and bilingual individuals who are ready to work. Puerto Rico's status as a U.S. jurisdiction furnishes numerous other comparative advantages in this respect. For instance, the territory receives over \$60 million annually from the U.S. Department of Labor (DOL) under the Workforce Innovation and Opportunity Act to provide training for youth, adults and dislocated workers that have lost their jobs and need to rapidly acquire new skills. The DOL also provides about \$17 million in annual funding to support three Job Corps centers in Puerto Rico that provide vocational training to island youth so they are prepared to enter the workforce. The U.S. Small Business Administration administers various programs in Puerto Rico that help small businesses obtain bank loans and venture capital, develop sound business plans, and compete for Federal contracts. The U.S. Department of Commerce, through its Economic Development Administration, provides grants and loans to support economic development projects throughout Puerto Rico. The Rural Development arm of the U.S. Department of Agriculture provides grants, loans and loan guarantees to help improve infrastructure and enhance public services in the territory's rural communities. Puerto Rico must take full advantage of these and other Federal programs that are not available to its foreign competitors and that can serve as catalysts for economic growth.

In practice, however, the amount of job-creating, growth-generating capital investment in Puerto Rico's private sector is far lower than it should be. The main reason is that Puerto Rico has an excessively bureaucratic and inefficient central government whose competence and credibility—when it comes to fiscal policy, budgeting, financial recordkeeping, tax collection, business permitting, professional contracting, use of modern technology and overall performance—are questioned by companies and individuals deciding whether and where to open a store, build a factory, construct or acquire a hotel, buy a stock or bond, and otherwise invest their money. Anyone who has dealt with the Puerto Rico Government knows how opaque and difficult to navigate it can be. In short, rather than facilitating Puerto Rico's economic growth, the territory government has constrained it. Instead of unleashing the private sector's potential, the government has stifled it. While this is a serious, self-inflicted wound, it is also one that can be healed with the proper course of treatment. But without the right medicine, the patient will not recover.

Beyond improving government, Puerto Rico needs to reform its fiscal policies in order to compete—and win—in the global economy. Puerto Rico must learn to live within its means, especially given its uncertain access to the capital markets. To reduce unnecessary spending, the territory should adopt “zero-based” budgeting, in which each agency of the central government is required to freshly justify its proposed expenses every fiscal year, rather than automatically enshrining those expenses (with or without adjustments) in each successive budget request. On the revenue side, the current corporate tax system is complicated and inequitable. Many companies pay the top marginal rate of 39 percent, while other companies doing business on the island pay less than 5 percent in income taxes pursuant to multi-year agreements signed with the government. While there is an appropriate place for targeted tax incentives, the government should not pick winners and losers. Instead, it should establish a simple and fair tax system that creates an environment in which companies compete based on their relative merits, not on who can extract

the most generous tax deal from the government. I have a straightforward proposal to address this problem that I am happy to brief the Committee on.

Moreover, in recent years, the Puerto Rico Government has prioritized raising revenue to support its profligate spending habits, when it should be focused, laser-like, on promoting growth. Accordingly, the government has enacted a welter of new business taxes that have exerted a stranglehold on the economy and discouraged job creation. These new taxes are poorly conceived, poorly implemented, and must be repealed or refashioned. Once Puerto Rico has a sensible and stable tax policy in place, the government must collect the taxes it imposes. According to recent studies by respected Puerto Rico economists, an estimated 44 percent of sales taxes and 28 percent of all taxes are not presently collected by the government. This sort of dysfunction is a disservice to the public and a warning sign for potential investors who value predictability and competence.

In addition, the Puerto Rico government must take all reasonable steps to ensure that businesses and households on the island have access to affordable and reliable electricity generated from natural gas or renewable sources; a modern transportation system of roads, highways and bridges; and other basic infrastructure like water and wastewater services. As noted, these respective services are provided in Puerto Rico by public corporations—PREPA, PRHTA, PRASA—that, to varying degrees, are experiencing severe financial distress and struggling with significant debt loads. To the extent these public corporations have become obstacles to economic growth, they must be fundamentally reformed. In certain instances, Puerto Rico's public corporations should enter into public-private partnerships, transferring the operation of assets (and the revenues from those assets) to the private sector. In Puerto Rico, public-private partnerships have already proven to be a valuable tool to improve a public corporation's fiscal standing, to maintain and improve existing assets and to undertake new infrastructure projects that might otherwise be financially infeasible.

Finally, on the issue of Puerto Rico's ability and willingness to pay its debt, five points are in order. First, the Governor and his advisors have claimed that, if Puerto Rico continues on its current path, the debt is "unsustainable" and "unpayable." However, the current path can and must change. If the government of Puerto Rico takes serious and realistic steps to cut unnecessary spending, implement a fair tax system and collect the taxes it is owed, and execute a growth-oriented strategy, the debt situation can be made far more manageable. Second, Puerto Rico—a U.S. jurisdiction—values the rule of law and reveres the territory constitution authorized and approved by Congress. Therefore, debt service on the \$18.6 billion in bonds issued or guaranteed by the central government must be sacrosanct. Most of these bonds carry reasonable interest rates. The exception is a \$3.5 billion bond emission from March 2014, which carried a coupon rate of 8.0 percent. The Federal Government should explore whether it can help the Government of Puerto Rico refinance this bond issue on more affordable terms, as well as whether it can help the Government of Puerto Rico obtain short-term bridge financing to meet immediate liquidity needs. Third, as noted above, there are approximately 18 government entities in Puerto Rico with bonds outstanding. The financial condition of each entity is different, as are the legal terms governing the bonds they issue. This Governor's strategy to essentially treat the territory's debt as monolithic is unwise and unlikely to produce the desired outcome. Instead, each entity should be considered on a case-by-case basis. Fourth, the Puerto Rico Government must comprehend that Puerto Rico will need to access the bond market in the future in order to make critical investments for the benefit of the public. The government's recent actions have badly tarnished Puerto Rico's credibility and standing among investors, and it must take great care not to pursue a strategy going forward that will make permanent adversaries of those whose capital it will one day require. And fifth, the Puerto Rico Government must bear in mind that countless numbers of its own residents own Puerto Rico bonds either directly or indirectly through pension funds, credit unions, mutual funds, and retirement accounts. Many of these individuals depend on their monthly interest payments to make ends meet. Hundreds of thousands of Puerto Rico residents are member-owners of credit unions. The Governor and his advisors have sought to create the narrative that the debate over whether Puerto Rico will pay its debts is a story of "us" versus "them." That is far from the case.

#### *Solutions at the Federal Government level*

As the foregoing demonstrates, I am the first to insist that the government of Puerto Rico must take steps to address the island's toxic brew of economic, fiscal and demographic problems. That said, any notion that the territory alone got itself into this situation and the territory alone must extricate itself from this situation

is totally false. The truth is that the Federal Government bears tremendous responsibility for the crisis in Puerto Rico, and so Congress and the president must be part of any solution.

The root cause of Puerto Rico's crisis is our political status, a subject that is within the jurisdiction of the Senate Energy and Natural Resources Committee, but a topic that I hope every U.S. Senator comprehends and considers with care, because the Constitution vests Congress with nearly unlimited power over its territories.

Because Puerto Rico is a territory, my constituents fight for this country in the armed forces but cannot vote for their President and Commander-in-Chief, are not represented in the Senate, and have a single non-voting delegate in the House. In this position, I can introduce bills and vote on my committees, but I cannot vote on the House floor. Accordingly, Puerto Rico has limited capacity to use the political process to protect and promote its interests, which is the essence of our democratic system of government. Simply stated, Puerto Rico's status cannot be reconciled with the principles the United States strives to uphold at home and promotes abroad.

Moreover, because Puerto Rico is a territory, Congress has a license to treat Puerto Rico worse than the States under Federal spending and tax credit programs, and Congress often uses that license.<sup>11</sup> This is not a partisan critique; both Republicans and Democrats, acting over the course of many years, are to blame.

Some of the worst disparities that Puerto Rico confronts are under Federal programs within the jurisdiction of the Finance Committee. For example:

- *Medicaid* is the Federal-State health insurance program for the poor. Federal funding for a State Medicaid program is open-ended, but capped for Puerto Rico. The Federal Government currently provides about \$1 billion a year in Medicaid funding for Puerto Rico. In comparison, the Federal Government provides annual Medicaid funding of \$3.6 billion for Mississippi (which has the lowest per capita income of any State) and \$5 billion for Oregon (which has a similar population size to Puerto Rico). Federal law also requires Puerto Rico to pay a much larger share of the cost of operating its Medicaid program (45 percent) than a similarly-situated State would pay (17 percent). Finally, due to a defect in Federal law, at some point within the next several years, Federal funding for Puerto Rico's Medicaid program will fall from about \$1 billion a year to about \$400 million a year unless Congress takes action.
- *Medicare* is the Federal health insurance program for the elderly. Employers and employees in Puerto Rico pay the same Federal payroll taxes and Medicare beneficiaries in Puerto Rico pay the same monthly premiums as their counterparts in the States, and these payroll taxes and premiums fund a significant portion of the Medicare program. Nevertheless, Puerto Rico patients, doctors, hospitals and health insurance providers are treated unequally in key respects under Medicare Part A (inpatient hospital care), Part B (physician care and outpatient hospital care), Part C (Medicare Advantage) and Part D (prescription drug coverage).<sup>12</sup>
- *Health Insurance Exchanges*: Under the central provision of the 2010 Affordable Care Act, many individuals and families can purchase health insurance through an exchange or "marketplace" operated either by the Federal Government or a State government, with the Federal Government providing subsidies to those households with annual incomes below a certain level. The Congressional Budget Office projects that, within a few years, 25 million Americans will receive health insurance coverage through the exchanges and the Federal Government, over the next decade, will spend over \$1 trillion on exchange subsidies and related expenditures. Puerto Rico and the other territories were unable to establish State exchanges and territory residents are not eligible to participate in a Federal exchange.

<sup>11</sup> See "Puerto Rico: Information on How Statehood Would Potentially Affect Selected Federal Programs and Revenue Sources," U.S. General Accountability Office (GAO-14-31; March 31, 2014), available at [www.gao.gov/products/GAO-14-31](http://www.gao.gov/products/GAO-14-31); see also Pedro R. Pierluisi, "Statehood Is the Only Antidote for What Ails Puerto Rico," *N.Y. Times* (July 10, 2015), available at [www.nytimes.com/2015/07/11/opinion/statehood-is-the-only-antidote-for-what-ails-puerto-rico.html?\\_r=0](http://www.nytimes.com/2015/07/11/opinion/statehood-is-the-only-antidote-for-what-ails-puerto-rico.html?_r=0).

<sup>12</sup> For an in-depth-discussion of the disparities that Puerto Rico faces under Medicaid and Medicare, see the section-by-section summary of H.R. 2635, *Improving the Treatment of the U.S. Territories Under Federal Health Programs Act of 2015*, available at <http://pierluisi.house.gov/>.

- *Supplemental Security Income*, administered by the Social Security Administration, provides monthly cash assistance to blind, disabled or elderly individuals who have limited or no income. SSI applies in all 50 States, the District of Columbia, and one U.S. territory. However, since its inception in 1974, SSI has not been extended to Puerto Rico. A far less generous block grant program known as Aid to the Aged, Blind, and Disabled (AABD) applies in Puerto Rico in lieu of SSI. While the average monthly SSI payment in the States is \$540—and close to \$650 for beneficiaries under the age of 18—the average monthly AABD payment in Puerto Rico is less than \$80. Moreover, while the SSI program requires no financial contribution from State governments, the Government of Puerto Rico must pay a 25 percent “match” in order to access its annual AABD block grant from the U.S. Department of Health and Human Services.
- *Temporary Assistance for Needy Families (TANF)* is a Federal block grant program that enables States and territories to help low-income families with children meet their basic needs. Puerto Rico currently receives a basic TANF grant of \$71.6 million a year. But, unlike the States, Puerto Rico is not eligible for three other TANF funding streams—namely, supplemental grants, contingency funds and mandatory child care funds. Also, unlike in the States, Federal law imposes an annual cap on the overall funding that Puerto Rico can receive under a variety of Federal public assistance programs, including TANF, title IV–E foster care and adoption assistance programs, and AABD. Puerto Rico’s overall annual cap—which is set by section 1108(a) of the Social Security Act—is only \$107.2 million, and has not been increased since 1996.
- The *Child Tax Credit*, which was established in 1997, seeks to ease the financial burden that families incur when they have children. The CTC is refundable, meaning that it can exceed a taxpayer’s tax liability and result in a cash payment from the Federal Government to low-income households that owe little or no income tax. The refundable portion of the CTC currently applies in Puerto Rico, but in limited and unequal fashion. Island families with one or two children are not eligible for the refundable portion of the CTC at all. And while island families with three or more children are eligible for a CTC refund, an alternative formula—which is less generous than the formula available in the 50 States and the District of Columbia—is used to calculate the amount of the refund payment.
- The *Earned Income Tax Credit*, which was established in 1975, has become the Nation’s largest anti-poverty cash assistance program. Because it is refundable, an EITC recipient need not owe Federal income taxes to receive the benefit. The EITC creates a financial incentive for individuals to seek and retain employment because it increases the ability of workers in low-paying jobs to support themselves and their families. The EITC has never been extended to Puerto Rico.

The disparities that Puerto Rico faces under the aforementioned Federal programs, especially when their impact is considered cumulatively, have been devastating for the territory. The disparities are harmful to Puerto Rico’s real economy, because they mean billions of dollars less are circulating throughout the island on an annual basis, available to be spent and invested. The disparities are detrimental to Puerto Rico’s fiscal condition, since the territory government spends or borrows to compensate for the shortfall in Federal support, exacerbating deficits and debt. And the disparities contribute to Puerto Rico’s demographic disaster by compromising the quality of life of my constituents and impelling them to move to the States, where—unlike in Puerto Rico—they are entitled to equal treatment under all Federal laws.<sup>13</sup>

As set forth in the accompanying footnote, I have introduced legislation to eliminate or mitigate the program disparities within the Finance Committee’s jurisdiction, and in certain cases a U.S. Senator has introduced companion legislation.<sup>14</sup> I

<sup>13</sup>For further discussion of the causal relationship between Puerto Rico’s disparate treatment under Federal programs and the economic, fiscal and demographic crisis in the territory, see Rep. Pedro R. Pierluisi, testimony, hearing on “Examining Procedures Regarding Puerto Rico’s Political Status and Economic Outlook,” House Subcommittee on Indian, Insular and Alaska Native Affairs (June 24, 2015), available at <http://naturalresources.house.gov/calendar/eventsingle.aspx?EventID=398833>.

<sup>14</sup>See (1) H.R. 1125 (Pierluisi) and S. 1602 (Menendez, Nelson, Rubio), *Puerto Rico Hospital HITECH Amendments Act of 2015*; (2) H.R. 1417 (Pierluisi, Curbelo), *Puerto Rico Hospital Medicare Reimbursement Equity Act of 2015*; (3) H.R. 1418 (Pierluisi) and S. 1453 (Schumer), *Puerto Rico Medicare Part B Equity Act of 2015*; (4) H.R. 1822 (Pierluisi), *Supplemental Security In-*

urge the Committee—respectfully, but in the strongest possible terms—to take action on these bills. Congress cannot in good conscience criticize Puerto Rico without acknowledging the fact that Congress shares culpability for the territory’s problems.

On a separate note, the Finance Committee is considering legislation to reform the taxation of corporate income attributed to operations outside of the 50 States and the District of Columbia—that is, corporate income attributed to Puerto Rico, the four other U.S. territories, and foreign jurisdictions. An important purpose of reforming the current “international” business tax system is to promote U.S. growth and job creation, to reduce incentives for U.S. companies to move jobs or the entire company overseas, and to make the U.S. more attractive and competitive for multinationals to invest and create jobs. While Puerto Rico and the other territories are treated as “international” for some (though by no means all) purposes under the Internal Revenue Code, they are U.S. jurisdictions, home to millions of U.S. citizens. Jobs in Puerto Rico are American jobs. The laudable goal of tax reform—to encourage investment and employment in the United States—will not be fully achieved if the legislation has the effect of discouraging job-creating investment in Puerto Rico. Tax reform should seek to foster economic opportunities in Puerto Rico to the same degree and extent as in the States.<sup>15</sup>

In addition, although I recognize that this subject is within the jurisdiction of the Senate Judiciary Committee, I would be remiss if I did not briefly mention the pending legislation—H.R. 870 (Pierluisi) and S. 1774 (Blumenthal, Schumer, Booker, Durbin, Gillibrand, Heinrich, Hirono, Leahy, Menendez, Murphy, Nelson, Reid, Sanders, Warner, Warren)—to provide Puerto Rico with state-like treatment under Chapter 9 of the Federal bankruptcy code. Congress has empowered each State government to authorize an insolvent “municipality”—defined as a political subdivision, public agency, or instrumentality of the State—to restructure its debts in an orderly fashion under the supervision of a Federal bankruptcy judge, in accordance with Federal law. A State government may authorize, or decline to authorize, its insolvent municipalities to file for Chapter 9 protection. The power to decide rests with the State government. Unfortunately, while Puerto Rico is treated like a State under the chapters of the Bankruptcy Code involving individuals and corporations, it is not treated like a State under the chapter pertaining to municipalities. Congress did grant Puerto Rico the power to authorize its municipalities to adjust their debts between 1938 and 1984, but in 1984—for reasons unknown—Congress excluded Puerto Rico from Chapter 9. H.R. 870 and S. 1774 would rectify this unprincipled disparity. Under the bills, Puerto Rico could seek to restructure the debts of its severely distressed public corporations, not the central government. Chapter 9 provides a forum for the Federal courts to consider the best interests of all stakeholders and to reach a fair, equitable and binding resolution. Chapter 9 can be a useful tool even if it is not used, since the prospect of a Chapter 9 filing by a municipality can foster consensual negotiations between a municipality and its creditors. If Chapter 9 is appropriate for the States, it is appropriate for the U.S. territory of Puerto Rico. I ask you: if Chapter 9 is good enough for your constituents, why isn’t it good enough for mine?<sup>16</sup>

In closing, I want to return to the subject of Puerto Rico’s political status, the fundamental problem from which nearly all of Puerto Rico’s other problems emanate.

I look forward to the day when the U.S. citizens that reside in Puerto Rico can vote for their national leaders and fully partake in debates over national policy that affect every aspect of their lives.

I look forward to the day when Puerto Rico will be treated equally as a matter of right, and does not have to beseech and beg this Congress to treat the territory fairly or even just a little better than it does now.

*come Equality Act*; (5) H.R. 2635 (Pierluisi) and S. 1961 (Schumer, Blumenthal, Gillibrand, Menendez, Nelson), *Improving the Treatment of the U.S. Territories Under Federal Health Programs Act of 2015*; (6) H.R. 3552 (Pierluisi), *Child Tax Credit Equity for Puerto Rico Act of 2015*; (7) H.R. 3553 (Pierluisi), *Earned Income Tax Credit Equity for Puerto Rico Act of 2015*; (8) H.R. 365 (Pierluisi; 113th Congress), *Territorial TANF Equity Act of 2013*; (9) H.R. 3966 (Pierluisi; 113th Congress), *Territories Medicare Prescription Drug Assistance Equity Act of 2014*.

<sup>15</sup> See Letter from Rep. Pedro R. Pierluisi to Senate Finance Committee Regarding International Business Tax Reform and Puerto Rico (January 8, 2014), available at <http://pierluisi.house.gov/sites/pierluisi.house.gov/files/1.8.14%20Rep.%20Pierluisi%20%28Puerto%20Rico%29%20Comment%20on%20Chairman%20Baucus%20Staff%20Discussion%20Draft%20on%20International%20Business%20Tax%20Reform.pdf>.

<sup>16</sup> For a list of individuals and organizations that have endorsed H.R. 870 and S. 1774, see <http://pierluisi.house.gov/media-center/press-releases/running-list-of-editorials-letters-and-statements-in-support-of-hr-870>.

I look forward to the day when Federal policy towards Puerto Rico is consistent and coherent—when Puerto Rico is not classified as domestic under one section of the Federal tax code and international under another section of the code, or included in nearly all chapters of the Federal bankruptcy code but excluded from one critically-important chapter for no evident reason.

I look forward to the day when Puerto Rico is not treated in shockingly immoral fashion under Federal health programs for lower-income and elderly individuals, as if we are lesser human beings than residents of Utah, Oregon, Florida or New York.

I look forward to the day when Puerto Rico is not excluded from the SSI program, which helps the most vulnerable members of our society—elderly, blind and disabled individuals who live in extreme poverty—afford food, clothing and shelter.

I look forward to the day when my constituents have the exact same rights and responsibilities as their fellow American citizens in the States—not better treatment, not worse treatment and not “special” treatment.

That new day is just over the horizon. Puerto Rico voted against territory status and for statehood in 2012, and it is likely that voters in the territory will confirm their desire for statehood in a federally-sponsored referendum in 2017. Puerto Rico will then use every appropriate means to petition Congress to enact legislation making the territory a State. In the history of this country, no valid statehood petition by a territory has been rejected by the Federal Government. In the immediate term, there is much that the Puerto Rico Government and the Federal Government can do to help the territory manage its economic, fiscal and demographic crisis. However, for Puerto Rico to truly prosper, it must be treated equally. And to be treated equally, it must become a State.

Tinkering around the edges of this problem will not suffice. Bold action that goes straight to the heart of the problem is required.

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QUESTIONS SUBMITTED FOR THE RECORD TO HON. PEDRO R. PIERLUISI

QUESTIONS SUBMITTED BY HON. ORRIN G. HATCH

*Question.* Would you recommend any changes in federal tax policy that would affect Puerto Rico and, if so, what specific changes would you recommend and why?

*Answer.* As stated in my written testimony, I recommend that Congress enact legislation to extend the federal Earned Income Tax Credit to Puerto Rico and to fully extend the federal Child Tax Credit to Puerto Rico. Both of these are refundable tax credits—meaning they are claimed by millions of households in the 50 states who owe no federal income taxes—and the latter already partially applies to Puerto Rico.

The Earned Income Tax Credit, which was established in 1975, is widely recognized as the nation’s most effective anti-poverty assistance program. I recommend the EITC’s extension to Puerto Rico because it rewards work, and the territory has a very low labor participation rate. The EITC creates a financial incentive for individuals to seek and retain employment, increasing the ability of workers in low-paying jobs to support themselves and their families. The EITC has never been extended to Puerto Rico. Its extension to the territory would provide a direct stimulus to the economy, increasing purchasing power and consumer demand.

These positive outcomes would also be generated if Congress were to fully extend the Child Tax Credit to Puerto Rico. The CTC was established in 1997 and seeks to ease the financial burden that families incur when they have children. The refundable portion of the CTC currently applies in Puerto Rico, but in limited and unequal fashion. Island families with one or two children are not eligible for the refundable portion of the CTC at all. And while island families with three or more children are eligible for a CTC refund, an alternative formula—which is less generous than the formula available in the 50 states and the District of Columbia—is used to calculate the amount of the refund payment. Congress should amend the law so that the CTC has its full, intended effect in Puerto Rico.

On the business tax side, I wrote a detailed letter to the Committee on January 8, 2014, laying out my views on how potential legislation should treat Puerto Rico. The letter is attached.

*Question.* In a response to various questions that I recently posed to Health and Human Services Secretary Burwell, I have been told that the Department of Health

and Human Services (HHS) has been working closely with the government of Puerto Rico, and with you, to gain a better understanding of the health care challenges Puerto Rico faces. I was also told that efforts to help confront those challenges would likely require both administrative and legislative action. Of course, it would be helpful to everyone in Congress if we could be informed about the specifics of what the administration is doing along these lines, particularly—at least for our purpose in this committee—in those areas related to health policy, tax policy, and other areas under our jurisdiction. Since HHS—and perhaps other agencies of the federal government as well—have reportedly been working closely with you on these matters, could you describe the work that has been done to date and the results of that work, including any administrative policy changes that have occurred or are being planned?

Answer. I have repeatedly urged HHS and CMS to exercise their discretion to make immediate improvements in various rules and formulas used to calculate payments to Puerto Rico under the Medicare and Medicaid programs. I can provide a full briefing to the Committee on each of the specific requests I have made. Most recently, I sent CMS a detailed paper—which I have attached—outlining three administrative requests related to Medicare. These proposals are as follows: (a) CMS should use an alternative means for calculating Puerto Rico’s Practice Expense GPCI (Geographic Practice Cost Index) payment formula to adequately compensate doctors who treat Medicare patients in the territory; (b) CMS should exercise its discretion to ensure Puerto Rico hospitals are not shortchanged by administratively providing a proxy for the Supplemental Security Income (SSI) factor in the Medicare Disproportionate Share Hospital (DSH) payment formula as it applies to Puerto Rico hospitals (existing statute already states that Medicare DSH payments made to Puerto Rico hospitals should be computed in the same manner and to the extent as payments made to hospitals in the states); and (c) CMS should remove the local matching requirement from the annual Enhanced Allotment Program (EAP) funding that CMS provides Puerto Rico and the other territories in lieu of the Medicare Part D low-income subsidy.

I have also introduced a bill that would provide a statutory fix to these three issues. See Sections 203, 212, and 231 of H.R. 2635/S. 1961, Improving the Treatment of the U.S. Territories Under Federal Health Programs Act of 2015. Whether through administrative action by CMS or legislative action by Congress, these disparities should be eliminated.

*Question.* What, in your view, are Puerto Rico’s comparative advantages, which should be built upon to help promote economic growth on the island? What pro-growth policies would you recommend?

I discussed this subject at length in my written testimony, and to complement that testimony I offer some additional observations and ideas here. Puerto Rico has talented professionals working across multiple sectors. In particular, there are several sectors of Puerto Rico’s economy that have the potential to be strengthened. Manufacturers, particularly small and medium size enterprises, are poised to serve as a backbone for growing the economy. The pharmaceutical, life sciences, and medical device sector, as well as the aeronautical and space industries, are potential growth areas within the manufacturing sector. The engineering school at the University of Puerto Rico-Mayagüez is one of the most reputable engineering schools in the United States, with its graduates heavily recruited for federal positions with NASA, NSF, the United States Patent and Trademark Office, and other federal agencies. This speaks to the human capital in Puerto Rico and the capacity of its system of higher education to help grow the economy in the engineering and technical fields.

Unfortunately, the U.S. Department of Commerce missed an ideal opportunity this summer to support the manufacturing sector in Puerto Rico when it bypassed for selection the application of the Puerto Rico Industrial Development Company (PRIDCO) to designate the entire island for participation in the “Investing in Manufacturing Communities Partnership” (IMCP) program—an initiative of the current Administration designed to focus federal economic development funds on distressed manufacturing communities with potential for growth. Through IMCP, communities are given federal support in developing comprehensive economic development strategies that strengthen their competitive edge for attracting global manufacturer and supply chain investments. At a minimum, I recommend that the Commerce Department formally designate Puerto Rico as a supplemental selectee for the IMCP program based on the earlier-submitted PRIDCO application.

Puerto Rico, because of its geographic location and rich natural resources, also has potential for growth in the tourism industry. The hotels, restaurants, and tourism-oriented retailers stand to benefit from boosts in visitor arrivals. This week, a Spain-based airline announced plans to return to the Puerto Rico market after an absence of almost three years. Once its service connecting San Juan and Madrid commences in May, Puerto Rico's non-stop connections with cities in Europe will up-tick to 11 flights a week. Expansion of air service should also be coupled with strategies to grow cruise ship arrivals and the nautical tourism industry. Just last week, the third largest cruise ship in the world arrived for the first time in Puerto Rico, indicative of the attractiveness of San Juan for cruise ship port calls. Yet, certain federal rules and regulations unnecessarily restrain growth in the nautical tourism sector. For example, in 2011, I offered an amendment on the House floor to the Coast Guard Reauthorization Act that would have made a narrow modification to the Passenger Vessel Services Act of 1886 (PVSA) as it applies to Puerto Rico. This amendment, which was adopted on the House floor with significant bipartisan support, would have authorized foreign-flagged vessels to transport tourists and other paying passengers between ports within Puerto Rico. Current federal law allows foreign-flagged vessels to transport customers from a port in Puerto Rico to any port in the Caribbean region outside of Puerto Rico, including to ports in the neighboring U.S. Virgin Islands, where the PVSA does not apply. Yet, these same vessels cannot be used to transport tourists and other paying passengers between Puerto Rico's ports. So, for example, individuals and businesses in Puerto Rico cannot charter foreign-flagged megayachts or specialty cruise passenger ships to operate excursions for tourists who wish to travel between Puerto Rico's various marinas. Regrettably, the Senate stripped this sensible House provision from the bill before it became law—thereby depriving the U.S. of an opportunity to compete fairly with foreign jurisdictions in the Caribbean when it comes to attracting investment in nautical tourism. While the increased nautical tourism that my amendment would have opened the door for would not alone solve the economic challenges in Puerto Rico, it is but one example of a cost-free change in federal policy that could make a meaningful difference. More ships mean more shore-side investment. Ships require repair work, spare parts, and fuel. Their owners pay insurance and docking fees. And when the tourists on these vessels disembark at different ports around Puerto Rico, they eat at restaurants, go shopping, rent cars and otherwise inject money into the local economy. Yet, these net positives fell on deaf ears to the Senate. I urge the Senate to reverse its position on this matter.

The Administration can also intensify its focus and become more creative in working to boost visitor arrivals in Puerto Rico. I propose, for example, that Voice of America begin to run targeted ads in South American or European markets, particularly in countries participating in the U.S. Visa Waiver Program, that would promote travel to Puerto Rico. The U.S. Postal Service could also issue an international postage stamp that would feature Puerto Rico and encourage travel to the island. And finally, the Corporation for Travel Promotion that Congress established in 2009, and that it reauthorized in 2014, should work with the International Trade Administration at the Commerce Department, on specific strategies and marketing focus to generate greater visitor arrivals in Puerto Rico.

Apart from enacting the EITC and health care fixes like the HITECH Act for participation of Puerto Rico hospitals to convert to electronic health records under the Medicare program, Congress and the federal government should actively seek out ways to bolster Puerto Rico's manufacturing, agriculture and visitor industries.

*Question.* In July 2011, Puerto Rico expanded Medicaid eligibility to cover adults without children with incomes up to 100 percent of the poverty level. Then, in January 2014, Puerto Rico again expanded its Medicaid eligibility to include residents with income up to 133 percent of the local poverty level. What can you tell me about the impact of these Medicaid expansions? Have enrollments expanded? What has been the cost to Puerto Rico and the federal government?

*Answer.* The premise of the question is incorrect. Because of capped federal funding, Puerto Rico's Medicaid program—both before and after the ACA—cannot come close to covering individuals earning up to 100 percent of the FPL, much less 133 percent. A chart showing current eligibility levels under the Puerto Rico Medicaid program is pasted below. I have introduced legislation that would provide state-like treatment to Puerto Rico under Medicaid, up to 100 percent of the FPL. See Sections 101 to 104 of H.R. 2635/S. 1961, Improving the Treatment of the U.S. Territories Under Federal Health Programs Act of 2015.

**Puerto Rico Medicaid Standard Monthly Income Eligibility Levels**

Household Size	PRPL	FPL	Delta	PRPL Coverage as Percent of FPL
1	\$550.00	\$980.83	\$430.83	0.56
2	\$650.00	\$1,327.50	\$677.50	0.49
3	\$750.00	\$1,674.17	\$924.17	0.45
4	\$850.00	\$2,020.83	\$1,170.83	0.42

**Puerto Rico Medicaid Standard Annual Income Eligibility Levels**

Household Size	PRPL	FPL	Delta	PRPL Coverage as Percent of FPL
1	\$6,600.00	\$11,770.00	\$5,170.00	0.56
2	\$7,800.00	\$15,930.00	\$8,130.00	0.49
3	\$9,000.00	\$20,090.00	\$11,090.00	0.45
4	\$10,200.00	\$24,250.00	\$14,050.00	0.42

PRPL: Puerto Rico Poverty Level  
 FPL: 2015 Federal Poverty Guidelines for the 48 Contiguous States and DC

*Question.* It is my understanding that Puerto Rico does not cover nursing home services in its Medicaid program. How much does Puerto Rico spend on Long-Term Services and Supports in Puerto Rico? Could you explain how Long-Term Services and Supports are provided and paid for in Puerto Rico if Medicaid is not being used?

