



CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

June 3, 2016

H.R. 5278

Puerto Rico Oversight, Management, and Economic Stability Act

As ordered reported by the House Committee on Natural Resources on May 25, 2016

SUMMARY

H.R. 5278 would create a legal framework for the federal government to oversee the fiscal and budgetary affairs of certain U.S. territories. In particular, the bill would outline procedures under which the governments of such territories and their instrumentalities could establish an oversight board and thus restructure their public debt. The bill would immediately establish such a board for the Commonwealth of Puerto Rico.

In CBO's view, and in keeping with guidance specified by the *1967 President's Commission on Budget Concepts*, a control board established under H.R. 5278 should be considered a federal entity largely because of the extent of federal control involved in its establishment and operations. Because it would be a federal entity, all cash flows related to the board's administrative costs should be recorded in the federal budget. On that basis, over the 2017-2026 period, CBO estimates that enacting H.R. 5278 would:

- Increase direct spending by \$370 million for the board's administrative costs;
- Increase revenues—from amounts transferred to the oversight board by the government of Puerto Rico to cover the board's expenses—by \$370 million; and
- Have no significant net effect on the federal deficit.

In addition, CBO estimates that completing various reports and administrative requirements specified by the bill would cost about \$1 million in 2017; such spending would be subject to the availability of appropriated funds.

Pay-as-you-go procedures apply because enacting the legislation would affect direct spending and revenues. CBO estimates that enacting the legislation would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2027.

H.R. 5278 contains intergovernmental and private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the aggregate costs of the mandates on public entities would exceed the annual threshold established in UMRA for intergovernmental mandates (\$77 million in 2016, adjusted annually for inflation). Because CBO is uncertain about how claims by creditors would be affected and the amount of losses that would occur as a result of the bill, CBO cannot determine whether the aggregate cost of the mandates on private entities would exceed the annual threshold established in UMRA for private-sector mandates (\$154 million in 2016, adjusted annually for inflation).

MAJOR PROVISIONS

Under the United States Constitution, the federal government retains sovereign authority to govern U.S. territories and insular areas. H.R. 5278 would create a legal framework for the federal government to establish oversight boards with broad authority to exercise control over the fiscal and budgetary affairs of U.S. territories.¹ The bill also would outline procedures under which territorial governments could restructure public debt, subject to the approval of any such oversight boards established on their behalf.

In general, oversight boards would be established only at the request of territorial governments; however, H.R. 5278 would automatically establish an oversight board for the Commonwealth of Puerto Rico, which currently faces a financial crisis. It has already failed to make scheduled payments to service the territory's outstanding public debt—which currently totals more than \$70 billion—and further defaults are widely viewed as inevitable.²

To help Puerto Rico address its mounting financial difficulties, the bill would establish a seven-member Financial Oversight and Management Board (hereafter, the board) that would assume control over fiscal and budgetary decisions of the Puerto Rican government, including its municipalities, agencies, and public corporations (hereafter, instrumentalities). The President would appoint all seven members of the board, six of whom would be chosen among individuals recommended by Congressional leaders. The Governor of Puerto Rico (or a designee) would serve on the board as an ex officio member without voting rights.

1. Such territories include Puerto Rico, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the U.S. Virgin Islands.

2. D. Andrew Austin, *Puerto Rico's Current Fiscal Challenges*, Report for Congress R44095 (Congressional Research Service, May 2, 2016).

Under H.R. 5278, the board would:

- Ensure that fiscal plans and annual budgets developed by the governor and legislature of Puerto Rico and territorial instrumentalities meet certain accounting standards and fiscal requirements;
- Review and approve such fiscal plans and budgets (or, if necessary, develop alternative plans that meet all such standards and requirements);
- Monitor ongoing budget execution to identify any differences between projected and actual revenues and expenditures; and
- Determine whether any such differences require corrective actions, including potential reductions in certain nondebt expenditures, hiring freezes, or other measures to reduce expenditures.

To achieve those objectives, the bill would give the oversight board certain sovereign powers over the Puerto Rican government and its instrumentalities. In particular, the bill would authorize the board to require the Puerto Rican government to provide the board with a dedicated source of funding, not subject to further legislative action, to cover its expenses. In addition, the board could issue subpoenas, obtain any necessary information and data from agencies and entities of the United States or Puerto Rico, and initiate civil actions in U.S. courts to enforce its authority. The board could enforce laws of Puerto Rico that prohibit employees of the territorial government and its instrumentalities from participating in a strike or lockout and, if necessary, effectively nullify any new laws or policies adopted by Puerto Rico that did not conform to requirements specified in the bill.

