



Restoring Growth through Fiscal Responsibility

OPENING REMARKS BY
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TO THE 2012 PUERTO RICO CREDIT CONFERENCE
SAN JUAN, PUERTO RICO
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Good morning. And thank you all for coming.

It's truly a pleasure for me to welcome all of you to this "2012 PUERTO RICO CREDIT CONFERENCE: Restoring Growth through Fiscal Responsibility." I'm delighted to once again have this opportunity to greet so many of you...our investors, credit analysts, local and stateside financial industry professionals and all the members of our fiscal and economic team.

I want to thank our Government Development Bank President Juan Carlos Batlle, his entire GDB team, and our entire fiscal and economic team, for putting together this excellent conference. And I want to thank you specially, Juan Carlos, for your leadership and your excellent stewardship of the GDB and our fiscal responsibility agenda over the past 14 months. With you at the helm I know we will continue to be successful in the tasks we still have at hand.

Today, we meet in a fiscal and economic environment quite different...and much more encouraging...than what we had when we held our first credit conference back in 2009.

As all of you are well aware, we have come a long, long way during the past 40 months. We have delivered—and will continue to deliver—on the fiscal and economic reconstruction plan we presented to you and to the People of Puerto Rico from the beginning of our Administration.

As a result, we stand today at a promising new threshold for our Island. The fiscal and economic reforms we've implemented have not only stabilized our government finances, protected and improved our credit rating and restored modest but sustainable economic growth, but are now being considered a roadmap for other states and countries to follow.

In fact, the theme of this year's conference is entirely appropriate...because "Restoring Growth through Fiscal Responsibility" is exactly what we have done in the past three and a half years and, God willing, will continue to do in the years ahead.

So, once again, I would like to take this opportunity to thank you and the entire investment community, both in Puerto Rico and stateside, for staying by our side and believing in our plan and in our ability to deliver on it.

Juan Carlos and the other members of our fiscal and economic team will expound in greater detail on a number of the topics I will touch on only briefly in these opening remarks. But I do appreciate the opportunity to say a few words from my perspective as governor on the progress we have made in such a short time to stabilize our fiscal situation, rebuild our economy and create the conditions for an exciting new period of economic growth. And that you hear directly from me how steadfast we remain in our commitment to finish the job still ahead.

As I'm sure most of you know, when we came into office we faced quite a dismal fiscal picture. Indeed, much worse than we had been led to believe during the transition process.

We had a budget deficit of \$3.3 billion, equivalent to 44% of revenues...at the time, the worse in the Nation. We had a cash flow deficit of some \$4.5 billion—including some \$960 million in checks issued but without funds to cover them—and about \$1 billion in additional payables. In fact, we had to borrow in order to meet our first payroll...which, by the way, our predecessors had increased by a whopping 57% in the previous eight years!

In short, we were on the brink of bankruptcy and on the verge of having our General Obligations (GOs) downgraded to non-investment grade.

Even before taking office, I flew up to New York with my would-be economic and fiscal team to ask the rating agencies for some time in order to put together an emergency fiscal plan. And I committed my word that we would fix the mess we had inherited.

We were then, and continue to be today, very grateful that we got that break. But we were all very much aware of how short the window was. So we put together a plan in record time to reign in expenses, boost revenues and implement sweeping measures to jumpstart our economy.

Three and a half years later, I am proud to report that we have made tremendous progress meeting our goals and remain more committed than ever to continue moving forward, staying the course of fiscal responsibility and economic growth.

Yet, if there's one message I would like you to take away from me this morning is this: we continue as committed to our fiscal stabilization and economic reconstruction plans as we were from day one. Our Administration has already delivered and we expect to continue to deliver impressive results thanks to our fiscal and economic policy. But we still have a lot to do and will not retrench one iota. **OUR FISCAL POLICY IS WORKING AND REMAINS IN PLACE, AND IT WILL REMAIN IN PLACE PRECISELY BECAUSE IT'S WORKING.**

Since we started, we have reduced our budget deficit by 90%, from \$3.3 billion in 2009 to just \$333 million, or 3.8% of revenue, in the budget I just submitted to the Legislature two weeks ago for the fiscal year that starts July 1st, the smallest deficit we've had since 2004. And we will completely eliminate the remaining deficit in the budget that, God willing, we will present for fiscal year 2014.

Although one option would have been to wipe the remaining deficit out completely in the budget for fiscal 2013, we need to be very careful with our economy, now that it's coming slowly out of recession. So we have decided to invest some more resources in it to address public safety, education, health care and infrastructure, rather than forcing a balanced budget prematurely that could derail our efforts to date.

I trust you'll agree that carrying forward such a small deficit for just one more year does not detract one bit from the fiscal discipline we have imposed on ourselves. In fact, in the last four budget cycles, we have reduced government expenses by an impressive 17% and increased revenue by 14% during the same period.

As a matter of fact, for the last four fiscal years—including 2012 about to end June 30—we will have reached our revenue and expense projections almost to the penny...something Puerto Rico hadn't seen since the year 2000.