*Answer.* It is my understanding that the Puerto Rico Medicaid program does not cover institutional long-term care because it cannot afford to do so as a result of the annual spending cap for the program that Congress has established under Section 1108 of the Social Security Act. Partly as a result of the Medicaid program not covering this service, there are very few institutional long-term care facilities in Puerto Rico. This situation makes it difficult to care for the aging in Puerto Rico, and it aggravates a situation already made worse for persons with disabilities who need long-term care because of the exclusion of Puerto Rico from the Supplemental Security Income (SSI) program. I represent the highest number of Social Security beneficiaries in the U.S. House of Representatives—845,860 as of December 2014, according to the Social Security Administration. The 2010 Decennial Census indicates that 14.5 percent of Puerto Rican's population is 65 years of age or older. This percentage has increased according to the most recent ACS population estimates available from the U.S. Census Bureau, rising to 17.3 percent in the 2014 estimates. By comparison, the figure is 14.5 percent for the United States as a whole. These realities demonstrate the importance of Congress adjusting upward or eliminating the Medicaid cap on Puerto Rico's Medicaid program, while also providing for fairer treatment under the FMAP.

For more information, see "U.S. Insular Areas: Multiple Factors Affect Federal Health Care Funding," U.S. Government Accountability Office (GAO), GAO-06-75, October 17, 2005.

*Question.* Hospitals in Puerto Rico have been eligible to receive Medicaid HITECH payments, which are incentive payments under the Medicaid program that are meant to encourage hospitals to develop electronic medical records capability. I'm hoping you can tell me how, if at all, Puerto Rico has benefitted from these payments. How much money—in aggregate—has Puerto Rico received through these payments? And, what is the current status of implementation of electronic medical records in Puerto Rico?

*Answer.* For the two payment years under which HITECH incentive payments have been available for hospitals under the Medicaid program, CMS reports that it has paid out a total of \$49,360,201 to 49 hospitals in Puerto Rico—with 46 hospitals receiving these incentive payments in the aggregate amount of \$46.7 million in the first payment year and three hospitals receiving a combined amount of \$2.7 million in the second year.

Expansion of the HITECH Act by Congress to embrace Puerto Rico hospitals under the Medicare side of the program is essential if Puerto Rico providers are to receive the same tools, support, and incentives that are available in the rest of the United States and that are needed in Puerto Rico in order to develop and build out a health information network that would be interoperable with, and ultimately keep

pace with, the state of health information technology infrastructure being established in the rest of the United States. Numerous scholars have published research validating the economic growth generated around health information technology and the savings in overall health care costs achieved with applying this technology to the sector. The government of Puerto Rico and CMS are actively collaborating on ways to maximize participation on the island of the Medicaid HITECH program and to strengthen program controls.

Additionally, the Puerto Rico Hospital Association reports that while hospitals in Puerto Rico are working with the government of Puerto Rico and CMS to improve upon the cumbersome parts of the HITECH application and implementation processes, the number of hospitals in Puerto Rico eligible for and actually participating in the Medicaid side of the program represents a higher percentage of participation as compared with hospitals in many states. Congress should spare no time in enacting legislation to correct its oversight in law which prevents hospitals in Puerto Rico from becoming meaningful users of certified electronic health record technology under the Medicare side of the program. This is especially important given the high number of Medicare beneficiaries residing in Puerto Rico as compared with the states. I have introduced bipartisan legislation to achieve this purpose; this legislation is H.R. 1225/S. 1602, the Puerto Rico Hospital HITECH Amendments Act of 2015, and Section 202 of H.R. 2635/S. 1961, the Improving the Treatment of the U.S. Territories Under Federal Health Programs Act of 2015.

## Congress of the United States

### House of Representatives Washington, DC 20515-5401

January 8, 2014

The Hon. Max Baucus  
Chairman  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Hon. Orrin G. Hatch  
Ranking Member  
Senate Committee on Finance  
219 Dirksen Senate Office Building  
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Hatch:

On November 19, 2013, Chairman Baucus released a staff discussion draft of legislation to reform the taxation of corporate income attributed to operations outside of the 50 states and the District of Columbia. This includes corporate income attributed to the U.S. territory I represent, Puerto Rico; to the four other U.S. territories; and to foreign jurisdictions. A summary of the staff discussion draft, under the heading “Unaddressed Issues and Requests for Comments,” states: “The staff discussion draft does not separately address the taxation of foreign subsidiaries doing business in the U.S. territories. Comments are requested regarding the appropriate scope of U.S. taxation of such territory operations in light of the changes proposed in the staff discussion draft.”

Given that, in the absence of legislative provisions regarding the taxation of controlled foreign corporations (CFCs) in the territories, they would be taxed in the same manner as CFCs in foreign jurisdictions, I write to provide a comment on this issue. I have held numerous conversations about this matter with your counterparts on the House Committee on Ways and Means, Chairman Dave Camp and Ranking Member Sander Levin, as well as with senior officials in the Obama Administration. I look forward to discussing this important subject in more detail with you and your staffs as the effort to enact comprehensive tax reform moves forward.

My first point is the most fundamental. As the staff discussion draft explains, an important purpose of reforming the current international business tax system is to “promote U.S. growth and job creation,” to “reduce incentives for U.S. companies to move jobs or the entire company overseas,” and to “make the U.S. more attractive and competitive for multinationals to invest and create jobs.” As you know, while Puerto Rico and the other territories are treated as “international” for some (though by no means all) purposes under the Internal Revenue Code, the territories are U.S. jurisdictions, home to millions of U.S. citizens. Jobs in the U.S. territories are American jobs. The laudable goal of tax reform—to encourage investment and employment in the United States—will not be fully achieved if provisions are included in the legislation that have the effect of discouraging job-creating investment in Puerto Rico and the other territories. Tax reform should seek to foster economic opportuni-

ties in the American territories to the same degree and extent that it seeks to promote those opportunities in the states.

Puerto Rico and the other territories face severe economic and fiscal challenges. For at least four decades, Puerto Rico's economic performance has been far worse than any state according to every indicator, and the gap between Puerto Rico and the states is widening, not narrowing. The November 2013 unemployment rate in Puerto Rico was 14.7 percent, which is 7.7 percent above the U.S. national average. In December, Moody's Investors Service placed Puerto Rico's general obligation and other bonds—which the three main credit rating agencies have rated one notch above junk status—on review for downgrade. The Puerto Rico Government Development Bank's Economic Activity Index (GDB-EAI)—a useful tool for evaluating the overall health of the territory's economy—was 5.7 percent lower in November 2013 than in November 2012, and the cumulative Fiscal Year 2014 GDB-EAI (July–November) was about 5.3 percent below the corresponding period in 2012. In November, in a clear sign of the gravity of the situation, the White House assigned an inter-agency team to work with the government of Puerto Rico to “strengthen Puerto Rico's fiscal situation and economic outlook.” Primarily because of the lack of economic opportunities in Puerto Rico, island residents are leaving in staggering numbers for the states. Between 2004 and 2013, the territory's population fell from 3,826,878 to 3,615,086—a loss of 211,792 individuals or 5.5 percent. As the Committee considers provisions related to Puerto Rico for inclusion in tax reform legislation, I respectfully ask that you bear in mind that, in economic and demographic terms, Puerto Rico is in an extraordinarily delicate and deteriorating condition.

Forty years of empirical evidence establishes, beyond any doubt, that Puerto Rico's economic problems are inextricably linked to its political status. As a territory, Puerto Rico is treated unequally under, or excluded entirely from, key federal spending and tax credit programs, most of which are within the jurisdiction of your Committee. This disparate treatment is the principal reason why Puerto Rico's economy has consistently struggled, regardless of who holds power in Washington or San Juan. I support statehood for Puerto Rico, and do so in meaningful part because history shows that every territory that joins the Union experiences a substantial increase in its economic activity and standard of living. Statehood is the only status that will enable Puerto Rico, on an enduring basis, to reduce unemployment, attract investment, retain talent, promote growth, and manage our deficits and debt. A November 2012 referendum on the island demonstrated that a majority of my constituents oppose the current territory status and that there are now more people in Puerto Rico who support statehood than who support any other status option, including the current status. To honor this democratic vote, and to most effectively assist the economic development of Puerto Rico, I respectfully urge the Committee, as part of comprehensive tax reform, to provide for the equal treatment of Puerto Rico under the refundable Child Tax Credit program and to extend to Puerto Rico the refundable Earned Income Tax Credit program. I also request that the Committee take separate legislative action to treat Puerto Rico equally in Medicare, the Temporary Assistance for Needy Families (TANF) program, Supplemental Security Income (SSI), and Medicaid.

My hope and expectation is that Puerto Rico will soon become a full and equal member of the American family, that island residents and corporations will be treated in the same manner as their counterparts in the states under all federal spending and tax programs, and that local leaders will no longer need to seek special treatment under federal law in order to encourage companies to invest and create jobs in Puerto Rico. Until that day arrives, however, I believe that it is appropriate for Congress to enact tax provisions that are tailored for Puerto Rico and the other U.S. territories, given that the territories are treated in unequal fashion under many federal programs; that territory residents will continue to relocate to the states if there are not sufficient economic opportunities available to them at home; and that these are American—not foreign—jurisdictions. But a caveat is in order. In the past, federal legislation to exempt territory income from corporate taxation has arguably done more to benefit companies than to benefit Puerto Rico, so it is important that any provision included in corporate tax reform legislation be designed to promote job creation or other measurable contributions to the island's economic development. I trust that you, your counterparts on Ways and Means, and the Obama Administration fully share this objective.

If the Committee, notwithstanding the arguments I have made, is inclined to treat foreign subsidiaries doing business in Puerto Rico and the other U.S. territories in more or less the same fashion as foreign subsidiaries doing business in foreign juris-

dictions, I ask the Committee—at a minimum—to adopt the following proposal, which I believe would be fair and beneficial.

As background, although there are meaningful differences between the various business tax proposals in Chairman Baucus' staff discussion draft and the proposals contained in the discussion draft released by Chairman Camp in October 2011, both drafts seek to ensure that reform does not result in base erosion—that is, does not encourage U.S. companies to shift an even greater share of their production to low tax “foreign” jurisdictions. Therefore, both chairmen have made proposals under which the United States would impose a tax on certain profits of CFCs operating in jurisdictions where the local tax is below a certain minimum rate. In the event that a foreign jurisdiction raises its rate to the minimum level, the U.S. would not impose this levy. In effect, this could create a global minimum level of taxation.

Although the overarching purpose of the various base erosion proposals that have been put forward for discussion is to equalize the tax treatment provided in all jurisdictions, such a provision could create an unintended problem in the case of Puerto Rico absent modification. Puerto Rico's highest corporate income tax rate is 39 percent, which is well above the minimum rate that would be established under any of the proposals to prevent base erosion. However, to attract investment, the Puerto Rico government has entered into multi-year agreements with many CFCs affiliated with companies based in the states. These agreements provide for the CFC in question to pay a reduced income tax rate that is substantially below the minimum rate called for under the base erosion proposals. The Puerto Rico government may not be able to unilaterally modify or set aside the income tax agreements in the event that base erosion provisions are enacted. In that event, Puerto Rico's corporate tax rates would be below the minimum rate proposed in the staff drafts and, as a result, Puerto Rico would not be able to derive any fiscal benefit from the additional revenue raised as a result of the application of tax reform to CFCs doing business on the island.

Consistent with the principle that tax reform should help and not hurt Puerto Rico, I therefore propose the following modification to the base erosion provisions:

- Until the expiration of the multi-year tax reduction agreements that are in place at the time of the enactment of federal tax reform legislation, any revenue raised as a result of the application of base erosion provisions to business activities in Puerto Rico would be granted by the U.S. government to the territory government.
- Congress should place reasonable conditions on the granted revenue, requiring that such revenue be used by the Puerto Rico government for specified *public* purposes, such as initiatives to reduce the cost of electricity and water, improving the public education system, enhancing public safety, and reducing public debt.

Thank you in advance for your attention to this matter, and I look forward to working with you and your colleagues on the Committee to ensure that whatever tax reform legislation is enacted by Congress promotes job-creating investment in Puerto Rico and the other U.S. territories. Sincerely,

Pedro R. Pierluisi  
Member of Congress

cc: The Honorable Dave Camp, Chairman, House Committee on Ways and Means  
The Honorable Sander M. Levin, Ranking Member, House Committee on Ways and Means  
The Honorable Ron Wyden, U.S. Senator

**HHS Administrative Relief Proposals for Puerto Rico**

**Requested by Rep. Pedro R. Pierluisi**

**June 15, 2015**

**Modify Practice Expense Geographic Practice Cost Index (GPCI)  
Payment Formula**

[Proposed Legislative Solution: Section 212 of H.R. 2635]

**Description of Problem**

Puerto Rico doctors who serve traditional, fee-for-service Medicare patients are unfairly treated under the current Practice Expense Geographic Practice Cost Index

(GPCI) payment formula determined by CMS on an annual basis. Lack of fair treatment under the GPCI system is an important factor behind the well-documented exodus of Puerto Rico physicians to the U.S. mainland. The Medicare program compensates doctors pursuant to the Physician Fee Schedule (PFS). Three separate Relative Value Units (RVUs) are associated with the calculation of a physician payment under the PFS. The Physician Work RVU reflects the relative time and intensity associated with providing a Medicare service. The Practice Expense RVU reflects the costs of maintaining a practice (such as renting office space, buying supplies and equipment, and paying staff). The Malpractice RVU reflects the cost of malpractice insurance. GPICs are adjustments that are applied to each of the three RVUs in order to account for geographic variations in the costs of practicing medicine in different areas within the United States. Using U.S. Census Bureau data, the Centers for Medicare and Medicaid Services (CMS) has calculated for Puerto Rico the lowest Work GPCI, Practice Expense GPCI, and Malpractice GPICs of any payment locality in the United States, including the other territories. The Practice Expense GPCI calculated for Puerto Rico is particularly problematic, and there is strong evidence to suggest that the current formula—particularly its reliance on residential rent data as a proxy for commercial rent data—unduly disadvantages Puerto Rico, and results in payments to physicians that do not adequately capture the actual cost of practicing medicine in the territory. Additionally, the Practice Expense GPCI assumes a national market for the cost of medical supplies and equipment. CMS assigns every payment locality the same value for this part of the GPCI, which works to Puerto Rico's disadvantage. Doctors in Puerto Rico face higher shipping rates and logistical challenges in acquiring medical supplies and equipment than their counterparts in the 48 contiguous states. For Calendar Year 2015, Puerto Rico's Practice Expense GPCI is 0.705, whereas the state with the lowest Practice Expense GPCI is West Virginia at 0.836—a huge gap.

#### **Proposed Administrative Solution**

In proposing and finalizing Calendar Year 2016 and future year GPICs, CMS should utilize an alternative means for calculating Puerto Rico's Practice Expense GPCI. Relying on residential rent data from the American Community Survey (ACS) is inadequate in the case of Puerto Rico due to the lack of a developed rental market there. CMS should explore substituting U.S. Postal Service rental information, employing a private sector-developed model, using an inflation or adjustment factor for the residential data reported for Puerto Rico, or analyzing and validating data that would capture actual costs from doctors and be compiled by the Puerto Rico Institute of Statistics. Rep. Pierluisi made specific suggestions for improving the GPCI calculations for Puerto Rico in official comment letters during the rulemaking process for Calendar Years 2013 and 2014.<sup>1</sup> CMS should re-examine those suggestions. Additionally, CMS should develop a shipping differential to apply to the cost of medical supplies and equipment value for Puerto Rico and also possibly for the other non-contiguous jurisdictions (Alaska, Hawaii, and the other territories). See for example, Reimbursement Transportation Cost Payment Program (RTCP) by Department of Agriculture.

#### **Provide SSI Proxy to Calculate Medicare DSH Payments for Puerto Rico Hospitals**

[Proposed Legislative Solution: Section 203 of H.R. 2635]

#### **Description of Problem**

CMS should ensure Puerto Rico hospitals receive fair Medicare disproportionate share hospital (DSH) payments. Since the 1980s, CMS—through the Medicare DSH program—has provided additional financial support directly to hospitals that treat a high percentage of the most vulnerable population groups—Medicaid beneficiaries, low-income Medicare beneficiaries, and the uninsured. The formula that CMS uses to calculate Medicare DSH payments to hospitals consists of several factors, including a factor called “Medicare SSI days.” This factor measures the number of times a hospital treats a patient who has Medicare Part A *and* who receives benefits under the federal Supplemental Security Income (SSI) program. The formula operates to Puerto Rico's disadvantage because Congress has not extended the SSI program to the territory. While the ACA modified the formula used to distribute Medicare DSH payments nationally—a modification which substantially improved the amount Puerto Rico hospitals receive—the modified formula still uses the “Medicare SSI days” factor in two places.

<sup>1</sup>See Rep. Pierluisi's letter of September 6, 2013.

### **Proposed Administrative Solution**

CMS should exercise its discretion to administratively provide a proxy for the SSI factor in the Medicare DSH payment formula as it applies to Puerto Rico hospitals given that residents of Puerto Rico are statutorily ineligible for SSI payments regardless of whether or not they meet the income thresholds required for SSI eligibility. Rep. Pierluisi proposes in Section 203 of H.R. 2635 that HHS credit a Puerto Rico hospital for a Medicare SSI day when a patient the hospital treats has Medicare Part A *and* either (1) receives benefits under SSI, (2) receives benefits under the Aid to the Aged, Blind and Disabled (AABD) program that applies in Puerto Rico in lieu of SSI, *or* (3) is a “dual eligible” enrolled in both Medicare and Medicaid.

But CMS can take administrative action to address this problem without the need for Congress to enact legislation. Under 42 U.S.C. Section 1395ww(d)(9)(D), Congress appears to state that Medicare DSH payments made to Puerto Rico hospitals should be computed “in the same manner and to the extent” as payments made to hospitals in the states. The statute, which is complicated and confusing, provides CMS with ample authority to utilize a proxy for SSI in the case of Puerto Rico. If Congress wanted to ensure that Puerto Rico hospitals would be shortchanged, it would to reason that it would not have written the statute as it did.

### **Remove Matching Requirement from EAP Funds Used for Medicare Part D Assistance**

[Proposed Legislative Solution: Section 231 of H.R. 2635]

#### **Description of Problem**

Puerto Rico and the other territories cannot fully use—and currently forfeit to the federal government—annual Enhanced Allotment Program (EAP) funding that CMS provides in lieu of the Medicare Part D low-income subsidy (LIS). Part D covers prescription drugs. It is voluntary, requiring a monthly premium. If a beneficiary is enrolled in traditional Medicare, the beneficiary can purchase standalone Part D coverage through a private drug plan. If the beneficiary is enrolled in a Medicare Advantage (MA) plan, the beneficiary pays a monthly Part D premium to that plan. In the 50 states and the District of Columbia, Medicare beneficiaries with annual income below 150 percent of the federal poverty level are eligible to receive a low-income subsidy from the federal government, which reduces or eliminates their monthly premium and other out-of-pocket costs associated with Part D. The subsidy is paid directly by the federal government to the beneficiary’s plan, whether it is a standalone drug plan or an MA plan. However, beneficiaries in Puerto Rico and the other territories are not eligible for the low-income subsidy. Instead, CMS provides each territory government with an “enhanced allotment”—known as an EAP—to supplement the territory’s annual Medicaid cap under Section 1108 of the Social Security Act. Under the EAP formula, the Puerto Rico government is eligible to receive about \$44 million a year, a paltry amount compared to the \$400–\$600 million that low-income seniors in the territory would receive directly if they had access to LIS. (Under EAP, the USVI receives about \$1.1 million annually; Guam about \$817,000; the CNMI about \$114,000; and American Samoa about \$270,000.) Moreover, CMS requires each territory government to pay a 45 percent local match in order to draw down EAP funds, just as the territory governments must do to access all other federal Medicaid funding because they have a 55 percent FMAP. The Puerto Rico government annually returns about half of its \$44 million in annual EAP funding to the federal government because it struggles to meet the local match, even though the funding is badly needed. Specifically, in FY 2011, Puerto Rico forfeited \$28 million; \$26 million in FY 2012; \$22 million in FY 2013; and \$25 million in FY 2014.

#### **Proposed Administrative Solution**

CMS should remove the local matching requirement from EAP funding, which was arguably not intended to apply in the first place. An independent analysis of the statute provided by the American Law Division of the Congressional Research Service indicates CMS has “gap filling authority” due to the ambiguous nature of the relevant section of law that provides EAP funding and rules. Because of the ambiguity and case law, CMS has the ability both to reasonably apply the FMAP to the EAP and to reasonably refrain from doing so. Use of the EAP requires submission and approval of a plan separate and distinguishable from the “State plan” required for regular Medicaid assistance and to which the FMAP is tethered. Therefore, CMS would be on sound legal footing if it were to take a fresh look at the applicable law and to revise/refine its practice of subjecting EAP to the FMAP. Allowing Puerto Rico to access 100 percent of its annual EAP funding without a local match would

relieve local resources and increase the amount of federal funding already appropriated and otherwise available to help poor seniors in Puerto Rico pay for prescription drugs. [SEE ATTACHED CRS MEMORANDUM]

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**MEMORANDUM**

June 9, 2015

**To:** Hon. Pedro Pierluisi; Attention: Jed Bullock**From:** Edward C. Liu, Legislative Attorney, x7-9166**Subject: Amounts for Territories Under § 1935(e) of the Social Security Act**

This memorandum responds to your request for an analysis of § 1935(e) of the Social Security Act (SSA),<sup>1</sup> which authorizes federal financial assistance for territories that provide medical assistance for prescription drugs to low-income individuals who are also eligible for prescription drug benefits under Medicare Part D.<sup>2</sup>

**Background**

Medicare is a federal program that pays for health care for individuals who are disabled, or who are 65 and older.<sup>3</sup> Medicaid is a joint federal-state program which provides health coverage for certain low-income individuals.<sup>4</sup> Under Medicaid, health care expenses of eligible individuals are covered pursuant to a federally approved state plan, and the state is subsequently reimbursed by the federal government for a portion of those expenses known as the state's federal medical assistance percentage (FMAP), which varies from state to state according to each state's per capita income. Specifically, § 1903(a) of the SSA provides that the federal government "shall pay to each State which has a plan approved under this title . . . an amount equal to the Federal medical assistance percentage . . . of the total amount expended during such quarter as medical assistance under the State plan."<sup>5</sup> Territories are also allowed to establish Medicaid plans and are reimbursed pursuant to their applicable FMAP, which is set at 55%. However, § 1108 of the Social Security Act imposes a ceiling on the amount of federal Medicaid assistance that can be paid to a territory in any given fiscal year, while federal Medicaid funding to the states and the District of Columbia is open-ended.<sup>6</sup>

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA), created a voluntary, outpatient prescription drug benefit for Medicare beneficiaries, known as Medicare Part D.<sup>7</sup> Some Medicare beneficiaries, referred to as "dual-eligible individuals" are also eligible for coverage under a state's Medicaid plan, which provides health coverage for low income individuals. Under the MMA, Part D is the primary source of drug coverage for dual-eligible individuals, and the Act created premium and cost-sharing subsidies for these individuals to facilitate their purchase of coverage under Part D.<sup>8</sup> Prior to Medicare Part D, the prescription drug costs of these individuals would have been shared by the state and federal government under the state's Medicaid plan. In order to offset the federal government's costs in subsidizing dual-eligible individuals under Medicare Part D, the MMA included a "clawback" provision which requires states to pay a percentage of the costs that they would have incurred for this population if Medicaid were still the primary payer.<sup>9</sup>

Residents of the territories are not eligible for the low-income subsidies under Medicare Part D. However, under § 1935(e) of the SSA, if the territory "establishes and submits to the Secretary a plan . . . (for providing medical assistance with respect to the provision of prescription drugs to part D eligible individuals), the amount otherwise determined under section 1108(f) (as increased under section 1108(g)) for the

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<sup>1</sup> 42 U.S.C. § 1396u-5(e).

<sup>2</sup> 42 U.S.C. §§ 1395w-101 *et seq.*

<sup>3</sup> See CRS Report R40425, *Medicare Primer*, coordinated by Patricia A. Davis and Scott R. Talaga.

<sup>4</sup> See CRS Report R43357, *Medicaid: An Overview*, coordinated by Alison Mitchell.

<sup>5</sup> 42 U.S.C. § 1396b(a).

<sup>6</sup> 42 U.S.C. § 1308(f), (g).

<sup>7</sup> For more information about Medicare Part D, see CRS Report R40611, *Medicare Part D Prescription Drug Benefit*, by Suzanne M. Kirchoff and Patricia A. Davis.

<sup>8</sup> 42 U.S.C. § 1395w-141.

<sup>9</sup> 42 U.S.C. § 1396u-5(c).

[territory] shall be increased.”<sup>10</sup> This additional federal Medicaid assistance is available only if the plan “provides medical assistance with respect to the provision of covered part D drugs,” and if the territory “provides assurances that additional amounts received by the [territory] that are attributable to the operation of this subsection shall be used only for such assistance and related administrative expenses.”<sup>11</sup>

### Application of the FMAP to the § 1935(e) Increase

You have asked whether there is statutory authority for limiting the amount of federal financial assistance under § 1935(e) by applying the FMAP to the amount of prescription drug expenses attributable to the plan established by a territory under that section.

#### Statutory Text

In order to obtain the increase in the annual federal Medicaid assistance, § 1935(e) requires a territory to establish and submit a “plan” providing prescription drug coverage for Part D eligible individuals. Section 1935(e) further requires that any amounts attributable to this increase in the annual limit must be used only for prescription drug coverage. However, § 1935(e) does not make any explicit mention of the FMAP, either to state that it is applicable to the increase in federal assistance, or to disavow such applicability. The requirements that § 1935(e) does impose would not appear to be incompatible with the application of the FMAP. The FMAP would not appear to frustrate either the submittal of a plan providing prescription drug coverage or the use of increased federal funds under this subsection for such expenses.

On the other hand, neither does the language of § 1935(e) appear incompatible with the use of the increased federal assistance without applying an FMAP.

Looking more broadly at the rest of the SSA, and particularly within Title XIX of the SSA which establishes the Medicaid program, the phrase “the State plan” is frequently used to refer to the medical assistance plan established under § 1902 to provide coverage for low-income individuals generally.<sup>12</sup> The plan under § 1902 is clearly subject to the FMAP as it makes reference specifically to the “non-Federal share of the expenditures under the plan.”<sup>13</sup> Arguably, the use of the word “plan” in § 1935(e) could be read as incorporating the same meaning of “plan” under § 1902, or at least the accompanying FMAP.<sup>14</sup> On the other hand, § 1935(e) does not identify the required plan using either a definite article or the adjective “State,” raising the possibility that the use of the word “plan” in § 1935(e) is meant to refer to a distinct type of plan that is narrowly focused on dual-eligible individuals solely for purposes of that section.<sup>15</sup>

Section 1903 of the SSA may also be relevant in that it provides that the federal government “shall pay to each State which has a plan approved under this title [Title XIX] . . . an amount equal to the Federal medical assistance percentage . . . of the total amount expended during such quarter as medical assistance under the State plan.”<sup>16</sup> The dual-eligible plan under § 1935(e) is a plan under Title XIX, and it is required to provide medical assistance with respect to prescription drug coverage. Therefore, § 1935(e) and § 1903 might be read in conjunction to support the argument that federal assistance under a § 1935(e) plan should be limited to the FMAP. However, one could also argue that § 1903 was enacted well before § 1935(e), when the only type of state plan under Title XIX was the generic state plan under § 1902, and that § 1903 should not be read to encompass a § 1935(e) plan.

<sup>10</sup> 42 U.S.C. § 1396u-5(e)(1)(B).

<sup>11</sup> 42 U.S.C. § 1396u-5(e)(2)(A), (B). The Secretary may also establish other criteria that the plan must meet. 42 U.S.C. § 1396u-5(e)(2)(C).

<sup>12</sup> 42 U.S.C. § 1396a.

<sup>13</sup> 42 U.S.C. § 1396a(a)(2).

<sup>14</sup> *Ratzlaf v. United States*, 510 U.S. 135, 143 (1994) (“A term appearing in several places in a statutory text is generally read the same way each time it appears.”).

<sup>15</sup> *Atlantic Cleaners and Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1933) (The general presumption that repeated phrases have the same meaning “readily yields when there is such variation in the connection in which the words are used as reasonably to warrant the conclusion that they were employed in different parts of the act with different intent.”).

<sup>16</sup> 42 U.S.C. § 1396b(a).

### Legislative History

With respect to the § 1935(e) increase in federal Medicaid assistance, the conference report accompanying the MMA provides little additional information regarding the applicability of the FMAP to that increase. The conference report simply states:

Residents of territories would not be eligible for regular low-income subsidies. However, territories would be able to apply for additional Medicaid funds. The total amount available is \$28.125 million beginning in the last 3 quarters of 2006, \$37.5 million in 2007 and increasing in subsequent years by the annual percentage increase in prescription drug costs for Medicare beneficiaries. In order to obtain these funds, territories would be required to provide assurances that additional funds would be used for covered drugs and administrative costs (with no more than 10 percent of the total used for administrative expenses.)<sup>17</sup>

As with the statutory text of § 1935(e), no mention of the applicability *vel non* of the FMAP to the increased federal assistance is made in the conference report. Still, there are two points about the conference report that may be relevant to the instant discussion.

First, the report acknowledges that the low-income subsidies available to the 50 states and the District of Columbia are not available in the territories, and further suggests that the enhanced federal assistance under § 1935(e) is a substitute for those low-income subsidies. Second, the conference report's discussion of the House bill indicates that this earlier version of the bill would have eventually provided for the full federal assumption of the costs of the low-income subsidies for dual-eligible individuals. In contrast, the final version that was enacted into law includes a "phased-down state contribution" under which the states retain some financial responsibility indefinitely for the costs of individuals that have transitioned from Medicaid to Part D. Together, these two points may support the inference that Congress considered and rejected a proposal in which the cost of prescription drug coverage for dual-eligible individuals in the 50 states would be borne entirely by the federal government under Medicare. To the extent that § 1935(e) is intended to approximate the position of the states vis-à-vis the low-income subsidies under Medicare Part D, the report may support a further inference that the cost of covering prescription drugs under § 1935(e) for dual-eligible individuals was intended to be shared by both territorial and federal coffers.

### Chevron Deference

The preceding review of the statutory text and legislative history reveals that neither source explicitly acknowledges an intent to apply the FMAP to the increased federal assistance under § 1935(e), nor appears to bar the application of the FMAP. Instead, it may be most accurate to describe both the text and legislative history as being entirely silent on this point. In the seminal *Chevron v. Natural Resources Defense Council*, the Supreme Court held that if a court were to conclude that the text and legislative history taken as a whole still did not clearly indicate Congress' intent, and the statute explicitly or implicitly indicates that Congress delegated authority to the agency to make rules filling in the gaps of the legislation, an agency's interpretation of a statute should be accorded such deference that it will only be overturned if it is an unreasonable interpretation.<sup>18</sup> Here, the SSA appears to grant the Secretary such "gap filling" authority, both with respect to the SSA generally and specifically in the context of § 1935(e).<sup>19</sup> Further, the statutory text and legislative history of § 1935(e) appears to be ambiguous with respect to application of the FMAP. Therefore, if the Secretary interprets § 1935(e) as requiring application of the FMAP to the increased federal assistance under that section, such an interpretation would be accorded deference to the extent that it is reasonable. In this case, application of the FMAP to federal assistance under Medicaid is a common feature of the program, and the 50 states and the District of Columbia are required to contribute, at least partially, to the low-income subsidies for dual-eligible individuals under Medicare Part D. Both of these facts would appear to support a court's conclusion that the Secretary's interpretation was reasonable, and therefore permissible under the Supreme Court's holding in *Chevron*.

<sup>17</sup> H. Rept. 108-391, at 510.

<sup>18</sup> *Chevron v. NRDC*, 467 U.S. 837, 844 (1984).

<sup>19</sup> 42 U.S.C. §§ 1302, 1396u-5(e)(2)(C).

PREPARED STATEMENT OF HON. MARK R. WARNER,  
A U.S. SENATOR FROM VIRGINIA

While I find these theoretical discussions interesting, the people of Puerto Rico need practical solutions. The average debt service cost for U.S. States hovers between 5–10 percent of revenue, while Puerto Rico is facing an average of 36 percent over the next 5 years (excluding Federal transfers). Clearly, this is unsustainable.

Soon after I was elected Governor of Virginia, I found out the Commonwealth was facing a \$6 billion budget deficit. We cut spending and reorganized government to close the gap. I have to emphasize, however, that this was in a place with a population of 7–8 million people, more than twice the size of Puerto Rico, and therefore substantially better-suited to use fiscal policies to put the Commonwealth back on solid footing.

Puerto Rico has a smaller population and a much larger debt burden. The island's government has already taken drastic measures to address its fiscal challenges, including public pension cuts, tax increases, tax administration reforms, reductions in public sector employment, school closings, and transitioning retirement benefits from a defined benefit to a defined contribution system.

I remain unconvinced as to how Puerto Rico can service its debt burden without destroying basic public services and ruining its economy.

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PREPARED STATEMENT OF HON. RON WYDEN,  
A U.S. SENATOR FROM OREGON

There are more than 3 million United States citizens living in the Commonwealth of Puerto Rico, where longstanding economic challenges have developed into a very real and very immediate crisis.

