

**FINANCIAL OVERSIGHT AND MANAGEMENT BOARD
FOR PUERTO RICO**



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BY ELECTRONIC MAIL

August 4, 2017

The Honorable Ricardo A. Rosselló Nevares
Governor of Puerto Rico
La Fortaleza
P.O. Box 9020082
San Juan, PR 00902-0082

Dear Governor Rosselló Nevares:

During the certification process of the Commonwealth Fiscal Plan, we agreed that to achieve structural balance and maintain necessary liquidity it was critical to reduce the overall size of government. We also agreed that right-sizing government would include the reduction of subsidies and both personnel and non-personnel measures, to be taken over three years to accomplish an overall 30 percent reduction in general government spending. While we agreed that the current level of government spending was not sustainable and determined the level of savings to be realized, as well as the pace in which savings would be phased-in, we did not agree on the relative distribution of cuts between personnel and non-personnel spending, or on the specific measures that would be implemented to achieve the necessary ongoing savings.

It was with these shared goals that, on March 13, 2017, the Oversight Board delivered to you and the Legislature its certification of the Fiscal Plan subject to the inclusion of two amendments as part of the Fiscal Plan. To ensure savings were achieved, one of those amendments (the “Furlough Amendment”) required the implementation of a furlough program of up to four days per month unless, in the Oversight Board’s sole discretion, the Government met specific requirements relating to liquidity and to development of implementation plans that clearly demonstrate that necessary budget savings would be achieved. The Furlough Amendment related to the target of \$851 million in savings to be achieved through a combination of right-sizing measures that

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included subsidy reductions, as well as reductions to government operations, including personnel-related measures. During the final stages of the budget process, after the Oversight Board certified the Fiscal Plan, the Government agreed with the Oversight Board to increase the \$851 million right-sizing target to \$880 million due to the reallocation of reserves to cover additional agency expenses.

The Furlough Amendment established clear criteria, including a deadline of April 30, 2017, for the submission of required implementation plans for right-sizing measures. The Oversight Board has provided the Government ample opportunities to comply, including extending deadlines, identifying savings strategies for the Government's consideration, and being flexible in the Oversight Board's assessment of implementation plans. Given the considerable work required to achieve the savings targets set forth in the Fiscal Plan over the next three years, and the Oversight Board's responsibility to ensure the Fiscal Plan is implemented – and that implementation occur with all deliberate speed – the Board cannot grant additional delays or flexibility.

It is the Oversight Board's assessment that of the required \$880 million in right-sizing policy measures, the Government has submitted \$662 million in measures, while the remaining \$218 million are unaccounted for in the Government's implementation plans.

The Oversight Board recognizes that the Government has made significant progress in enacting meaningful spending controls to curb Puerto Rico's history of poor fiscal discipline, and in demonstrating a commitment to bringing spending in line with Puerto Rico's dire fiscal reality. The Oversight Board has concluded that the Government submitted a liquidity plan which accounted for the required \$200 million in additional cash reserves by June 30, 2017. Further, the Oversight Board has concluded that the Government has provided enough documentation to reasonably conclude that Puerto Rico will achieve \$441 million in subsidy reductions and \$221 million in other right-sizing measures, which include payroll-related measures, such as reduction in Christmas bonuses, contract eliminations, and operational reductions.

Unfortunately, the Oversight Board is unable to credit any additional savings from the Government's submitted right-sizing measures. The most common deficiency is lack of detail in the implementation plans, which makes it impossible for the Oversight Board to validate a specific savings potential. The Oversight Board also wishes to express particular concern that the submitted implementation plans rely heavily on reducing funding to independent programs and one-off reductions in de facto subsidies, such as the Green Energy Fund, that require minimal operational changes with regard to the way the Government conducts business. Given our experience to date, the Oversight Board believes the Government must redouble its efforts to develop and implement the core operational transformations required to achieve right-sizing targets in future fiscal years. For cost savings to reflect true right-sizing, it should be clear what the Government will either no longer be doing, or will be doing differently, to lead to such savings. Only then can proposed cost savings reflect real changes in the size and operations of government.

The Government must put in place lasting, truly transformative reforms, which will not only reduce the magnitude and duration of the required furlough period, but also set Puerto Rico on course to achieving fiscal balance. Specifically, the Government must urgently:

- Develop a clear plan to reduce, eliminate, or consolidate services and/or entities that are non-essential and pave the way toward a smaller and more efficient overall government.
- Build a transparent, centralized, and high-performing procurement function with capabilities including, but not limited to: identifying the most promising opportunities to reduce spending, analyzing supplier cost structures to support re-negotiation, and identifying ways to reduce and thereafter manage demand from Government consumers of procured goods and services; and
- Develop a sophisticated and centrally run project management capability.

