



ADDRESS BY HONORABLE ALEJANDRO GARCÍA PADILLA,
GOVERNOR OF THE COMMONWEALTH OF PUERTO RICO,

at

Oversight Board created by PROMESA

October 14, 2016

Thank you, Mr. Chairman. Distinguished members of the Oversight Board, members of the press, puertorriqueños y puertorriqueñas, amigas y amigos todos, good morning.

It has been a long and challenging road that has brought me, and the residents of Puerto Rico, here before you. I am here this morning to present to you a fiscal plan for the Commonwealth of Puerto Rico. I am confident that we are advancing—together—on a path of real progress that brings recovery to the 3.5 million American citizens living in Puerto Rico.

By now, the story of Puerto Rico’s economic and humanitarian crisis is well known. Equally well known are the root causes of the persistent fiscal and economic challenges that have brought us to this point. When I took office in 2013, the island had suffered from almost a decade of economic contraction, out-migration,

deterioration of living conditions, and had almost seventy billions dollars of debt. Puerto Rico's problems did not develop overnight, and they are not the result of any single factor, political decision or political party. Rather, they are the culmination of decades of misguided and unscrupulous public policies in San Juan, Wall Street and Washington. Those policies placed us in a downward cycle of ever-widening operating deficits covered with ever-increasing public borrowing at ever-increasing financing costs.

During my administration, it became clear that we could no longer, in good conscience, continue down this irresponsible route. I took the decision to face our debt crisis head-on. After implementing many emergency measures, I commissioned three former IMF economists to assess the island's economic situation and to examine the sustainability of our debt. Thereafter, I established a working group of key officials to put together the first comprehensive fiscal and economic growth plan for Puerto Rico. Drawing from that first plan, we have upgraded our calculations and measures to present a new plan that represents my administration's best efforts to balance our obligations to creditors and pensioners with our duty to provide essential services to our citizens. Today, over a year later, with PROMESA in place, I take this opportunity to work together with the Oversight Board to carry this mission through.

Many sectors of the community, here and in the island, have criticized the appointment of this Board and are understandably concerned with the extent of the powers vested in it. Initially, I disagreed with Congress's approach, but favored the passing of PROMESA to avoid having my people suffer the misery of a looming government collapse.

Therefore, my administration intends to collaborate with the Board in the belief that this process will soon lead to the economic recovery our people deserve. That said, we will work with you to help you get up to speed in the coming days and weeks with vast amounts of information and analyses we have put together during my term. My team and I look forward to coordinating as many technical work sessions between you and our advisors and experts as necessary.

You must, however, be mindful of this reality as you carry out your duties under the statute. Since the people of Puerto Rico lack democratic tools to check the Board's powers, you owe them a high degree of care and caution. It is my duty as Governor of Puerto Rico to represent the people of Puerto Rico and ask you to put them ahead of any competing considerations. Over the last years my administration has put the people of Puerto Rico ahead of powerful economic and political interests. I have faced relentless pressures to fire workers, reduce pensions and pay full amounts owed to

bondholders. You will too. But, in the face of the largest municipal bankruptcy in history, we have managed to guarantee essential services and have avoided further economic deterioration by escaping self-defeating austerity measures. I withstood that pressure and now encourage you to do the same. That does not mean that we should act in a fiscally irresponsible fashion. We have reduced the number of public workers through attrition and reformed pension systems to make good on our obligations to pensioners, although at levels that are materially lower than the benchmarks in the mainland. These measures should remain in place. It would be fundamentally unfair if the needs of Puerto Ricans are not made the paramount priority.

Puerto Rican children and retirees are not to blame for careless decisions made here in New York by the rating agencies who supported the close to thirty two billion dollars in debt issued by the two previous administrations, or the mistaken decisions made by Congress to repeal section 936 of the Internal Revenue Code and remove Puerto Rico's eligibility under Chapter 9 of the Bankruptcy Code. Puerto Rican pensioners will not carry the burdens of wrong government decisions. To reduce challenges to the legitimacy of this process, the aspirations of Puerto Rican families and workers should not be bound by the irresponsibility of prior governments and greedy lenders that opted to fill-in with unsustainable loans the gaps of a

failing economy that has stalled in recession for a decade. The cost of this crisis cannot be for the students of the University of Puerto Rico to bear. And, even if spending is reduced to pay the debt, you will soon realize that any reduction in spending implies intolerable effects in aggregate demand and will further throw Puerto Rico into a death spiral that will directly affect creditors' recoveries across the board.

You will soon agree that Puerto Rico requires substantial foreign direct investment and a meaningful partnership with the federal government to lift itself out of this crisis and invest in our economy to pay our creditors. You will also realize that PROMESA offers useful tools to restructure our unsustainable debt. It was necessary to approve the bill as it was before July 1st. However, we told members of Congress for many months that a federal solution also needed to eliminate inequities in funding for healthcare and provide the Commonwealth with tools to bring back the jobs that Puerto Rico lost to foreign jurisdictions when section 936 was eliminated. I urge you and our creditors to join today the Commonwealth in one voice before Congress.

Based on the foregoing, our fiscal plan was developed by forecasting the revenues and expenses of all the entities dependent on the Commonwealth's tax and other revenue generating capacity.

Only issuers of debt that operate solely with internal resources or that were established as special financing vehicles without recourse to the Commonwealth-collected taxes were excluded. The fiscal projections are then presented in two ways. We first show the base projections, which we commonly refer to as the “base line”, and then show the same projections including revenue-generating and efficiency measures. The base line assumes status quo, implying current laws remain in place and laws with certain sunset provisions expire as legislated. For example, the base projections assume the phase out of Act 154 excise tax on foreign corporations that will occur next year. Then, the projections including our recommended measures add back the revenues lost for that concept by assuming the approval of a substitute revenue structure.