No single policy or harsh austerity platform is going to save the day. The solutions in Puerto Rico must be focused, first and foremost, on helping its millions of American citizens get ahead and putting its economy on solid ground by any available means.

In order to accomplish that task, policymakers in Washington and in San Juan need to take a hard look at the origins of the crisis. Puerto Rico won't be able to move forward until there's an understanding of what's holding it back.

The core of Puerto Rico's problems is simply that the commonwealth, its public corporations, and other entities issued more debt than they're able to pay back. Without a process for restructuring that debt, the problem won't go away on its own. But just solving the immediate crisis is not a long-term solution. Puerto Rico also needs to find ways to modernize and grow its economy, or it will find itself right back here again.

For example, the Commonwealth's electric utility, which is responsible for the largest share of Puerto Rico's debt, still burns diesel fuel to generate power. By converting its archaic generators to use lower cost, cleaner-burning natural gas, the utility could make more money on the power it sells. But that type of conversion requires upfront investment, and Puerto Rico can't attract that investment without addressing its immediate financial crisis.

A lot of people engaged in this debate blame Puerto Rico's economic struggles on the ending of an old tax policy that gave corporations tax-free income in the commonwealth. But in my view, the history is a lot more complicated than that, especially when it comes to taxes.

Companies based in Puerto Rico are foreign in the eyes of the IRS—the same as if their headquarters were in Mexico, China, or the UK. But there's a major benefit that no other foreign companies get, which is access to American incentives for investments in R&D and manufacturing. There are a lot of people who view Puerto Rico as a tax haven tucked within the U.S., and this is a big reason why.

There are also other special breaks that are unavailable in the mainland. For example, there is a longstanding policy known in the tax world as the rum cover-over, which for decades provided a big economic boost to Puerto Rico. But in recent years, instead of being invested in roads or schools or health care, the proceeds from the rum cover-over have mostly gone straight to large distillers.

And the Commonwealth's own tax policy has been less than helpful as well. By some estimates, Puerto Rico collects less than half of its sales tax. It recently put

in place a program to attract certain Americans and their firms by zeroing out local taxes on capital gains, with no requirement that they contribute to the economy. Under a local tax break known as Act 20, service providers who move to the commonwealth have their corporate tax rate drop from 30 percent to 4 percent.

These strategies may appeal to some companies and attract some wealth, but there's not much evidence to suggest they're steering Puerto Rico's economy toward prosperity. Scaling back or eliminating overly generous or ineffective tax breaks should be on the table as part of any long-term financial recovery plan.

In this debate, some people have made the argument that Puerto Rico's safety net programs are too generous and need to be rolled back. For example, there's a belief among some that Puerto Rico needs a lower minimum wage. But changing the law to cut people's pay makes hardly any sense when American citizens in Puerto Rico already make less than half as much on average as those in the mainland U.S. In addition, lower wages and a tattered safety net will drive more young workers to the mainland, costing the island a vital engine of growth.

The Medicaid program in Puerto Rico is less generous than in the mainland U.S. And its capped funding system means that it continues to face harsh spending limits that undermine its ability to meet the health care needs of the lowest-income U.S. citizens.

In addition, Puerto Rico is locked out of one of the most successful pieces of the Medicare prescription drug benefit, which is the Part D Low-Income Subsidy. The people this hurts already live with extremely limited means.

A better funding system for Medicaid and improvements to Medicare should be on the table. Puerto Rico could adopt an Earned Income Tax Credit to help raise incomes and encourage employment. The Child Tax Credit could be a bigger help to more families. And the commonwealth could change its own tax policies to make sure it's able to invest in education and infrastructure in the years ahead.

It's important to move ahead with policies that amount to more than a momentary sugar high. The bottom line is that the solutions have to help Puerto Rico and its millions of American citizens build a stronger economic future, or else the debt cycle will continue.

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## COMMUNICATIONS

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LETTER SUBMITTED FOR THE RECORD BY RAFAEL COX ALOMAR,  
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September 28, 2015

The Honorable Orrin G. Hatch  
*Chairman*  
Committee on Finance  
U.S. Senate  
219 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Ron Wyden  
*Ranking Member*  
Committee on Finance  
U.S. Senate  
219 Dirksen Senate Office Building  
Washington, DC 20510

### **Re: Committee Hearing on Financial and Economic Challenges in Puerto Rico**

Dear Chairman Hatch and Ranking Member Wyden,

In anticipation of the Finance Committee Hearing on the Financial and Economic Challenges besieging Puerto Rico, to be held on Tuesday, September 29, 2015, I am hereby submitting this written statement for the Finance Committee's consideration and incorporation into the record of the proceedings.

#### **I. Introduction**

The colossal collapse of Puerto Rico's fiscal edifice—and, more importantly, the crisis's ever-increasing ripple effect on the pricing and financial viability of the United States' \$4.3 trillion municipal bond market<sup>1</sup>—has brought to bear not only the systemic infirmities of the island's archaic economic and governmental models but even more poignantly the inadequacy of its current neocolonial relationship with Washington. The commonwealth status, as it stands, does not serve the people of Puerto Rico well, and it certainly does not promote Washington's geopolitical interests in the Western Hemisphere, either.

It is no secret that Puerto Rico today is on the verge of virtual bankruptcy. And, yet, the writing has been on the wall for some time now. In the words of President Obama's Task Force on Puerto Rico's Status, "After several years of negligible growth, high unemployment, and deficit increases, the Puerto Rican economy start-

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<sup>1</sup> Puerto Rico's default could potentially cost states and cities across the United States billions of dollars in additional interest rate charges. For a provocative argument, see Larry McDonald, "Could Puerto Rico Default Hammer the \$3.7 Trillion U.S. Muni Bond Market in 2014?" *Forbes*, Jan. 3, 2014, <http://www.forbes.com/sites/larrymcdonald/2014/01/03/puerto-rico-default-to-re-price-the-3-7-trillion-municipal-bond-market-in-2014>.

ed to slow as early as 2006 . . . leading to the sharpest economic contraction on the island since the late 1980s.”<sup>2</sup>

The picture is bleak indeed. And all available economic indicators confirm it. As the Government Development Bank of Puerto Rico (GDB) makes clear in its most recent Quarterly Report (dated May 7, 2015), Puerto Rico’s GNP for fiscal years 2013 and 2014 “decreased by 0.2% and 0.9%, respectively.”<sup>3</sup> In its Quarterly Report GDB also confirms that “although the forecast for fiscal years 2015 and 2016 has not been made public, the cumulative values for the monthly economic indicators for fiscal year 2015 indicate that the real gross national product for fiscal year 2015 could also show a decrease during the first 9 months of fiscal year 2015.”<sup>4</sup>

As regards employment figures during this same period, the GDB also concludes in its Quarterly Report that “total employment in the island fell by 0.8% as compared to the same period for the prior fiscal year, and the unemployment rate averaged 13.1% compared to 14.7% for the same period of the prior fiscal year.”<sup>5</sup> Unemployment in the island is persistently higher than in any of the 50 states or the District of Columbia,<sup>6</sup> while the labor participation index has recently fluctuated between 38% and 41%, among the lowest in the world.<sup>7</sup> Puerto Rico’s chronic incapacity to generate jobs at home or to successfully compete in the global labor market is the most eloquent demonstration of the island’s broken institutional repertoire.

A decade of negative growth has led to widespread poverty, pervasive migration, and insurmountable levels of public debt. Close to 45% of Puerto Ricans live in poverty<sup>8</sup> (twice as many as in Mississippi, the poorest state in the United States), and 38% receive food stamps (three times as many as in the mainland).<sup>9</sup> Not surprisingly, these conditions have led to a massive exodus not seen since the days of Operation Bootstrap in the 1950s.<sup>10</sup> Puerto Rico’s population has decreased from 3.81 million in 2000 to 3.667 million in 2012. Between 2000 and 2012, 141,000 people left the island; in the last 2 years alone, Puerto Rico has lost 59,000 residents, or 1.5% of its population.<sup>11</sup>

And, to make matters worse, those who are leaving are precisely the ones Puerto Rico needs the most at this juncture: young, well-educated, productive professionals in their prime who cannot survive at home. This brain drain is, undoubtedly, one of the crisis’s most tragic phenomena.

Puerto Rico, the third-largest municipal bond issuer in the United States after New York and California,<sup>12</sup> has long enjoyed unencumbered access to the markets, due in no small measure to its bonds’ high yields and triple exemption from federal, state, and local taxes.<sup>13</sup> Yet negative growth, together with uncontrolled deficit financing, has led to unmanageable levels of public debt. According to figures from the Commonwealth’s Government Development Bank, as of May 31, 2015, the total outstanding debt of the island’s government (including its instrumentalities and mu-

<sup>2</sup> President’s Task Force on Puerto Rico’s Status, *Report by the President’s Task Force on Puerto Rico’s Status* (Washington, DC: White House, 2011), 38.

<sup>3</sup> Government Development Bank for Puerto Rico, *Commonwealth of Puerto Rico Quarterly Report Dated May 7, 2015* (San Juan: Government Development Bank for Puerto Rico, 2015), 50.

<sup>4</sup> *Ibid.*

<sup>5</sup> *Ibid.*

<sup>6</sup> President’s Task Force, *2011 Report by the President’s Task Force on Puerto Rico’s Status*, 38.

<sup>7</sup> Report on the Competitiveness of Puerto Rico’s Economy, *The Federal Reserve Bank of New York*, June 29, 2012, iii.

<sup>8</sup> D’vera Cohn, Eileen Patten, and Mark Hugo López, “Puerto Rican Population Declines on Island, Grows on U.S. Mainland,” *Pew Research*, Aug. 11, 2014,

<http://www.pewhispanic.org/2014/08/11/puerto-rican-population-declines-on-island-grows-on-u-s-mainland/>.

<sup>9</sup> *Ibid.*

<sup>10</sup> During this period, approximately 500,000 people left the island for jobs on the mainland. See Michael A. Fletcher, “Puerto Rico, with at Least \$70 Billion in Debt, Confronts a Rising Economic Misery,” *Washington Post*, Nov. 30, 2013,

[http://www.washingtonpost.com/business/economy/puerto-rico-with-at-least-70-billion-in-debt-confronts-a-rising-economic-misery/2013/11/30/f40a22c6-5376-11e3-9fe0-fd2ca728e67c\\_story.html](http://www.washingtonpost.com/business/economy/puerto-rico-with-at-least-70-billion-in-debt-confronts-a-rising-economic-misery/2013/11/30/f40a22c6-5376-11e3-9fe0-fd2ca728e67c_story.html).

<sup>11</sup> Maye Primera, “Puerto Rico se vacía lentamente,” *El País*, Aug. 19, 2014, [http://internacional.elpais.com/internacional/2014/08/18/actualidad/1408390645\\_767393.html](http://internacional.elpais.com/internacional/2014/08/18/actualidad/1408390645_767393.html).

<sup>12</sup> Close to 75% of U.S. municipal bond funds own Puerto Rican bonds.

<sup>13</sup> Fletcher, “Puerto Rico, with at Least \$70 Billion in Debt.”

municipalities) was of \$72.204 billion, “equivalent to approximately 104% of the Commonwealth’s gross national product for fiscal year 2014.”<sup>14</sup>

So far, the pro-cyclical measures enacted by the local authorities,<sup>15</sup> far from containing the crisis, have further arrested the island’s economic growth, while “adversely affecting governmental revenues.”<sup>16</sup> More specifically, the 4.5% increase in the island’s sales tax (from 7% to 11.5%),<sup>17</sup> which went into effect on July 1, 2015, has had a chilling effect on consumption, while leading to further tax evasion and even lesser revenues.

The deficits have become so pervasive, short-term financing and liquidity sources so scarce,<sup>18</sup> and the avalanche of credit downgrades so monumental<sup>19</sup> that on June 28, 2015 the Government of Puerto Rico announced to the world that the island’s debt “is not payable.”<sup>20</sup> Shortly thereafter, on August 3, 2015, the Public Finance Corporation (PFC), a GDB subsidiary, was unable to service its debt. The GDB’s lack of liquidity precluded the legislature from appropriating the necessary funds for servicing the \$58 million payment due to the creditors of the Public Finance Corporation.

The default on the PFC’s debt not only marks the beginning of a long and protracted legal battle, on multiple fronts, between Puerto Rico and its creditors, but equally importantly brings to the fore the apparent incapacity of the island’s current fiscal team to articulate and execute, on its own, a successful exit strategy from this labyrinth. To the extent Puerto Rico was unable to reach a compromise with PFC debt holders, who different from GO bondholders enjoy no full, faith and credit guarantee under the Commonwealth Constitution,<sup>21</sup> it is highly unlikely it will be able to craft a consensual deal with those creditors against whom it holds less bargaining power. In short, with no precise strategy at hand, no access to an emergency source of liquidity, no Chapter 9 bankruptcy protection for its municipalities and public corporations, and none of the tools available to sovereign nations, Puerto Rico stands today at a perilous crossroads.

For Puerto Rico, the only way forward appears to be brokering a deal with the Obama Administration and Congress whereby, on the one hand, the Federal Government and Puerto Rico sit on the same side of the negotiating table with the island’s creditors; while dismantling the current colonial arrangement that has bred most of the fiscal and economic evils afflicting the island today.

The perpetuation of a territorial relationship with Washington, fostering values of dependency while severely limiting the island’s policy options, has no doubt exacerbated the catalysts behind the meltdown, making it even harder for Puerto Rico to overcome an endogenous economic depression in a weakened global economy.

<sup>14</sup> Government Development Bank for Puerto Rico, *Commonwealth of Puerto Rico Quarterly Report Dated May 7, 2015* (San Juan: Government Development Bank for Puerto Rico, 2015), 18.

<sup>15</sup> See Ley Núm. 3–2013 [Law No. 3 of 2013], 2013 L.P.R.A. 3 (2013) (P.R.) (reform to the Employees’ Retirement System); Ley Núm. 160–2013 [Law No. 160 of 2013], 2013 L.P.R.A. 160 (2013) (P.R.) (reform to Teachers’ Retirement System); Ley Núm. 162–2013 [Law No. 160 of 2013], 2013 L.P.R.A. 162 (2013) (P.R.) (reform to Judiciary Retirement System); Ley Núm. 66–2014 [Law No. 66 of 2014], 2014 L.P.R.A. 66 (P.R.) (legislation approving sale of U.S. \$3.5 billion of general-obligation bonds); Ley Núm 71–2014 [Law No. 71 of 2014], 2014 L.P.R.A. 71 (2014) (P.R.) (Puerto Rico Public Corporation Debt Enforcement and Recovery Act).

<sup>16</sup> Government Development Bank, *Commonwealth of Puerto Rico Quarterly Report*, July 17, 2014, 5.

<sup>17</sup> See P.R. Law No. 72–2015 of May 29, 2015.

<sup>18</sup> Ted Hampton, “Puerto Rico’s Liquidity Remains at Risk Despite Recent Borrowings, Restructuring Law,” *Moody’s Investors Service*, Aug. 1, 2014, [https://www.moody.com/research/Moodys-Puerto-Rico-s-liquidity-remains-at-risk-despite-recent-borrowings\\_PR\\_305269?WT.mc\\_id=NLTITLE\\_YYYYMMDD\\_PR\\_305269](https://www.moody.com/research/Moodys-Puerto-Rico-s-liquidity-remains-at-risk-despite-recent-borrowings_PR_305269?WT.mc_id=NLTITLE_YYYYMMDD_PR_305269).

<sup>19</sup> In February 2014, the credit ratings of Puerto Rico’s general-obligation bonds and commonwealth-guaranteed bonds were lowered to noninvestment grade (commonly known as “junk status”) by Moody’s Investors Service, Standard and Poor’s Ratings Services, and Fitch Ratings. Soon thereafter, in July 2014, each of the credit agencies lowered the commonwealth’s ratings by two notches into junk status. And from then on, the list of further downgrades has gone in crescendo. As recent as September 10, 2015, Standard and Poor’s lowered its ratings on Puerto Rico’s true-backed debt (COFINA) to ‘CC’ from ‘CCC’.

<http://www.reuters.com/article/2015/09/10/usa-puertorico-debt-idUSL1N11G37S20150910>.

<sup>20</sup> Michael Corkery and Mary Williams Walsh, “Puerto Rico’s Governor Says Island’s Debts Are ‘Not Payable,’” *The New York Times*, June 28, 2015.

<sup>21</sup> P.R. Const. Art. VI, § 8 (“In case the available revenues including surplus for any fiscal year are insufficient to meet the appropriations made for that year, interest on the public debt and amortization thereof shall first be paid, and other disbursements shall thereafter be made in accordance with the order of priorities established by law.”)

Thus, the opportunity has arisen for turning around the economic collapse by way of concurrently addressing the island's status quagmire.

The time is ripe for Congress to articulate a coherent policy for addressing the Puerto Rican labyrinth.<sup>22</sup>

## II. The Financial Control Board Proposal and the “Structural” Problem

Following the release of its Fiscal and Economic Growth Plan, on September 9, 2015, the Government of Puerto Rico announced its intention to engage in far-reaching debt restructuring negotiations with its creditors.<sup>23</sup>

It seems as if the Commonwealth's fiscal team intends to begin negotiations with the island's creditors by mid-October. However, the island's systemic institutional infirmities, its acute illiquidity, its lack of access to Chapter 9's restructuring mechanism and the absence of consensus among the wide panoply of creditors besieging it will in all probability drive any unilateral attempt at restructuring to failure. And this is precisely what must be averted at all costs.

As both Chairman Hatch and Treasury Secretary Lew have suggested “Puerto Rico needs an orderly process to restructure its unsustainable liabilities;”<sup>24</sup> “orderly resolution of debt defaults are preferred to chaotic ones”<sup>25</sup> that “could cause long-term damage to the health, safety and financial well-being of the families living and working in Puerto Rico.”<sup>26</sup>

However, the island's liquidity deficiency is of such magnitude that “neither the Commonwealth nor GDB may be able to honor all of their obligations as they come due nor may the Commonwealth be able to fund all necessary governmental programs and services if it does not have sufficient access to the capital markets or alternative sources of financing to satisfy its liquidity needs.”<sup>27</sup> According to Conway MacKenzie, Inc., a U.S. based consulting firm retained by the GDB, avoiding “full cash depletion at the Treasury's Concentration Account by September 2015” will be highly improbable “in the absence of new TRANs or other cash flow financing for fiscal year 2016.”<sup>28</sup>

A humanitarian crisis of grave proportions will soon unfold in this U.S. territory of 3.6 million U.S. citizens if the political branches in Washington, in conjunction with the island's elected officials, fail to craft an innovative strategy for cleaning up this mess.<sup>29</sup>

It is against this background, that the idea that Congress (in the exercise of its authority under the Constitution's territory clause) should pass legislation establishing a federal financial control board over Puerto Rico has begun to gain momentum in Washington (and bond holders) circles.<sup>30</sup> This proposition should not be taken lightly. It merits grave and careful consideration.

As a threshold matter, it is essential to discard the possibility of blindly extrapolating the 1995 District of Columbia Revitalization Act to the Puerto Rican scenario. The District's \$722 million budget deficit and \$5 billion unfunded pension liability (as measured by 1995 standards)<sup>31</sup> pale in comparison to Puerto Rico's chronic \$2.5 billion per year budget deficits (3.5% of GNP) and over \$33 billion unfunded pension liability.<sup>32</sup> While certain provisions of the District's Revitalization Act would cer-

<sup>22</sup>Beyond uttering vague and sporadic statements in favor of providing technical assistance to local authorities, the political branches of Washington have yet to shoulder their part of the blame. See, e.g., Dereck Wallbank, “Congress Open to Puerto Rico Technical Aid, Hoyer Says,” *Bloomberg*, July 8, 2014, <http://www.bloomberg.com/news/2014-07-08/congress-open-to-puerto-rico-technical-aid-hoyer-says.html>.

<sup>23</sup>See, for instance, Michelle Kaske, “Puerto Rico Sends Reassurance as Debts Talks Poised to Begin,” *Bloomberg Business*, September 25, 2015.

<sup>24</sup>Letter from Secretary Lew to Chairman Hatch, July 28, 2015.

<sup>25</sup>Letter from Chairman Hatch to Secretary Lew, July 17, 2015.

<sup>26</sup>Letter from Secretary Lew to Chairman Hatch, July 28, 2015.

<sup>27</sup>*Qualifying Report*, May 7, 2015, 15.

<sup>28</sup>*Ibid.*, 49.

<sup>29</sup>As regards the health aspects of this impending humanitarian crisis see, for instance, Lizette Alvarez and Abby Goodnough, “Puerto Ricans brace for Crisis in Health Care,” *The New York Times*, August 2, 2015.

<sup>30</sup>See, for instance, *Dear Colleague* letter authored by Congressman Jeff Duncan (R-SC), June 19, 2015. Also, Jack Casey, “Puerto Rico Control Board Discussion Simmers in Congress,” *The Bond Buyer*, September 4, 2015.

<sup>31</sup>Michael Janofsky, “Congress Creates Board to Oversee Washington, DC,” *The New York Times*, April 8, 1995.

<sup>32</sup>*Qualifying Report*, 43–46. *Krueger Report*, 15.

tainly prove useful in the Puerto Rican context, such as for instance those addressing governmental cash-flow problems,<sup>33</sup> these measures alone will prove insufficient to assure the island's long-term sustainability.

As the 2015 Krueger and the 2014 Federal Reserve Bank of New York Reports have both suggested, solving Puerto Rico's woes will require much more than a powerful dose of austerity. It will also require doing away with the applicability to Puerto Rico of a host of federal statutes and regulations, such as the Jones Act (1920 Merchant Marine Act as amended), which have severely diminished the island's competitiveness in the global economy.<sup>34</sup>

While it is true that local politicians have recklessly mismanaged the island's finances, it is pretty clear that the fundamentals of Puerto Rico's political relationship with the U.S. are highly unsatisfactory. The political status meltdown has clearly spilled over to the island's fiscal and economic health. Therein lies what some voices in Congress have now come to describe as the island's "structural" problem.

In light of the above-referenced observations, the Senate's Finance Committee would be well advised to pay heed to the following recommendations as it explores the possibility of introducing a financial control board bill for Puerto Rico:

1. The proposition that the federal government "cannot" and "should not" extend to Puerto Rico bridge financing facilities is unrealistic. Addressing the island's long-term structural asymmetries, will require in the short-term access to external sources of liquidity. If seen in light of the impending debt service deadlines facing the island's central government and public corporations (totaling close to \$3.5 billion over the next 10 months),<sup>35</sup> and these entities' incapacity to access the markets, it becomes patently clear that there will be no successful debt restructuring without short-term liquidity. Nothing, as a matter of law or policy,<sup>36</sup> stands in the way of the Treasury's or the Federal Reserve's assistance by way of facilitating Puerto Rico appropriate short-term financing facilities within a wider revitalization strategy that brings to the fore the federal financial control board mechanism. One thing must go with the other.
2. The sheer magnitude and complexity of Puerto Rico's debt restructuring negotiations (an exercise without precedent in Puerto Rico's history) will no doubt require that any federal financial control board legislation bestow on the control board broad authority to engage the island's creditors in the restructuring negotiations—bearing in mind, of course, the fiduciary duties that would necessarily make the board accountable to the people of Puerto Rico and to Congress.
3. Federal legislation establishing a financial control board for Puerto Rico (legislation that would amend the Federal Relations Act (48 U.S.C. § 731 *et. seq.*)) must also contain explicit provisions detailing a fixed and specific timetable for Puerto Rico's decolonization. As soon as Puerto Rico hits the applicable fiscal and economic growth benchmarks the federal financial control board legislation would put in place, the people of Puerto Rico should then face a stark choice between sovereignty and annexation. For this approach to work, the political branches in Washington must pay attention to the following elements. First, the status quo must be discarded from the outset because it is both the source of the structural crisis besieging the island and a colonial anachronism at odds with the U.S.'s

<sup>33</sup> Pursuant to the District's Revitalization Act, the U.S. Treasury, *inter alia*, provided the District short-term capital to refinance close to \$500 million in debt; assumed the District's \$5 billion unfunded pension liability; increased the federal Medicaid payment to 70%; and took over the financing of the courts and the prison facilities.

<sup>34</sup> *Krueger Report*, 1; Update on the Competitiveness of Puerto Rico's Economy, *Federal Reserve Bank of New York*, July 31, 2014, 9.

<sup>35</sup> GOs: \$357 million of interest due in January 2016 and \$805 of principal and interest in July same; COFINA: \$1.2 million of interest due in November 2015, February and May 2016; PREPA: \$196 million of interest in January 2016 and \$420 million of principal and interest in July 1 same; GOB: \$354 million in December 2015 and \$422 million in May 2016; PR Highway and Transportation Authority: \$106 million of interest in January 2016 and \$220.7 million of principal and interest in July same; PR Public Buildings Authority: \$102.4 million of interest in January 2016 and \$207.6 million of principal and interest in July same; PRASA: \$86.5 million of interest in January 2016 and \$135.1 million of principal and interest in July same; PR Financing Authority: \$37.2 million of interest in January 2016 and \$77.8 million of principal and interest in July same.

<sup>36</sup> See, for instance, Arturo Estrella (Professor of Economics at Rensselaer Polytechnic Institute), *Puerto Rico Debt and the U.S. Federal Government: Potential Assistance Tools and Policy Practice* (Discussion Paper Prepared at the Auspices of the Fundación Carvajal), October 2014.

geopolitical interests in the Americas.<sup>37</sup> Second, the sovereignty formula presents, in of itself, a dual choice between separate sovereignty and associated sovereignty (as both terms are defined under Public International Law). Third, the annexation alternative would amount to Puerto Rico becoming a “part” of the United States as an “incorporated” territory—bearing in mind that it befalls on Congress to spell out the conditions the island would then have to meet in order to, on the one hand, bear the fiscal and economic burdens of statehood and, on the other, enter the Union as a state on an equal footing with the 50 states.

### III. Conclusion: A Path to Decolonization

The Puerto Rican fiscal crisis presents a unique opportunity for articulating a sound policy for disentangling an ancient jigsaw puzzle—the solution of which has so far eluded Washington. The current territorial condition of Puerto Rico has become an albatross around the neck of any possible path for undoing the epic fiscal crisis besieging the island and, no doubt, a source of acute embarrassment to the people of Puerto Rico and to the United States.

I call on the members of the Senate’s Finance Committee to analyze the issues raised in this written statement and do what is right by Puerto Rico.

Cordially,

Rafael Cox Alomar

c. Chris Campbell, Majority Staff Director of the Senate Finance Committee

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STATEMENT OF DENNIS O. FREYTES

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## U.S. SENATE FINANCE COMMITTEE HEARING ON PUERTO RICO— SEPTEMBER 29, 2015

### SUPPORT U.S. TERRITORY OF PUERTO RICO MASTER RECOVERY AND PROSPERITY PLAN

**HONORABLE U.S. SENATORS: THANKS for receiving and reading my testimony!**

It is the sacred DUTY of the Federal Government (U.S. President, U.S. Congress, U.S. Federal Courts/Supreme Court) to exercise its oversight and fairly support the U.S. Territory of Puerto Rico (under Article 4—U.S. Constitution’s Territorial Clause), in its hour of need to include to end the Fiscal and Economic crisis! Plus, ensure a fair/equal U.S. Citizenship; end the federally undemocratic Territorial Status! Treat all U.S. Citizens—including Puerto Ricans) equally under just laws!

For the Purpose of these hearings, I recommend passage of H.R. 870, the Puerto Rico Chapter 9 Uniformity Act of 1915 (Debt Restructure—that is fairly applied to other States, and did apply to Puerto Rico until 1984 when the U.S. Congress removed Puerto Rico).

The U.S. Territory of Puerto Rico—with Federal Government fair support and constructive oversight—needs to develop a comprehensive (not piecemeal) *Economic/Fiscal Recovery and Prosperity Plan*; take action to do various structural reforms to get Puerto Rico out of economic recession; create good jobs that will also help improve the U.S. Economy; ensure fairness/equality and progress for the good of all U.S. Citizens; help stem the Puerto Rican exodus to the States!

### BACKGROUND

U.S. Citizens with Puerto Rican Heritage/Roots are about 9 million strong; are the 2nd largest Hispanic Group in the U.S. (most live in the States—can Vote in Fed-

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<sup>37</sup>It was Ranking Member Wyden who summed it up best when, in adjourning the Senate’s Resources Committee Hearing on Puerto Rico, he said: “Two out of 3 of you seem to believe that the current status and enhanced Commonwealth are no longer options. . . . So looking forward it seems to me that it’s especially important to see if the 3 of you can come to an agreement on the language of a ballot that, in effect, has 2 remaining options: statehood, or sovereignty as an independent or freely associated State. Absent an agreement of the 3 of you it seems that this will just go round and round some more.” See *Puerto Rico: Hearing before the Committee on Energy and Natural Resources, United States Senate, One Hundred Thirteenth Congress, First Session, to Receive Testimony on the Nov. 6, 2012, Referendum on the Political Status of Puerto Rico and the Administration’s Response*, 113th Cong. 35–36 (2013).

eral Elections; are mostly concentrated and are the majority of Hispanics) in Central Florida (swing State), and New York. The U.S. Territory of Puerto Rico has about 3.6 million U.S. Citizens, more than about 22 States. (It used to be more than 24 States, but, the Exodus has taken its toll; taxing the resources of the States they move to.)

For over 117 years, Puerto Rico has faced discrimination where Residents suffer a 2nd Class U.S. Citizenship, including American Veterans who have shed blood, sweat, and tears for our beloved USA! These American Citizens don't have any rights to Vote for their U.S. President/Head of State nor have just representation in the U.S. Congress that determines their destiny nor statutory permanent U.S. Citizenship nor full benefits (they paid for) . . . nor treated justly under fair laws!

This is WRONG—un-American—strikes at the essence of the U.S. Republic's Representative Democracy “consent of the governed;” the building block of our democracy—the U.S. Citizens—with protected individual civil rights—so there is no tyranny of a majority!

It takes two to tango! The Federal Government has been mostly benevolent with Puerto Rico; but, it has treated U.S. Citizens residing there un-justly. Thus, the Federal Government must lead—move to Stop Institutional discrimination; take action to redress a wrong. In Fiscal matters, the Puerto Rican Government has behaved irresponsibly—like drunken Sailors (no offense to the Sailors). . . . Thus, both must take action (for the good of all U.S. Citizens):

#### RECOMMENDATIONS

##### Federal Government:

- **Equal/Fair application of our “We the People” U.S. Constitution**—for all under our noble U.S. Flag! Overturn the racist Insular Cases (1901–1925+)—where a racist Supreme/Federal Courts UN-FAIRLY held—Puerto Rico to be an un-incorporated U.S. Territory; more foreign and domestic; belongs to but, is not part of the U.S. . . . (Terms not found in the U.S. Constitution); the U.S. Congress can discriminate (differentiate) in applying the U.S. Constitution to U.S. Citizens residing in Puerto Rico. . . .
- **Terminate statutory/un-permanent 2nd Class U.S. Citizenship!**
- **Break Puerto Rico's trite federally un-democratic Territorial Shackles!**
- **Support Puerto Rico** on finding solutions to the fiscal, economic/job, and security problems . . . This includes treating Puerto Rico (with about 3.7 million U.S. Citizens) fairly like it treats other U.S. Jurisdictions (New York, Detroit, Chicago . . . when in financial problems; debt restructure . . .)!

**\*\* Example: New York** (with 9 million U.S. Citizens), from 1975–1986, went through a dire fiscal/economic crisis. In this case, the Federal Government—backed up or guaranteed New York's loans/bonds (with fees attached) until New York resolved its fiscal problems; was solvent (paid fees), and prosperous again; continued to make mayor contributions to the MACRO U.S. Economy. . . .

##### Pass (on a non-partisan basis):

- **H.R. 870**, the Puerto Rico Chapter 9 Uniformity Act of 1915 (Debt Restructure—that is fairly applied to other States).
- **H.R. 727**—Puerto Rico Statehood Admission Process Act—STATEHOOD: YES or NO.

**\*\* Yes vote means:** Equal U.S. Citizenship; own State Identity and State Sovereignty—like other States of our “Union of States” have (*e.g.*, The Lone Star State-Republic of Texas). . . .

(This bill has over 110 Congressional Co-Sponsors; but, U.S. Senate Sponsors are needed to support Equal U.S. Citizenship!)

\*NOTE: 2nd Alternative—the Federal Government conducts a sanctioned Referendum between constitutionally defined Non-Territorial Options: STATEHOOD vs INDEPENDENCE. (and its forms)

##### Besides, the Federal Government should:

- **Create Federal Enterprise Zone**—provide economic development incentives—tied to Job creation, and other Metrics.
- **Exempt Puerto Rico from the 1920 Jones Shipping Act**—Legislate to exclude Puerto Rico from this trite un-competitive Act—that raises prices that consumers pay and has other negative impacts on the MACRO U.S. Free Market Economy (especially to Puerto Rico, Hawaii, Alaska, and others).

