



## GOVERNOR OF PUERTO RICO

Ricardo Rosselló Nevares

Friday, January 20, 2017

José L. Carrión

Chairman

Fiscal Oversight and Management Board

Response to Financial Oversight and Management Board Letter January 18, 2017

Dear Mr. Carrión:

Your January 18, 2017, letter provides detailed information with respect to the proposed goals and objectives that the members of Oversight Board believe to be appropriate for inclusion in a viable and certifiable fiscal plan. We thank you for the clarity of your views and agree on certain baseline views of the fiscal situation. However, we are still in the process of obtaining and assessing critical financial information and must note that we have a clear difference in approach and outlook from those expressed in your letter. It is my view, that any fiscal plan premised exclusively on a reduction in the health, well-being, and living standards of the People of Puerto Rico through healthcare delivery cutbacks, current retiree pension reductions of our most vulnerable segments of the population, and layoffs is by its nature unacceptable. It is also inconsistent with PROMESA, which requires the preservation and delivery of essential services and adequate funding of public pension benefits. I firmly believe that we should endeavor to jointly create a fiscal plan that (i) reflects a consensus between my office and the Oversight Board and (ii) meets the statutory requirements for certification by the Oversight Board.

As I have said to you in person, advised the Oversight Board by letter dated January 12, 2017, and as my representative Mr. Elías Sánchez wrote in his letter dated January 4, 2017:

"The only way to solve Puerto Rico's economic and fiscal crisis is 'through real economic growth'."

Our government has put forward a Plan through the "Plan Para Puerto Rico", which can be found at (<http://www.planparapuertorico.com>). In that Plan we detail the requisite policies that underlay the actions we have already undertaken and support our approach to the development of a fiscal plan. While we agree with your assessment of the magnitude of the crisis, **our approach is in sharp contrast with some of your proposed initiatives** and we look forward to working with you to find an acceptable balance.

On January 2, 2017, immediately after taking the Oath of Office, I issued Executive Order No. 2017-001, which, among other cost reduction initiatives, (1) imposed a reduction of ten percent in government spending for the current fiscal year; (2) ordered a reduction of ten percent (10%) in professional service contracts, and a five percent (5%) decrease in utility spending for all government agencies and public corporations; and (3) mandates a twenty percent (20%) reduction in positions of trust in each agency and/or public corporation.



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Executive Order No. 2017-002, signed that same day, created the Center for Federal Opportunities to improve the Government's ability to obtain, maximize and improve the oversight of federal funds and resources. This is an important step towards addressing your concern that "there is no central office to manage federal funds and optimize use of proceeds."

Furthermore, Executive Order No. 2017-003, declares a state of emergency in infrastructure, thus creating an expedited process for infrastructure projects which are much needed in order to boost the local economy and, as complement, Executive Order No. 2017-004 creates a Governmental Task Force for urgent infrastructure projects that require the approved expedited process. Through these Orders, we have set in motion the process to "build a modern, efficient and cost-effective infrastructure that ensures quality utility services are delivered fairly to every island region".

Also, Executive Order No. 2017-005 requires all agencies and public corporations to establish a Zero-Base Budgeting methodology as a way to reduce government spending. Lastly, Executive Order No. 2017-009 imposes a five percent (5%) reduction in purchases of goods in all government agencies. These orders will result in more efficient government operation "while preserving essential services for the People of Puerto Rico".

Likewise, I have introduced a series of bills that will jump start the economic development of the Island. Specifically, during the first day of our administration, I introduced ten (10) bills, seven (7) of which were geared at promoting economic development and putting controls on government spending. These seven (7) legislative measures include:

- (1) The creation a non-profit entity, in partnership with the private sector, named "Enterprise Puerto Rico, Inc.", to stimulate local investments and promote Puerto Rico as an investment and business destination;
- (2) Tax incentives for medical doctors to stop the exodus of our physicians and bring more health professionals to our island. These incentives will be the most competitive in the United States;
- (3) Tax amendments to provide incentives to other professionals to stay in Puerto Rico by promoting and facilitating the creation and management of retirement plans and other trusts to promote financial stability and job creation;
- (4) The creation of a Direct Marketing Organization ("DMO") that, through the expertise of the private sector, will handle the marketing of Puerto Rico as a tourist destination in order to develop and promote tourism so that it may serve as a cornerstone to the island's economic development;
- (5) Amendments to the Public-Private Partnership (3Ps) Act in order to expand the projects and initiatives that may be subject to a 3Ps and allow



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the public employees retirement systems to invest and participate in 3Ps agreements to raise much needed funds that will help in the recovery of the now nearly insolvent pension systems;

- (6) Creation of the Office of the Inspector General to guarantee unbiased preventive audits of government spending to detect and deter waste, fraud, and abuse;
- (7) Creation of the Puerto Rico Social and Community Economic Development Office attached to the Office of the Governor which shall, through a more efficient administration of federal funds, work with nonprofit organizations and the private sector to empower and strengthen communities so that they take charge of their future, break the chain of poverty and contribute to the island's economic development as well as their own.