This, as you know, is quite an accomplishment when compared with our peers in the rest of the Nation, where we see states missing or adjusting revenue estimates during the course of their fiscal years—we have not done that once

since I took office in 2009—not to mention what we are seeing in some countries in Europe.

In the process, we have come a long way in improving transparency and disclosure in order to regain and maintain credibility and market access. That has allowed us to refund and restructure debt, as fully disclosed since 2009, and even access the markets for new money to allow us to invest in infrastructure and stimulate our economy.

We have developed a P3 program that has garnered global praise and has already yielded impressive results, as you will see this afternoon. And have implemented a comprehensive tax reform that has already slashed taxes on individuals by 25% and will cut them by half by 2016. We already cut the top corporate rate from 41 percent to 30 percent, and the previous seven-tier corporate bracket system has been simplified into three lowered rates— 20 percent, 25 percent and 30 percent—and starting in 2014, we are moving toward an even lower top bracket of 25 percent.

All of this, in the midst of deep financial troubles and the longest and deepest recession in our history...against all odds, and against the status quo.

Moreover, effective July 1, 2011, we began to deliver on our pension reform plan. I am the first one to acknowledge the seriousness of the situation of our pension systems and that there is still quite a lot of work to be done. However, I am also the first to tell you, without holding back, that the decisions that had to be made—and that will continue to have to be made—require someone who not only has the understanding and the commitment to make them, but with a team with the experience to execute a plan with a real and permanent solution and within an established timeframe.

Our pension systems have been a major problem for decades. Even back in the 90s when our economy was growing, our budgets were balanced and our GOs had a rating of “A” with a stable outlook, our pension system was in trouble. Back then we took action, closing the Central Government’s system and converting it into a defined contribution system to stop the bleeding. But, obviously, it was not enough.

Unfortunately, a decade went by and nothing was done. Nothing at all.

Many of you may have even questioned why we didn’t tackle this issue at the beginning of my administration together with the fiscal situation. Well, the answer is quite simple, actually. We had to make a choice. We either dealt with the fiscal imbalance we encountered or we dealt with the pension system, but we couldn’t do both. Our economy and our finances were simply too weak to handle both issues at the same time. We decided to stabilize our finances first,

buy time and look for orderly, well thought out and permanent solutions to our pension system situation.

Faced with a dilemma with no easy answer, I'm convinced we made the right decision. Just look around the U.S. and around the world...some states and countries that decided to tackle the pension issue first are now in the middle of a major fiscal crisis that threatens toppling their economies in a downward spiral. And who knows where they will end up.

I'm well aware of the challenge we face regarding the unfunded status and solvency of our pension system and that time is running out. That's why we already took several actions to extend the life of the systems' assets through the early 2020s, and continue to model all of our options to make sure we have the right set of measures to achieve a permanent and orderly solution to the problem.

The Legislature and I have spent a lot of political capital in implementing our fiscal and economic reconstruction plan. And we have been glad to do it, because it was the right thing to do. Many hard and unpopular decisions had to be made. And we made them. Today, I stand here to tell you that I will deliver on the rest of our pension reform plan. But we need a little more time to make sure we can do it. In the same manner that we have delivered on every other front, we will deliver on this one too. We just need a few more months to do it, and we will.

For that to happen, we all share a responsibility in sending the right kind of message—NOT THE WRONG KIND OF MESSAGE—not only to the markets, but to our People, that the measures we've implemented are the right ones and that Puerto Rico is moving in the right direction, not the wrong direction. Otherwise, we risk throwing by the wayside all the enormous progress we have achieved together.

Our economy is clearly showing signs of improvement. In the last 12 to 18 months we've seen principal economic indicators such as retail sales, auto sales, home sales, cement sales, among others, showing a consistent upward trend.

In addition, our pro-growth tax reform has been showing great results, clearly evidenced by improvements in sales and use tax collections and better than expected collections of the special excise tax on foreign corporations, allowing us to leave more of our people's money in their own pockets, rather than us spending it for them.

Then, for the first time in 69 months, the GDB Economic Activity Index moved out of negative territory in December 2011 and has since maintained that trend. In

fact, March was the third month in a row of consistent year-over-year growth in our Economic Activity Index.

Finally, a few weeks ago, our Planning Board had to revise upwards its own economic growth projection for fiscal 2012, pinning it now at 0.9%. IN SHORT, FOR THE YEAR TO END JUNE 30, PUERTO RICO'S ECONOMY WILL HAVE GROWN FOR THE FIRST TIME SINCE 2006. And now the Planning Board estimates that in fiscal year 2013 we will have the most robust growth in eight years.

Our economic recovery will be moderate and gradual, but there's no question that we have put Puerto Rico back on track and on the right direction.

Friends, with our actions, we have together, started to restore the confidence of both investors and consumers. Things are looking up, but we won't stop until we get the job done.

Steadfastly committed to the fiscal responsibility we have embraced, we will continue to restore growth as we look confidently towards a brighter future for Puerto Rico. And continue to look forward to sharing that future with you.

Thank you all very much.