A variety of provisions of H.R. 5278 would establish the legal framework for restructuring public debt issued by Puerto Rico and its instrumentalities. The bill would prohibit Puerto Rico from issuing any new debt without the board's approval and would grant the board the sole authority to approve agreements to restructure existing public debt. (The bill specifies requirements that would pertain to any debt restructuring agreements negotiated prior to the bill's enactment.) Title III of the legislation would outline procedures—enforceable in U.S. courts—for such debt restructuring. The control board would represent Puerto Rico and its instrumentalities in all such proceedings. Upon enactment, H.R. 5278 would establish a stay on judicial or administrative proceedings against Puerto Rico (or a territorial instrumentality) related to existing debts. Finally, title VI would establish a process for creditors to pursue collective actions related to proposals to restructure some types of debt.

Once established, the control board would continue to operate until it certified that the government of Puerto Rico had, for at least four consecutive fiscal years, developed and

adhered to budgets that met the bill’s requirements, and that the territorial government had sufficient access to credit markets at reasonable rates.

Finally, H.R. 5278 contains a variety of other provisions that would:

- Affirm Puerto Rico’s right to determine its future political status with respect to the United States;
- Modify the minimum wage for most Puerto Rican workers under age 25;
- Require the Government Accountability Office to prepare a report on implementation in Puerto Rico of certain programs of the Small Business Administration;
- Establish a Congressional task force to recommend changes to federal laws and activities that would support economic growth in Puerto Rico; and
- Specify procedures aimed at accelerating review and permitting, by Puerto Rican and U.S. government agencies, of specific types of infrastructure projects.

BUDGETARY TREATMENT

Cash flows of the government of Puerto Rico and its instrumentalities currently are excluded from the federal budget. In CBO’s view, enacting H.R. 5278 would not change that general budgetary treatment; under the bill, overall net costs related to Puerto Rico’s ongoing operations—including those stemming from decisions made by the control board established under the bill—would remain separate from the federal budget.

H.R. 5278 would specify that the proposed control board should not be considered part of the U.S. federal government; however, in CBO’s view the activities of such boards should be considered federal activities, consistent with principles specified by the *1967 President’s Commission on Budget Concepts*. Although the report issued by that commission has no legal status, it remains the primary authoritative statement on the scope of the federal budget. The commission recommended that, “the budget should, as a general rule, be comprehensive of the full range of federal activities. Borderline agencies and transactions should be included...unless there are exceptionally persuasive reasons for exclusion.”³ Thus, CBO believes the control board should be included in the budget

3. President’s Commission on Budget Concepts, *Report of the President’s Commission on Budget Concepts* (October 1967), p.25.

because of the significant degree of federal control involved in its establishment and operations. In particular:

- The authority to establish the oversight board derives from the federal government’s constitutional power to “*make all needful rules and regulations*” regarding U.S. territories;⁴
- The President would appoint all seven voting members of the board; and
- The board would have broad sovereign powers to effectively overrule decisions by Puerto Rico’s legislature, governor, and other public authorities.

As a result, in CBO’s view, all cash flows related to the oversight board established for Puerto Rico under H.R. 5278 should be recorded in the federal budget. More specifically, amounts provided by Puerto Rico to fund the board’s operations should be recorded in the federal budget as revenues, and subsequent expenditures should be recorded as federal direct spending because they would not be contingent on further legislation.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary effect of H.R. 5278 is shown in the following table. The costs of this legislation fall within budget function 800 (general government).

	By Fiscal Year, in Millions of Dollars											
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2017-2021	2017-2026
INCREASES IN DIRECT SPENDING												
Estimated Budget Authority	200	150	5	5	5	5	0	0	0	0	365	370
Estimated Outlays	200	150	5	5	5	5	0	0	0	0	365	370
INCREASES IN REVENUES												
Estimated Revenues	200	150	5	5	5	5	0	0	0	0	365	370
NET CHANGE IN THE DEFICIT												
Impact on Deficit	0	0	0	0	0	0	0	0	0	0	0	0

Note: Implementing the bill also would increase discretionary costs by \$1 million in 2017 and by less than \$500,000 in subsequent years.

4. Art. IV, sec. 3, cl. 2 of the U.S. Constitution.

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 5278 will be enacted before the end of fiscal year 2016. The bill would authorize the oversight board to require the government of Puerto Rico government to establish a dedicated source of funding to fully cover anticipated direct spending for the board's expenses. Under H.R. 5278, such amounts—which would be considered revenues—would be transferred to the board and would remain available, without further appropriation, for the board's ongoing operating costs.