The Government's recent announcement that it intends to implement an Incentivized Transition Program, which could produce significant long-term savings, is a step in the right direction. However, the more critical and necessary work is for the Government to decide the specific services, programs, and departments that will be discontinued, downsized, externalized, or delivered differently. Even under the most optimistic of scenarios, the Incentivized Transition Program will not produce budgetary savings in fiscal year 2018 or necessarily generate savings in future fiscal years. Therefore, the recent announcement does not alter the Oversight Board's conclusion that the furlough program is necessary this fiscal year.

It is therefore the Oversight Board's determination that **the furlough program can be reduced but cannot be repealed, and the Government must plan for and execute a furlough program across the Executive Branch.** The implementation of this furlough program **must result in a net savings of at least \$218 million for fiscal year 2018.** The implementation date of the furlough program is extended to September 1, 2017 to provide sufficient time for the Government to plan its implementation. Additionally, the fiscal year 2018 budget may be revised to reflect these changes, reversing other savings assumed without implementation plans and reflecting the expenditure adjustments resulting from the furlough program.

In light of the significant progress that the Government has made on identifying concrete actions to generate right-sizing savings, we foresee that the furlough program will be reduced to a two-day per month furlough for all Executive Branch government employees, with the exclusion only of front-line police, for fiscal year 2018. This is reduced from the furlough program that the Furlough Amendment had assumed, which was an up to four-day per month furlough. When the Government designs the furlough program, we think it is advisable that it adhere to the following principles:

- Prevent adverse effect on public safety or critical health services;

- Minimize impact on any single Executive Branch government employee, including but not limited to requiring the participation of all Executive Branch government employees, with the only exceptions being those required to satisfy the principle of preserving public safety; and
- Minimize accrued liability of deferred furloughs by establishing strict criteria for any deviation from a standard furlough schedule.

The Oversight Board hereby formally informs the Government that the furlough program required by the Fiscal Plan will remain active until two criteria are met: (1) the required savings of \$218 million have been achieved or are reasonably expected to be achieved based on actual fiscal year to date and projected fiscal year performance; and (2) the Oversight Board determines in its sole discretion that the Government has made material and sufficient progress toward identifying opportunities, developing plans, and beginning to execute the transformational changes required to truly right-size the Government, in the spirit described in this letter.

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Should the Government fail to implement the furlough program as described herein, the Oversight Board intends to pursue all appropriate means to enforce the certified Fiscal Plan, as required by PROMESA. This may include seeking a judicial determination that the furlough program is a binding component of the Fiscal Plan that the Government lacks the authority to disregard.

The Oversight Board adopted the furlough program as an integral, mandatory part of the Fiscal Plan. Section 201(b) of PROMESA requires that a Fiscal Plan “provide a method to achieve fiscal responsibility” and “provide for the elimination of structural deficits.” The Oversight Board and the Government agreed that a key means for achieving fiscal responsibility and eliminating structural deficits was to implement \$851 million (now \$880 million) in right-sizing measures, and that the furlough program was one such right-sizing measure. In formulating the furlough program, the Oversight Board recognized that the Government should have the opportunity to achieve the liquidity and budgetary savings goals set forth in the Fiscal Plan without imposing furloughs, and left the precise details of any furlough program to the Government’s discretion. The Oversight Board did not, however, leave the decision of whether to implement, repeal or reduce the furlough program to the Government. That decision rests solely with the Oversight Board, as laid out in the certified Fiscal Plan.

The Oversight Board believes it is in everyone’s best interest that we avoid litigation because of the cost, delay, and distraction it would entail. Moreover, because any judicial resolution may take time, the required right-sizing savings for fiscal year 2018 would have to be obtained in a much shorter period. This would make the furloughs more painful and disruptive because they may need to be more than two-days per month. The Oversight Board strongly desires to avoid this fate and trusts that the Government does as well.

Honorable Ricardo A. Rosselló Nevares

August 4, 2017

Page 5

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Notwithstanding the beginning of the furlough program on September 1, 2017, we urge reenergized focus to develop measures that will successfully make the Government more efficient, transparent, and fiscally sound, while focusing on efficient delivery of the critical services most required to serve the people of Puerto Rico. The Oversight Board believes that this Government has within its power the ability to take actions to reduce the magnitude and duration of the furloughs program during the course of the fiscal year.

The Oversight Board will continue to carry out its statutory mission under PROMESA for the welfare and future of Puerto Rico. We trust the Government will cooperate in that endeavor by, among other things, complying with the certified Fiscal Plan. As explained in my letter of June 16th, the fiscal situation is dire, and compliance with the Fiscal Plan in its entirety is critical to the Commonwealth's well-being and turnaround.

Sincerely,



José B. Carrión
Chair

Andrew G. Biggs
Carlos M. García
Arthur J. González
José R. González
Ana J. Matosantos
David A. Skeel, Jr.

CC: Natalie A. Jaresko
Christian Sobrino Vega