WRITTEN TESTIMONY OF

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before the

House Committee on Natural Resources

PROMESA Implementation during the Coronavirus Pandemic

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Chairman Grijalva, Ranking Member Bishop, and Members of the Committee, I am Natalie Jaresko, Executive Director of the Financial Oversight and Management Board for Puerto Rico (the "Board"). Thank you for this opportunity to update the Committee on the challenges and the work of the Board during the COVID-19 pandemic. As soon as the pandemic hit the Island, the Board began working closely with the Commonwealth to provide the people of Puerto Rico critical support for public health and financial assistance during the crisis. In addition, the Board recently certified an updated 2020 Fiscal Plan which further addresses the needs of residents and the Puerto Rican Government. I would also like to take the opportunity to comment on the "Amendments to PROMESA Act" recently introduced by Chair Grijalva and Members of the Committee.

I. <u>Introduction</u>

To put the Board's work during the pandemic in context, please allow me to start by recounting some of the early work of the Board, as well as our work leading up to the pandemic.

As you know, when the Board began its work, Puerto Rico faced an unsustainable burden of more than $70 billion in debt and more than $50 billion in unfunded pension liabilities, a decade of economic decline, and significant outmigration. In PROMESA, Congress charged us with guiding and overseeing the restoration of the Island's fiscal health via long-term fiscal planning and annual balanced budgeting, the restoration of its ability to access private capital via both debt restructuring and economic development and, as part of that, the Island's transition to a sustainable economic model that provides opportunities for our citizens.

A. The Board's Work in the Aftermath of Hurricanes Irma and María and the Resignation of Governor Rosselló

The pandemic afflicting the Island is not the first disaster Puerto Rico has faced since the adoption of PROMESA. Shortly after the Board got underway, Hurricanes Irma and María inflicted the most horrific natural disaster devastation to strike the U.S. in 100 years, compounding the financial and emotional distress of the Island and its people. As detailed in my testimony before this Committee on November 17, 2017, the Board worked extensively with the Government in post-hurricane efforts. On the day after Hurricane María hit, the Board immediately provided Governor Rosselló authority to reallocate up to $1 billion of the Commonwealth's budget to give the Government flexibility to respond during the first weeks of the crisis. The Board also worked closely with the Governor to help estimate the cash-flow shortfall and need for emergency liquidity assistance caused by the sudden drop in revenues and increase in expenditures. In the two and a half years since, the Board continues to do everything in its power to support the efforts of the Commonwealth and the U.S. Government to provide critical disaster relief funding to the Island and its residents.

The subsequent political upheaval around the resignation of Governor Rosselló was unfortunate and very disruptive to the Government and the people of Puerto Rico. The Oversight Board watched the protests with admiration for the fortitude of the people of Puerto Rico and with sadness for the crisis that made the protests necessary. For far too long the Island's residents have not been treated with the respect that they deserve. However, it did not deter the Board from carrying out its obligations under PROMESA. The Board continued to work with the leaders of Puerto Rico to provide its people with the stability needed by all stakeholders. Since Governor Wanda Vázquez Garced took office last August, the Board has engaged in a collaborative working relationship with the Governor and her team. In many respects, the increase in collaboration and engagement is a night and day difference as compared with previous Governors and their respective staffs.

B. Board's Work Leading up to COVID-19

I think it is helpful to recap next the Board's progress leading up to the pandemic, which represents the culmination of our work from the start. In furtherance of PROMESA's mandates, the Board had taken the following steps:

- **Section 201(b)(1) Budgetary controls and fiscal discipline:** Implemented best practices budgetary controls and constraints on Government spending to avoid previous overspending practices. Given the absence of audited financial statements and previous spending practices, prior multi-year appropriations are suspended with few exceptions. Total Government spending must now be reviewed and certified. All tax initiatives must have a neutral or positive budgetary impact, and all expenses and revenue must be conservatively estimated.

