

December 23, 2013

The Hon. Tony West
Associate Attorney General
Co-Chair
The President's Task Force
on Puerto Rico's Status
950 Pennsylvania Avenue, NW
Washington, DC 20530

The Hon. David Agnew
Director of Intergovernmental Affairs
Co-Chair
The President's Task Force
on Puerto Rico's Status
1600 Pennsylvania Avenue, NW
Washington, DC 20502

Dear Associate Attorney General West and Director Agnew:

In November, the White House announced that, as part of the efforts of the President's Task Force on Puerto Rico's Status, it was establishing an inter-agency team to work with the government of Puerto Rico to "strengthen Puerto Rico's fiscal situation and economic outlook." According to an explanation provided on the White House website, the interagency team would "offer strategic advice to assist Puerto Rico in promoting its economic development and maximizing the impact of existing federal funds flowing to the Island." In early December, two officials from the U.S. Treasury Department traveled to Puerto Rico to meet with officials from the territory government.

When the Task Force announced the creation of the inter-agency team, I expressed my strong support for this initiative. I noted that, for months, I had respectfully urged Administration officials to move beyond monitoring the deteriorating situation in Puerto Rico and had asked you to take concrete steps to help the government of Puerto Rico formulate sound policies that will spur economic growth and enable the territory to maintain access to capital markets. I am grateful the Administration is now doing precisely that.

The work of the inter-agency team has taken on increased urgency as a result of recent events. In particular, on December 11th, Moody's Investors Service placed Puerto Rico's general obligation bonds—which the three main credit rating agencies have rated one notch above junk status—on review for downgrade. Moody's has placed Puerto Rico's related bonds, including the Puerto Rico Sales Tax Financing Authority (COFINA) and the Puerto Rico Electric Power Authority (PREPA), on review for downgrade as well. Moreover, according to the U.S. Department of Labor's Bureau of Labor Statistics, the unemployment rate in Puerto Rico climbed to 14.7 percent in October and November, the highest rate since March 2012 and 7.7 percent above the U.S. national average. The Government Development Bank's Economic Activity Index was 5.4 percent lower in October 2013 than in October 2012, and the cumulative 2014 GDB-EAI (July-October) was 5.3 percent lower than the corresponding period in 2012. It is clear that Puerto Rico is moving in the wrong direction.

I write now for two purposes. First, I want to reiterate that, while I am encouraged that the inter-agency team will seek to identify instances where the Puerto Rico government is not taking full advantage of current federal funding opportunities, the Administration should not stop there. As a territory, Puerto Rico is treated unequally under, or excluded entirely from, numerous federal spending and tax credit programs. This disparate treatment is the principal, though not the sole,

reason why Puerto Rico's economy has consistently struggled. Therefore, it is not enough for the Administration to focus only on "maximizing the impact of *existing* federal funds flowing to the Island." Instead, the Administration should supplement this effort by including legislative proposals in its forthcoming budget request that will address a number of the federal funding disparities that Puerto Rico faces. On December 11th, I wrote you a letter in which I provided a (non-exhaustive) list of options for your consideration. I included a proposal to extend the child tax credit program to families in Puerto Rico with fewer than three children—which the Task Force recommended in its report, but upon which no Administration action has been taken. I hope that some of these proposals will appear in the budget request the Administration transmits to Congress early next year.

The second purpose of this letter pertains to the inter-agency team's stated mission of providing "strategic advice to assist Puerto Rico" on fiscal and economic matters. In dispensing such advice, I ask the inter-agency team to bear in mind that I have serious policy disagreements with the Governor and the legislative majority. I believe certain actions they have taken—or proposed to take—are counterproductive, and are doing more harm than good. Given my role as Puerto Rico's representative to the federal government, it is my responsibility to articulate such disagreements so as to inform the work of the inter-agency team.

For example, on the spending side of the ledger, I believe it was a mistake for the governing party to increase the level of government spending called for in its Fiscal Year 2014 budget, which covers the period from July 1, 2013 to June 30, 2014. The more prudent and disciplined course of action would have been to maintain spending at the Fiscal Year 2013 level. Moreover, I have proposed to the governing party that it refrain from filling tens of thousands of non-essential government positions that have been vacated in recent months when workers chose to take early retirement in light of the changes made to the government employee pension system. The government could realize substantial savings, without any meaningful adverse impact on public services, through a thoughtful policy of attrition.

On the revenue side of the ledger, despite the fact that Puerto Rico is in a recession, the governing party has imposed a range of new taxes that are shortsighted. For example, the governing party raised the corporate income tax rates, increasing the top rate from 30 to 39 percent. By contrast, under the federal income tax, the top corporate rate is 35 percent and, indeed, the Administration has proposed reducing it to 28 percent. From the perspective of local companies, who employ most workers in Puerto Rico, the tax system is not only onerous, it is also highly unequal, given that controlled foreign corporations doing business on the island pay little in income taxes because they operate under tax incentives legislation.