- **Provide Federal Oversight:** As last resort, if the PR Government does not show internal/local results soon—The Federal Government must positively act to resolve the situation directly. . . .
- **Take any other actions for fairness; the good of ALL U.S. Citizens,** no matter where they reside.

#### **U.S. Territory of Puerto Rico Government:**

##### **Internal Actions:**

##### **1. Government:**

- Reform/cut the size of Government (Territorial/Local/Public Corporations . . .): consolidate the 139 Government Agencies into about 75; cut municipalities from 78 to about 45; regionalize some government functions—into about 8 Government Service Regions—decentralize Territorial control, as appropriate and with safeguards;
- prioritize needs; use modified 0-Base Budgeting (make Agencies justify their Budgets);
- establish a Government Professional Merit System based on metrics and evaluations (non-partisan); Workfare not Welfare (all abled un-employed work at least 25 hrs. a Week—Community Services . . .) as the Government coordinates with the Private sector for jobs;
- Streamline/make Government more responsive, effective, efficient, compassionate, and accountable.

##### **2. Fiscal Policies:**

- end dependency on spiraling high interest rate Loans to pay operating deficits; a growing \$72+ Billion Debt (which is actually closer to about \$163 billion);
- reform the Tax structure (make it simpler—with incentives for those that work and invest);
- prioritize needs (essential necessities first: water, electricity, security, health, education, transportation, care of the indigent . . .) than other nice to have things if the budget allows, cut government spending, balance the budget;
- eliminate the operational and structural debt in the long run; bring liquidity to the “Banco de Fomento;”
- Don’t over-tax because it can kill the economy . . . but, provide incentives for capital and business enterprises . . . etc. that will grow the economy; bring in more Revenues.

##### **3. Educate/Re-train the Work Force for today’s Job Market.**

- Establish a seamless and coordinated education system (under a State or Territory Board of Education—5 Division Chiefs): (1) Pre-K; (2) K–12, (3) Vocational Schools, (4) Community/Colleges, and (5) Universities. (Public, Private or Chartered)/with an Education Jobs Advisory Council made up of Community Leaders—include accomplished Businesspersons;
- Start education at Pre-K level;
- Establish good education Standards based on the foundation/priorities of: Reading, Writing, STEM (science, technology, engineering and mathematics), Social Sciences, Personal Affairs (Conduct, Management, Responsibilities, Discipline, and Tolerance); Critical Thinking;
- Establish a seamless and coordinated education system (under a State or Territory Board of Education—5 Division Chiefs): (1) Pre-K; (2) K–12, (3) Vocational Schools, (4) Community/Colleges, and (5) Universities. (Public, Private or Chartered) (With a Core and Elective Curriculum);
- Teach to Individual Learning Style (e.g. 4-MAT Learning System); use technology.
- Performance Scholarships (Government/Public/Private)

##### **4. End Territorial Status through Statehood:** provide stability for investors/capital investment; stem the vast historic exodus of Puerto Ricans (many professionals) to the States (as they vote with their moving feet for equality and better opportunities).

##### **5. Unleash the Entrepreneurial Spirit**

- Transform PR’s Economy/Jobs from Centralized Government Based to Private Sector/Business Based;
- minimize regulations, permit process; income inequalities;
- create an *incentive based* (Investors, Managers; Worker profit sharing)—tempered Free Market economy that is competitive on the Global Stage.

##### **Recommendations:** (For both the U.S. and Puerto Rico)

We need to demand our government come up with proper solutions, now. Some are:

1. Prioritize needs;
2. Implement correctly modified Zero-Base Budgeting;

3. Cut spending;
4. Stimulate (with incentives) the economy to create more jobs and growth;
5. Gradually stop borrowing or keep it at 20% of GDP;
6. Cut the size of the government;
7. End unneeded regulation;
8. Reform the Tax System;
9. Balance the budget;
10. Establish work fare—end dependence (except/compassion for the truly disadvantaged);
11. Reform entitlement programs that we can afford;
12. Provide incentives/profit sharing formula (Investors, Management, and Workers);
13. Induce fair opportunity; a level playing field;
14. Deal with income inequality—Fairness in a tempered FREE Market/Enterprise System;
15. Facilitate Business (includes Small Business); liberate the entrepreneurial spirit!

#### **OTHER FACTS:**

Facts are: the Federal Government desperately treats American Hispanics-loyal Puerto Rican U.S. Citizens by denying full Civil Rights; in many programs, like—MEDICARE, MEDICAID, Social Security, SSI funding for the poor . . . where Puerto Ricans pay fully and receive less than the States.

Also, it excludes Puerto Rico from Federal Code 9-Debt Restructure (which all States have); doesn't exempt Puerto Rico from the 1920 Jones Act (monopolized Shipping Law) that hurts Puerto Rico's economy and the MACRO U.S. Economy. . . . Even Bill Gates stated that the Federal Government treats Puerto Rico wrong! The Feds must be fair; help, not sink, Puerto Rico.

The Federal Government has been benevolent in many ways, but, it doesn't treat Puerto Rico equally or fairly. U.S. Citizens/American Veterans, from Puerto Rico, don't have full civil rights; don't receive all benefits; are under the will of Congress with no just representation or federal voting rights for their Head of State-U.S. President.

Congress has passed many good Laws like the: Foraker Act (1900) creating a Civilian Government; Jones Act (1917) provides a 2nd Class U.S. Citizenship; U.S. Law 600—Federal Relations Act (1950) allows Puerto Rico its local Constitution (approved in 1952—with a local form of Republican government but, still under the will of Congress). There are a number of Laws and Federal Programs that treat Puerto Rico almost like an incorporated State of the Union with only local powers, but, still under the will of Congress.

Plus, the designation of a Federal Court District (under Article III of the U.S. Constitution); the presence of the principle Federal Agencies on the Island; the integration of Puerto Rico's culture to the Macro USA National Western Culture, and its treatment by Federal Agencies (as can be done) as a State—has transformed the 1898 Puerto Rico to today's Puerto Rico that has become a fully integrated U.S. Territory; aspiring to become a full Partner of the U.S.—ready to enter the "Federal Union of Sovereign States" that come together *equally* under our U.S. Constitution. Puerto Rico sacrifices, serves, defends, contributes, and spills blood for our U.S.—deserves to be treated equally!

A representative Government should serve the People, not be their Master; unfairly subjugate them with no right to just representation in Congress. There is no true democracy without equal representation; protected individual civil rights. Even if one U.S. Citizen can't Vote . . . it is one too many!

\***Note:** About 5 million U.S. Puerto Ricans have "voted with their feet"—moved to the States (with more on the way)—wanting equal rights, benefits, and better opportunities. To stem the flow, resolve PR Status. . . .

But, the Federal Government still has oppressive powers to discriminate (differentiate) in applying the U.S. Constitution to Puerto Rico. This is incongruent with what the U.S. stands for—equal/protected civil rights!

Puerto Ricans/Hispanics are part of the kaleidoscopic or intertwined strong threads that make up the resilient (red, white, and blue) Fabric of the USA—the land of Free Immigrants (united under our "We the People" U.S. Constitution/Flag—with own identities, respect, and tolerance for others; have made valuable contributions (created hundreds of thousand Mainland jobs).

Besides, Puerto Ricans have help develop and defend our USA since 1513—(Puerto Rican Ancestors fought in the U.S. War of Independence, Civil War). Since, Puerto Rico became a U.S. Territory in 1898—it has bravely sacrificed, shed blood and tears—under the American Flag—till today!

In the interim Status resolution—the Federal Courts/U.S. President/Congress must give more weight to the Bill of Rights/Constitutional Amendments—Incorporate Puerto Rico; overturn the biased and racist rooted Insular Cases (Bidwell; Balsac)—that, along with the old Territorial Clause—are still, today—the veiled basis for Federal discrimination in applying the U.S. Constitution, and un-democratic governance of Puerto Rico.

In sum, Puerto Rico's economy is subservient, but, contributes to the U.S. economy/jobs (which also has its problems). To move forward the U.S. Federal Government must cut Puerto Rico's territorial shackles as Puerto Rico conducts structural internal reforms . . . that will bring prosperity as we work for the good of all: Family, Community, Puerto Rico, USA, and Humanity.

The Federal Government controls Puerto Rico, under the undemocratic U.S. Territorial Clause, to include: the economy/business market, currency, security, borders, shipping, taxes, benefits; oversees all local laws; can cede PR to another Nation. Plus, PR has a 2nd Class statutory U.S. Citizenship (can't vote in Federal elections/for their U.S. President; has no just representation in the Congress that determines its destiny); has no power in Congress—only one Resident Commissioner—(without a vote) that represents millions of U.S. Citizens (does the job of about 6 Representatives and 2 Senators)!

Besides, Puerto Rico is an island colonial possession of the U.S.—which contributes in many ways to the U.S. defense, macro economy, creation of American jobs, and in other areas. But, its economic growth is: forcefully linked to the U.S. economy; hamstrung by many imposed senseless stranglehold U.S. regulations and the must use of un-competitive and very costly \* American Ships—which adversely impacts on PR's and the U.S. economy/creations of jobs!

\***Note:** Puerto Rico, Alaska, Hawaii, and others agree (and want to change) this unfair and uncompetitive shipping—that cost their economies and consumers much more than other continental States . . . but, Puerto Rico has no just representation; no power in Congress to fight for its U.S. Citizens!

These regulatory shackles are a hindrance to “Free Market” that kills competition; monopolizes shipping; reduces incentives for capital investment; raises immensely the cost of products and services-including electricity. . . . Besides, along with the territorial status (which fuels investor uncertainty) and other factors, it adversely affects PR's economy; denies, to an extent, a “Free Market” with competition, and incentives for capital investment; stifles economic growth, creation of good jobs. . . .

Bill Gates (Microsoft has operations in PR—with an educated workforce) is quoted as saying that the way the U.S. treats Puerto Rico is “*just wrong*. . . .” Plus, on Shipping—the Federal Government must take action to redress this wrong; ensure we have an competitive open Market (with incentives) that will boost the economy/create more jobs; reform the trite 1920 Jones Act, as we also protect our U.S. Merchant Marine. . . .

#### **CLOSE**

“No Taxation without just representation!” Many in PR are forced to pay Federal taxes (without just representation), such as: Social Security, Medicare, Payroll, and other indirect/invisible taxes, but, U.S. Citizens there don't get full rights or benefits. . . .

The Federal Courts/Supreme Court needs to, also, take action by overturning the Insular Cases (Bidwell and Balzac) that, during racist and biased times, have allowed the U.S. Congress to discriminate when applying the U.S. Constitution to Puerto Rico—to this day!

Loyal U.S. Puerto Ricans/Hispanics (which cherish their U.S. Citizenship), and Ancestors—have contributed greatly to the advanced civilized development of the now U.S. (since 1513)—107 years before the Pilgrims; bravely fought in the U.S. War of Independence and other Wars; have courageously defended our noble U.S. Flag with utmost sacrifice and blood . . . (Includes, from 1899—the valiant Borinqueneers—U.S. 65th Infantry Regiment—Winners of the Congressional Gold Medal—highest honor U.S. Congress can bestow)!

**The USA MANTEL of LIBERTY** (includes Hispanics/Puerto Ricans)—is made from a strong resilient Fabric of intertwined golden Multi-Threads of loyal and con-

structive contributing Individuals and Groups; Natives and Immigrants—with own Individual and State Identities, Customs, and Traditions (based on the MACRO Western Culture)!

**WE ARE UNITED** (with respect, tolerance, responsibility, duty . . . loyalty)—under our U.S. Flag (that represents “WE the People”)/Constitution; Humanitarian Values (Right to Life, Creed, Equality, Fair Opportunity, Justice, pursuit of happiness); and Good Principles—that liberates the Entrepreneurial Spirit in a tempered Free Market; with a Safety Net for the disabled and disadvantaged; reasonable Freedom to be—for all!

**OUR USA, is a Kaleidoscope of Beauty**; has the best Quality of Life in the World—as we work together to sustain what we have; but, also strive (with reason) for PROGRESS—make positive improvements (Security, Food, Medical, Housing, Education, Grow our Economy, Creation of Jobs, Fair Income . . . Social Justice); work together for the good of ALL: Family, Community, State, USA, and Humanity!

Let’s advocate (illuminate the truth)—stand up for a just cause, don’t fall trapped to political excuses, distortion, generalizations, speculation, or stonewalling by close-minded closet Chauvinists, or support actions that lead to impasse that result in Voter segregation of loyal U.S. Citizens! Let’s work together for the good of all: Family, Community, USA, and Humanity!

**THANKS for the many good things you do for our beloved noble USA! HOOAH!**

**John Oliver Video:** <https://www.youtube.com/watch?v=CesHr99ezWE>  
**Equality for Puerto Rico:**  
<https://www.youtube.com/watch?v=5EWzqvRZJOY>  
**Harvard (Feb. 2014)—Chief Judge Torruella:**  
<https://www.youtube.com/watch?v=aixtvS4Jack#t=20>

**\* QUESTION—for PRESIDENTIAL-CONGRESSIONAL CANDIDATES \***

**What will you do**—end a Statutory 2nd Class U.S. Citizenship—where U.S. Citizens (including American Veterans) that have sacrificed; shed Blood, Sweat and Tears for our noble USA, but,

- can’t VOTE for their U.S. President/Head of State;
- don’t have JUST REPRESENTATION in the U.S. Congress that determines their Destiny or full permanent U.S. Citizenship nor full benefits (like MEDICARE, MEDICAID, Social Security, etc., they pay for);
- BREAK the U.S. Territory of Puerto Rico’s 118 years’ undemocratic federal shackles?

Also, what action will you take to get the Federal Government to DO ITS PART—in dealing with the economic, fiscal, security, and other problems facing U.S. Puerto Rico; stop institutional discrimination; includes EQUAL TREATMENT under just Laws—like U.S. Bankruptcy Laws; protected Individual Civil rights? (Remember, PR is at times powerless to act because of U.S. Colonial Status!) **THANKS!**

- This strike’s at the essence/equal application of our U.S. Republic’s “We the People” Constitution (with a Representative Democracy—“consent of the Governed”)—where the BUILDING BLOCK is the U.S. CITIZEN—with protected Individual Civil Rights—so, there is no Tyranny of a majority!

**Best Wishes! Respectfully,**

**Dennis O. Freytes, U.S. Army Retired; Community Servant Leader**

Master Public Administration (MPA); Master Human Resources (MHR); Bachelor Business Administration (BBA)—Management; other Courses; Former Professor (PMS)/Department Director University of Puerto Rico; Trustee, Valencia College (confirmed by the Florida Senate twice); Work: Senior Leader; Executive, Manager, Advisor/Consultant—in Business, Non-Profit, Government, U.S. Army. Served: Florida Governor Jeb Bush—Member Policy Transition Team; U.S. President Policy Transition Advisory Committee; Non-Partisan Congressional Advisor, etc. (Please, see Master Professional Resume—that includes work with the Small Business Administration; many other Organizations.)

**ENCLOSURE—EQUALITY FOR PUERTO RICO**

**We leave no American Veteran or 1st Responder behind!  
There is one RACE—the Human RACE!  
Judge on MERIT based on fair opportunity—a Level playing field!**

**THE TIME IS NOW!****Canto Claro como un Gallo de Manati!****\*The Feds Discriminates Against 2nd Class U.S. Citizens!\***

Our Federal Government preaches equality in our U.S. Republic with a “We the People” Constitutional Representative Democracy—“Consent of the Governed” . . . under our noble American Flag!

In our times—how can the U.S. be a just Representative Democracy, when millions of its loyal born Citizens (including American Veterans) in the U.S. Territory (Colony) of Puerto Rico—can’t Vote for their President/Head of State; don’t have fair representation in the U.S. Congress that controls their destiny or same full benefits or entitlements (they paid for) or a permanent U.S. Citizenship—as other U.S. Citizens?

Other facts are: the Federal Government desperately treats loyal Puerto Rican U.S. Citizens by—denying full civil rights; as it discriminate in many Federal programs, like—MEDICARE, MEDICAID, Social Security, SSI funding for the poor . . . (Where Puerto Ricans pay fully, but, receive less than other U.S. Citizens)!

Also, the Federal Government—excludes Puerto Rico from Federal Code 9-Debt Restructure (which all States have); doesn’t exempt Puerto Rico from the 1920 Jones Act (monopolized Shipping Law) that hurts Puerto Rico’s economy and the MACRO U.S. Economy; controls Puerto Rico’s borders, currency, economy, shipping, defense, foreign affairs, business market—under the federally undemocratic, and outdated Territorial Clause!

The U.S. Citizen (with protected individual civil rights) is the fundamental building block of our representative democracy!

This un-American wrong (discrimination against U.S. Citizens-Hispanics-Puerto Ricans-Veterans); strike’s at the soul or essence of our U.S. Republic with an evolved Constitutional Representative Democracy (which we now own)—“Consent of the Governed” with protected Individual Civil Rights for ALL!

There is no fair/equal treatment under just laws—when millions of loyal 2nd Class U.S. Citizens (including U.S. Veterans) are unfairly subjugated by Congress/the Federal Government! Even if one U.S. Citizen can’t vote . . . its one too many! You are either for Equality and fairness or you discriminate!

Where is the MEDIA and American Patriots’ out-cry; action to get the Federal Government to do right?

**The Federal Government should serve all U.S. Citizens equally—must do right (without giving old biased excuses); take action—stand to protect full Individual Civil Rights as it fairly applies the U.S. Constitution; equal protection under just laws!**

Let’s stand up for a just cause; educate based on facts . . . (don’t be trapped by political old excuses, distortion, generalizations, speculation, or stonewalling by close-minded closet Chauvinists, or support actions that lead to impasse that result in Voter segregation of loyal U.S. Citizens!

**TAKE ACTION CONCURRENTLY:**

**1. PASS H.R. 870**, the Puerto Rico Chapter 9 Uniformity Act of 1915 (Debt Restructure—that is fairly applied to other States)

**2. Support Puerto Rico** on finding solutions to the fiscal, economic/job, and security problems. . . . This includes treating Puerto Rico (with about 3.7 million U.S. Citizens) fairly (like it treats other U.S. Citizens)!

\*\***New York** (with 9 million U.S. Citizens) from 1975–1986 went through a dire fiscal/economic crisis. In this case, the Federal Government—backed up or guaranteed New York’s loans/bonds (with fees attached) until New York resolved its fiscal problems; was solvent and prosperous again; continued to make mayor contributions to the MACRO U.S. Economy. . . .

**3. Federal Enterprise Zone (FEZ)**—Declare Puerto Rico a FEZ—that provides economic development incentives—tied to Job creation, and other Metrics.

**4. 1920 Jones Shipping Act**—Legislate to exclude Puerto Rico from this trite Act (which needs to be updated because it's detrimental to the U.S. MACRO Economy; especially to Puerto Rico).

**5. Federal Oversight:** As last resort, if the PR Government does not show internal/local results soon—The Federal Government must positively act to resolve the situation directly. . . . (This is about the suffering People first; not its Government!)

The Federal Government must respect PR's local plebiscite (Nov. 2012) results:

**\*End Territorial Status: 54% (958,915); \*Statehood: 61+% (824,195);**

**\*Independence 5% (74,812)**—(has never received more than 5% in the past) . . .

**(Total Voted: 78+%)** The plebiscite results were clear: a Non-Territorial Status through Statehood won as duly ratified by the PR's Elections Commission. . . .

**Pass (on a non-partisan basis): H.R. 727**—Puerto Rico Statehood Admission Process Act—**STATEHOOD: YES or NO** (This bill has over 108 Congressional Co-Sponsors; but, U.S. Senate Sponsors are needed to support Equal U.S. Citizenship!)

**\*\*2nd Alternative**—Congress conducts a prompt sanctioned Referendum with defined non-territorial Constitutional Options: STATEHOOD vs INDEPENDENCE (or forms of Independence like: ELA Soberano; Free Associate Republic).

Puerto Rico—will keep its own Boricua Identity and have Sovereignty (like other States—the Lone Star Republic of Texas) upon becoming a Full and Equal Member of the U.S. (“Union of States”)!

Moreover, President Obama—the U.S. Justice Department must act to overturn unjust racist laws (Insular Cases); file a Class Action Equal U.S. Citizenship Law Suit. . . .

The Federal Government must give more weight to the Bill of Rights/Constitutional Amendments—Incorporate Puerto Rico; overturn the racist rooted Insular Cases (Balsac–1922) where a biased Supreme Court made up the term “not incorporated” to keep a Territory out of the path of Statehood forever. This was not used against other Territories that became States before nor is this term in the U.S. Constitution.

The Insular Cases (some of the same Judges served on Plessy vs Ferguson—1896-Blacks are equal but, separate), along with the old Territorial Clause—, *are still today*—the veiled basis for Federal discrimination in desperately applying the U.S. Constitution, and un-democratic governance of Puerto Rico.

**CONTRIBUTIONS:** Loyal U.S. Puerto Ricans/Hispanics (who cherish their U.S. Citizenship), and Ancestors—have contributed greatly to the advanced civilized development of the now U.S. (since 1513)—107 years before the Pilgrims; bravely fought in the U.S. War of Independence and other Wars; have courageously defended our noble U.S. Flag with utmost sacrifice and blood since 1899—WW–I, WW–II, Korea, Vietnam until today. . . . (Includes nine Medal of Honor Winners; the valiant Borinqueneers—U.S. 65th Infantry Regiment—Winners of the Congressional Gold Medal—highest honor U.S. Congress can bestow)!

Puerto Ricans/Hispanics are part of the multi-ethnic kaleidoscope or intertwined strong threads of sub-groups that make up the resilient fabric of the U.S. Mantel—the land of Free Immigrants with own identities and tolerance! But, united under our U.S. Constitution; and with State Sovereignty (like other States of our Union)—for the good of all!

The U.S. belongs to Puerto Ricans too! Out of about 9 million Puerto Ricans, some 5 million have “voted with their feet”—moved to the States (with more on the way). . . . They want to have equal rights, responsibilities, full benefits, better opportunities . . . to stem the exodus resolve the issues/PR Status.

**Now is the time:** Patriots of true Grit must stop discrimination; advance our evolved U.S. Democracy—ensure equal protected civil rights for all; end a statutory 2nd Class U.S. Citizenship; cut Puerto Rico's federally undemocratic Territorial Shackles! With truth and right—*WE SHALL OVERCOME!*

**\*NOTE: Three main sources of this U.S. Federal Government's repressive power are:**

- The original outdated Territorial Clause—states: “Congress shall have the power to dispose of and make all rules and regulations pertaining to the Territory . . . or Property belonging to the U.S. . . .” which conflicts with the Constitutional Amendments—U.S. Citizen Bill of Rights. . . .

- The discriminatory/racists vestiges of the “Insular Cases” (1901–1925+/still enforced under a veil today) that allows the U.S. Congress to discriminate when applying the U.S. Constitution to born U.S. Citizens residing in Puerto Rico . . . which conflicts with the Constitutional Amendments—U.S. Citizen Bill of Rights.
- Federal Government’s (President, Congress and Federal Courts) incongruence; inaction to make right—after 117 years of federal oppression; wrong interpretation of the trite original undemocratic Territorial Clause (which wasn’t meant to be forever), and its conflict (when statutory U.S. Citizens are involved)—with our U.S. Constitution’s Individual Civil Rights Amendment/Bill of Rights—the bed rock of our representative democracy.

Also, we need a Constitutional Amendment to ensure—the U.S. Citizen (with equal protected individual Civil Rights) is the building block of our U.S. Republic with a Representative Democracy (consent of the governed)—where the Federal Government serves all the People—U.S. Citizens equally . . . under the jurisdiction of the United States. . . .

The complex U.S. Territory of Puerto Rico’s equal rights quandary—that affects millions of discriminated U.S. Citizens, is not only about a “Group Vote” on the status question, but, more essentially crucial, it’s about equal application of the U.S. Constitution to all U.S. Citizens (with full protected Individual Civil Rights); ending institutional discrimination/2nd Class U.S. Citizenship; advancing equality/consent of the governed—where the *U.S. Citizen* is the epicenter of our Republic, not the U.S. Government’s trite un-democratic territorial control of the Land and People (without just representation)!

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FUNDACIÓN FRANCISCO CARVAJAL

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**Financial and Economic Challenges in Puerto Rico**  
**Hearing date, September 29, 2015**

**Fundación Francisco Carvajal and Arturo Estrella, Ph.D.**  
**P.O. Box 1298, Guaynabo, PR 00970**

**Executive Summary**

**Puerto Rico Government Debt and the U.S. Federal Government:**  
**Potential Assistance Tools and Policy Practice**

**By Dr. Arturo Estrella, Professor of Economics, Rensselaer Polytechnic  
Institute**

***The Francisco Carvajal Foundation commissioned this work in its desire to  
make a contribution to the public discussion about a very relevant issue in  
these challenging times.***

The objective of the study is to analyze the tools and historical policy practice of the Government of the United States to provide assistance in financial crisis situations such as the one that Puerto Rico faces today.

The discussion paper has three principal goals: to review the framework under which federal assistance could be extended to Puerto Rico, to examine the actual policy practice of the federal government in addressing financial crises in the past, and to suggest possible alternatives to deal with the pressing issues regarding the fiscal and financial crisis in Puerto Rico. These suggestions are informed by the analysis described above and include options that are in line with both the principles and practices of the U.S. federal government in dealing with prior crisis situations.

There is no simple existing law or regulation that was designed specifically to address the problems Puerto Rico faces today. However, a multitude of existing measures were designed to deal with similar situations, and it is important to identify possible ways to make use of such means and in the process to accept enthusiastically the offer of help extended by the president of the Federal Reserve Bank of New York to decision makers in Puerto Rico.

Based on thorough analysis and many years of experience at the Federal Reserve Bank of New York applying laws and regulations and participating in the creation of new regulations, the study concludes that there are no legal or regulatory impediments that prevent the Federal Reserve System and the U.S. Department of the Treasury from providing financial assistance to Puerto Rico, that there are precedents of assistance offered to other entities in previous situations, and that the Federal Government has the tools to provide such assistance. An important finding of the study is that treatment of the Commonwealth of Puerto Rico under the laws and regulations of the Federal Reserve System has been and continues to be internally inconsistent.

The study identifies a number of stylized principles that the federal government has followed in the past to deal with financial crises. The principles include the following.

- Exercise flexibility in interpreting statutes and regulation.
- Take actions that are not prohibited as well as actions expressly allowed by law.
- Work with Congress to pass legislation that allows the federal government to act.
- Use discretion to reduce delays and preserve confidentiality.
- When there's a will, there's a way.

Based on the analysis, the study suggests a non-exhaustive menu of specific actions that the federal government could take to assist Puerto Rico in resolving its liquidity problems while in no way resorting to a bailout. These options include the following.

- The Federal Reserve could purchase Puerto Rico debt as a U.S. municipality under Section 14(2) of the Federal Reserve Act.
- The Federal Reserve could purchase Puerto Rico debt as a foreign country under Section 14(2) of the Federal Reserve Act.
- The Federal Reserve could extend credit to Puerto Rico government corporations under section 13(3) of the Federal Reserve Act.
- Historical experience also suggests other types of loans or debt guarantees that the federal government could provide.
- The Federal Reserve and the Treasury Department could provide financial planning assistance to the government of Puerto Rico.

These steps and others like them may be taken singly or jointly.

The federal government and its agencies can apply the same will to find solutions that has been applied in the past to so many cases, domestic and foreign, a sample of which is considered in the study. History shows that when the will is there and the situation is deemed sufficiently important, effective solutions have been found either within the existing legal structure or by advancing that structure further to tackle new problems.

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Jose Calderon, President, Hispanic Federation  
Written Testimony  
United States Senate Committee on Finance  
“Financial and Economic Challenges in Puerto Rico”  
September 29, 2015

Chairman Hatch, Ranking Member Wyden, and distinguished members of the Committee on Finance thank you for the opportunity to provide testimony on the crisis facing Puerto Rico.

My name is Jose Calderon. I am the President of the Hispanic Federation. Hispanic Federation is the nation's premier Latino membership organization with a mission to advance and empower the Hispanic community locally and nationally. For over 25 years, Hispanic Federation has provided critical nonprofit capacity-building grants, launched innovative community programs and led public advocacy efforts in the areas of education, health, immigration, economic empowerment, civic engagement, civil rights and the environment. Through its network of nearly 100 affiliated community-based organizations, HF reaches thousands of Hispanics each year including a large number of Puerto Ricans living on the mainland.

Recently, Hispanic Federation has been helping to lead efforts to support Puerto Rico and its 3.5 million U.S. citizens, along with an extensive coalition of Latino, labor, environmental, health and economic justice advocates from across the nation. With our partners, we have organized press conferences in several cities from Hartford to Orlando and we are currently working to get 100,000 signatures on a White House petition calling for the President to respond to the crisis and organizing a congressional briefing to inform our nation's leaders about the situation on the island. We strongly believe the federal government bears a social, moral and economic responsibility to directly address the Puerto Rican debt crisis.

The ramifications of the island's economic crisis have been far reaching: 150 public schools have already been shuttered in the last 5 years. Puerto Rico has increased the retirement age and required heftier pension fund contributions from public sector workers. And more pain is coming. Puerto Rico passed a budget for the fiscal year beginning July 1, 2015 that increased the sales and use tax from 7 percent to 11.5 percent and reduced public investment by \$674 million.

Severe current and future government budget cuts threaten to undermine the already tenuous economic situation of hundreds of thousands of Puerto Ricans on the island. And there is good chance that the crisis will be increasingly felt in many U.S. states, through potential pension asset losses and a growing reliance on local social services by those who migrate to the U.S. In short, Puerto Rico's near calamitous economic crisis, if left to fester, will almost certainly reverberate far beyond the geographic limits of the island.

The reasons behind the island's current economic woes are complex, with plenty of blame to go around: poor budget practices by the island, federal funding shortfalls and tax policies that hamper economic growth, predatory lending by hedge funds, and the complicated and oft unjust relationship between the U.S. and Puerto Rico, to name just a few. There are also wider forces to blame, such as the Great Recession, outmigration from the island, and escalating energy and health care costs.

Setting the stage for the crisis were stagnant economic conditions in Puerto Rico over the past 10–15 years, brought about by the elimination of Section 936 of the Internal Revenue Code. Section 936 encouraged mainland companies to locate on the island. Unfortunately, when the tax breaks were eliminated by Congress, these companies moved out. The Great Recession of 2008 compounded this stagnation, leaving almost half the island's residents in poverty and unemployed. Forced to seek economic opportunity, hundreds of thousands of Puerto Ricans moved stateside to places like Florida, draining the island's tax base which funds basic public services.

However, structural economic inequalities—in part driven by federal policies—date back long before the recent decline. A prime example is the burdensome costs of transporting goods created by the U.S. Jones Act, which has increased shipping costs by billions over many decades. In effect, the law requires every car, food item or other product that enters or leaves Puerto Rico to be carried on a more expensive U.S.-flagged vessel. If a foreign-flagged ship enters the island, high taxes and customs fees essentially double the price of transported goods.

Puerto Rico also faces growing costs to its public services. The electricity system led by the Puerto Rico Electric Power Authority (PREPA) is more than \$8 billion in debt. A recent deal to restructure the debt still leaves the systemic challenge of reducing sky-high energy costs to homeowners and businesses from the outdated and unhealthy use of fossil fuels, as opposed to cleaner, renewable energy systems.

Federal health care funding inequities have also contributed to the ongoing crisis. Approximately 60% of the island's population is enrolled in Medicaid or Medicare, both which face an uncertain future due in part to an archaic capping of federal contributions which was imposed upon Puerto Rico. As a result, healthcare costs represent an estimated \$25 billion of its \$72 billion debt.

Declining tax revenue forced risky borrowing to keep public utilities and local government running, which in turn generated massive debt because of predatory interest rates aimed at creating a big fiscal windfall for hedge funds looking to make a fast buck at the island's expense. In fact, these same hedge fund interests were backers of changes in the island's constitution that mandated the local government to first pay debt relief before continuing to fund schools, energy and other vital public services.

Unfortunately, these measures will only help to exacerbate the current vicious cycle of outmigration, with the only certainty being that more pain for Puerto Rico is in store in the near future. Below are more details regarding the main causes of the island's financial troubles, focusing on labor force decline, the health care crisis, and debt and debt service costs.

The depth and scope of Puerto Rico's economic crisis has forced leaders on the island to make difficult and painful choices. The Commonwealth has already laid off over 30,000 employees, raised utility and college tuition prices, raised taxes, cut public health and pension benefits, closed schools, and raised the retirement age. On September 8th, the Governor announced a new round of austerity measures that calls for additional cuts to social services, layoffs and reductions in job protections. Meanwhile, Puerto Rico is also bracing for a health care crisis with federal funds rapidly diminishing and no clear plan on how to keep island residents covered in the coming years.