- **Section 201(b)(1) PayGo Pension System:** Moved to a PayGo pension system allowing retirees to receive their pensions without interruption, despite the insolvency of Puerto Rico's pension funds, and enrolled police officers in Social Security to increase their security and retirement benefits.

- **Section 202(e) Ensuring critical services:** The Board-certified budgets carefully balance the need to maintain funding for critical services commensurate with the size of the population and prioritize critical services such as education, public safety, and healthcare. These include (1) funding of $200 million a year to support increased labor participation; (2) funding for safe kits to insure proper forensic analysis and long-await justice for victims and the accused; (3) pay increases for teachers and police to ensure more competitive compensation; (4) funding new positions for Forensics to rebuild capacity; (5) funding to repay ten years of back pay to police officers; (6) creating a reserve account to ensure the ability to act to protect the population immediately in case of future emergencies; (7) budgeted funds to cover any cost-share required for federal disaster funding; (8) funding to enable compliance with certain consent decrees; (9) budgeting $400 million annually in

Commonwealth capital expenditures to improve significantly underfunded infrastructure; and (10) over $300 million in needs-based scholarships for University of Puerto Rico students.

Without the Board and associated fiscal plans, projections show that Government spending would have ballooned from $19 billion in fiscal year 2018 to $22 billion in fiscal year 2025 (an increase of 16%). The Board, meanwhile, has contained expenditures to a 2% increase between fiscal year 2018 to fiscal year 2025, or up 12% on a per-capita basis (given the decline in population), while providing valuable investments in frontline services (in the wake of multiple crises).

- **Section 204(b) Transparency and accountability in government spending:** Fostered more transparency and visibility into Puerto Rico's government finances, including Puerto Rico's liquidity, budgets, and other intergovernmental spending – notwithstanding the Government's continued delays in completing its overdue audited financial statements. Moreover, the people of Puerto Rico now have access to public reports, including: bank balances, quarterly budget to actuals, payroll and attendance, and tax expenditures.

- **Section 204(b) Contract Review:** The Board reviews major contracts before they can be ratified to ensure both consistency with the certified fiscal plans and budgets, as well as to ensure they promote market competition. This process has brought much-needed transparency, with all responses and analyses posted in the Board's website.

Since the inception of PROMESA, the Board has played a critical role in helping Puerto Rico respond to crises. Moreover, it has worked with the Government to institute much more effective fiscal management after decades of mismanagement. The fiscal plans that the Board has certified have walked a very prudent balance between driving more effective and sustainable Government, while investing in critical needs on the Island. Lastly, the Board has articulated a detailed and comprehensive roadmap of the actions that must be taken to restore growth through economic development, with structural reforms being particularly critical. However, given the constraints of PROMESA, the Board must rely upon the political will of the Island's elected leadership in order to truly transform the Government of Puerto Rico and the economic landscape into what the people and businesses of Puerto Rico deserve.

II. COVID-19 and the Preceding Earthquakes

Before I address the Board's work with the Government during the public health pandemic, I would like to update you on the earthquakes that shook Puerto Rico about six months ago. Beginning in late December, these were the most intense earthquakes on the Island in recent memory, causing structural damage to buildings across southwestern Puerto Rico. Residents of these communities were subjected to hundreds of aftershocks over several months, some approaching the strength of the first earthquakes. Communities face concerns over public safety as infrastructure was affected, businesses suffered further disruption, and the Government suffered damage to schools, prisons and other crucial infrastructure. The full extent of the damage is still unknown, and rebuilding efforts in some places have yet to begin.

Only two months later, Puerto Rico – along with the rest of the world – was confronted with the COVID-19 pandemic. Overnight, the economy shut down except for the most critical activities, as the Government took prudent steps to mitigate the risk of a catastrophic public health crisis. The Government acted promptly and decisively by implementing a curfew, limiting entry to points to the Island monitored by the National Guard, and shutting down virtually the entire economy to enforce social distancing.