Additionally, on January 9th we introduced profound labor reforms. Our Employment Transformation and Flexibility Act is a growth initiative aimed at reducing the cost of doing business in Puerto Rico and creating a more competitive economy in order to attract new capital and allow the private sector to create much needed jobs. This bill includes most if not all of the comprehensive labor reforms that you stated in your letter, including, among other things, significant changes related to severance pay, flexible scheduling, employee retention and mandatory vacation days. Simultaneously, we introduced a bill which converts the Government into a single employer. Through our Personnel Management Transformation Act, we will reduce spending and create efficiencies in all government agencies.

Against this backdrop of active fiscal reform and growth initiatives, the Oversight Board has proposed five guidelines to be incorporated in the Government's proposed fiscal plan in order to achieve a balanced budget by fiscal 2019 and to serve as the fiscal baseline. In essence, the guidelines to fiscal sustainability as seen by the Oversight Board are:

1. Increase government revenues by \$1.5 billion annually;
2. Generate approximately \$1.5 billion in savings annually by "Right-sizing" the Government;
3. Generate annual savings in health care spending of \$1.0 billion;
4. Realize approximately \$0.3 billion in annual savings from reduced subsidies to UPR;
5. Reduce approximately 10% in pension costs and related expenses for savings of \$0.2 billion; and



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6. Target \$800 million in available funds for annual debt service.

Consistent with our *Plan Para Puerto Rico*, we note the following responses will be included in our work plan:

1. Increase \$1.5 billion in yearly revenues -
  - a) **We will not increase taxes on the poor and middle class. Instead, where opportune to spark economic growth we intend to reduce such personal income taxes.**
  - b) We seek to establish a comprehensive tax reform.
  - c) We have already achieved a 10-year extension to the 4% excise tax of Act 154-2010.
  - d) We will focus on increased collection rates of existing taxes through increased resources and improved processes and technology.
    - i. We will achieve approximately \$600 million in potential incremental revenues from effective collections of the SUT.
    - ii. Currently, only 89,000 individuals file tax returns reflecting earnings in excess of \$60,000. This represents only 2.5% of the population. A collaboration strategy with the IRS or global experts could help the Government assess the degree of tax evasion faced by the Commonwealth and will form the basis for new compliance strategies.
  - e) As was our commitment, a permits reform will be proposed in the next two weeks.
  - f) We will seek to increase SUT collections and level the playing field with local businesses by collecting taxes on internet retail sales.
  - g) We will approve a new Incentives Code to rationalize tax incentives and only maintain the ones that produce a quantifiable return on investment.
  - h) And we intend to overhaul and modernize municipal property tax and other taxes system to implement projected municipal subsidy reduction.
2. Decrease \$1.5 billion in expenses by “Right-sizing” the Government -
  - a) **We do not agree with a payroll-focused approach to right-sizing government.** As we have detailed in our "Plan Para Puerto Rico", viewing the Government as a single employer can allow us to implement dramatic structural reforms in reducing the size of Government without incurring in massive layoffs that will have a dramatic effect in our economy by preventing growth. If we are granted



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the requested 45-day extension for the certification of the fiscal plan, our team will work together with your advisors to present different scenarios of overhead reduction and reduced government structures that can produce the required savings. Our aim is to reduce the complexity and bureaucracy of the 118 government agencies to a streamlined and efficient 35-40 agency government as part of the 10 year fiscal plan.

- b) We have already issued Executive Orders to reduce operating expenses, including political appointments and professional services.
- c) We have already approved a new AAFAF organic act to provide the oversight and control powers of the fiscal agent over other government agencies and public corporations.
- d) We have already approved a new Public Private Partnerships law to externalize non-essential public services and invest in infrastructure that will drive private and public sector productivity. P3s can be valuable vehicles to reduce the cost and size of government.
- e) We have already filed a Fiscal Sustainability law to extend the savings of Act 66 and contain public sector expense growth.
- f) We have already filed "Single Employer" bill to reduce operating expenses and drive increased attrition rates.
- g) We remain focused on driving down contracting and operational cost of government, which represents more than 50% of expenditures.
- h) And we intend to implement an electronic payments system and consolidate the number of "colecturias" while expanding the number of points of payments.

