Prepared Statement by Senator Chuck Grassley of Iowa
Chairman, Senate Judiciary Committee
Hearing on "Puerto Rico's Fiscal Problems:
Examining the Source and Exploring the Solution"
December 1, 2015

Good morning. The purpose of today's hearing is to learn more about the origin of Puerto Rico's fiscal problems, and what's needed to help restore fiscal balance and economic growth. It's my hope that we'll have a valuable discussion based on facts, and informed by our witnesses' expertise.

Puerto Rico's debt crisis didn't happen overnight. It's been years in the making. Fundamentally, the starting point for any solution is to first identify the problem and understand its size and scope. Unfortunately, confusion reigns as Puerto Rico has failed to provide audited financial statements for the past two years.

What we do know is that for many years as Puerto Rico's economy suffered, debt and spending increased to the point where the Island lost investor confidence. Puerto Rico has defaulted on certain debt obligations, lost access to the normal markets, and now faces a liquidity crisis. The Governor and others have stated that the Island's current debt "is not payable."

Puerto Rico's economy has suffered for decades in part because of barriers to job creation and labor force participation. The federal minimum wage mandate, generous entitlement programs, bureaucratic red tape, and a bloated public sector have stifled business activity. This has a direct impact on Puerto Rico's residents, who are our fellow U.S. citizens. High unemployment rates have resulted in a declining population as Puerto Ricans have left the Island in search of jobs. A diminished population means lower tax revenues to fund government spending.

Despite these long-term economic challenges, for many years Puerto Rico maintained a balanced budget and high credit ratings on its debt. What, then, led to the fiscal crisis the Island faces today? While the economic challenges may be debatable, it's clear that since 2000, Puerto Rico's public debt has risen from 60 percent of GDP to now more than 100 percent. This is an indication of serious fiscal mismanagement.

Thanks to the highly attractive triple-tax exempt status of its bonds, it was easier for Puerto Rico to borrow and paper over deficits, rather than address financial shortcomings and economic realities in order to balance its budget. The consequence of this decision is an accumulation of approximately $72 billion of debt, arising from roughly 17 different debt issuers. This includes more than $18 billion in constitutionally protected general obligation debt. And, also around $24 billion in debt issued by public corporations, like the Puerto Rico Electric Power Authority (PREPA).

Moreover, because of its triple-tax exempt status, a wide array of investors own Puerto Rican bonds. According to Bloomberg, Puerto Ricans alone hold $20 billion of the debt. And nearly 60 percent of Puerto Rico's debt is held largely in the individual retirement accounts and 401(k)'s of regular folks throughout the U.S. I'm told that approximately 16,000 Iowans are invested in funds that hold PREPA bonds. These folks aren't vultures. They're middle-class Americans who probably knew little about Puerto Rico's finances. They simply invested in one of many tax-exempt municipal bond fund's containing Puerto Rico's bonds.

Notwithstanding all of this, we're told that Puerto Rico's debt needs to be restructured in order to address its fiscal challenges. Puerto Rico, though, lacks access to an orderly debt restructuring mechanism, like Chapter 9 of the bankruptcy code. Thus, Congress has been called upon to extend Chapter 9 to Puerto Rico's public corporations. Or to create a broad new bankruptcy regime, dubbed "Super Chapter 9," to restructure all debt, including the Island's constitutionally guaranteed general obligation bonds. According to a recent New York Times article, "advisers to the island's government have been urging the governor to default on the debt, saying that only a catastrophe would move Congress – especially Republicans – to help." I hope the Governor will tell us whether this is accurate. It would trouble me greatly if true.

This isn't the first time Congress has been asked to help address a situation like Puerto Rico now faces. In the past, we've provided help in a bipartisan way. During the 1990s, the District of Columbia faced its own fiscal crisis, as it was insolvent and unable to pay its bills. Congress worked with District and Clinton Administration officials to pass the District of Columbia Financial Responsibility and Management Assistance Act in 1995. We'll hear more about the response to that crisis and others from our witnesses today. I'll note that Congress considered extending Chapter 9 to the District of Columbia, but decided that there was "little practical significance or advantage to such a legislative gesture." As the committee report to the bill stated, "the issues facing the District of Columbia . . . require political and structural, as well as financial remediation."

One of the reasons extending Chapter 9 to the District was rejected is because it's designed primarily to restructure and decrease municipal debt. The idea being that relief from creditors is what's needed in order to gain a fresh start. But Chapter 9 cannot bring about financial rehabilitation. It does not increase economic growth or alter the fundamental fiscal trajectory. In short, Chapter 9 cannot address the root causes of fiscal problems, but instead pushes them off to future generations.

As for "Super Chapter 9," this is something that no State can do, and has been described as "unprecedented in the American context." It would be a bad idea, with negative consequences, for Congress to permit Puerto Rico to walk away from its constitutional debt obligations. Unlike other bonds, constitutional debt, whether issued by Puerto Rico or a State, has that government's full faith and credit commitment to repay the debt.

Let's not forget that Puerto Rico issued its bonds with the knowledge that Chapter 9 bankruptcy wasn't an option in the event of a default. Is it fair to retroactively change the rules at the expense of these investors, if other options exist for addressing Puerto Rico's debt problems? At the very least, this is an idea that should be at the end of the line, not the front.

The challenges Puerto Rico faces are great and require more than just short-term solutions that don't provide long-term relief. The debt is a symptom of a bigger problem. Merely extending debt restructuring authority, absent tools to address the fundamental causes of the fiscal problem, is not a long-term solution that will help Puerto Rico.

Puerto Rico has struggled to make the difficult decisions to cut spending and balance its budget. If Congress is to act, then we must ensure that Puerto Rico has the tools to help itself out of this situation. Today's hearing can help us identify what may, or may not, need to be looked at for Puerto Rico to get its balance sheet back in order.

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