For this analysis, CBO examined the administrative costs—particularly for legal and financial expertise required to oversee procedures related to bankruptcy and debt restructuring—incurred by institutions involved in resolving financial crises faced by U.S. municipalities, including Detroit, Philadelphia, New York City, and the District of Columbia. For example, according to media reports the city of Detroit spent more than \$170 million over a period of about 18 months for the services of legal and financial firms to manage bankruptcy proceedings related to that city's \$18 billion in public debt. Other major bankruptcy cases in the private sector have involved administrative costs that have totaled hundreds of millions of dollars over a few years.

According to a 2015 report by Bloomberg news service, Puerto Rico and the Puerto Rico Electric Power Authority—a public corporation that serves as the territory's primary electric utility—have already spent more than \$60 million for legal and financial advisory services to explore options for restructuring more than \$70 billion in existing public debt. In addition, officials of the government of Puerto Rico indicated to CBO that they anticipate spending around \$75 million in 2017 for ongoing legal and financial services related to restructuring the government's debt.

Based on those previous costs for restricting government debt, as well as information from the Department of the Treasury about the likely costs to operate the Puerto Rican oversight board, CBO expects that the board would spend roughly twice as much as the city of Detroit over the next two years to restructure the territory's debt and to prepare balanced budgets. CBO estimates that the board's activities would increase direct spending by \$370 million over the 2017-2022 period. Most of that increase—\$350 million—would occur within the first two years and would primarily cover fees of legal and financial consultants hired to restructure Puerto Rico's debt. After that restructuring was achieved, CBO estimates the board would spend \$5 million annually to help the Puerto Rican government prepare and execute balanced budgets for the next four consecutive years as required by the bill—or through fiscal year 2022. For this estimate, CBO assumes that after the debt is restructured Puerto Rico would be able to meet the requirement of having balanced budgets for four consecutive years; however, if Puerto Rico could not meet that requirement, or if the board considered Puerto Rico's access to capital markets to be insufficient to meet the country's needs, the board would continue to operate after 2022.

This estimate does not include any additional budgetary effects that could occur under the bill if other U.S. territories requested to have similar boards established on their behalf.

The estimated increase in direct spending under H.R. 5278 would be fully offset by increased revenues from transfers of cash from Puerto Rico, which CBO estimates would total \$370 million over the 2017-2022 period. Under the bill, the Puerto Rican government would be required to provide such amounts to the oversight board. (That requirement is an intergovernmental mandate and is discussed in more detail in the section entitled Intergovernmental and Private-Sector Impact.) For this estimate, CBO assumes that amounts necessary to cover the oversight board’s expenses would be transferred to the board as needed to pay expenses.

Finally, CBO estimates that establishing a Congressional task force to address economic issues in Puerto Rico and completing various reports and administrative tasks would increase federal costs. Based on information about the cost of similar activities, CBO estimates such costs would total \$1 million in 2017 and less than \$500,000 annually thereafter; such spending would be subject to the availability of appropriated funds.

PAY-AS-YOU-GO CONSIDERATIONS

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table.

CBO Estimate of Pay-As-You-Go Effects for H.R. 5278, as ordered reported by the House Committee on Natural Resources on May 25, 2016.

	By Fiscal Year, in Millions of Dollars												2016- 2021	2016- 2026
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026			
NET CHANGE IN THE DEFICIT														
Statutory Pay-As-You-Go Impact	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Memorandum:														
Changes in Outlays	0	200	150	5	5	5	5	0	0	0	0	0	365	370
Changes in Revenues	0	200	150	5	5	5	5	0	0	0	0	0	365	370

INCREASE IN LONG-TERM DIRECT SPENDING AND DEFICITS

CBO estimates that enacting the legislation would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2027.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 5278 contains intergovernmental and private-sector mandates as defined in UMRA. CBO estimates that the aggregate costs of the mandates on public entities would exceed the annual threshold established in UMRA for intergovernmental mandates (\$77 million in 2016, adjusted annually for inflation). Because CBO is uncertain about how claims by creditors would be affected and the amount of losses that would occur as a result of the bill, CBO cannot determine whether the aggregate cost of the mandates on private entities would exceed the annual threshold established in UMRA for private-sector mandates (\$154 million in 2016, adjusted annually for inflation).