At the onset of the COVID-19 crisis and prior to the adoption of the CARES Act, the Board in close partnership with the Government, mobilized to deliver immediate support and relief to residents. This included providing a $787 million package of measures including, among other things, (1) hazard pay for front-line workers of $213 million; (2) direct payments to residents of $160 million including a $500 one-time cash payment to 20,000 self-employed individuals and a $1,500 one-time cash payment to 40,000 small businesses; (3) essential supplies and equipment of $50 million; (4) distance learning equipment in the public education system of $255 million; (5) assistance in the face of lost revenues for municipalities of $100 million; and (6) funding of research and development of $2 million at UPR's Medical Sciences Department.

The Board also supported Government executive actions to provide temporary relief on tax payment deadlines, as well as to authorize more than $50 million in sales and use taxes exemptions for prepared foods and first-necessity items. The Board further approved and supported a $400 million advance on federal funding for economic rebate payments administered by the local Treasury Department, as well as a liquidity facility of up to $185 million for municipalities suffering from revenue collection deferrals.

The Board also provided the Government with recommendations on how to effectively disburse the $2.2 billion allocated to Puerto Rico through the *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) to finance eligible unbudgeted expenses related to the pandemic in a way that is targeted to the most critical pandemic-related needs.

Since certifying its first Fiscal Plan in 2017, notwithstanding the intervening emergencies, the Board has been able to drive meaningful progress in creating a more affordable Government. This has resulted in the ability of the Government to increase expenditures at a time of crisis, while ensuring that total expenditure levels remain within total available revenues. Puerto Rico was not forced to make urgent and drastic cuts to its expenditures and essential services as revenues dropped, as other states had to do. Moreover, budgeting practices introduced by the Board enabled setting aside an Emergency Reserve Fund to mitigate and contain COVID-19, as well as provide immediate support after the earthquakes.

However, it cannot be denied that there have also been several setbacks. The situation caused by the Commonwealth's procurement of COVID-19 test kits shows that the Government gets easily trapped in its own poor procurement practices despite best intentions. Additionally, complications in ensuring the distribution of school lunches and the slow distribution of payments to front-line workers and unemployed workers illustrates the challenges to efficient implementation. The good news is the economy is slowly reopening, and hospital capacity remains ample, suggesting that the virus might be contained.

Nonetheless, the shock of the COVID-19 pandemic on Puerto Rico is severe. Unemployment has skyrocketed, as many businesses have been forced to shut down, and local and federal governments have quickly mobilized to provide support. Many projections indicate the economic shock due to COVID-19 will be worse than that of the Great Recession. The pathway to economic recovery remains highly dependent on the overall public health response and the federal Government's ability to provide economic support for those whose livelihoods are at risk.

The Board's analysis shows that the Puerto Rico economy will contract by 4.0% in the current 2020 fiscal year. Financially, the impact to the Puerto Rican economy is as devastating as the impact of Hurricane María. There is a sharp decline in real GNP with a very mild projected recovery of 0.5% in the 2021 fiscal year, with the help of COVID-19-related federal funds from the CARES Act, CDBG-DR, and other federal programs. To illustrate, we estimate a revenue reduction of $1.3 billion in current fiscal year 2020, $1.2 billion in fiscal year 2021, and $774 million in fiscal year 2022, relative to the 2019 Certified Fiscal Plan.

Our projections show further declines in real GNP in fiscal years 2022 and 2023, and close to zero growth in 2024 and 2025. Simply put, the Puerto Rico economy will contract over the next five years, and Puerto Rico can only recover if the Government implements the necessary structural reforms. These reforms are more important than ever because the economic decline is even more severe.

III. <u>2020 Commonwealth Fiscal Plan</u>

The Board spent the last months analyzing the effects of the COVID-19 pandemic on the Puerto Rican economy and the path to recovery in times of uncertainty. Based on careful study of the data, in particular, Congressional Budget Office data, the Board believes its certified 2020 Fiscal Plan is the best possible forecast under the current circumstances.