Moreover, the governing party has imposed an additional tax—known as the *patente nacional*—on the gross income of corporations on income of at least \$1 million at graduated rates ranging from 0.2 percent to 0.85 percent. Given current conditions, this levy is ill-advised, threatening investment and job creation. In recent testimony, a Walmart official stated: "The national *patente* has raised our taxes by more than 70 percent, leading us to re-evaluate the expansion of our operations on the island." The Chamber of Food Marketing, Industry & Distribution (MIDA), which filed a legal challenge against the tax, has said: "We can't sit back as the economic initiative and economic development activity of the entrepreneurial sector is run

down. Rather than helping to find a solution, the tax deepens the economic crisis that is holding the island back.”

In addition, the governing party has made substantial changes to the sales and use tax regime, subjecting a wide range of business-to-business (B2B) services to the tax and repealing an exemption from the tax for resellers. According to reports, both changes are having a disproportionately adverse impact on small and medium sized businesses.

Furthermore, the Puerto Rico Aqueduct and Sewer Authority (PRASA), a government-owned corporation, substantially increased water rates for residential and commercial clients earlier this year. The ramifications for consumers have been severe, compounded by the fact that they are also paying electricity prices that are about two-and-a-half times more expensive than the national average. A coalition of businesses in Puerto Rico has projected that the rate hike could ultimately result in the loss of 15,000 private sector jobs. Numerous proposals have been put forward that would undo or scale back the rate increase while still enabling PRASA to address its budget gap in a responsible fashion, but the governing party has not given any indication that it will reconsider its action.

In short, although I am fully cognizant of the scope, severity and structural nature of the challenges that the governing party faces, I believe it has made a number of policy choices that—however well-intentioned—are exacerbating the situation. On a more positive note, I credit the governing party for keeping in place the excise tax on non-resident businesses that purchase goods or services from certain Puerto Rico affiliates. Whatever changes may be made to the structure or level of that tax, I believe it is critical that the revenue raised from the tax be specifically targeted to address Puerto Rico’s most pressing issues. These include expediting the conversion of the fuel used at Puerto Rico Electric Power Authority’s plants to natural gas to lower electricity costs for consumers; to provide relief to families and businesses from the increase in water rates; to increase salaries for public school teachers and to otherwise mitigate the impact of any forthcoming changes to their pension system; and to improve public safety on an island that has experienced an unprecedented level of drug-related violence in recent years. It is critical that such revenue not simply disappear into the general fund to be used for non-urgent purposes. I ask the inter-agency team to consider all of these points in the course of providing guidance to the Puerto Rico government on economic and fiscal matters.

I want to close with a word about status. I have consistently made the case—to federal officials and my constituents alike—that Puerto Rico will not realize its economic potential if it remains a territory. This is the only reasonable conclusion to draw from at least four decades of empirical evidence, which shows that Puerto Rico’s economic performance has—without exception—lagged behind the economic performance of all 50 states based on every criterion. The Task Force acknowledged as much in its March 2011 report, stating that it “recognizes that the status question and the economy are intimately linked” and that “the long-term economic well-being of Puerto Rico would be dramatically improved by an early decision on the status question.” See Report, page 33.

Given my belief that any comprehensive effort to help Puerto Rico address its economic challenges must include an effort to facilitate resolution of the status issue, I was gratified when the

Administration—in response to the historic results of the November 2012 referendum—sought funding as part of its Fiscal Year 2014 budget request to conduct the first federally-sponsored status vote in Puerto Rico’s history, to be held among one or more options that would “resolve” the issue and that are consistent with U.S. law and public policy. As you are aware, I have introduced legislation—H.R. 2000, the *Puerto Rico Status Resolution Act*—that is consistent with the Administration’s proposal, insofar as it would call for a federally-sponsored, up-or-down vote in Puerto Rico on the territory’s admission as a state. This legislation has obtained bipartisan support from 129 Members of Congress.

Recently, the Chairman and Ranking Member of the Senate Energy and Natural Resources Committee sent a letter to local political leaders in which they emphasized that, in any process to decide Puerto Rico’s political future, “non-viable status options such as ‘enhanced commonwealth’ should not be considered, as they confuse the debate and undermine efforts to resolve this issue of great importance to both Puerto Rico and the United States.” This is consistent with the Task Force’s conclusion that the indispensable core of the Popular Democratic Party’s “enhanced commonwealth” proposal—the mutual consent provision—is unconstitutional, a conclusion also reached by the Clinton and George W. Bush administrations. See Report, page 26.

At this juncture, there can be no more confusion regarding Puerto Rico’s status options. It can remain a territory, although a majority of voters already rejected that option in the November referendum; it can become a U.S. state; or it can become a sovereign nation, either fully independent from or in a free (voluntary) association with the U.S.

As always, I am grateful for the diligent work that this Administration—through the President’s Task Force that you lead—is doing to promote equality and improve quality of life for the 3.6 million U.S. citizens of Puerto Rico.

Sincerely,

Pedro R. Pierluisi
Member of Congress