Mandates that Apply to Public Entities

The bill would impose a number of mandates on the territorial government of Puerto Rico and its instrumentalities. Those instrumentalities include 78 municipalities, the Government Development Bank for Puerto Rico, public utilities and corporations, and other public entities within the territory.

Oversight Board and Administrative Costs. The bill would create a framework for the federal government to oversee the fiscal affairs of the territory and would require the territorial government and its instrumentalities to comply with the directives and processes instituted by the board. The board would have the power to oversee and direct most of the budgetary activities of the territorial government and its instrumentalities. Government agencies and other public entities would be required to:

- Develop and submit fiscal plans, budgets, certifications, and other budgetary analyses;
- Provide the board with direct access to written and electronic records, documents, information, and data;
- Undertake reforms within their organizations, including reductions in spending and staff, necessary to achieve the goals of fiscal plans and budgets approved for the territory and instrumentalities; and
- Enforce laws necessary for the board to carry out its oversight activities;

According to officials in the territorial government, many government agencies and other public entities would have to hire additional personnel, particularly those with financial expertise, in order to comply with directives, information requests, and audits from the board. In some cases the territorial governments might be able to draw upon existing resources to fulfill some of those requirements, but the scope of activity for governmental agencies will expand significantly as the new directives from the oversight board are fulfilled and restructuring plans are implemented. Although the magnitude of those costs is uncertain, CBO estimates that public entities would spend several hundred million dollars over the next several years to comply with the board's requirements and to implement new fiscal plans. CBO expects that most of those costs would be incurred in the first few years after enactment of the legislation, when the board would be active.

The bill also would require the government of Puerto Rico to pay for the costs of the board's operations and activities. CBO estimates that the board's operations would cost \$370 million over the 2017-2022 period, with most of those costs occurring in the first few years.

Preemption of Territorial and Local Laws. The bill contains several preemptions of territorial and local authority. Because preemptions limit the authority of territorial and local governments, they are intergovernmental mandates as defined in UMRA. Among those preemptions,

- Section 4 of the bill would broadly preempt any general or specific law or regulation of the territory or its instrumentalities that is inconsistent with the legislation;
- Section 105 would exempt the board and its employees from liability for any claim brought against them resulting from actions taken to carry out the legislation; and
- Section 504 would preempt territorial and local laws governing permitting for infrastructure projects by creating a fast-track authority for critical projects.

Infrastructure. The bill would authorize an expedited approval process for critical infrastructure projects and would require the governor of Puerto Rico to appoint a revitalization coordinator, who would serve under the board, to coordinate critical infrastructure projects for the territory.

The bill would require territorial and local agencies that oversee permits to operate as if the governor had declared a state of emergency. Under Puerto Rican law, projects undertaken pursuant to an emergency order are exempt from the requirements of various Puerto Rican laws governing environmental reviews and administrative proceedings for projects. As part of that process, the bill would prohibit territorial and local agencies from requiring any permit, certificate, right-of-way, lease or other authorization from including a term or condition if the coordinator determines that it would impair the approval of those projects.

The expedited approval process could result in a loss of revenue from permits and fees for government agencies; however, because of the low cost of permits and limited number of projects that would be fast-tracked under this process, CBO estimates that the amount of forgone revenue would be small.

Other Effects on Public Entities

The bill would provide benefits to the government of Puerto Rico and its instrumentalities by authorizing the rights and procedures under U.S. bankruptcy laws to be applied to those public entities. In the aggregate, territorial and local governments, as well as other public entities in Puerto Rico, owe more than \$70 billion to creditors. By providing access to U.S. bankruptcy laws, the bill would allow those entities to restructure or possibly reduce their outstanding debt.

Mandates That Apply to Both Public and Private Entities

The bill would impose mandates on public and private creditors that own Puerto Rican debt in two ways:

- By imposing a temporary stay on litigation relating to defaults by Puerto Rico while the board develops its bylaws and procedures, the bill would limit the ability of those entities to file claims in court or receive compensation for existing claims related to the recovery of their assets.
- By requiring creditors that are placed into specific debt pools to accept modifications to debt, the bill could affect public or private creditors in a number of ways, causing savings for some and losses for others. The amount recovered by a creditor through the procedures established in the bill and the timing of payments to creditors relative to what would happen in the absence of the bill would depend on several factors. Those factors would include market conditions and decisions by the courts and the oversight board.

Because of uncertainty about the number of creditors that would have their debt restructured, the scope of that debt, and changes to debt obligations, CBO has no basis for estimating either the overall direction or magnitude of those effects on public or private entities.

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