In order to address impending events such as the expiration of the stay on litigation and of the moratorium in debt payments, and because of the need to instill confidence, Puerto Rico needs a plan in place immediately. Currently, the government is operating under a moratorium budget that allows the central government to redirect funds from several entities to the Treasury Single Account, including funds that were pledged to certain entities for repayment of their debts or assigned by law and then pledged to their bondholders by the entities. This allows the Puerto Rico Treasury Department to sustain operations and essential services, pursuant

to the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act. In our judgement, if these were to change as a result of litigation, the termination of the stay under the terms of section 405 of PROMESA, or the expiration of the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act, the Commonwealth would need quick access to the protection of the stay under Title III of PROMESA and DIP financing. Thus, I urge you to promptly evaluate the Commonwealth's compliance with the requirements of section 201 and 206 of PROMESA in order to issue a restructuring certification as soon as possible. The first step in reaching that goal is to establish a short working schedule that enables swift approval of the plan.

Our plan shows that, even if Puerto Rico and its creditors were to do their part, we need the assistance of the federal government to bring this economic and humanitarian crisis to an end. The plan reflects the core principles that my administration believes must underlie a fiscal plan for Puerto Rico. Indeed, these principles should continue to guide us in the future even after we emerge from this crisis. These principles can be summarized as follows:

First, we must ensure that austerity policies that inhibit growth no longer drive fiscal decisions. While we recognize that fiscal discipline is a necessary component of our return to fiscal

health, we cannot afford to double-down on austerity. A strategy based on austerity will only deprive the economy of resources for public and private investment necessary to generate economic growth.

Second, we must create more disciplined financial decision making with improved budgetary controls and financial transparency.

Third, we must rationalize expenditures and tax policies that promote efficiency. Agencies with overlapping functions should be consolidated and procurement should be further centralized to promote economies of scale. Also, tax enforcement and administration should be improved to increase the capture rate and reduce evasion.

Fourth, we must do our part to make Puerto Rico a competitive place for private investment and employment again. We must undertake reforms to local laws to create a more business-friendly environment, and we must leverage public-private partnerships in areas such as energy infrastructure and provision of services. We recognize that attracting the participation and partnership of the private sector will be critical to our economic future, and we are proposing major infrastructure investments to promote growth.

Fifth, we must protect those most vulnerable as a result of Puerto Rico's fiscal crisis. This includes our seniors, people with disabilities and/or our low-income citizens, who are reliant on the social safety net provided by the government's healthcare system. We also have to safeguard Puerto Ricans' savings by ensuring the stability of the local credit union system and provide adequate funding for our public pension plans. Ignoring the needs of these stakeholders would only serve to dampen demand, create instability and increase the shocks to the island's economy.

Sixth, we must adjust our debts to sustainable levels. Over a year ago, we stated that our approximately \$50 billion of tax-supported debt is not payable in full without renewed economic growth and that the level of debt payments required to service the existing debt stock was crowding out public and private investments to jump-start economic growth. We must use the tools provided by PROMESA to achieve a debt restructuring that gives us the breathing room to recover, allows us to invest in growth and create a foundation upon which market access can be restored.

And seventh, we and the federal government must be partners in returning Puerto Rico's economy to growth. Our island has not recovered from the economic damage caused by the repeal of the

section 936 tax incentives, which caused the loss of more than 100,000 private sector jobs.

I want to make the importance of this last principle clear. The fiscal plan that I am presenting today shows a ten-year projection of the Commonwealth's finances. If things do not change on the island, we end the next ten years with a cumulative deficit of \$34 billion dollars. "Things not changing" also means that we maintain the same level of federal assistance that we currently receive. If we lose the current level of federally legislated support, most importantly as a result of the phase-out of funds provided under the Affordable Care Act to Puerto Rico's healthcare system and the creditability of a local excise tax against federal income tax is removed, we will end the next ten years with a cumulative deficit of \$59 billion dollars. Even after the implementation of the on-island measures in the fiscal plan that we in Puerto Rico can control, our cumulative deficit would still be \$40 billion dollars. On top of that, even if you take out all of the remaining debt service over the next ten years, which is a total of 34 billion dollars, we project that the Commonwealth will still be in the red by approximately \$6 billion dollars. So the message should be clear: without a change in federal policy and without a change in the trajectory of the island's economy toward real growth, there will be no money for any debt service at all without jeopardizing the Commonwealth's ability to provide essential services.

These are sobering numbers that underscore the gravity of the task that Puerto Rico and the Oversight Board have to fulfill in the coming months.

Today, I am submitting a plan that conveys these numbers, but it is a plan that puts first our people's priorities and ambitions. As we progress together in the process of approving a comprehensive fiscal plan, I will make sure that the interests of the people of Puerto Rico are protected and will strive for minimum hampering with our priorities.

Members of the Board, on behalf of the people of Puerto Rico, I thank you for your commitment of time and energy to assist the Commonwealth in achieving economic recovery. I now urge you to use the powers vested in you by PROMESA having in mind, first and foremost, the wellbeing of the people of Puerto Rico. This will only happen if this Board removes itself from the political ideologies and partisanship that dragged us here. I assure you of the full cooperation of my administration in the coming months and wish to be helpful in any way to my successor.

Thank you.