### 3. Generate annual savings in health care spending of \$1.0 billion -

- a) At all times, our government will be guided by the fundamental principal, that **we will not sacrifice our people's health or access to health services.**
- b) Although additional ACA funding is not contemplated in your baseline assessment, we feel highly confident that we will convince the Congress of the grave challenges that our people will face if not granted parity in Medicaid and Medicare funding. There is no single political leader in the world that would want to be responsible for bearing the weight of endangering the health and wellbeing of 3.5 million of its citizens. A parametric vehicle within the model to consider this change should be implemented, as it could significantly alter the fiscal strategies employed.
- c) However, we do have strategies that can significantly reduce costs, end wasteful processes, and enhance the quality of care:



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- i. Implement a distinction between basic and additional services, which may have patient contributions and empower patient choice.
  - ii. Allow patients to choose providers and services competitively across Puerto Rico.
  - iii. Open competition island-wide for coverage services between insurance companies and accredited providers or cooperatives. This will drive down the competitive costs.
  - iv. Establish drug transparency laws to drive down costs of medicines, as well as our policy to implement a bulk purchaser of medicines based on consumer use in Puerto Rico to reduce costs.
  - v. Implement a new healthcare model that emphasizes preventative care and patient, provider, and insurer accountability.
  - vi. Implement and integrate the various electronic health-records and analytics (STARS Ratings) systems to improve quality of care while reducing operational expenses and fraud, waste, and abuse.
4. Decrease \$300 million in expenses at the University of Puerto Rico -
- a) **We will not limit access to higher education as a key enabler of social mobility and economic development.**
  - b) Intend to take steps to improve the governance of the University system by providing for independent governance of the primary research campuses and specializing the remaining campuses in order for them to remain productive and viable.
  - c) We will implement means-testing of tuition rates for students that do not qualify for Pell grants.
  - d) As part of our novel policy proposals to be incorporated in the fiscal plan, the Government will collaborate with the UPR to provide services that traditionally have been outsourced to the private sector. This will allow a greater flow of funds to the UPR not as subsidies, but as a result of services rendered.
5. Reduce pension benefits by 10% for savings of approximately \$200 million -
- a) At all times, our government will be guided by the fundamental principal that **poverty is not an option for people that have worked tirelessly for the government.** Our government will also implement new policy to bring resources outside of the pension systems to those that may be affected, particularly the elderly.



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- b) We intend to take steps designed to guarantee the sustainability of our public pensions, with particular emphasis on the most vulnerable segments by:
  - i. Reform the various retirement systems, privatizing the defined contribution plans by liquidating the trust fund and transferring the assets to a 401(k) program and honor the defined benefits plans with a PAYGo system.
  - ii. Implement a progressive outlook to pensions by consider certain retirement benefits as taxable ordinary income targeting “Cadillac” pensions.
  - iii. Maintain and/or enhance the more vulnerable of pension recipients, such as police officers and teachers.
  - iv. Already signed amendments to the P3 law to channel a percentage of concession earnings into the pension funds.
  - v. Establish a property trust, where proceeds generated from rent can go to the pension system.
  
- 6. Target \$800 million in annual debt service (average 79% haircut) -
  - a) **We will reflect a fundamental willingness to pay based upon available resources, while satisfying the need for essential services,** adequate funding for public pensions and providing a platform for economic growth, all as required by PROMESA.
  - b) We will continue to negotiate with the various creditor groups in good faith, respecting the rule of law, and based on a transparent and audited baseline. As we have agreed, the Government will lead the good faith negotiations with creditor groups with the Board's collaboration.
  - c) We will respect the priority of payments established in the various credits and we will establish alternative paths for various creditors, including the possible implementation of a mechanism to mitigate losses incurred by local resident investors.

Our goal is to achieve fiscal responsibility through bold, innovative and reformative efforts. These changes need to always have the best interests of the people of Puerto Rico as a top priority. Consistent with our goals, we will also promote and push forward an agenda to reform the education system in Puerto Rico as well as create a department of Public Safety.

Let me take the opportunity to follow up on our petition to recruit human resources from the US Digital Service, as well as other areas such as OMB office personnel and federal procurement and grant writing staff.

Lastly, let me reiterate that without a fundamental growth, these strategies will all fall short. I implore you to be part of the effort to help achieve a federal solution for Puerto Rico. As with your predecessors in the Washington DC board, it is



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imperative to get access to instruments of economic growth, and equal treatment as a State. If history has taught us anything, it is that these instruments will be critical to the overall success of Puerto Rico.

Very truly yours,

A handwritten signature in blue ink, appearing to read "Ricardo Rosselló Nevares".

cc: Members of the Financial Oversight and Management Board