Puerto Rico is considering reforms to all aspects of its economy and governance, including taxes, labor laws and administrative practices. Negotiations are underway to explore debt restructuring and other options, but financial interests are resisting payment reductions. Meanwhile, there are estimates that this year's \$5 billion principal and interest payments alone would require \$1,400 in increased tax levies for every resident of the island, roughly 9% of per-capita income. Unfortunately, Puerto Rico does not have the cash flow or tax base to make anything close to the required payments.

Despite these cuts and the pain they're causing millions of American citizens on the island, the same hedge fund interests who urged the Commonwealth to continue to unwisely borrow well beyond its means are now calling for further severe austerity and privatization measures to protect their financial windfall. The IMF's "Krueger Plan" perfectly encapsulates this thinking with its severe budget cuts and related proposals calling for even more massive school closures and wage reductions.

While there will undoubtedly be further fiscal pain for the families of Puerto Rico, we do not believe the island can or should cut its way through this crisis. Further reductions to government services and pensions threaten to undermine the Puerto Rican economy so deeply that it may take generations to recover. Any realistic solution must instead include reasonable debt restructuring and relief, immediate federal investment and reforms, and a long-term economic growth and diversification strategy that will create living-wage jobs, grow small businesses, improve infrastructure and provide opportunities for local residents.

President Obama and Congress cannot stand on the sidelines when it comes to Puerto Rico. Elected officials and civil servants in both the executive and legislative branches have a legal and moral obligation to support Puerto Rico in its time of dire need. Over 3.5 million U.S. citizens are counting on them to act immediately to help the island get through this fiscal crisis and on a path to economic recovery. Below are select key actions the federal government can undertake to offer resources and enact reforms to assist Puerto Rico through this fiscal and economic crisis.

- **Bankruptcy Protection:** Congress should pass legislation granting Puerto Rico the right to declare Chapter 9 bankruptcy or another orderly and fair alternative in order to renegotiate the debt and establish a fair repayment plan. See Puerto Rico Chapter 9 Uniformity Act—H.R. 870, introduced by Representative Pedro Pierluisi (D-PR) and Senators Richard Blumenthal (D-CT) and Charles Schumer (D-NY).
- **Debt Renegotiation and Relief:** President Obama should convene a Working Group on Financial Markets to bring all parties to the table in order to negotiate a fair debt repayment and relief deal. In doing so, the President could sit down with all relevant stakeholders and explore a Federal Reserve loan or any other bridge or gap financing options for the Commonwealth of Puerto Rico. In addition, the President should exercise his authority to convene both the Government of Puerto Rico and its creditors, and urge the parties to find an orderly negotiated resolution of this crisis in order to avoid further costs to the vulnerable residents and populations in Puerto Rico.

- **Health Care:** Congress should bolster Puerto Rico's health care safety net by passing legislation that will eliminate the annual Medicaid/Mi Salud funding cap on Puerto Rico in favor of funding based on FMAP per-capita income. Congress should include all U.S. territories in this legislation. Congress should also improve the formula for the Medicare Disproportionate Share Hospital Program, reduce by 50% the fee on insurers in the territories, and establish a floor for Medicare payments. In the interim, the President should establish a multi-billion dollar health care program as has been done in some states to ensure vital health care services continue past 2017, when existing funds will run out. See Improving the Treatment of the U.S. Territories Under Federal Health Programs Act of 2015—H.R. 2635 introduced by Representative Pedro Pierluisi (D-PR).
- **Energy and the Environment:** President Obama should direct the Department of Energy (DOE) and Environmental Protection Agency (EPA) to engage in a full review and collaborative analysis of all federal policies and programs that apply to Puerto Rico in the areas of clean energy generation and environmental cleanup. This will ensure the development of a comprehensive policy plan that addresses the energy, clean environment, safety and health needs of Puerto Rico, including the cleanup of toxic sites within the island municipalities of Vieques and Culebra.
- **Jones Act:** The President should grant a temporary waiver and Congress should pass legislation that amends the costly shipping mandates dictated by the Jones Act, which unfairly increases the prices of imports and exports to and from Puerto Rico. Any funds from foreign-vessel fees should also be directed to the Puerto Rico Treasury.
- **Tax Policy:** Following the loss of Section 936 tax incentives, the federal government should institute tax policies that foster economically-diverse and living-wage job creation. President Obama should also support local government implementation of an Earned Income Tax Credit (EITC) that rewards work and supplements earnings to low-income workers in Puerto Rico.
- **Federal Policy and Funding Formula Assessment:** There should be a full Administration and Congressional review of all federal policies that apply (or not) to the Commonwealth of Puerto Rico. This review should seek to eliminate or reduce the impact of federal policies that put the island at an economic disadvantage, as well as look for ways to expand access to federal investments and programs.

Puerto Rico and its citizens are inextricably intertwined with the United States by history, emigration and economics. Puerto Ricans, both on the island and stateside, have fought valiantly in every war since World War I, and its citizens have contributed to this nation in innumerable ways. Its diaspora—5 million strong, still intimately connected to the island—are a visible presence in communities throughout the 50 States of the Union. Just as significantly, three out of every four municipal funds in the country hold Puerto Rico's bonds.

Because of these intimate interconnections, what affects Puerto Rico affects the U.S. The fact that Puerto Rico faces the worst economic crisis in more than a century should be of the highest concern to all Americans. If Puerto Rico is forced to enact even more draconian cuts to its budget, the island will almost certainly spiral into an even deeper crisis. Given the interpenetration of the Puerto Rican population and economy with the U.S., this will have incalculable repercussions on communities, towns and cities stateside.

The time to debate or assign blame is past, as is any hope that the U.S. could avoid economic fallout from this crisis. The real question is, do we have the will to act in order to ameliorate its very worst effects?

To do so, we urge the Administration and Congress to resist calls by hedge funds to force more cuts to social services. We urge Congress to give Puerto Rico the ability to file for bankruptcy protection and to pass legislation rectifying economic inequities including the Jones Act and Mi Salud. We urge the President to call for a full federal agency review of policies that are economically harmful to Puerto Rico, including health care reimbursement, and convene his Working Group on Financial Markets to develop an in-depth debt relief, repayment, and investment plan to stabilize the island's economy.

We urge the Congress to take strong, substantive and constructive action that stabilizes Puerto Rico and protects the livelihoods of 3.5 million American citizens living on the island.

Thank you for your time and consideration.

Jose Calderon  
 President  
 Hispanic Federation

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LETTER SUBMITTED FOR THE RECORD BY  
 JOSÉ A. ORTIZ-DALÍOT

P.O. Box 366218, San Juan, PR 00936, (787) 764-9969, FAX (787) 765-8955, E-MAIL ODSA@ONELINKPR.NET  
 October 5, 2015

Hon. Orrin G. Hatch  
 Chairman  
 Senate Committee on Finance  
 219 Dirksen Senate Office Building  
 Washington, DC 20510-6200

Dear Senator Hatch:

I would like to submit this statement for the record to the hearing held by the Finance Committee on September 28, 2015 on the fiscal situation of Puerto Rico.

It is indisputable that the fiscal and economic situation of Puerto Rico looks bleak. I agree that it is difficult to precisely ascertain without audited financial statements. But it is also indisputable that much of the blame for the island's present situation lies with the U.S. government. Probably, the most powerful economic development instrument the island had was section 936. It was not only a significant incentive for U.S. manufacturing companies, it provided great amounts of capital for Puerto Rican banks to invest in other economic sectors within our economy and also served as an economic tool for an effective U.S. foreign policy in Central American and the Caribbean in the late 1980s. But for whatever reasons, Congress decided to repeal the biggest economic incentive the island had to create good paying jobs—section 936 of the Internal Revenue Code, without providing a substitute mechanism for economic growth. The present chaos we live in Puerto Rico now started with the date of the repeal of section 936.

The other elephant in the room is the colonial situation in which we live in Puerto Rico since 1898, due to the fact that the 1952 experiment failed to provide the island and its government the necessary political powers a nation needs to have the ability to fight hard economic times, such as treaty making powers (tax treaty with Japan voided by the U.S.) and choosing transportation carriers for its imports, particularly from the U.S. (cabotage law) as well as other legal restraints.

The political status situation cannot go without mentioning. The U.S., particularly U.S. Congress, has failed on its face as a metropolitan power to its territories. Not once since the U.S. invaded in 1898, the Puerto Rican people have been provided the opportunity to decide their political future. It is hard to believe coming from the U.S., the great promoter of freedom and democracy around the world.

The 1952 exercise did not provide political options to our people. The only option was to remain a colonial possession of the U.S., with a Constitution of our own doing as long as it met with the standards set by Congress which did not accept the initial draft from our constitutional assembly. Since then, Puerto Ricans have been knocking at congressional doors without receiving an adequate response. Every year, the United Nations calls on the U.S. to comply with its international responsibility to let us exercise our right to self-determination. Never has there been a response. Puerto Ricans have held political status plebiscites and the U.S. provides no response to its results. The last plebiscite was held as recently as November of 2012. Fifty four percent (54%) of the voters rejected the present colonial political status. Puerto Rico was hoping the U.S. would take notice. But again, the U.S. has not responded as of to date. From my perspective, to ignore the latest expression is highly irresponsible.

Mr. Hatch, the fiscal problems we presently have are closely related to our colonial situation, which you and your colleagues refuse to deal with. Puerto Rico has done relatively well in spite the lack of political powers and the constant irrational mandates imposed by the U.S. to our government.

You, as well as the members of your committee, could very well bring positive change, by providing Puerto Rico its right for self-determination. That would help, significantly. We took in 2012. Congress, as usual, has yet to response.

Sincerely,

José A. Ortiz-Daliot  
 Senator (2001–2005)

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PUERTO RICO COLLEGE OF PHYSICIANS AND SURGEONS  
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September 28, 2015

Senator Orrin G. Hatch, Chairman  
 Senator Ron Wyden, Ranking Minority Member  
 Senate Finance Committee  
 219 Dirksen Senate Office Building  
 Washington, DC 20510–6200

Re: Public Hearing of the Senate Finance Committee, “Financial and Economic Challenges in Puerto Rico”

Dear Messrs. Chairman and Ranking Member:

On behalf of the Puerto Rico College of Physicians and Surgeons, we submit the following written statement for the Senate Finance Committee hearing, “Financial and Economic Challenges in Puerto Rico,” scheduled for Tuesday, September 29, 2015.

Our association remains committed to working with you and the committee to legislate the necessary changes to ensure that Medicare and Medicaid beneficiaries and U.S. veterans receive the same medical services in Puerto Rico as they can in all 50 states. Doctors in Puerto Rico rightfully deserve to be appropriately reimbursed for the services they provide in Puerto Rico just as they would if providing such care in any U.S. state.

We believe the Finance Committee and the entire U.S. Senate agrees that Medicare must treat every American equally, including those living in Puerto Rico today and in the future.

Our comments today focus on one component of the physician fee schedule formula that has a dramatically negative impact on the entire health care system of Puerto Rico. The Geographic Practice Cost Index (GPCI) formula as currently implemented by the Centers for Medicare and Medicaid Services (CMS) produces Medicare reimbursements far below the actual cost of providing care to Medicare beneficiaries in Puerto Rico. The GPCI is designed to reflect the variation in practice costs in each geographic locality across the United States and the territories and has been established for each of the three components of a procedure’s relative value unit (*i.e.*, costs for physician work, practice expense, and malpractice insurance). This formula fails health care providers in Puerto Rico for two primary reasons.

First, Puerto Rico is in the unenviable position of having the highest energy prices in the nation, roughly three times the cost of energy in California. Unfortunately, energy costs are not taken into account in determining medical practice costs.

Second, CMS applies a formula to determine medical office rents based on a residential housing rental rate. This in no way reflects the actual cost of running a medical practice in Puerto Rico. Puerto Rico has the highest percentage of HUD Section 8 rental units (*i.e.*, subsidized public housing), which lowers the average housing rental rate disproportionately to the rest of the United States. In fact, Puerto Rico has almost 9 times the national average of 2-bedroom renter-occupied public housing units. CMS has granted a waiver of the Section 8 rental units in the U.S. Virgin Islands due to a similar situation, but continues to ignore the U.S. citizens of Puerto Rico.

To illustrate, the Practice Expense (PE) GPCI for Puerto Rico in 2015 is 0.705. In the Virgin Islands, the PE GPCI is 0.960, 36% higher than Puerto Rico. In Hawaii, the PE GPCI is 1.162, almost 51% higher than Puerto Rico.

Data collection with respect to Puerto Rico is inadequate and the U.S. Census does not provide meaningful data. CMS relies on deficient data that results in inaccurate GPCI calculations for Puerto Rico. This causes an underestimation of the actual practice costs and results in Medicare reimbursement rates that do not reflect the cost of providing care to Medicare beneficiaries in Puerto Rico.

We have attached a report prepared by the Puerto Rico Institute of Statistics that examines the public housing bias in the CMS estimates of the office rent component of the GPCI. The report estimates that the public housing rent bias has a potential total negative economic impact on Puerto Rico of \$120 million annually.<sup>1</sup> As it relates to Medicare Part B expenditures, this bias represents between \$7 and \$15 million annually—a small drop in the ocean of tens of billions of dollars spent on Medicare Part B physician payments each year.

This bias was first introduced by CMS, without statutory mandate, in calendar year 2012. CMS thus has the authority to correct its mistake and should do so immediately. As the Puerto Rico Institute of Statistics concludes, “CMS’s use of uncontrolled residential rent estimates in different regions of the United States and Puerto Rico introduces a bias in the calculation of the Office Rent component of the GPCIs. The bias causes an underestimation in the uncontrolled median gross residential rent estimates in those regions with relatively large segments of the population living in public housing.”

The Senate Finance Committee and the U.S. Congress have the opportunity to provide meaningful and immediate relief to health care providers who serve Medicare beneficiaries in Puerto Rico. With the island facing an unprecedented financial crisis and a near collapse of the health care system, Puerto Rico’s Medicare population (American citizens who pay full Medicare taxes) cannot afford arbitrary CMS policies that ignore the harsh reality facing Puerto Rico.

Thank you again for your consideration of our comments. The Puerto Rico College of Physicians and Surgeons looks forward to working with the committee to ensure that the American citizens in Puerto Rico are fairly treated under the law.

Sincerely,

Victor Ramos, MD MBA  
President

Attachment:

<http://www.estadisticas.gobierno.pr/iepr/LinkClick.aspx?fileticket=ZdH5lxNObgs%3d&tabid=165>

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PUERTO RICO INSTITUTE OF STATISTICS REPORT TO THE BOARD OF GOVERNMENT OF  
THE PUERTO RICO PHYSICIANS AND SURGEONS GUILD

Regarding the possible existence of a Public Housing Prevalence Bias in the Estimation of the Office Rent component of the Geographic Practice Cost Index (GPCI) used by the Centers for Medicare and Medicaid Services (CMS) to provide differential compensation to physicians in different parts of the United States and Puerto Rico for providing services under Medicare Part B.

July 17, 2015

**Author**

DR. MARIO MARAZZI-SANTIAGO

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<sup>1</sup>The \$120-million figure breaks down as: \$7-15 million in additional Medicare Part B fee-for-service payments to providers; \$50-60 million in additional reimbursements under Medicare Advantage; and up to \$45 million in indirect and induced multiplier effects.

able data. Therefore, its use, and the Institute's role, is limited to the clauses contained in said Agreement and Puerto Rico Act No. 209–2003. The information that served as the base for this report has not been verified by the Institute or any auditors (independent or otherwise) nor have such auditors been consulted. The Institute has made no independent verification as to the accuracy or completeness of said information; therefore the Institute assumes no responsibility for the information contained herein. Accordingly, the Report is subject to modification or reconsideration at any time.

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## Executive Summary

The Puerto Rico Physicians and Surgeons Guild (*Colegio de Médicos Cirujanos de Puerto Rico*) requested the technical assistance of the Puerto Rico Institute of Statistics (PRIS) to understand a potential bias in the calculation of the Office Rent component of the Geographic Practice Cost Indexes (GPCIs) prepared by the Centers for Medicare and Medicaid Services (CMS). The GPCIs are used to adjust the compensation that physicians receive for providing services under Medicare Part B (see *Physician Fee Schedule (PFS)*) that may arise as a result of potential differences in the costs of providing Medicare services across different regions of the United States and Puerto Rico.

The purpose of this report is to present PRIS findings regarding CMS's use of data from the American Community Survey (ACS) and the Puerto Rico Community Survey (PRCS) of the U.S. Census Bureau to estimate the median gross rent of a 2-bedroom housing unit in different regions of the United States and Puerto Rico, which serves as a proxy for the calculation of the Office Rent component of the GPCIs. In specific, we control for the prevalence of non-market housing (*i.e.*, public housing) in each PFS payment locality to test for the existence of a bias. We find that:

- (1) After controlling for non-market housing, the median gross rent of a 2-bedroom housing unit changes in a statistically significant way in all PFS payment localities. This provides evidence to support the existence of a bias related to the differential prevalence of non-market housing in different parts of the United States and Puerto Rico.
- (2) Amongst all PFS payment localities, Puerto Rico obtains the lowest estimate for the median gross rent of a 2-bedroom housing unit (\$360). Once HUD public housing rent thresholds are applied, Puerto Rico continues to receive the lowest estimate for the median gross-rent of a 2-bedroom housing unit (\$510). But, in the case of Puerto Rico, this represents a statistically significant increase of 42 percent, by far the largest percentage increase amongst all PFS payment localities.
- (3) The use of uncontrolled residential rent estimates to proxy for commercial rents introduces a bias associated with factors unrelated to commercial rent markets, such as the prevalence of public housing, amongst others. Doctors in Puerto Rico have been affected more by this statistical bias than doctors in any part of the United States. We estimate that this statistical bias artificially

reduces Puerto Rico's GPCI by about 4 percent. According to a panel of experts, the total economic impact of this bias could reach \$120 million annually. We term this bias the "Public Housing Prevalence Bias."

- (4) The Department of Housing and Urban Development (HUD) has been using for many years the ACS/PRCS to estimate adequately controlled residential rent estimates, known as Fair Market Rents (FMR). In fact, prior to calendar year 2012, CMS used FMR estimates as the proxy for the Office rent component of the GPCI. But, when CMS switched to using its own uncontrolled residential rent estimates prepared from the ACS/PRCS, Puerto Rico's Practice Expense GPCI fell by 20 percent, the largest drop of any of the 89 PFS payment localities.
- (5) There is evidence that suggests that the costs of renting a high-quality residential housing unit in the San Juan, Puerto Rico Metropolitan Statistical Area, including energy costs, is much higher than properly controlled ACS/PRCS gross rent estimates would suggest. In specific, the Cost of Living Index of the Council for Community and Economic Research based in Arlington, Virginia suggests that the rent plus energy costs in Puerto Rico could be as high as in Beaumont, TX MSA and Chicago, IL MSA.

We recommend several ways that CMS could proceed to correct for the Public Housing Prevalence Bias in the Office Rent component of the Puerto Rico Geographic Practice Cost Index. The remediation of this situation should not have to wait any more time.

## I. Introduction

Title XVIII of the Social Security Act establishes regulations for Medicare, a health insurance program of the United States Government for people age 65 or older,<sup>1</sup> administered by the Centers for Medicare and Medicaid Services (CMS). Participants automatically pay into the system via payroll taxes on a regular basis throughout most of their working lives. The program currently covers people in the United States, Puerto Rico, the U.S. Virgin Islands, and Guam. In almost all cases, participants pay the same percent no matter where they live or where they obtain their medical services.

The Social Security Act also requires that CMS develop and update at least every 3 years the Physician Fee Schedule (PFS), which is used to determine physician compensation for providing services under Medicare Part B. The PFS is composed of three components (Work, Practice Expense, and Malpractice Premium) for 89 payment localities.<sup>2</sup>

The Practice Expense component is sub-divided into several components, including the topic of this study, the Office Rent component. This component attempts to capture the cost associated with the commercial rent necessary for a space of sufficient size and quality to adequately operate a basic doctor's office.

Section 1848(e)(1)(A) of the Social Security Act requires CMS to develop measures of the relative cost differences among the payment localities compared to the national average for each of the components of the PFS. To do so, CMS prepares Geographic Practice Cost Indexes (GPCIs) to adjust for cost differences associated with each of the components of the costs, amongst the 89 different Medicare payment localities.

However, currently, there is no publically available data on commercial office rental rates with sufficient geographic detail and reliability that can serve to adjust for cost differences associated with the Office Rent component.<sup>3</sup> Due to this lack of suitable commercial office rent data, CMS has relied on residential rental rates as a proxy for many years.

In particular, for several years, CMS used residential rent statistics prepared by Housing and Urban Development (HUD) using multiple sources of information including the American and Puerto Rico Community Surveys (ACS/PRCS) from the

<sup>1</sup> It also offers coverage to other people with certain disabilities or medical conditions.

<sup>2</sup> The current Physician Fee Schedule (PFS) locality structure was developed and implemented 18 years ago in 1997. It has 89 total PFS localities; 34 localities are statewide areas (that is, only one locality for the entire state). There are 52 localities in the other 16 states, with 10 states having 2 localities, 2 states having 3 localities, 1 state having 4 localities, and 3 states having 5 or more localities. The District of Columbia, Maryland, and Virginia suburbs, Puerto Rico, and the Virgin Islands are additional localities that make up the remainder of the total of 89 localities.

<sup>3</sup> Over the years, CMS has tested several alternatives without success.

U.S. Census Bureau.<sup>4</sup> However, starting in the calendar year 2012, CMS tested and approved the use of its own rent statistics it had prepared using ACS/PRCS data directly.

CMS has the responsibility of making sure that the GPCIs it proposes adequately reflect actual cost differences in the provision of Medicare services, not other unrelated factors. To do so requires controlling for any potential unrelated factors that may generate biases in the calculation of the GPCIs that have economically meaningful implications.

In this brief research note, we examine whether the prevalence of non-market housing (i.e. public housing) has influenced CMS estimates for the Office Rent component of the GPCIs, assigned to each of the 89 PFS payment localities. In specific, we answer the following questions:

- > Have differences in the prevalence of non-market housing generated a bias in the residential rent statistics prepared by CMS to estimate the Office Rent component of the GPCIs?
- > If so, what has been its impact?
- > Are there alternative methods that CMS could employ to correct for this bias?

## II. Background

### *Demographic developments and outlook*

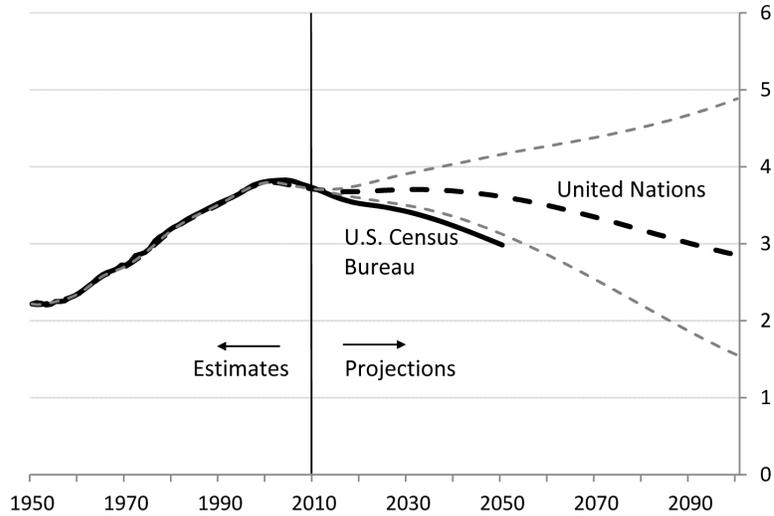
Over the past 10 years, Puerto Rico has experienced a loss of about 7.3 percent of its population, which is equivalent to about 278 thousand people.<sup>5</sup> This is the first population reduction in the recorded history of Puerto Rico.<sup>6</sup> The reduction owes largely to a secular downward trend in the number of births, as well as to a relatively high level of net outward migration. According to official population projections, this trend is expected to continue for the rest of this century. See Figure 1.

<sup>4</sup>See Fair Market Rent (FMR) program of HUD: <http://www.huduser.org/portal/datasets/fmr.html>.

<sup>5</sup>Source: U.S. Census Bureau, Annual Population Estimates 2004–2014 (2014 vintage and 2000–10 intercensal estimates).

<sup>6</sup>In the 16th Century, it is believed that the Taíno inhabitants of Puerto Rico became extinct as a culture following settlement by Spanish colonists, primarily due to infectious diseases to which they had no immunity. It is unclear whether the population of Puerto Rico as a whole declined during this period.

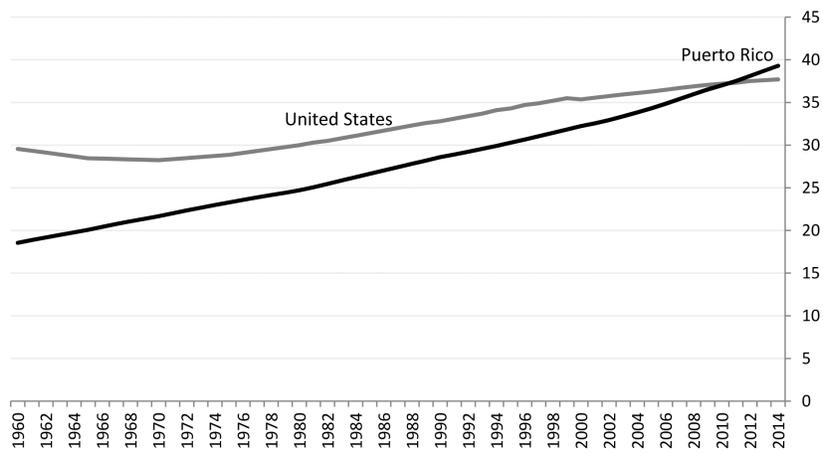
**Figure 1. Population of Puerto Rico**  
(millions of persons)



Source: Estimados anuales de la población 1950-2000, Junta de Planificación de Puerto Rico; Annual Population Estimates 2000-2010, U.S. Census Bureau; International Database, U.S. Census Bureau; World Population Prospects: The 2012 Revision, Population Division of the United Nations Department of Economic and Social Affairs.

Recent outward migrants have been relatively young, a factor which has accelerated the aging of Puerto Rico's overall population. In 2011, the median age in Puerto Rico surpassed the median age of the United States for the first time in recorded history. See Figure 2.

**Figure 2. Median Age of the Population**  
(in years)



Source: Estimados anuales de la población 1950-2000, Junta de Planificación de Puerto Rico; Annual Population Estimates 2000-2010, U.S. Census Bureau.

*Puerto Rico's housing markets*

According to the 3-year estimates of the 2013 Puerto Rico Community Survey of the U.S. Census Bureau, there are 1.6 million housing units in Puerto Rico, of which 1.3 million are occupied. Of these, approximately 385 thousand are occupied by a renter. In turn, of these, 115 thousand have 2 bedrooms.

Unfortunately, neither the American Community Survey nor the Puerto Rico Community Survey ask whether the housing unit is located in a public housing development project. Therefore, we cannot use the results of the Puerto Rico Community Survey alone to gauge the extent to which public housing exists in Puerto Rico.

Nevertheless, the Department of Housing and Urban Development (HUD) publishes detailed statistics on the characteristics of residents of public housing development projects across the United States and Puerto Rico. In specific, according to HUD's Residential Characteristics Report,<sup>7</sup> there were at least 18 thousand 2-bedroom renter-occupied public housing units in Puerto Rico as of May 2015. This represents about 16 percent of all 2-bedroom renter-occupied housing units, almost 9 times the national average. See Figure 3.

On the other hand, Figure 4 presents the median gross rent by state and Puerto Rico according to the 3-year estimates of the 2013 American and Puerto Rico Community Surveys of the U.S. Census Bureau. Nationwide, the median gross rent paid is estimated to be about \$900 per month. This is about twice the median gross rent paid in Puerto Rico of \$452 per month.

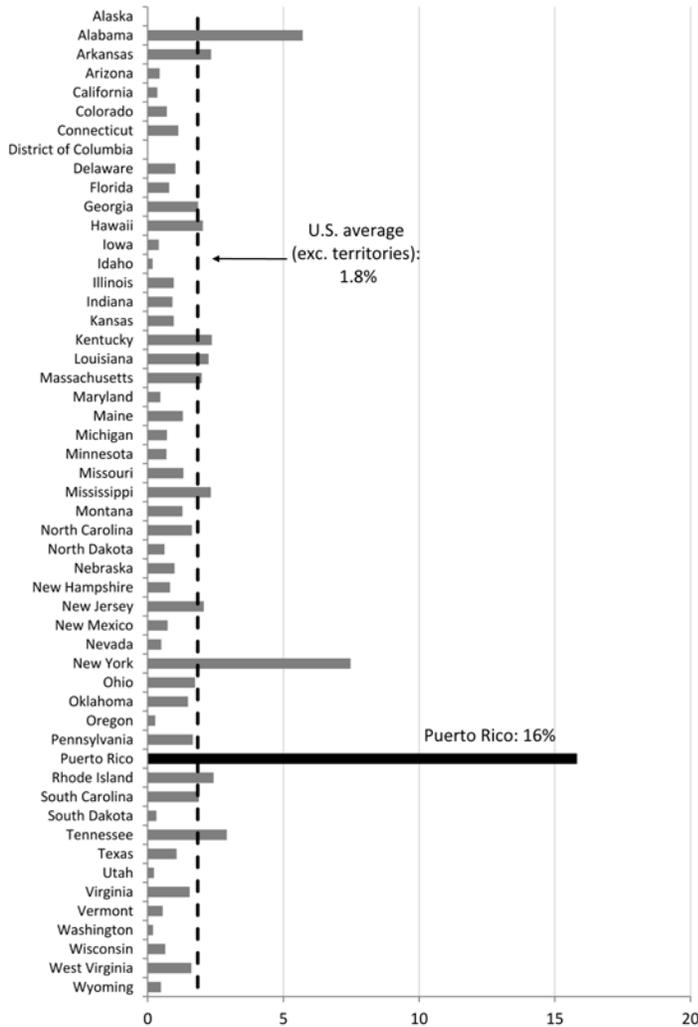
In this research note, we examine whether these two observations are related. In specific, we examine whether the greater provision of public housing in Puerto Rico is in part responsible for the very low median gross rent estimates that can be obtained for Puerto Rico from the uncontrolled residential rent estimates that can be gleaned from the standard tables of the Puerto Rico Community Survey of the U.S. Census Bureau.

Why might these two variables be related? Public housing rents are relatively very low, and are therefore typically located in the lower part of the rent distribution. Therefore, all else equal, an increase in the number of public housing units in the distribution will typically tend to lower measures of central tendency, such as the median.

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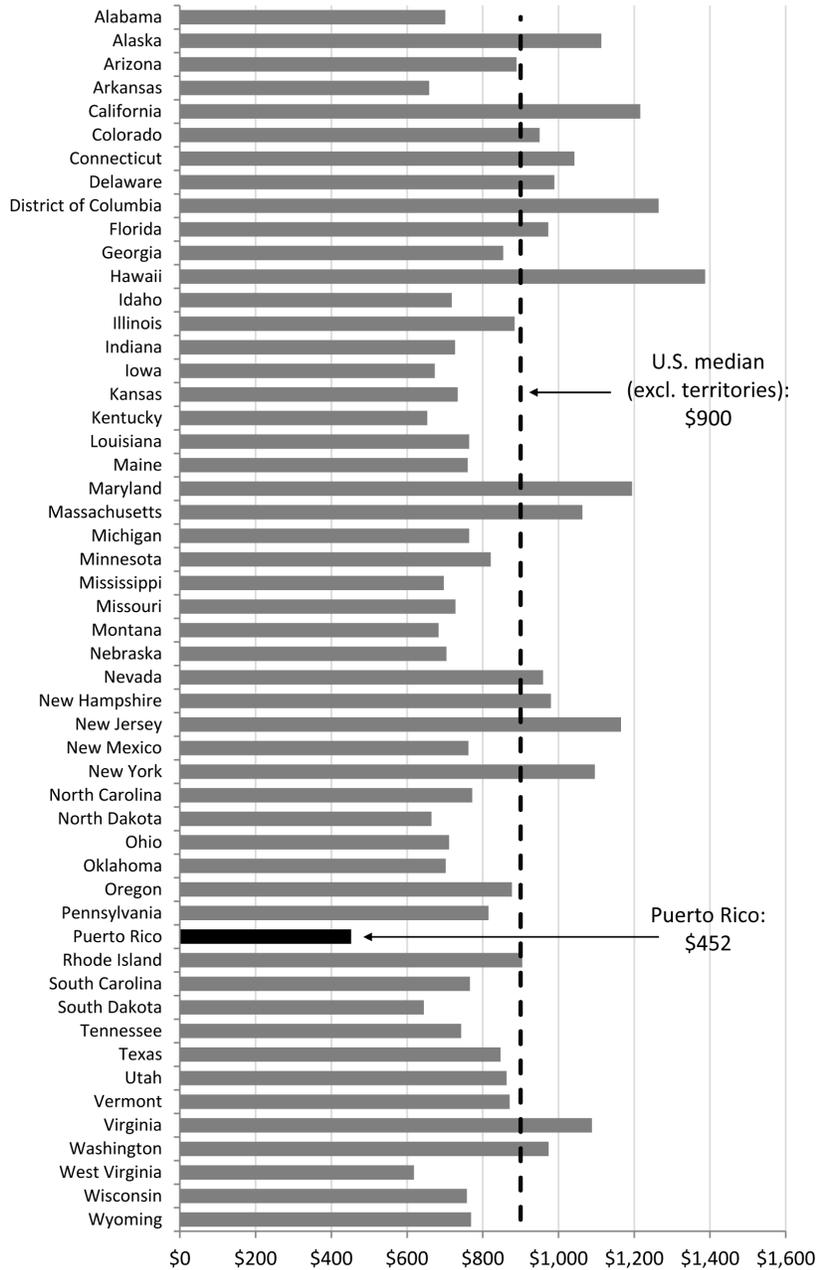
<sup>7</sup> See [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/public\\_indian\\_housing/systems/pic/50058/rcr](http://portal.hud.gov/hudportal/HUD?src=/program_offices/public_indian_housing/systems/pic/50058/rcr).