The 2020 Fiscal Plan is a road map for Puerto Rico's recovery and prosperity. It outlines necessary Government action to improve fiscal responsibility and foster economic growth. The effect of the destructive hurricanes, political upheaval, earthquakes and COVID-19 on the economy is severe and is exacerbated by the lack of structural reform implementation necessary to improve economic growth in Puerto Rico. With the ongoing support of the U.S. Government, this crisis presents an opportunity to redouble all efforts to reform the economy for the benefit of the people of Puerto Rico.

In that spirit, the 2020 Fiscal Plan requires commitment to swift implementation of an agenda that will transform government services. The 2020 Fiscal Plan reflects a one-year delay in most categories of budgetary reductions to allow the Government to focus on implementation. This pause in rightsizing includes maintaining the subsidies to the University of Puerto Rico and the municipalities at current fiscal year levels. Most agencies will maintain their fiscal year 2020 budgets in fiscal year 2021.

A. Investments

The 2020 Fiscal Plan includes substantial investments in the Government's response to the COVID-19 public health and economic crisis, as well as critical investment in the Island's human capital and telecommunications infrastructure to spur recovery and growth. It continues several investments outlined in the 2019 Fiscal Plan and provides new substantial investments of about $6 billion in fiscal years 2020 through 2025. Some examples include investments in: (1) healthcare, including capital expenditures for public hospitals, hiring public school nurses, funding for opioid treatment, and increased reimbursement rates for primary care and outpatient specialty providers; (2) public education, including to improve English language teaching, to incentivize schools to achieve better educational outcomes, and payment of disputed salary increases to transitory teachers; (3) public safety, including the third and final year of back pay for police, the second half of their 30% salary increase, funding for recruitment and training of cadets, and equipment for firefighters; (4) technology, to improve access to broadband in rural areas and increase business training; (5) a study for the private sector and the Government to define a comprehensive and actionable plan to reactivate the manufacturing sector; and (6) hurricane reconstruction to expedite efforts by providing $750 million in working capital to kick-off project work.

B. Financial Projections

As mentioned, the 2020 Fiscal Plan is based on the Board's projection that the Puerto Rico economy will contract by 4.0% in the 2020 fiscal year, with a mild 0.5% recovery in the 2021 fiscal year, dependent upon the support of federal funds related to COVID-19, and recent hurricanes and earthquakes. However, even with complete and timely implementation of all structural reforms outlined in the 2020 Fiscal Plan, the Board projects that the economy of Puerto Rico will contract over the next five years, with meager economic growth in some years.

The 2020 Fiscal Plan projects a Government deficit from fiscal year 2032 onward, six years sooner than the Board's 2019 Fiscal Plan projected, and a total primary surplus of about $8 billion between fiscal years 2020 and 2032, compared with an approximate $23 billion surplus projected in the 2019 Fiscal Plan. That amounts to a 65% decline in projected surplus.

Estimates of federal funding in the 2020 Fiscal Plan include: (1) hurricane-related funds amounting to $83 billion of disaster relief funding to be disbursed over 15 years, of which $48 billion is estimated to come from FEMA, $8 billion to come from private and business insurance pay outs, $7 billion to come from other sources of federal funding, and $20 billion to come from CDBG-DR; (2) earthquake-related funds amounting to $595 million from FEMA; and (3) COVID-19 related funds amounting to $14 billion based on U.S. Government sources, federal agency announcements, and past allocations under ARRA of 2009.

Given the Board's projections, we consider it imperative that the Government use the next year to implement critical, overdue structural reforms. The 2020 Fiscal Plan continues to require an agenda of Government transformation to efficiency, and outlines the minimal reforms needed to change the structural nature of the Puerto Rican economy. It requires commitment to swift implementation of an agenda that will transform the Government and the economic landscape.

