PUERTO RICO

Factors Contributing to the Debt Crisis and Potential Federal Actions to Address Them

What GAO Found

The factors that contributed to Puerto Rico’s financial condition and levels of debt relate to (1) the Puerto Rico government running persistent annual deficits—where expenses exceed revenues—and (2) its use of debt to cope with deficits. Based on a literature review and interviews with current and former Puerto Rico officials, federal officials, and other relevant experts, GAO identified factors that contributed to Puerto Rico’s persistent deficits:

- **The Puerto Rico government’s inadequate financial management and oversight practices.** For example, the Puerto Rico government frequently overestimated the amount of revenue it would collect and Puerto Rico’s agencies regularly spent more than the amounts Puerto Rico’s legislature appropriated for a given fiscal year.

- **Policy decisions by Puerto Rico’s government.** For example, Puerto Rico borrowed funds to balance budgets and insufficiently addressed public pension funding shortfalls.

- **Puerto Rico’s prolonged economic contraction.** Examples of factors contributing to the contraction include outmigration and the resulting diminished labor force, and the high cost of importing goods and energy.

Additional factors enabled Puerto Rico to use debt to finance its deficits, such as high demand for Puerto Rico debt. One cause of high demand was that under federal law, income from Puerto Rico bonds generally receives more favorable tax treatment than income from bonds issued by states and their localities. Based on an assessment of relevant literature and input from current and former Puerto Rico officials, federal officials, and other relevant experts, GAO identified three potential federal actions that may help address some of these factors. GAO also identified considerations for policymakers related to these actions.

- **Modify the tax exempt status for Puerto Rico municipal debt.** Making interest income from Puerto Rico bonds earned by investors residing outside of Puerto Rico subject to applicable state and local taxes could lower demand for Puerto Rico debt. However, reduced demand could hinder Puerto Rico’s ability to borrow funds for capital investments or liquidity.

- **Apply federal investor protection laws to Puerto Rico.** Requiring Puerto Rico investment companies to disclose risks with Puerto Rico bonds and adhere to other requirements could lower demand for the bonds. However, this action could also limit Puerto Rico’s ability to borrow funds.

- **Modify the Securities and Exchange Commission’s (SEC) authority over municipal bond disclosure requirements.** SEC could be allowed to require timely disclosure of materials—such as audited financial statements—associated with municipal bonds. Over the past decade, Puerto Rico often failed to provide timely audited financial statements related to its municipal bonds. Timely disclosure could help investors make informed decisions about investing in municipal bonds. However, a broad requirement could place additional burdens on all U.S. municipal issuers, such as the costs of standardizing reporting.