Figure 3. Percent of 2-Bedroom Renter-Occupied Housing Units that are in Public Housing



Source: Report Characteristics Report, HUD as of May 31, 2015; American and Puerto Rico Community Survey, U.S. Census Bureau, 2013 3-year estimates.

**Figure 4. Median Gross Rent of Renter-Occupied Housing Units**



Source: American and Puerto Rico Community Survey, U.S. Census Bureau, 2013 3-year estimates.

### III. Methodology

We use data from the American and Puerto Rico Community Surveys 2008–10 Public Use Microdata Sample (PUMS) to estimate the Median Gross Rent<sup>8</sup> of a 2-Bedroom Renter-Occupied Housing Unit in each of the 89 PFS payment localities.<sup>9,10</sup> Currently, CMS uses the results of this survey during the 3-year period, comprising calendar year 2008 through calendar year 2010, to estimate the GPCIs.

The medians are calculated using the appropriate replicate weights provided by the U.S. Census Bureau. Public Use Microdata Areas (PUMAs) from the 2000 Census were classified according to the PFS payment localities used by CMS. See Table 2 in the Appendix for a table showing the relation between the 2000 PUMAs and the PFS payment localities.

In order to control for differences in the prevalence of public housing, we estimate the Median Gross Rents for a 2-Bedroom housing unit, after excluding units which are likely to be non-market housing units. To determine which housing units to exclude we employ a simple criteria developed by the Department of Housing and Urban Development (HUD).

In specific, using internal administrative data,<sup>11</sup> HUD prepares estimates for the rent paid by public housing tenants in each of its regions, which it uses as thresholds or cut-offs. Housing units that pay a rent that is equal to or lower than this rent threshold or cut-off are considered to be either assisted housing or otherwise at a below-market rent.<sup>12</sup> See the Table 3 in the Appendix for a list of the rent thresholds used in each of the PFS payment localities.

We obtained the most recent rent cut-offs for over 4 thousand counties in the United States. The counties were classified and recoded following the 89 PFS payment localities.<sup>13,14</sup> Standard errors were computed using the replicate weights provided in the PUMS.

We test the following null hypothesis:

H<sub>0</sub>: Controlling for differences in the prevalence of non-market housing does not significantly change the median gross rent of a 2-bedroom housing unit.

against the alternative hypothesis:

H<sub>a</sub>: Controlling for differences in the prevalence of public housing does significantly change the median gross rent of a 2-bedroom housing unit.

In order to compare the medians of the gross rent, we must employ a non-parametric test for two independent variables, known as the Mann-Whitney U test. All statistical significance tests were performed at a 95% confidence level.

### IV. Results

After controlling for non-market rental housing, the median gross rent of a 2-bedroom housing unit changes in a statistically significant way in all PFS payment localities. See Table 1. This provides evidence to support the existence of a bias related to the differential prevalence of non-market housing in different parts of the United States and Puerto Rico.

<sup>8</sup>Gross rent is the contract rent plus the estimated average monthly cost of utilities (electricity, gas, and water and sewer) and fuels (oil, coal, kerosene, wood, etc.) if these are paid by the renter (or paid for the renter by someone else). Gross rent is intended to eliminate differentials that result from varying practices with respect to the inclusion of utilities and fuels as part of the rental payment. The estimated costs of water and sewer, and fuels are reported on a 12-month basis but are converted to monthly figures for the tabulations.

<sup>9</sup>The U.S. Virgin Islands is excluded from the analysis for lack of a Community Survey.

<sup>10</sup>We must estimate these rents, since CMS does not publish the actual estimates used in preparing the GPCIs.

<sup>11</sup>To generate this “cut-off” rent, HUD uses administrative data on public housing rents from the Multifamily Tenant Characteristics System (MTCS). There are several advantages of using MTCS data to generate the cut-off rent. Regular availability of MTCS data allows HUD to update the cut-off rent annually. Second, there is enough MTCS data to generate cut-off rents at the geographic level of the 89 PFS payment localities.

<sup>12</sup>In fact, these housing units are excluded from HUD’s Fair Market Rent (FMR) statistics.

<sup>13</sup>In those cases in which HUD uses a rent cut-off for part, but not all of, a PFS payment locality, we applied the rent cut-off to the entire PFS payment locality.

<sup>14</sup>In those cases in which HUD used more than one rent cut-off for different parts of a PFS payment locality, we used the weighted median of the rent cut-offs. The weights used were the population estimates from the 2010 Census for each county.

Amongst all PFS payment localities, Puerto Rico obtains the lowest estimate for the median gross rent of a 2-bedroom housing unit (\$360). Once HUD public housing rent thresholds are applied, Puerto Rico continues to receive the lowest estimate for the median gross-rent of a 2-bedroom housing unit (\$510). But, in the case of Puerto Rico, this represents a statistically significant increase of 42%, markedly, the largest amongst all PFS payment localities. The second largest percent increase is experienced by New York, Manhattan (22%). See Figure 5.

**Table 1. Median Gross Rent for Two Bedrooms Housing Units by PFS payment locality: 2008–2010**

Physicia Fee Schedule (PFS) Payment Locality Area	All renter-occupied housing units that pay cash rent					Percent Increase	Statistically significant change?
	All units		All units with rent above HUD rent cut-off				
	Estimate	S.E.	Estimate	S.E.			
1. Alabama, Statewide	\$630	±4	\$681	±10	8%	YES	
2. Alaska, Statewide	\$976	±37	\$992	±26	2%	YES	
3. Arizona, Statewide	\$840	±4	\$864	±8	3%	YES	
4. Arkansas, Statewide	\$610	±5	\$645	±10	6%	YES	
5. California, Anaheim-Santa Ana	\$1,484	±10	\$1,490	±13	0%	YES	
6. California, Los Angeles	\$1,286	±9	\$1,301	±6	1%	YES	
7. California, Marin-Napa-Solano	\$1,260	±19	\$1,281	±26	2%	YES	
8. California, Oakland-Berkeley	\$1,296	±13	\$1,324	±14	2%	YES	
9. California, San Francisco	\$1,690	±48	\$1,740	±29	3%	YES	
10. California, San Mateo	\$1,606	±43	\$1,620	±43	1%	YES	
11. California, Santa Clara	\$1,504	±34	\$1,525	±13	1%	YES	
12. California, Ventura	\$1,403	±25	\$1,421	±23	1%	YES	
13. California, Rest of state	\$1,001	±6	\$1,030	±6	3%	YES	
14. Colorado, Statewide	\$860	±10	\$871	±7	1%	YES	
15. Connecticut, Statewide	\$1,047	±11	\$1,077	±16	3%	YES	
16. Delaware, Statewide	\$952	±24	\$996	±22	5%	YES	
17. District of Columbia, MD-VA Suburbs	\$1,363	±18	\$1,392	±38	2%	YES	
18. Florida, Fort Lauderdale	\$1,067	±10	\$1,072	±9	0%	YES	
19. Florida, Miami	\$1,084	±11	\$1,097	±7	1%	YES	
20. Florida, Rest of state	\$890	±5	\$901	±4	1%	YES	
21. Georgia, Atlanta	\$885	±7	\$897	±8	1%	YES	
22. Georgia, Rest of state	\$642	±10	\$688	±10	7%	YES	
23. Hawaii-Guam, Statewide *	\$1,316	±28	\$1,352	±44	3%	YES	
24. Idaho, Statewide	\$650	±11	\$671	±11	3%	YES	
25. Illinois, Chicago	\$940	±6	\$950	±7	1%	YES	
26. Illinois, East St. Louis	\$681	±16	\$719	±9	6%	YES	
27. Illinois, Suburban Chicago	\$1,013	±16	\$1,023	±15	1%	YES	
28. Illinois, Rest of state	\$678	±14	\$699	±6	3%	YES	
29. Indiana, Statewide	\$700	±2	\$712	±7	2%	YES	
30. Iowa, Statewide	\$661	±8	\$681	±10	3%	YES	
31. Kansas, Statewide	\$690	±12	\$710	±9	3%	YES	
32. Kentucky, Statewide	\$608	±10	\$638	±7	5%	YES	
33. Louisiana, New Orleans	\$930	±15	\$942	±18	1%	YES	
34. Louisiana, Rest of state	\$680	±7	\$724	±7	6%	YES	
35. Maine, Southern Maine	\$925	±24	\$950	±28	3%	YES	
36. Maine, Rest of state	\$671	±17	\$729	±15	9%	YES	
37. Maryland, Baltimore, Surr. Counties	\$1,084	±11	\$1,102	±10	2%	YES	
38. Maryland, Rest of state	\$915	±24	\$942	±24	3%	YES	
39. Massachusetts, Metropolitan Boston	\$1,281	±19	\$1,343	±16	5%	YES	
40. Massachusetts, Rest of state	\$915	±15	\$982	±15	7%	YES	
41. Michigan, Detroit	\$830	±8	\$844	±13	2%	YES	
42. Michigan, Rest of state	\$680	±4	\$691	±9	2%	YES	
43. Minnesota, Statewide	\$820	±10	\$840	±12	2%	YES	
44. Mississippi, Statewide	\$632	±14	\$703	±12	11%	YES	
45. Missouri, Metropolitan Kansas City	\$742	±11	\$760	±15	2%	YES	
46. Missouri, Metropolitan St. Louis	\$800	±13	\$812	±12	1%	YES	
47. Missouri, Rest of state	\$586	±12	\$620	±5	6%	YES	
48. Montana, Statewide	\$651	±14	\$689	±19	6%	YES	
49. Nebraska, Statewide	\$680	±11	\$700	±14	3%	YES	
50. Nevada, Statewide	\$945	±10	\$960	±10	2%	YES	

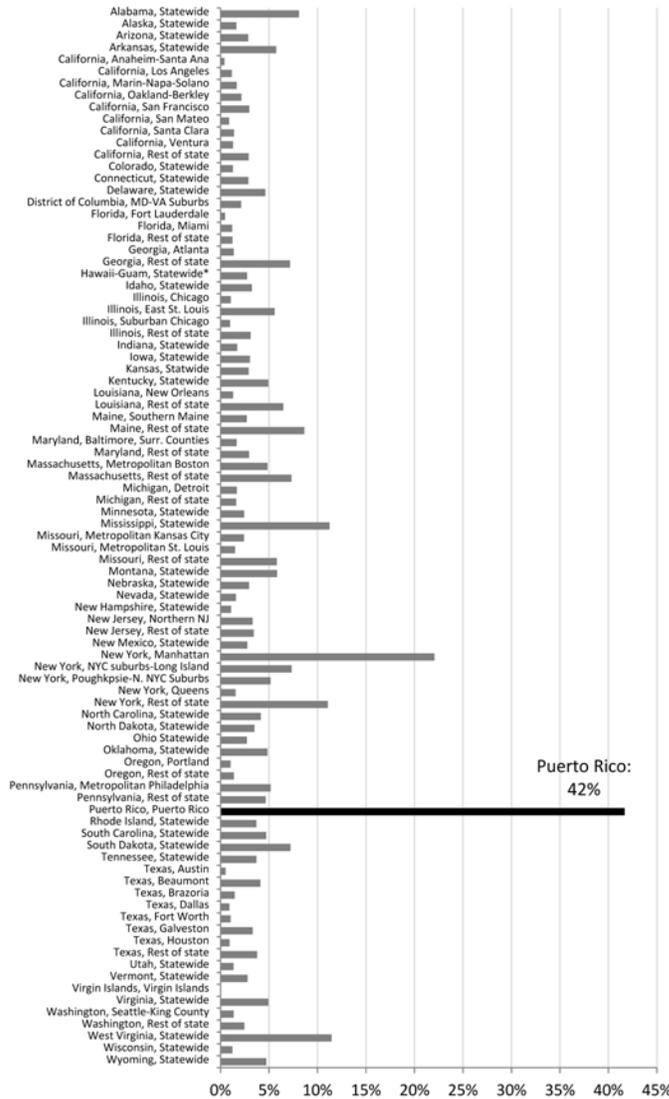
**Table 1. Median Gross Rent for Two Bedrooms Housing Units by PFS payment locality:  
2008–2010—Continued**

Physicia Fee Schedule (PFS) Payment Locality Area	All renter-occupied housing units that pay cash rent					
	All units		All units with rent above HUD rent cut-off		Percent Increase	Statistically significant change?
	Estimate	S.E.	Estimate	S.E.		
51. New Hampshire, Statewide	\$1,006	±12	\$1,017	±14	1%	YES
52. New Jersey, Northern NJ	\$1,210	±17	\$1,250	±17	3%	YES
53. New Jersey, Rest of state	\$1,108	±16	\$1,146	±15	3%	YES
54. New Mexico, Statewide	\$690	±9	\$709	±9	3%	YES
55. New York, Manhattan	\$1,147	±61	\$1,400	±43	22%	YES
56. New York, NYC suburbs-Long Island	\$1,118	±8	\$1,200	±12	7%	YES
57. New York, Poughkpsie-N. NYC Suburbs	\$1,027	±27	\$1,080	±20	5%	YES
58. New York, Queens	\$1,270	±24	\$1,300	±12	2%	YES
59. New York, Rest of state	\$732	±8	\$813	±15	11%	YES
60. North Carolina, Statewide	\$700	±2	\$729	±5	4%	YES
61. North Dakota, Statewide	\$599	±14	\$620	±12	3%	YES
62. Ohio, Statewide	\$700	±2	\$719	±7	3%	YES
63. Oklahoma, Statewide	\$640	±6	\$671	±6	5%	YES
64. Oregon, Portland	\$871	±6	\$880	±9	1%	YES
65. Oregon, Rest of state	\$730	±4	\$740	±6	1%	YES
66. Pennsylvania, Metropolitan Philadelphia	\$967	±15	\$1,017	±11	5%	YES
67. Pennsylvania, Rest of state	\$709	±10	\$742	±6	5%	YES
<b>68. Puerto Rico, Puerto Rico</b>	<b>\$360</b>	<b>±12</b>	<b>\$510</b>	<b>±8</b>	<b>42%</b>	<b>YES</b>
69. Rhode Island, Statewide	\$920	±16	\$954	±12	4%	YES
70. South Carolina, Statewide	\$680	±4	\$712	±7	5%	YES
71. South Dakota, Statewide	\$610	±14	\$654	±19	7%	YES
72. Tennessee, Statewide	\$676	±8	\$701	±7	4%	YES
73. Texas, Austin	\$955	±13	\$960	±11	1%	YES
74. Texas, Beaumont	\$731	±38	\$761	±29	4%	YES
75. Texas, Brazoria	\$825	±55	\$837	±29	1%	YES
76. Texas, Dallas	\$876	±8	\$884	±10	1%	YES
77. Texas, Fort Worth	\$865	±14	\$874	±11	1%	YES
78. Texas, Galveston	\$874	±51	\$903	±39	3%	YES
79. Texas, Houston	\$861	±7	\$869	±11	1%	YES
80. Texas, Rest of state	\$742	±4	\$770	±6	4%	YES
81. Utah, Statewide	\$750	±5	\$760	±8	1%	YES
82. Vermont, Statewide	\$900	±15	\$925	±41	3%	YES
83. Virgin Islands, Virgin Islands	n/a	n/a	n/a	n/a	n/a	n/a
84. Virginia, Statewide	\$851	±7	\$893	±9	5%	YES
85. Washington, Seattle-King County	\$1,114	±15	\$1,129	±13	1%	YES
86. Washington, Rest of state	\$815	±11	\$835	±10	2%	YES
87. West Virginia, Statewide	\$559	±9	\$623	±14	11%	YES
88. Wisconsin, Statewide	\$740	±2	\$749	±10	1%	YES
89. Wyoming, Statewide	\$658	±14	\$689	±30	5%	YES

\*The 23rd PFS payment locality includes Hawaii and Guam. However, because Guam does not participate in the Community Surveys, it is excluded in this analysis.

Source: Public Use Microdata Sample (PUMS), American Community Survey (ACS) and Puerto Rico Community Survey (PRCS), 3-year estimate 2008–2010, U.S. Census Bureau. Standard errors are calculated using replicating weights.

Figure 5. Percent increase in median gross rent after removing non-market housing units



**V. Discussion**

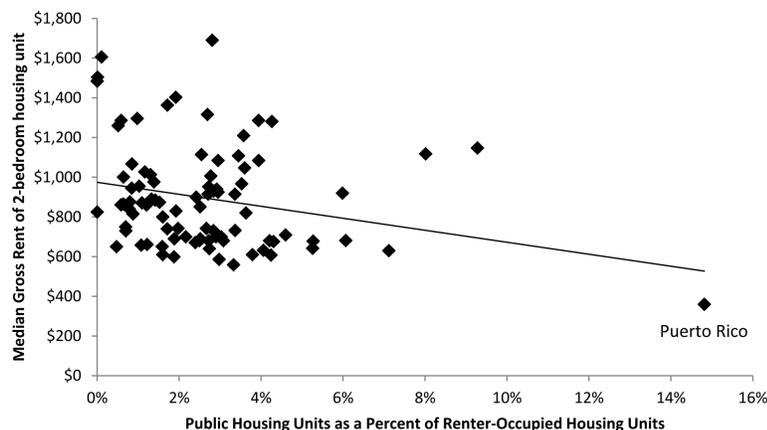
*How do we know there is a bias?*

This research note presents evidence that the ACS/PRCS-based estimates of the median gross rent of 2-bedroom housing units are statistically different when we apply HUD rent thresholds to exclude housing units whose rent is so low that they are considered to be either assisted housing or otherwise at a below-market rent.

The relative prevalence of this type of non-market housing across different parts of the United States and Puerto Rico has little (if anything) to do with commercial rent markets for medical offices and facilities in different parts of the United States and Puerto Rico.

Therefore, the use of uncontrolled residential rent estimates to proxy for commercial rents introduces a bias related to the relative prevalence of non-market housing across different parts of the United States and Puerto Rico. Current CMS practice includes the use of these biased uncontrolled residential rent estimates. Figure 6 highlights the situation for Puerto Rico.

**Figure 6. Median Gross Rent by Percent of Renter-Occupied Housing Units**



Source: American and Puerto Rico Community Survey, U.S. Census Bureau, 2010 3-year estimates (vertical axis). Residents Characteristics Report, Department of Housing and Urban Development (HUD) as of May 31, 2015, and American and Puerto Rico Community Survey, U.S. Census Bureau 2013 5-year estimates (horizontal axis).  
 Note: The horizontal axis presents the number of Annual Contributions Contracts (ACC) that were awarded in public housing facilities from HUD, as a percent of the number of renter-occupied housing units estimated in the ACS/PRCS.

*Does it have a meaningful impact on the GPCIs of any payment locality?*

Our results indicate that physicians and surgeons in Puerto Rico have been affected more by this statistical bias than physicians and surgeons in any part of the United States.

In the latest review, the Practice Expense GPCI had a cost share weight of 44.839 percent, of which 10.223 percentage points owed to the Office Rent component.<sup>15</sup> Therefore, a 42% increase in the Median Gross Rent used as a proxy for the Office Rent component implies an increase of Puerto Rico's GPCI by about 4%, or equivalently an increase of the Practice Expense GPCI of Puerto Rico by about 10%.

*What about any impacts on the broader economy and health care sector?*

In order to gauge the impact of the Public Housing Prevalence Bias on the overall Health Care sector in Puerto Rico, the Puerto Rico Institute of Statistics formed a panel of health care experts to independently assess the potential economic impact of this bias. In specific, we invited a group of health care experts<sup>16</sup> to prepare estimates on the total impact of a 10% increase in Puerto Rico's Practice Expense GPCI on Medicare receipts by entities in Puerto Rico.

The calculation of such estimates relies on numerous assumptions that need to be made about the way in which such an increase would be implemented. However, to simplify matters, we provided panel members with ample flexibility to make the assumptions necessary to provide a very rough estimate of the total impact of the bias. Here is a summary of the results:

- > Between \$7 and \$15 million in additional annual expenses through Medicare Part B's Fee For Service would be paid to Puerto Rico physicians directly.

<sup>15</sup> See <https://www.cms.gov/Medicare/Medicare-Fee-for-Service-Payment/PhysicianFeeSched/Downloads/CY2015-PFS-FR-GPCI.pdf>.

<sup>16</sup> The panel was composed of Dr. Jose E. Laborde, President, JEL Consulting Inc., a private health care analytics company that advises the Puerto Rico Health Insurance Administration, and Mr. Roberto Pando, Senior VP Strategy, Medical Card System, Inc., one of the main health insurance providers in Puerto Rico.

>Between \$50 and \$60 million in additional expenses would be paid through Medicare Advantage, on account of the resulting increase in the benchmark.

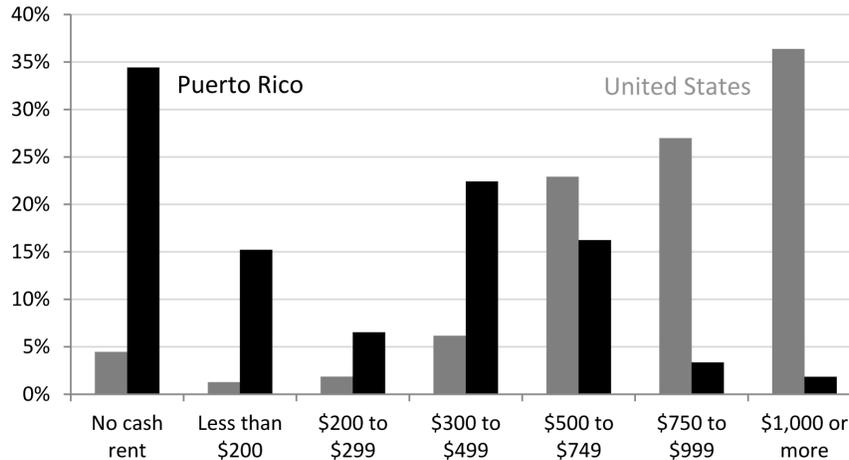
Therefore, total direct economic impact is between \$57 and \$75 million annually. Moreover, taking into account indirect and induced multiplier effects, the total impact on the health care sector could rise to as high as \$120 million annually.

*Are there any additional sources of potential bias?*

Yes. Figure 7 presents the distribution of the gross rent of a 2-bedroom housing unit in the United States and Puerto Rico. In this chart, we also include the housing units that pay no cash rent. In Puerto Rico almost 35 percent of 2-bedroom renter-occupied housing units pay no cash rent. In the United States, this only occurs in less than 5 percent of units. A sizable gap also exists in housing units that pay cash rents for less than \$200 a month.

This gap can be attributed to several types of factors, including socio-cultural differences, as well as socio-economic differences of the residents of Puerto Rico. These factors have no bearing or any relation to the cost of providing medical services.

**Figure 7. Distributions of Gross Rent of a 2-Bedroom Housing Unit**



Source: American and Puerto Rico Community Survey, U.S. Census Bureau, 2013 3-year estimates.

*Is there any source of data that controls for differences in the prevalence of public housing?*

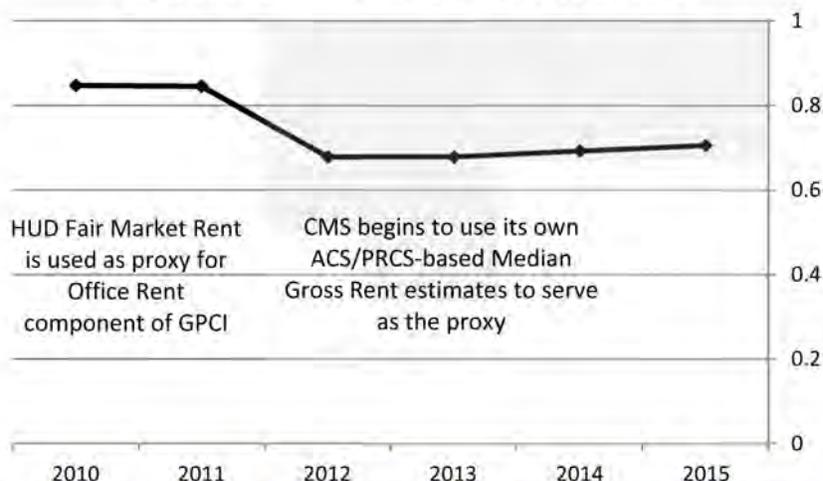
Yes, the Fair Market Rent (FMR) estimated by the Department of Housing and Urban Development (HUD). This statistical product is produced by HUD using ACS/PRCS median gross rent data, amongst other sources of historical information. The FMR is the rent used by HUD in the implementation of its section 8 housing subsidies. In addition to the non-market housing thresholds, the housing experts at HUD take into account differences in the quality of the housing stock in different parts of the United States and Puerto Rico, amongst other factors that can bias rent statistics. For more details on the FMR methodology, see:

<http://www.huduser.org/portal/datasets/fmr.html>.

*For how long has this been going on?*

Prior to Calendar Year 2012, CMS used FMR estimates as the proxy for the Office rent component of the GPCI. In fact, when CMS used HUD's FMR as the proxy before Calendar Year 2012, the Practice Expense GPCI for Puerto Rico was higher than it is today.

Moreover, Puerto Rico's Practice Expense GPCI fell by 20 percent the first year that CMS replaced HUD's FMR data with its own ACS/PPRCS median gross rent estimates. See Figure 8. This was the largest drop of any of the 89 PFS payment localities.

**Figure 8. Puerto Rico's Practice Expense GPCI**

Source: [Addendum E: Geographic Practice Cost Indices, Physician Fee Schedule, CY 2012-2015.](#)

The identification of the Public Housing Prevalence Bias, which has been undertaken in this study, should prompt policymakers to immediately correct this situation which has gone on long enough.

*Are there any additional data sources that control for these aspects as well?*

The Council for Community and Economic Research's (C2ER) Cost-of-Living Index (COLI) provides reference prices in more than 300 urban and other areas in the United States. It employs a simple methodology that attempts to measure the cost-of-living for a specific standard of living.

COLI is designed to answer the following question: How do urban areas compare in the cost of maintaining a standard of living appropriate for moderately affluent professional and managerial households?

We would argue that the relative gross rent costs of such a household in different parts of the country is a better proxy for the cost necessary to rent a space for a doctor's office that is adequate in terms of space and quality for the provision of medical services. After all, a physician's office contains sensitive equipment and supplies that need to be stored securely in a temperature-controlled environment. State and local health regulations do not allow a doctor to setup an office in an inadequate facility. Said in another way, physicians are very likely to use high-quality commercial office spaces. In this same vein, the housing units considered in the estimation of the median gross rent should include only the relatively more high-quality housing units that tend to attract moderately affluent professional and managerial households.

The COLI methodology includes a basket with 57 categories, including the following relevant categories:

(I) Apartment Rent

Apartment complexes sampled must be suitable for a childless professional and managerial couple with household income in the top 20% for their area. They are required to be suitable for a professional or managerial couple in terms of commuting, shopping, entertainment needs, and neighborhood quality. Apartment complexes should be no more than 10 years old. Sampled apartments should be 950 sq.ft. or pro-rated to an equivalent of 950 sq.ft. Sample apartments should be unfurnished, with 2 bedrooms and 1½ or 2 baths, amongst other criteria.

## (II) Total Energy Costs

COLI takes great care in incorporating different types of energy costs for the household, as these vary across the United States and Puerto Rico. C2ER has developed a computer model that incorporates local weather data from the National Oceanographic and Atmospheric Administration. This model allows COLI to measure the total energy costs from an equivalent level of consumption expected of a moderately affluent professional and managerial household.

According to the COLI results for the first quarter of 2015, apartment rents (as specified above) and total energy costs in the San Juan, Puerto Rico Metropolitan Statistical Area (MSA) are estimated to be about \$848 and \$438 per month, respectively. Summing these components provides a partial estimate of gross rents, which we believe is very illustrative: \$1,286 per month. See Table 2.

This places Puerto Rico's gross rent in between major metropolitan areas of the United States, such as the Chicago, Illinois Metropolitan Statistical Area (MSA) with an estimate of \$1,326 per month, and Beaumont, TX MSA with an estimate of \$1,218 per month. Despite this observation, the median gross rent estimate from the ACS/PRCS that are used by CMS for Puerto Rico (\$360) are less than half of the estimate used for Beaumont, TX (\$731).

**Table 2. Comparison of gross rent estimates: COLI versus ACS/PRCS**

	COLI—1st quarter of 2015			Median Gross Rent for 2-bedroom housing unit from ACS/PRCS	CY 2015 Practice Expense GPCI
	Apartment rent	Energy	Sum		
Chicago, IL MSA	\$1,158	\$168	\$1,326	\$940	1.037
<b>San Juan, PR MSA</b>	<b>\$848</b>	<b>\$438</b>	<b>\$1,286</b>	<b>\$360</b>	<b>0.705</b>
Beaumont, TX MSA	\$1,045	\$173	\$1,218	\$731	0.902

## VI. Recommendations

1. Correct for the Public Housing Prevalence Bias in the Office Rent component of Puerto Rico Geographic Practice Cost Index.

There are a number of ways to do this:

- (a) Exclude housing units with rents below the non-market housing rent thresholds developed by the U.S. Department of Housing and Urban Development (HUD), when estimating the median gross rents.
- (b) Return to using the Fair Market Rents (FMR) of HUD. The FMR is calculated with great care to control for differences in the quality of the housing stock, as well as for the prevalence of non-market housing. It is also based on the median gross rents obtained from ACS/PRCS. It is available in relatively smaller geographies (not just statewide), and can be easily converted to the PFS payment localities.
- (c) Tie Puerto Rico's office rent to a specific geography in the United States, for instance to Beaumont, TX or to Chicago, IL.<sup>17</sup>

2. Implement one of the above corrections immediately.

We estimate that the health care sector of Puerto Rico is losing almost \$120 million annually as a result of this statistical bias. The bias was first introduced in Calendar Year 2012. Therefore, over the course of the 3-year period between 2012 and 2015, the total income lost to Puerto Rico's health care sector rises to \$360 million. It only took one year to implement this bias and in the process reduce Puerto Rico's GPCI. It should not take any longer than one year to implement the correction to this bias.

## VII. Conclusion

CMS's use of uncontrolled residential rent estimates in different regions of the United States and Puerto Rico introduces a bias in the calculation of the Office Rent component of the GPCIs. In specific, the Public Housing Prevalence Bias, identified

<sup>17</sup>A similar strategy has been followed for the U.S. Virgin Islands in the past due to data quality issues.

in this report, causes an underestimation in the uncontrolled median gross residential rent estimates in those regions with relatively large segments of the population living in public housing. This federal statistical bias costs the Puerto Rico economy an estimated \$120 million annually. Policymakers need to immediately correct this bias. We have presented several potential methods that could be used to correct for this bias.

### References

Junta de Planificación (2010). Multiplicadores Interindustriales de Puerto Rico: Insumo-Producto 2002. Obtained from:  
[http://www.jp.pr.gov/Portal\\_JP/LinkClick.aspx?link=http%3a%2f%2fgis.jp.pr.gov%2fExterno\\_Econ%2fMultiplicadores%2fMultiplicadores+Interindustriales+2002.pdf&tabid=299&mid=969](http://www.jp.pr.gov/Portal_JP/LinkClick.aspx?link=http%3a%2f%2fgis.jp.pr.gov%2fExterno_Econ%2fMultiplicadores%2fMultiplicadores+Interindustriales+2002.pdf&tabid=299&mid=969).

### Appendix

**Table 3: Relation between the PFS localities and the 2000 PUMAs**

PFS Locality	Counties	2000 PUMA	Rent cut-off
(1) Alabama	(statewide)	0100100 thru 0102600	\$269
(2) Alaska	(statewide)	0200101 thru 0200400	\$347
(3) Arizona	(statewide)	0400101 thru 0400900	\$414
(4) Arkansas	(statewide)	0500100 thru 0501900	\$262
(5) Anaheim/Santa Ana, CA	Orange	0606801 thru 0607607	\$414
(6) Los Angeles, CA	Los Angeles	0604500 thru 0606120, and 0606122 thru 0606126	\$414
(7) Marin/Napa/Solano, CA	Marin, Napa, and Solano	0601000 thru 0601303	\$414
(8) Oakland/Berkeley, CA	Alameda and Contra Costa	0602101 thru 0602108, and 0602401 thru 0602410	\$414
(9) San Francisco, CA	San Francisco	0602201 thru 0602207	\$414
(10) San Mateo, CA	San Mateo	0602301 thru 0602306	\$414
(11) Santa Clara, CA	Santa Clara	0602701 thru 0602714	\$414
(12) Ventura, CA	Ventura	0606200 thru 0606602	\$414
(13) Rest of California	all except	0600100 thru 0600900, 0601401 thru 0602002, 0602500 thru 0602602, 0602801 thru 0604407, 0606121, 0606701, 0606702, and 0607700 thru 0608200	\$414
(14) Colorado	(statewide)	0800101 thru 0801000	\$325
(15) Connecticut	(statewide)	0900100 thru 0902500	\$416
(16) Delaware	(statewide)	1000101 thru 1000300	\$495
(17) DC + MD/VA Suburbs	District of Columbia; Alexandria City, Arlington, Fairfax, Fairfax City, Falls Church City in Vir- ginia; Montgomery and Prince George's in Maryland	1100101 thru 1100105, 2401001 thru 2401107, and 5100100 thru 5100305	\$313
(18) Ft. Lauderdale, FL	Broward, Collier, Indian River, Lee, Martin, Palm Beach, and St. Lucie	1203200 thru 1203903	\$269
(19) Miami, FL	Dade and Monroe	1204001 thru 1204020	\$269
(20) Rest of Florida	all except	1200101 thru 1203100	\$269
(21) Atlanta, GA	Butts, Cherokee, Clayton, Cobb, DeKalb, Douglas, Fayette, Forsyth, Fulton, Gwinnett, Henry, Newton, Paulding, Rockdale and Walton	1300700 thru 1302000	\$269
(22) Rest of Georgia	all except	1300100 thru 1300600, and 1302100 thru 1304300	\$269
(23) Hawaii	(statewide)	1500100 thru 1500307	\$414
(24) Idaho	(statewide)	1600100 thru 1600900	\$347
(25) Chicago, IL	Cook	1703401 thru 1703519	\$257
(26) East St. Louis, IL	Bond, Calhoun, Clinton, Jersey, Macoupin, Madison, Monroe, Montgomery, Randolph, St. Clair, and Washington	1700400, 1700500, and 1701000 thru 1701202	\$257
(27) Suburban Chicago, IL	Dupage, Kane, Lake, and Will	1703003 thru 1703305	\$257

Table 3: Relation between the PFS localities and the 2000 PUMAs—Continued

PFS Locality	Counties	2000 PUMA	Rent cut-off
(28) Rest of Illinois	all except	1700101 thru 1700300, 1700600 thru 1700900, and 1701300 thru 1703002	\$257
(29) Indiana	(statewide)	1800100 thru 1803800	\$257
(30) Iowa	(statewide)	1900100 thru 1901900	\$289
(31) Kansas	(statewide)	2000100 thru 2001600	\$289
(32) Kentucky	(statewide)	2100100 thru 2102500	\$269
(33) New Orleans, LA	Jefferson, Orleans, Plaquemines, and St. Bernard	2201801 thru 2201905	\$262
(34) Rest of Louisiana	all except	2200101 thru 2201700, and 2202001 thru 2202500	\$262
(35) Southern Maine	Cumberland and York	2300100 thru 2300400	\$416
(36) Rest of Maine	all except	2300500 thru 2301000	\$416
(37) Baltimore/Surr. counties, MD	Anne Arundel, Baltimore, Balti- more City, Carroll, Harford and Howard	2400400 thru 2400602, 2400801 thru 2400902, and 2401201 thru 2401204	\$313
(38) Rest of Maryland	all except	2400100 thru 2400300, 2400700, and 2401300 thru 2401600	\$313
(39) Metropolitan Boston	Middlesex, Norfolk, and Suffolk	2500300 thru 2500600, 2501300, 2501400, 2502400 thru 2504000	\$416
(40) Rest of Massachusetts	all except	2500100, 2500200, 2500700 thru 2501200, 2501500 thru 2502300, and 2504100 thru 2504800	\$416
(41) Detroit, MI	Macomb, Oakland, Washtenaw and Wayne	2602501 thru 2602508, 2603200, 2603300, 2603600 thru 2604104	\$257
(42) Rest of Michigan	all except	2600100 thru 2602400, 2602601 thru 2603100, 2603400, 2603500	\$257
(43) Minnesota	(statewide)	2700100 thru 2702500	\$257
(44) Mississippi	(statewide)	2800100 thru 2802300	\$269
(45) Metropolitan Kansas City, MO	Clay, Jackson, and Platte	2900800 thru 2901100	\$289
(46) Metropolitan, St. Louis, MO	Jefferson, St. Charles, St. Louis, and St. Louis City	2901601 thru 2901900	\$257
(47) Rest of Missouri	all except	2900100 thru 2900700, 2901200 thru 2901500, 2902000 thru 2902700	\$289
(48) Montana	(statewide)	3000100 thru 3000700	\$325
(49) Nebraska	(statewide)	3100100 thru 3100904	\$289
(50) Nevada	(statewide)	3200100 thru 3200511	\$414
(51) New Hampshire	(statewide)	3300100 thru 3301100	\$416
(52) Northern New Jersey	Bergen, Essex, Hudson, Hunterdon, Middlesex, Morris, Passaic, Somerset, Sussex, Union, and Warren	3400301 thru 3401002, and 3401301 thru 3401903	\$495
(53) Rest of New Jersey	all except	3400101 thru 3400200, 3401101 thru 3401203, and 3402001 thru 3402400	\$495
(54) New Mexico	(statewide)	3500100 thru 3501100	\$262
(55) Manhattan, NY	New York	3603801 thru 3603810	\$495
(56) NYC Suburbs/Long Island, NY	Bronx, Kings, Nassau, Richmond, Rockland, Suffolk, and West- chester	3603400 thru 3603505, 3603601 thru 3603710, 3603901 thru 3604018, and 3604114 thru 3604312	\$495
(57) Poughkpsie/NYC	Columbia, Delaware, Dutchess, Greene, Orange, Putnam, Sul- livan, and Ulster	3601900, 3602500, 3603101 thru 3603303, 3603506	\$495
(58) Queens, NY	Queens	3604101 thru 3604114	\$495
(59) Rest of New York	all except	3600100 thru 3601800, 3602000 thru 3602402, and 3602601 thru 3603000	\$495

Table 3: Relation between the PFS localities and the 2000 PUMAs—Continued

PFS Locality	Counties	2000 PUMA	Rent cut-off
(60) North Carolina	(statewide)	3700100 thru 3704800	\$269
(61) North Dakota	(statewide)	3800100 thru 3800500	\$325
(62) Ohio	(statewide)	3900100 thru 3904800	\$257
(63) Oklahoma	(statewide)	4000100 thru 4001700	\$262
(64) Portland, OR	Clackamas, Multnomah, and Washington	4101301 thru 4101313	\$347
(65) Rest of Oregon	all except	4100100 thru 4101200	\$347
(66) Metropolitan Philadelphia, PA	Bucks, Chester, Delaware, Montgomery, and Philadelphia	4203901 thru 4204303	\$495
(67) Rest of Pennsylvania	all except	4200100 thru 4204303	\$313
(68) Puerto Rico	(statewide)	7202500 thru 7200500	\$269
(69) Rhode Island	(statewide)	4400100 thru 4400700	\$416
(70) South Carolina	(statewide)	4500100 thru 4502300	\$269
(71) South Dakota	(statewide)	4600100 thru 4600700	\$325
(72) Tennessee	(statewide)	4700100 thru 4703202	\$269
(73) Austin, TX	Travis	4805301, 4805302, and 4805304 thru 4805402	\$262
(74) Beaumont, TX	Jefferson	4804300 and 4804400	\$262
(75) Brazoria, TX	Brazoria	4804801 and 4804802	\$262
(76) Dallas, TX	Dallas	4802301 thru 4802315	\$262
(77) Ft. Worth, TX	Tarrant	4802501 thru 4802511	\$262
(78) Galveston, TX	Galveston	4804901 and 4804902	\$262
(79) Houston, TX	Harris	4804601 thru 4804625	\$262
(80) Rest of Texas	all except	4800100 thru 4802202, 4802400, 4802600 thru 4804200, 4804501 thru 4804503, 4804701, 4804702, 4805000 thru 4805202, 4805303, 4805500 thru 4806900	\$262
(81) Utah	(statewide)	4900100 thru 4900700	\$325
(82) Vermont	(statewide)	5000100 thru 5000400	\$416
(83) Virgin Islands	(statewide)	n/a	n/a
(84) Virginia	All Counties, except Alexandria City, Arlington, Fairfax, Fairfax City, and Falls Church City	5100400 thru 5103500	\$313
(85) Seattle (King County), WA	King	5301801 thru 5302009	\$347
(86) Rest of Washington	all except	5300100 thru 5301702, and 5302101 thru 5302200	\$347
(87) West Virginia	(statewide)	5400100 thru 5401200	\$313
(88) Wisconsin	(statewide)	5500100 thru 5502500	\$257
(89) Wyoming	(statewide)	5600100 thru 5600400	\$325

PUERTO RICO HEALTHCARE COMMUNITY LEADERS

P.O. Box 009023547  
San Juan PR 00902-3547

*Written statement for the record in relation to the hearing:*  
**“Financial and Economic Challenges in Puerto Rico”**

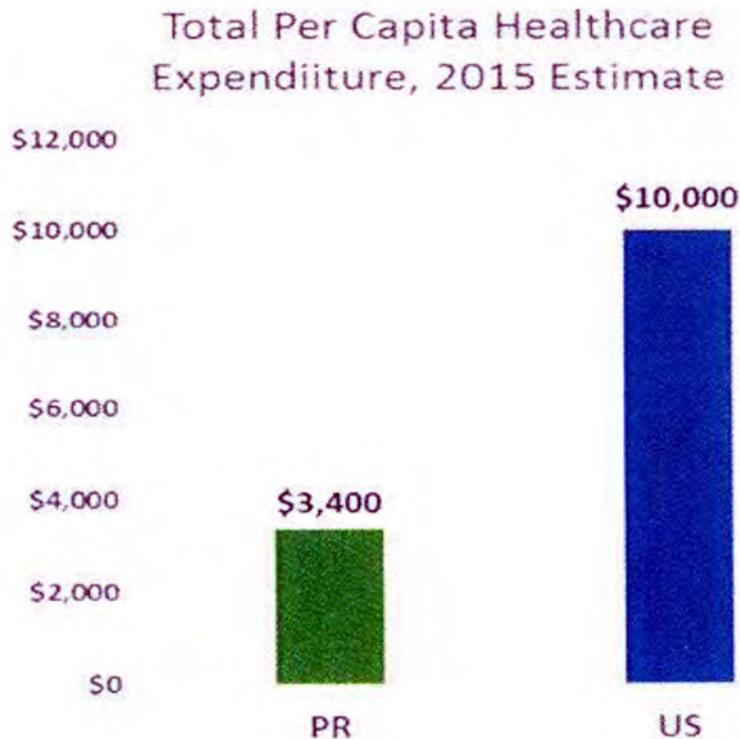
**United States Senate Committee on Finance**

Tuesday, September 29, 2015, 10:00 a.m.

Dear Members of the U.S. Senate Finance Committee:

In present times, a discussion about financial and economic challenges in Puerto Rico would be gravely incomplete without a careful assessment of the social and economic implications of the growing disparities and underfunding in the healthcare segment of the island. The case of Puerto Rico represents today a unique, and concerning, scenario within the United States (U.S.) healthcare economy. At the very macro level, total healthcare expenses per capita are approximately \$3,400 in Puer-

to Rico, compared to the national average projection of \$10,000 or more for 2015.<sup>1</sup> Not only is Puerto Rico very distant from U.S. average funding levels for healthcare, but it also has significantly less resources for healthcare than many countries with diverse healthcare systems like Canada, France, Germany, and the UK, which are also known to spend significantly less than the U.S. average.<sup>2</sup> Many of these so well studied and recognized healthcare systems spend \$4,000–\$6,000 per capita, placing Puerto Rico's expenditure levels at a distinct disadvantage from many perspectives, especially considering that core inputs like prescription drugs, equipment, electric power and others are acquired within the U.S. market, and mostly at above average prices. Moreover, the partial and uneven implementation of the Medicare and Medicaid programs for 5 decades has been a core element impacting the resulting imbalances that we see today. The situation of relative underfunding and increasing disparities within the same U.S. healthcare economy, and the same Federal programs, has sustained itself only by inevitably depressing professional compensation, stalling capital and information technology investments, and by increasing barriers to appropriate access to care for the low income population.



While there may be different theories about why this is the current scenario, our call for urgent action is borne out of the following facts:

1. **There is a problem with the economy of Federal healthcare programs in Puerto Rico**, and over 740,000 Medicare beneficiaries and 1,600,000 Medicaid beneficiaries are directly impacted with less benefits, much higher out

<sup>1</sup><http://www.forbes.com/sites/danmunro/2015/01/04/u-s-healthcare-spending-on-track-to-hit-10000-per-person-this-year/>. Estimates for Puerto Rico are based on the financial statements of health plans in the island reported to the National Association of Insurance Commissioners (NAIC), CMS reports for Medicare FFS, and reports of the Government of Puerto Rico Office of Management and Budget.

<sup>2</sup>World Health Organization (WHO) <http://apps.who.int/gho/data/node.main.78?lang=en>.

of pocket costs, and less disposable income than any similarly situated individual elsewhere in the U.S.

2. **The problem is inevitably tied to decades of partial and uneven implementation of Federal healthcare programs.** Medicare and Medicaid for Puerto Rico are impacted by particularly disparate treatment in the statute, while the implementation of “one-size-fits-all” regulation and calculations for the programs has not accounted for basic differences in statutory benefits, eligibility, and the socio-economic situation of Puerto Rico. The effect of unadjusted program implementation in the face of statutory differences for so many years has exacerbated disparities, produced harmful unintended consequences, and pushed Puerto Rico farther to the bottom with regards to healthcare funding.
3. **There are immediate solutions available.** With U.S. citizens in Puerto Rico paying the same Medicare Tax and the same Part B premium as any other citizen in the country, we unequivocally believe there are legitimate “NO-Bailout” solutions that directly impact the capacity of programs in Puerto Rico to provide appropriate access to quality care, and contribute to the strengthening of the economy in general, while also maintaining in Puerto Rico the most cost-efficient Medicare and Medicaid programs in the nation. Moreover, historic cuts and migration to the mainland could inevitably lead to higher costs for the Federal Government as beneficiaries would immediately participate in much higher-cost versions of the Medicare and Medicaid programs.

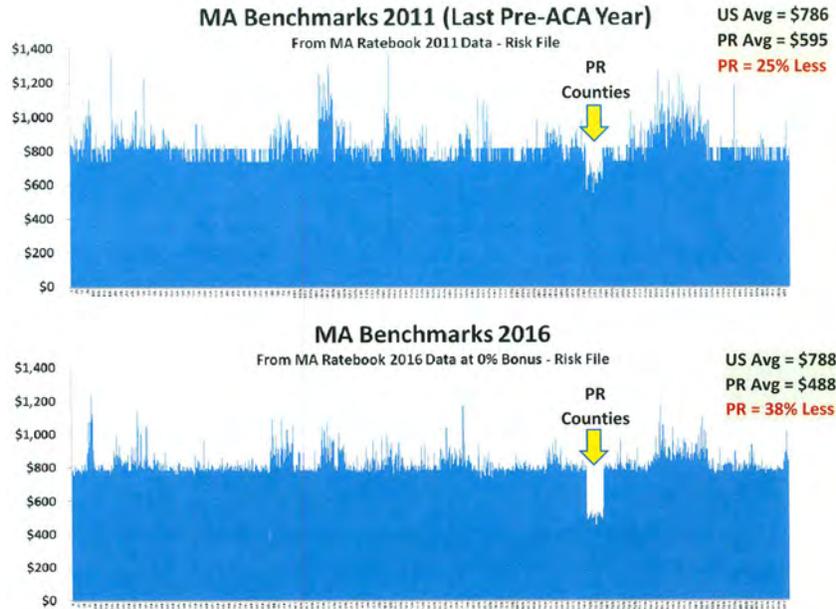
#### **Growing Disparities With Federal Healthcare Programs**

Due to historic deficiencies in the Medicare FFS reimbursement, Medicare managed care was not viable and non-existent for beneficiaries in Puerto Rico before 2001. Changes and protections to the lowest cost areas defined in the Benefits Improvement and Protections Act (BIPA, 2000), and the Medicare Modernization Act (MMA, 2003) provided the first real opportunity for the availability of coordinated care and plan choice. Subsequently, in the first decade of the century, Medicare Advantage (MA) became the preferred choice of beneficiaries in Puerto Rico, especially for the dual eligible and the low income beneficiaries. Today, Puerto Rico has the largest integrated Medicare-Medicaid program in the nation serving over 270,000 dual beneficiaries, and the MA program serves more than 570,000 beneficiaries in total. Most significantly, even before the Affordable Care Act (ACA) cuts began, the MA program in Puerto Rico had the lowest benchmark in the nation, 25% lower than the U.S. average and 21% lower than Hawaii. The MA program in Puerto Rico was doing a lot more, for a lot less.

Unfortunately, the ACA has provoked the highest Medicare funding cuts in history for citizens and providers residing in the island. Since 2011, MA benchmarks have decreased 18%, and payment levels are estimated to be \$1 billion less in 2015. Puerto Rico’s MA base rates are now 38% lower than the U.S. average, and 34% lower than the lowest state (HI). The aggregate funding reduction so far has reached over \$3 billion less in MA. These reductions have already generated tangible cuts in benefits, provider compensation and provider networks. Most importantly, the reductions have put at risk the viability of the program for dual eligible, Medicare Platino, and have basically eliminated crucial help in benefits for non-dual, but low income, beneficiaries that are also excluded by statute from the Part D Low Income Subsidy Program (LIS). With regards to duals, the local Government has estimated that it would need at least \$600–\$800 million more from the local general fund to maintain a Medicaid program for the dual eligible without MA.

**Chart 1—Illustration of the MA Benchmarks at 0% Bonus for Every County in the U.S.**

(Only Northern Marianas, American Samoa, and Guam are not included)

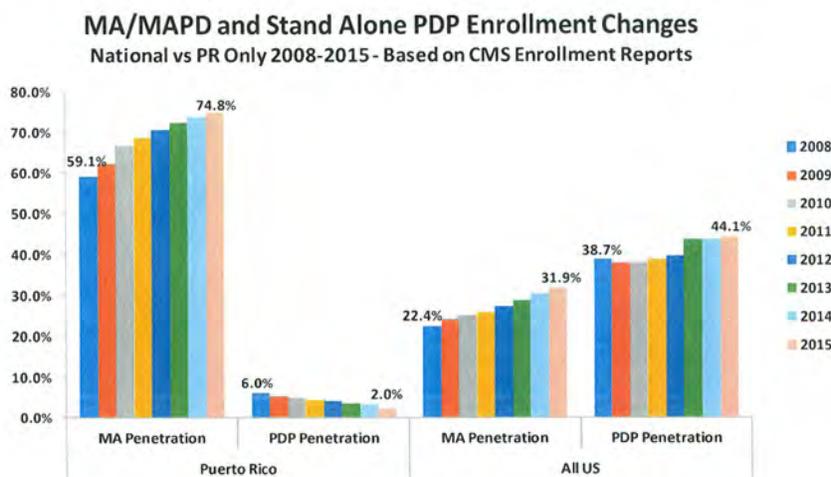


#### **Aggravating Disparities for the Low Income in MA and Part D**

After the enactment of the MMA (2003), the MA program increasingly became the vital platform for the dual eligible population and the low income non-dual population to get appropriate access to care. MA penetration is 75% of all Medicare, serving basically 9 out of every 10 beneficiaries with Parts A and B, while the national average penetration is 32%. Moreover, Stand Alone PDP enrollment is dramatically revealing, going down from 6% to 2% in Puerto Rico from 2008 to 2015, while at the national level the amount of beneficiaries buying a stand-alone part D plan has increased from 39% to 44% (See Chart 2). The disadvantageous socio-economic status of Medicare beneficiaries in the island evidently impacts their decision to use MA as their most, and for most the only, secure access to Medicare benefits. Without a viable MA program that helps with the gaps in Part D, access to prescription drugs for beneficiaries in Puerto Rico would be unaffordable for the majority of the population. In regards to hospital coverage, another example of anomalies alleviated by MA is the fact that the regular Medicaid program in Puerto Rico does not pay for the Part A deductible to hospitals. We estimate that over tens of millions in uncompensated care are saved yearly by the first-dollar hospital coverage under the MA-based Medicare Platino program for the dual eligible in Puerto Rico.<sup>3</sup>

<sup>3</sup>There are 270,000 dual beneficiaries in Medicare Platino D-SNPs for which the Part A deductible for 2015 is \$1,260. The regular Medicaid (Mi Salud) program does not cover this cost, while the MA-based dual program does.

**Chart 2—MA/MAPD and PDP Enrollment in PR Compared to National Perspective**



The recent national-level discussions about the need for socio-economic status (SES) adjustments for risk scores and STAR (quality) rating methodologies have underscored two key barriers for Puerto Rico with regards to the appropriate implementation and funding for the MA and part D programs: (1) almost 50% of MA beneficiaries are dual eligible, and (2) the fact that Part D has much less benefits in Puerto Rico (without the Part D LIS) compared to Part D benefits for citizens residing in the states and Washington, DC. Important studies have examined and concluded that plans that serve higher proportion of low income beneficiaries are disadvantaged in the current STARs methodology, and have proposed policy amendments accordingly (Innovation 2013, National Quality Forum 2014, Holtz-Eakin 2015).<sup>4</sup> However, while neither Congress nor CMS has acted to implement any conforming policies, the poorest beneficiaries have lost millions in benefits given continuing deficiencies in risk scores, and Lower-MA Rebate, NO-Bonus scores in the STARs program. For 2014 and 2015, over 60% of MA beneficiaries were at 4.0 STARs or more (5% Bonus), while there were none (0%) in Puerto Rico.

Furthermore, the alarming increasing disparity in Medicare Advantage has exacerbated the impact of the exclusion of the Part D LIS for beneficiaries in Puerto Rico since the MMA (2003). It is estimated that from 100,000–150,000 beneficiaries residing in Puerto Rico have income between 87% FPL and 150% FPL, and would be eligible to get help from Medicaid and/or from the Part D LIS if they resided elsewhere in the states. The partial Part D benefits for the low income beneficiaries aggravates the scenario with regards to quality measures. We have repeatedly presented this problem in Congress and to CMS, but responses have been null.<sup>5</sup> Holtz-Eakin (2015) concluded that plans with high LIS enrollment lost over \$470 million to pay for benefits due to missing the cut-off for bonus payment by less than half-star. With most plans in Puerto Rico at 3.0 or 3.5 STARs, we estimate that the lost funds for benefits (due to unattained MA rebate percentage and/or MA bonus) was at least \$200–\$250 million in 2015, and an amount close to \$200 million in 2014.

#### **Effect on Low Income Citizens' Financial Circumstances, and on Consumption for the Economy**

<sup>4</sup> *Inovalon* (October 2013); *National Quality Forum* (August 2014); Holtz-Eakin, Ryan; July 2015, <http://americanactionforum.org/research/medicare-advantage-stars-are-the-grades-fair>.

<sup>5</sup> The Obama 2008 healthcare proposals for PR explicitly included the elimination of the Part D LIS exclusion, but no meaningful action has been taken so far. The President's Task Force on Puerto Rico recognized this problem in March 2011 and later the HHS Report to the Task Force from April 2013 confirmed the problem. H.R. 3966 was introduced in 2014 by Resident Commissioner Pierlusi to address the LIS exclusion. The Community of PR presented a response with more details to the CMS RFI on November 2014.

There is no question that the MA cuts, the exclusion of the Part D LIS, and the lost resources under the related to the uneven implementation of the STARS rating program, have severely impacted the disposable income of citizens, with an effect on Puerto Rico economy in general. It should be noted, for example, that—different from all other similarly situated citizens—dual beneficiaries in the island do not get help to pay the monthly Part B premium, which is deducted from their Social Security checks. Starting in 2006, the MA program for duals provided consistent plan alternatives that effectively increased the social security payments for the poorest citizens by providing a credit to the Part B premium. Pre-ACA plan offerings mostly offered \$25 or higher in monthly credits. By 2016, the average Part B credit has gone down probably around \$25mpm. Using this assumption, 270,000 beneficiaries are each losing \$300 from their pockets in 2016, and over \$80 million as a group. Moreover, although a detailed analysis has not been not been finalized, it is fair to estimate that MA beneficiaries in Puerto Rico are losing \$45–\$60mpm from their pockets due to the ACA reductions. This means \$540–\$720 per beneficiary and \$300 to \$400 million in the aggregate, lost as disposable income most likely to be consumed in the local economy to cover other basic needs. With average Social Security payments that are ⅔ of the national average, and the exclusion from Supplemental Security Income (SSI), we can make two very logical and relevant conclusions (see Table 1):

1. MA cuts have a relatively higher impact on the disposable income in Puerto Rico given the lower level of poverty, coupled with the exclusion of Part D benefits and SSI;
2. MA cuts will directly reduce consumption in the local economy given that circumstances almost assure the healthcare help frees income for basic needs. This is the lowest income population in the nation, that is also paying a higher than average cost of living (COLI, Jan–Mar 2015).

From the national perspective, on the other hand, there is also increasing discussion and analysis about how expansions in healthcare coverage is generating increased consumption and supporting economic growth (WSJ Sept 2014).<sup>6</sup>

**Table 1—Comparison of the Typical Low Income Beneficiary Situation in PR vs Other Jurisdictions** <sup>7, 8</sup>

Puerto Rico Perspective	National Perspective
• <b>99.1%</b> Hispanic/Latino	• <b>7.3%</b> Hispanic/Latino
• <b>\$12,000</b> Average Social Security Income	• <b>\$19,000</b> Average Social Security Income
• <b>30%</b> with retirement income	• <b>48%</b> with retirement income
• <b>53%</b> have education less than a high school diploma	• <b>20%</b> have education less than a high school diploma
• <b>\$0</b> Supplemental Security Income (SSI)	• <b>\$8,841</b> Average Supplemental Security Income (SSI)
• <b>115.4 Cost of Living Index (COLI)</b> ; San Juan area Ranked #35 in highest cost of living compared to 296 U.S. metropolitan statistical areas (Jan–Mar 2015)	• <b>100.0 Cost of Living Index (COLI)</b> for Jan–Mar 2015

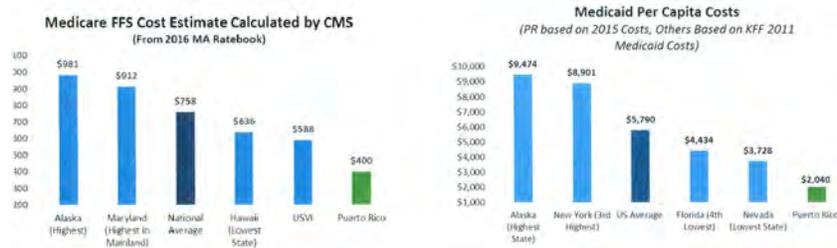
**Traditional Medicare Does Not Work in Puerto Rico as in Other Jurisdictions**

The increasing crisis in the beneficiary-chosen MA program in Puerto Rico brings back historic disparities and underfunding in the Medicare FFS program since 1988. For decades, Part A payments have been distinctly lower for hospitals in the island because of a discounted formula defined by law, and due to regulatory implementation that further reduced payments. An example of the later is the significant reduc-

<sup>6</sup><http://blogs.wsj.com/economics/2014/09/11/health-care-revenue-rebound-could-boost-u-s-economic-growth/>.  
<sup>7</sup>Selected figures from: U.S. Census Bureau, American Fact Finder, 2011–2013 American Community Survey 3-Year Estimates; <http://factfinder.census.gov/faces/nav/jsf/pages/index.xhtml>.  
<sup>8</sup>Cost of Living Index (COLI) of the Council For Community and Economic Research, <http://www.estadisticas.gobierno.pr/iepr/LinkClick.aspx?fileticket=SEqx6S18Ugo%3d&tabid=384>.

tion in DSH payments for PR given CMS has not used a proxy for the “Medicare SSI days” in the formula, even when this program is also excluded for the Territories by law. This makes the SSI days an unrealistic indicator of the low income population in Puerto Rico, and has reduced hundreds of millions of dollars in payments to Medicare hospitals in the island, which is contrary to the intent of Congress in relation to the DSH program policy. Under Part B, other examples of issues include the potential underestimation of the geographic practice cost indexes (GPCIs). For example, a recent study validated that the survey used by CMS for estimating office rent costs is disproportionately biased due to the use of 2-bedroom apartment rent which is subsidized in a much greater proportion in Puerto Rico relative to other jurisdictions.<sup>9</sup> In general, based on data reported by CMS as 2016 estimates, Medicare FFS payment estimates for PR are 47% lower than the U.S. average, also an outlier at the bottom among all jurisdictions (See Chart 3). Statutory, regulatory and context differences over 50 years have shaped a Medicare FFS program that is not reliable and not realistic as an accessible and appropriate coverage option for most beneficiaries in Puerto Rico. The program in the island is not what the ACA assumed as the good standard, like it may be elsewhere. In Puerto Rico, it is simply not a reliable source of what Medicare Parts A and B are supposed to be for eligible beneficiaries.

**Chart 3—Medicare FFS and Medicaid Expense in PR vs Other Jurisdictions**



### Medicaid Has Also Been Extremely Different

The Medicaid program in Puerto Rico has also developed under statutorily defined limitations since 1967. After being limited by a statutory cap on benefits under the 1967 Medicaid amendments that maintained the effective Federal matching percentage below 20%, the ACA approved a defined grant for the period of 2011–2019. The new grant totaled \$6.3 billion in additional Medicaid funds, and increased the FMAP to 55%.<sup>10</sup> Still, it should be noted that the applicable FMAP under the regular formula would be 83%. As a temporary measure, the new allocation has been crucial to maintain the healthcare of the poorest, while it has also helped to keep the government finances a float. Nonetheless, the Medicaid program premiums in Puerto Rico are still 65% lower than the U.S. average (See Chart 3, above). Moreover, there is certainly increasing concern about the upcoming scenario when the ACA funds run out. The program currently depends on the current annual level of Federal funds to support the coverage for over 1.6 million citizens. As we emphasize herein below, the “Medicaid Cliff” presents a situation for the local government finances that could put at risk the access to health for hundreds of thousands of beneficiaries and/or increase the local government’s deficit by another \$1 billion or more.

### The Health Insurance Providers Fee—A New Incongruence With the ACA

Finally, the uneven applicability of Sec. 9010—health insurance provider’s fee (“HIT”)—to the Territories is severely impacting the situation of healthcare under all segments: Medicare, Medicaid and Commercial. Our community has presented several legal analysis to HHS and to the U.S. Treasury in relation to our understanding that the inapplicability of many ACA provisions tied to new expenditures supported by the tax, is also basis for the inapplicability of Sec. 9010. As recent as July 2014, HHS re-interpreted its initial policy on the implementation of several

<sup>9</sup> Report about the *Public Housing Prevalence Bias in the Office Rent Component of the GPCIs*; PR Institute of Statistics, July 2015; <http://www.estadisticas.pr.gov/iepr/LinkClick.aspx?fileticket=ZdH5lxNOBgs%3d&tabid=165>.

<sup>10</sup> This includes the \$925 million initially allocated for an option to start a local health insurance marketplace. Government studies concluded that the marketplace was not viable with this fixed amount and decided to use the funds in Medicaid.

Title I provisions of the ACA to deem them inapplicable to Territories. Basically, plans, citizens and governments of the Territories are being required to pay the price for a product that they are not getting. Puerto Rico is excluded from key provisions like the individual and the employer mandates, the individual and small group subsidies, and the Federal funding for the Medicaid expansion. As reviewed by Federal Courts in recent ACA litigation, we understand the ACA is meant to be a coherent package of provisions, not a list of independent and unrelated rights and obligations. We contend that not re-assessing the applicability of the HIT is incongruent with the intent of the ACA, as validated by courts in different circumstances. The HIT is costing the PR health system about \$150 million in 2015 and would increase to annual payments of approximately \$250 million in the next few years.

### General Economic Impact

As part of our efforts to present the urgent situation of Medicare and Medicaid in Puerto Rico, we prepared estimates of the current shortfall in Federal resources for these programs, assuming a defined parameter of would could be an appropriate level of funding. For our exercise, the appropriate levels are mostly based on the list of policy proposals approved by the Puerto Rico Healthcare Crisis Coalition, which we include as the last section of this document. We can submit more detail or discuss the estimates with the Committee as requested.

Based on our analysis, the estimated Federal healthcare (Medicare and Medicaid) shortfall is approximately \$1.9 billion in 2015.<sup>11</sup> If we consider the exclusion of Supplemental Security Income (SSI) as well, the shortfall is \$3.6 billion. Unless urgent action is taken by Congress and by CMS, the projected worse case may occur in 2018–2019 and would be a shortfall of \$3.6 billion (not including SSI), with no ACA funds for Medicaid and after the potential additional incremental cuts to MA and FFS Medicare based on factors currently legislated or still unaddressed by regulation. At the current level, the shortfall for healthcare programs have an economic impact of approximately \$3.8 billion in a year, considering direct loss and a multiplier (×2) for indirect impacts. Healthcare is mostly a local economic activity, generating immediate impact on jobs, disposable income of beneficiaries and providers, and local government tax revenue. In addition, the direct impact to citizens and the economy is supported by the new minimum Medical Loss Ratio (MLR) requirements (85%), and the fact that currently direct medical services expenses for the combined Medicare and Medicaid programs in PR is at around 90%. All these factors closely link any shortfall or enhancement in healthcare program funding to local economic performance, to benefits, and to provider compensation.

With respect to the combined impact of local expenses and lost tax revenues, the estimate of the healthcare shortfall impact on the PR Government's budget is currently \$1.1 billion a year (using 2015). If we estimate the impact considering a \$3.6 billion shortfall after the additional ACA grant for Medicaid runs out, it means \$720 million less in tax revenue, and an expense to the Puerto Rico Government's budget of \$1.9 billion.<sup>12</sup> A \$2.6 billion total. The net increase to government expenses compared to 2015 would be \$1.4 billion in order to maintain the current Medicaid program and eligible population if there are no legislative and administrative fixes to Medicare Advantage and Medicaid urgently.<sup>13</sup>

The relation between economic performance, government finances and Medicaid expenditures is increasingly being studied across the nation. HHS recently published a summary of recent literature specifically describing impacts in the finances of low income citizens, impacts on uncompensated care, and impact on the states Gross Domestic Product (GDP).<sup>14</sup> Most of the work has also been reviewed by the Kaiser Family Foundation, which concluded that state case studies show savings to the

<sup>11</sup> Uses current MA and Mi Salud membership and premiums. The MA shortfall is based on the minimum MA rate proposed in the Schumer bill and the Medicaid shortfall is based on the use of 83% Federal matching percentage instead of the cap and the 55% limit that applies today. No projections of increased trends or increases to provider payment levels are added, therefore estimates of the shortfall would be higher if these factors are incorporated.

<sup>12</sup> For the purposes of these estimates we are simply assuming that, given Puerto Rico's current income, corporate and consumption tax levels, any Medicare, Medicare Advantage or Medicaid funding change creates an impact to government tax revenue equivalent to 20% of the change in funding.

<sup>13</sup> Considers \$800 million increase to cover regular Medicaid and a \$600 million increase to cover for dual eligible beneficiaries if Medicare Platino is not viable under the MA platform.

<sup>14</sup> Economic Impact of the Medicaid Expansion. Office of the Assistant Secretary for Planning and Evaluation. Department of Health and Human Services. March 23, 2015; <http://aspe.hhs.gov/pdf-document/economic-impact-medicaid-expansion>.

local government expenses and revenue gains in relation to increased Medicaid expenditures.<sup>15</sup>

#### **Healthcare Economic Impact**

The healthcare segment in Puerto Rico represents approximately 11% of the Gross Domestic Product (GDP) and supports directly from 60,000 to 80,000 jobs. At the current underfunding levels, legitimate fixes to Medicare and Medicaid would not only stop the growing crisis in healthcare, but also immediately generate jobs, increases in disposable income of the poor, increases in tax revenues and reductions in local Government expenses on healthcare. Healthcare expenses are too low for Puerto Rico as a community that is part of the U.S. healthcare economy and part of the U.S. healthcare programs, as decided for many decades by Congress and the Federal Government. It should be noted that, the cost of living in Puerto Rico is on average significantly higher than in the mainland. This has recently been validated when Puerto Rico was included the Cost of Living Index (COLI) of the Council for Community and Economic Research<sup>16</sup> (C2ER) which has shown consistently that PR is over 15% costlier than other jurisdictions for the composite index.

Contrastingly, significantly lower compensation in healthcare is part of the context for historic levels of migration to the U.S. mainland. The Puerto Rico Institute of Statistics just reported that in 2014 about 84,000 citizens moved to the mainland, resulting in a net migration of 64,000. This level of migration is the highest recorded in history, and is even higher compared to the exodus of Puerto Ricans to the mainland in the 1950s.<sup>17</sup> More specifically, data from the American Community Survey and the PR Community Survey suggests a net migration of 12% of the physicians in Puerto Rico moving to the U.S. mainland between 2005–2013. The latest figures suggest that over 200 physicians are migrating from the island annually.

Moreover, with over 4.5 million Puerto Ricans residing in the mainland, the decision for many Medicare and Medicaid to move to Florida, New York or Texas, is much easier. At the macro level, the scoring of policy adjustments for Puerto Rico, has to include the increased Federal expenses related to migration. For example, if a beneficiary moves from Puerto Rico to Florida, the Federal Government:

- Will pay 65% more for Medicare Advantage beneficiaries, plus the LIS as applicable;
- Will pay 100% more for a beneficiary in FFS Medicare;
- Will pay 115% more for a beneficiary in Medicaid.

Saving healthcare programs in Puerto Rico saves money to the Federal Government.

#### **Conclusion:**

#### **Congressional and Administrative Action for Healthcare Funding is Part of the Solution for PR**

We ran out of time. Healthcare in Puerto Rico cannot wait. Benefit reductions to the poorest, increasing migration, and impacts on the economy and the government's financial crisis are already real. Moreover, Federal action would actually save money to the Federal Government.

We respectfully request the U.S. Senators and staff of the Senate Committee on Finance to carefully consider the following basic points:

1. There are legitimate legislative and administrative fixes to Federal healthcare programs funding that can be part of the immediate support to our economy and government finances, while NOT being a Federal bailout. Given the cuts in MA that continue to increase, the net result of the ACA for beneficiaries in the island is a net loss in funding even before 2019.
2. Continuing administrative and legislative inaction in relation to the imbalances of the Medicare and Medicaid programs in Puerto Rico will worsen the crisis in government finances and the Puerto Rico economy given significant incremental cuts anticipated in 2016, 2017 and 2018.

<sup>15</sup> Dorn, S., et al. (March 2015). Kaiser Family Foundation and Urban Institute (March 2015). The Effects of the Medicaid Expansion on State Budgets: An Early Look in Select States. Kaiser Family Foundation. Accessed at: <http://kff.org/medicaid/issue-brief/the-effects-of-the-medicaid-expansion-on-state-budgets-an-early-look-in-select-states/>.

<sup>16</sup> See: <http://www.c2er.org/>.

<sup>17</sup> <http://www.estadisticas.gobierno.pr/iepr/LinkClick.aspx?fileticket=KmY2LP3VLPw%3d&tabid=39&mid=590>.

3. Not acting on healthcare in Puerto Rico can cost the Federal Government more, given that the fixes proposed will still leave the island at the lowest level of healthcare expenditure in all the nation. Any beneficiary that moves from Puerto Rico to the mainland will automatically mean higher Federal expenses of 50% or more.
4. Fixing Medicare Advantage, Part D and Medicaid for Puerto Rico will have direct impact on beneficiaries' disposable income, on the economy through increased consumption, on local government expenditures and on tax revenues. Efforts to invest time and funding on other types of economic development projects are currently hindered by the continuing crisis in healthcare.
5. The incongruences and funding disparities in the island are a result of decades of partial and uneven implementation of the Medicare and Medicaid programs, which has influenced the structure and economics of the PR healthcare system in general. In particular, we stress the importance of corrections in the Medicare program, for which citizens in Puerto Rico pay the same Medicare Tax and the same part B premium as residents anywhere else.
6. The MA program in Puerto Rico has reported higher improvement measures in the part C and part D STAR rating system compared to the national average. CMS has noted significant improvement in quality even at the lowest levels of cost. This means that fixes for MA and part D will work on a highly monitored, measured, and performance improving platform. Actually, the most cost-effective healthcare platform in the entire U.S.
7. Common Ground: Amidst all the complexities and positions about the economic situation of Puerto Rico, policy proposals for Federal healthcare programs have revealed common ground across political parties and segments both in Puerto Rico and in the U.S. We strongly urge you to support the proposals listed by the Coalition (See last page).

**List of Legislative and Administrative Policy Proposals Approved by the PR Healthcare Crisis Coalition  
September 15, 2015**

**Legislative Proposals Needed for PR**

1. **Urgent Minimum Protection for Beneficiaries in Medicare Advantage With Part D (MAPD), Including Duals**—(A) Establish a minimum MA benchmark rate for Territories at 20% lower than the national average Medicare FFS per-capita costs, or at an amount equal to the lowest MA benchmark county among the States and the District of Columbia, whichever is the lowest; and (B) Eliminate the exclusion of the Part D Low Income Subsidy (LIS) for beneficiaries residing in Territories. This would provide part D funding to cover essential benefits for all dual eligible and citizens with incomes below 150% FPL.
2. **Parity for Beneficiaries in the Medicaid Program**—(A) Eliminate the total dollar cap on Federal funding, and (B) the Federal Medical Assistance Percentage (FMAP) limit of 55% for citizens residing in Puerto Rico that eligible to Medicaid under the program standards for the rest of the nation.
3. **Eliminate Disparities in Traditional Medicare**—In the Part A Inpatient Prospective Payment System (IPPS) Formula, use the regular national costs formula for 100% of the standard operating costs and capital cost components of the DRG base rates for inpatient services. Establish a new wage index floor to avoid increasing disparity.
4. **Medicaid DSH**—Extend Medicaid Disproportionate Share Hospital (DSH) payments for Hospitals in Puerto Rico.
5. **Medicare HITECH Funds** for hospitals in PR.
6. **Medicare Part B** auto-enrollment and waiver of late enrollment penalty.

**Administrative Adjustments Needed for PR**

1. **Inapplicability of Health Insurance Tax (“HIT”)**—The U.S. Treasury and HHS have the authority to deem Sec. 9010 of the ACA inapplicable to the Territories to avoid the current incongruence in the implementation of inter-related provisions of the law.
2. **Part A—Use of Alternative to SSI Days**—Establish an alternate indicator of “Medicare SSI Days” in the Part A formulas to calculate payment using mainly the “dual days.”

- 3. Adjust MA and Part D Risk Scores and STAR Ratings Based on Socio-economic Status (SES)** to account for increased challenges for plans that serve a high proportion of dual eligible beneficiaries (similar to national policy proposal) and the additional distinction of the lack part D LIS benefits for citizens residing in the territories.
- 4. Appropriate Part B Physician Fees**—Make corrections to the Practice Expense GPCI (current is 0.705).

Respectfully,

James P. O'Drobinak  
President  
Medicaid and Medicare Advantage  
Association of Puerto Rico (MMAPA)

Dr. Joaquín Vargas  
President,  
PR IPA Association

Lcdo. Jaime Plá-Cortés  
President  
PR Hospital Association

José Vázquez-Barquet, Ph.D.  
President and Chairman of the Board  
Puerto Rico Chamber of Commerce

Dr. Wanda Velez  
President  
Puerto Rico Medical Association

Alicia Suárez  
Primary Health Association of  
Puerto Rico

Eliot Pacheco  
President  
Puerto Rico Community Pharmacies  
Association

Dennis Rivera  
Chairman  
PR Healthcare Crisis Coalition

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PUERTO RICO HOSPITAL ASSOCIATION

**Mr. Jaime Plá-Cortés, Executive President**

**For the Hearing Record  
of the  
Finance Committee  
U.S. Senate**

**Hearing on**

**“Financial and Economic Challenges in Puerto Rico”**

**September 29, 2015**

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Chairman Hatch, Ranking Member Wyden and distinguished members of the Senate Finance Committee, thank you for the opportunity to provide this Statement for the Record on behalf of the Puerto Rico Hospital Association. Our organization represents the 69 hospitals serving approximately 3.6 million U.S. Citizens residing in the U.S. Territory of Puerto Rico; a population larger than 20 States. Notably, we are particularly proud that not only was our organization founded in 1942 but we are the home of the America's oldest continuously operated hospital: El Hospital La Concepcion of San German, founded in 1524.

We appreciate the interest of the Committee in the current state of Puerto Rico's economy as well as the fiscal crisis facing our local government and its institutions. Unfortunately, our island's weak economy, high level of poverty, record unemployment and troubled government finances are contributing to the challenges we face in managing a health care system designed to provide the best quality care for the U.S. Citizens we serve each and every day.

Frankly, we face a larger challenge as we work to deliver quality health care. Our Medicaid funding is capped and our treatment under Medicare is significantly less than that received by identical stateside hospitals. However, we are expected to deliver the same level of quality care for our Citizens and visitors as that provided by our sister stateside institutions.

The Government of Puerto Rico is behind in its Medicaid reimbursements to the tune of at least \$200 million today. Since 43% of our local population is living in poverty every one of our member hospitals serves Medicaid patients. This combined with our lesser Medicare reimbursement levels has put an incredible strain on the operations of every hospital. We also note that 40% our hospital services are for Medicaid recipients.

We recently surveyed our member hospitals and found that over the past 12 months almost every institution has been forced to scale back operations in some way due to the Government of Puerto Rico's delayed Medicaid payments due to the inability to obtain an additional line of credit through the Government Development Bank (GOB). This reduction in services has resulted in employee cutbacks and reduced hours impacting thousands of employees, with many hospitals reducing beds, closing floors and eliminating specialized services as well as an additional delay in payment of bills and payroll. One hospital is forced to close its doors after the local government owned electrical utility announced it would cut off its electricity service due to late payment of bills.

The facts show that Puerto Rico's hospital system is in a crisis due to the combination of the government's delay in reimbursing its medical providers and the secondary treatment our hospitals receive under Medicare. We are struggling to maintain our staff and see many of our experienced doctors and other health professionals recruited away with offers of better compensation by stateside hospitals.

You've noted in your opening statements as well as through comments by individual Members during this hearing that you wish to focus on solutions that can be enacted under the Finance Committee's jurisdiction. While there are many areas in health care where the disparity in treatment under Medicare can be identified, my intent with this statement is to ask your attention to the initiatives where Congress can make a difference in the short term. In fact, each of these initiatives addresses a fairness issue resulting from disparate treatment of Puerto Rico hospitals. These are our priorities:

#### ISSUE #1: MEDICARE'S IPPS SINGLES OUT PUERTO RICO'S HOSPITALS

The federal government reimburses hospitals who admit Medicare patients for inpatient care under a system known as the Inpatient Prospective Payment System, or IPPS. The IPPS payment is intended to cover the costs that a reasonably efficient hospital would incur in furnishing high quality care.

The current IPPS results in the federal government reimbursing Puerto Rico hospitals that treat Medicare patients a lower amount than hospitals in the 50 states and other Territories. Puerto Rico's hospitals are not paid the same base rate as identical hospitals in the states, resulting in these hospitals receiving lower payments than identical hospitals elsewhere receive per discharged patient. This is because hospitals in Puerto Rico do not receive a base rate based on 100% of the national average operating and capital costs associated with running a hospital. Instead, they receive a base rate based on 75 percent. When combined with the disparity in the Medicare Wage Index administered by CMS, Puerto Rico hospitals only receive 52% of the reimbursement given to identical hospitals elsewhere.

Puerto Rico's hospitals are the only U.S. hospitals treated under the IPPS in this fashion. Even the other Territories are not treated this way. We ask your support for correcting this disparity when the Senate Finance Committee considers appropriate legislation. We believe identical hospitals should be treated equally as they work to serve Medicare patients, provide quality care and remain financially stable. It's a fundamental issue of fairness.

There is no principled basis to treat Puerto Rico hospitals under the Medicare IPPS as Puerto Rico residents pay the Medicare payroll tax just like their fellow citizens in the 50 states and District of Columbia. This disparate treatment significantly hampers Puerto Rico's hospitals' goal of providing the highest quality care for almost 3.6 million U.S. citizens; a population larger than 20 States.

Legislation to address IPPS for Puerto Rico is offered by Senator Schumer and other Members of this Committee, as part of a broader package of reforms is included in

S. 1961. This legislation would eliminate this disparity and treat Puerto Rico's hospitals under the IPPS the same as identical hospitals elsewhere. This solution has been endorsed by both the American Hospital Association and the Puerto Rico Hospital Association.

#### ISSUE #2: INCLUDE PUERTO RICO HOSPITALS IN THE HITECH ACT

The Health Information Technology for Economic and Clinical Health (HITECH) Act was enacted in 2009. The goal of the HITECH Act is to advance the design, development and operation of a nationwide health information infrastructure that promotes the electronic use and exchange of information. Doctors and hospitals are encouraged to use electronic health records (EHR), so, patient care is improved, medical errors are curtailed and lower health care delivery costs.

To promote the adoption of EHRs, the HITECH Act authorizes bonus payments under both Medicare and Medicaid for eligible doctors and hospitals that become "meaningful users" of certified EHR systems. The Medicare incentive program consists of both "carrots" and "sticks" in that physicians and hospitals will be penalized if they fail to adopt EHR technology by a certain date.

Unfortunately, apparently due to a drafting error, the final HITECH legislation omitted Puerto Rico hospitals from the Medicare component of the incentive program. The current law makes Puerto Rico physicians eligible for both the Medicaid and Medicare payments and Puerto Rico's hospitals are eligible for the Medicaid bonus payments, yet our hospitals were omitted from the Medicare provision, which is likely attributed to the definition of an eligible hospital as a "subsection (d) hospital," an acute care hospital located in the 50 states or District of Columbia. The proposed amendment would simply add for purposes of this Act the inclusion of subsection (d) hospitals in Puerto Rico, thus putting Puerto Rico hospitals on parity with those in the States.

This inadvertent exclusion significantly hampers Puerto Rico's hospitals' efforts to adopt EHR systems putting at stake a vital modernization initiative. Unfortunately, only Puerto Rico was excluded from the program by a drafting error.

Bi-partisan legislation known as the Puerto Rico Hospital HITECH Amendments Act of 2015 to correct this oversight has been introduced in the Senate, S. 1602, by Senators Menendez, Nelson and Rubio. Both the Puerto Rico Hospital Association and the American Hospital Association (AHA) endorsed this fix.

#### ISSUE #3: MEDICARE WAGE INDEX LACKS SSI PROXY

As you know the Wage Index takes into consideration a number of factors when determining Medicare reimbursements. Unfortunately, the Wage Index includes SSI as a factor in the formula even though U.S. Citizens living in Puerto Rico are ineligible for SSI. The failure of the CMS to substitute a proxy for SSI has penalized Puerto Rico far more than Congress intended. We have attempted to work with CMS over the past few years to identify and put into use a proxy for SSI in the Wage Index for Puerto Rico but so far they have not taken the necessary step. When combined with the disparate treatment under the Medicare PPS for Puerto Rico this omission results in our hospitals receiving approximately 52% of the reimbursement received by an identical Stateside hospital. CMS has the administrative authority to make this change and we ask your help in convincing them to act promptly.

#### ISSUE #4: THE MEDICAID CLIFF IN 2017

Another issue needing Congress' attention will cause a further shock to Puerto Rico's health care system in the coming 2 years is the impending "Medicaid Cliff" involving an allocation of federal funds included in the Affordable Care Act to increase the amount of the Federal funds for matching against local funds to be used for Medicaid reimbursement. This allocation is expected to be exhausted in just 2 years; 2017. Once these funds are exhausted, Federal matching funds will drop significantly due to the permanent statutory cap on Federal Medicaid funding for Puerto Rico.

We also noted during the hearing the comments of one witness who justified disparate treatment of Puerto Rico under Medicare with a two pointed argument. First, it was said that health care funding levels should not be considered as part of an economic development strategy. Second, it was noted while workers in Puerto Rico pay taxes into the Medicare system, they do not all typically pay Federal income tax. We respond by noting that Congress has made it a policy priority to ensure ac-

cess for quality health care for all Americans regardless of whether they are rich or poor. If U.S. Citizens do not believe they can obtain quality health care in Puerto Rico, they then as U.S. Citizens have the right to find that quality health care elsewhere within the United States.

We do not ask for a bailout and never have. However, we ask for fair treatment and note that equal treatment for all American Citizens is a guiding principle for our great Nation. Parity is a fair request.

Mr. Chairman, Ranking Member Wyden and members of the Finance Committee, our health care system is in a crisis. We have offered a set of priorities and ask to work with you to ensure fair treatment for all U.S. Citizens when it comes to health care. These priorities deserve prompt action and are solutions within your Committee's jurisdiction and we look forward to working with you.

Thank you for the opportunity to share our statement with you.

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PUERTO RICO MANUFACTURERS ASSOCIATION

**Carlos Rivera Vélez, Ph.D., PE, President**

**For the Hearing Record  
of the  
Finance Committee  
U.S. Senate**

**Hearing on  
"Financial and Economic Challenges in Puerto Rico"**

**September 29, 2015**

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Mr. Chairman, Ranking Member Wyden, and distinguished Members of the Finance Committee, it is my pleasure to represent the Puerto Rico Manufacturers Association as its elected Chairman and share our statement with you. The PRMA is one of Puerto Rico's oldest business organizations organized in 1928 and representing 1,200 companies in America's largest and most important Territory. Our Members make up the primary private sector source of local jobs.

In particular, we are concerned about the negative impact proposals similar to last Congress' H.R. 1, or the Administration's 2016 Treasury Budget proposal would have on Puerto Rico's manufacturing sector. We believe these approaches would discourage investment in Puerto Rico and accelerate the current loss of manufacturing operations and jobs.

We appreciate the special attention you are giving to the Commonwealth of Puerto Rico in today's hearing on the current fiscal and economic crisis facing our island of 3.56 million U.S. Citizens. We also urge you to consider the importance of the private sector in discussions regarding the long term resolution of today's fiscal crisis. It's estimated that our manufacturing sector provides one-third of local tax revenues and our high wage employees contribute even more in individual income taxes.

Puerto Rico is unique because it is the most manufacturing dependent jurisdiction in the United States with one-half of its GDP generated by our sector. This is the result of the historical approach taken by the Congress to utilize Federal tax policy as a tool to address Puerto Rico's high poverty levels and create good paying job opportunities for our U.S. Citizens. This approach has resulted in the creation of a unique manufacturing ecosystem generating 320,000 direct and indirect jobs locally. We also note that Puerto Rico and stateside interests are directly aligned as

partners in the U.S. supply and values chain and some economists suggest 80,000 mainland jobs are generated as a result of this relationship. The bottom line is that manufacturing jobs in Puerto Rico are U.S. jobs.

We've previously noted in the information we've shared with the Finance Committee that Puerto Rico was once heavily dependent on low wage agricultural employment. Congress then began in the 1920's to provide Federal tax policy designed to incentivize U.S. companies to set up operations in our U.S. Territory and provide higher wage employment. This effort continued with Operation Bootstrap in the 1950s and Section 936 created in the 1970s. When Section 936 was phased out by Congress, most U.S. Corporate subsidiaries converted to Controlled Foreign Corporations and today Puerto Rico is the only location in the world where controlled foreign corporations (CFCs) employ U.S. Citizens and operate under U.S. laws.

Frankly, the Congress' experiment in targeted tax policy was successful and today our manufacturing sector has grown to include knowledge-based industries such as life sciences, medical device and electronics manufacturing. These sectors require a highly skilled workforce and manufacturing today provides a typical wage at twice our island's per capita income of \$19,500.

We also note that Puerto Rico's manufacturing sector is an example of 21st Century advances and we are working to develop new innovations through research in closed loop development areas as well. In fact, global statistics today identify Puerto Rico's life sciences sector as the fifth largest in the world.

We now face many challenges in the competitive global economy. We compete with the lower costs of doing business offered by our regional neighbors, such as Costa Rica and the Dominican Republic, for investment. We are subject to the Jones Act and all other U.S. business mandates and laws while our energy costs are three times the U.S. average. Federal tax policy has provided us with a counter to these challenges and we note that changes to the Federal tax code could result in significant consequences for the long term vitality of Puerto Rico's manufacturing sector.

We continue to be concerned as talented and well-educated young people and their families move away from Puerto Rico to pursue better economic opportunities. Almost 10 percent of our population has left the island in the past 10 years, and for the first time in our history we have seen a significant net reduction in population as a result of this "brain drain."

As you consider how Congress can best address the current fiscal and economic crisis, we ask that you do no harm to our vital manufacturing ecosystem upon which Puerto Rico has become so economically dependent upon. We appreciate the leadership of the Chairman and Ranking Member to foster discussion of a bipartisan strategy and approach to reform of the Federal tax code, especially the international tax rules which impact our manufacturing sector in Puerto Rico.

We are also grateful for the attention of the Committee and an invitation by the Finance Committee's International Tax Working Group to make a presentation and discuss how best to position Puerto Rico in the future. We continue to urge that the Committee take a position of "doing no harm" by not putting Puerto Rico at a disadvantage compared to foreign jurisdictions.

We continue to be concerned about the consequences which our manufacturing base could suffer if approaches similar to last Congress' H.R. 1, or the Administration's 2016 Treasury Budget proposal were to become reality. Frankly, we believe their approaches would discourage investment in Puerto Rico and cause a gradual loss of manufacturing operations and its job base over time. Should Congress decide that you wish to pursue a similar approach to these two proposals we ask for a significant, competitive differential in treatment of CFCs employing U.S. Citizens in Puerto Rico versus controlled foreign corporations operating in foreign jurisdictions.

No one doubts the recognition by the Finance Committee of the importance of the manufacturing sector and its role in resolving Puerto Rico's current fiscal crisis. We seek to work with you in developing an approach to tax reform that results in policy that is pro-growth and best positions Puerto Rico manufacturing in a competitive position in today's global economy.

We also recognize that tax policy is just one key tool that your Committee may consider to provide short as well as long term solutions to our current fiscal and economic challenges. We look forward to collaborating with you to find positive solutions for the challenges faced by Puerto Rico today.

Again, thank you for the opportunity to provide our statement towards today's hearing.

Carlos Rivera-Vélez, Ph.D.

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STATEMENT OF MIRIAM J. RAMIREZ, M.D.

FORMER PUERTO RICO STATE SENATOR

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**THE MJR REPORT**

**TESTIMONY FOR THE RECORD  
SENATE FINANCE COMMITTEE  
HEARINGS ON PUERTO RICO—SEPTEMBER 29, 2015**

Honorable Senator Hatch, Senator Wyden, and members of the committee: My name is Miriam Ramirez, I am a medical doctor, former Senator of the New Progressive Party in Puerto Rico, and founder of a non-partisan grassroots movement, called Puerto Ricans in Civic Action, which gathered more than 350,000 individually signed petitions for statehood and delivered them to Congress in the 1980s.

In my testimony at a House Hearing, on May 22, 1986, when Congressman Morris Udall was the Chairman, I identified our lack of full rights as U.S. citizens as the fundamental reason for the poor economic performance of Puerto Rico, compared to other states. Today I want to focus my testimony on the negative consequences of the federal tax regime that has kept Puerto Rico labeled as a "foreign" jurisdiction for almost a century.

In 1996 after Section 936 was eliminated, the former Section 936 firms used Puerto Rico's "foreign" tax status and converted to Controlled Foreign Corporations (CFCs). However, the CFCs in Puerto Rico are not obligated to create local jobs or to generate any real investments in order to benefit from the federal tax deferral. Using transfer pricing abuses, the CFCs in the Island are causing the U.S. Treasury to lose billions in federal tax revenue without creating jobs and investment in the Island. The Senate Permanent Subcommittee on Investigations identified one company in Puerto Rico that benefitted from a tax savings of \$22 million per employee, but yet only generated 177 jobs.

Also, to exploit this special federal tax status, the supposed pro-statehood administration of former Governor Fortuño adopted two laws in 2012. Act 20 and Act 22 entice millionaires who reside in the 50 states to locate to Puerto Rico by taxing their corporate profits from exported services at a flat 4% rate and allowing those profits to be paid out to these owners free of Puerto Rico income tax. Thus, the CFC regime in Puerto Rico has become a significant drain of tax revenue and a formidable opponent of statehood for Puerto Rico. Keeping Puerto Rico as a "foreign" country inside the United States undermines the U.S. federal tax base and creates unfair competition against local communities in the 50 states. But the truth is that Puerto Rico is governed by the CFC REGIME and the economic power of super billionaires who since Law 22 of 2012 can relocate to Puerto Rico without paying state or federal taxes.

But that is not the only damage they do . . . they have the most powerful Public Relations army in the World, ready to lobby and fight against anything that endangers this outrageous tax evasion scam to the U.S. and the U.S. Taxpayer. Their worst concern is that Puerto Rico may become a state of the Union. They are ruthless in their attacks when they feel threatened with that possibility and will destroy or attempt to destroy anything or anyone that even remotely attempts to help the U.S. citizens of Puerto Rico gain full citizen rights. The CFCs are effectively in control of our major political parties and their governing agenda. Whenever the people put pressure for a process of self determination, millions of dollars appear out of nowhere to campaign against statehood, since it will be the death knoll for the CFC scam.

It is for this reason that it is impossible to fight against the CFCs if we want to achieve statehood in Puerto Rico. We have to make the CFCs part of the political status solution. Mr. Chairman, I propose that a statehood bill, with the defined terms of admission and a 20 year transition period for maintaining the CFC's in Puerto Rico, come out of your Committee. There is a precedent for previous state-

hood bills to include temporary tax benefits, and a transition period was included in the Senate Bill 712 in 1990.

Thank you very much.

Miriam J. Ramirez

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STATEMENT OF JORGE A. RIVERA  
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September 28, 2015

**The Honorable Orrin G. Hatch**

*Chairman*  
 Committee on Finance  
 United States Senate  
 219 Dirksen Senate Office Building  
 Washington, DC 20510

Dear Senator Hatch:

Tuesday, September 29, 2015 you will hear from Puerto Rico politicians and others, their reasoning as to why Puerto Rico is in the fiscal condition it is. These will be some excuses and even some lies just to justify their point of view.

You, as well as they, do know what the basic problem for the island's mismanagement is. Under the present Territorial status, the Government of Puerto Rico has its hands tied behind its back and depends totally on the U.S. Congress's whims to try to economically develop the island.

The Territorial status is the culprit. You, on October 1, 2013 and then on December of the same year did confirm your request for the parties, PPD, PNP and the PIP to DEFINE their status definition and to send it to the Department of Justice for verification that they were NON-Territorial and Constitutional.

The Statehood and Independence definition, in reality are not an issue. Everyone knows what they are and the only thing to negotiate would be the transitional period to whichever status the people preferred. Now, the PPD (the party today in Government) definition is something else.

You see they want to have most of the Independence rights, things none of the 50 States of the Union can now have, keep the U.S. citizenship, and still stay within the umbrella of the U.S. Constitution. They call it the "Enhanced Commonwealth."

They know it is unconstitutional but, they also know that if they take out the U.S. Citizenship from their definition, the party will loose over 50% of its members to Statehood.

For this simple reason YOU WILL NEVER see a definition of the Non-Territorial and Constitutional Commonwealth (ELA) coming from the Popular Democratic Party of Puerto Rico (PPD).

This is what is holding Puerto Rico back. I know that you will do whatever the people want, or so you have said, but, how do we break this standstill because the PPD will never admit to a Commonwealth without the U.S. Citizenship. You must remember they control 48% of the electorate.

Jorge A Rivera  
 Riverview, FL

PD: to see their unofficial definitions of their Enhanced Commonwealth please visit my page, <http://puertorico51ststate.us/docs-page.html>.

Specifically read "La Nueva Tesis," "Pacto de Asociacion," "Pacto de Futuro," and "Definicion del ELA Soberano." And yes these are definitions of a Free Association only that they have added the U.S. Citizenship and the protection of the Constitution.