C. Structural Reforms

Since 2017, the Board has worked with the Government to implement numerous structural reforms, but there has been little meaningful progress in most areas. The structural reforms in the 2020 Fiscal Plan are those where the Government has aligned with the need to pursue change. Nonetheless, each year, as a result of disasters and poor implementation, the reforms have been delayed. As such, the 2020 Fiscal Plan provides an updated forecast reflecting such delays but also outlining the potential positive impact looking forward, specifically:

- **Human capital and welfare reform***:* Promoting participation in the formal labor force by creating incentives to work through Earned Income Tax Credit (EITC) benefits and Nutritional Assistance Program (NAP) reform, as well as providing comprehensive workforce development opportunities.

- **K-12 education reform***:* Transforming the K-12 education system to dramatically improve student outcomes and contribute to an effective workforce long- term.

- **Ease of doing business reform***:* Improving the competitiveness and attractiveness of Puerto Rico's economy in order to attract a greater amount of investment and job creation. Promoting economic activity and reducing the obstacles to starting and sustaining a business in Puerto Rico. This includes comprehensive reform to permitting, registering property, and tax administration. Establishing best-in-class entities that can attract investment and increase tourism.

- **Power sector reform***:* Providing lower cost and more reliable energy through: (1) the transformation of PREPA; (2) the establishment of an independent, expert, and well-funded energy regulator; and (3) the development of cleaner and lower cost power generation.

- **Infrastructure reform***:* Prioritizing economically transformative capital investments with federal funds available as a result of recent disasters and on a regular basis from annual obligations, for example from the Federal Highway Administration.

- **Strengthening Puerto Rico's technology sector.** Addressing the digital divide is critical to ensuring that all residents of Puerto Rico can take advantage of the well-documented socioeconomic benefits afforded by Internet connections (e.g., telehealth, distance learning, remote work). Important infrastructure gaps remain, particularly across rural areas of the Island. The 2020 Fiscal Plan includes $400 million to expand access to broadband for the residents of Puerto Rico, thereby improving economic opportunities for those in rural areas. The 2020 Fiscal Plan also recognizes that technology skills are critical for the future of the workforce; it thus includes $50 million in funding to invest in workforce development, specifically focused on business- and technology-related disciplines.

D. Government Efficiency

Finally, the main measures in the 2020 Fiscal Plan aimed at efficiency and cost reduction, some of which have not been implemented since the 2018 Fiscal Plan, include: (1) agency efficiencies; (2) creation of the Office of the CFO; (3) Medicaid reform; (4) enhanced tax compliance and optimized taxes and fees; (5) reduction of appropriations; and (6) comprehensive pension reform.

Without the need to achieve incremental budget savings, the Government should focus all its efforts in fiscal year 2021 on real changes across the Government that assure better delivery of essential services. In that light, the 2020 Fiscal Plan outlines key reforms for the Department of Education, Department of Health, Department of Public Safety, Department of Corrections and Rehabilitation, and Department of Economic Development. These reforms focus on improving implementation, increasing efficiency, and consolidating regional and similar offices.

To drive implementation of key reforms and outcomes, the 2020 Fiscal Plan introduces milestone budgeting, which will allow for investments in certain areas once key milestones are met. Milestone budgeting is introduced because urgent action is necessary to support the broader reform journey for particular agencies. Crucial milestones and incentives include for the: (1) Employee Retirement System to finalize establishment of defined contribution accounts for public retirees and employees; (2) Department of Treasury to issue the 2017 Comprehensive Audited Financial Report, draft the 2018 Comprehensive Audited Financial report, and develop an ERP system; (3) Department of Education to implement attendance reporting, school scorecards, and digitalization of Special Education Individualized Education Programs; and (4) Department of Economic Development and Commerce to publish regularly in a transparent manner economic incentives provided to businesses and associated returns.

E. Implementation is Key to Puerto Rico's Success

Unfortunately, Governments have failed to achieve meaningful economic growth through structural reforms or drive operational change that would deliver greater responsiveness and efficiency of government services. Efforts at private sector labor market reforms have stalled and the impact of human capital and welfare reform is not expected for several years. The Government's efforts to improve the ease of doing business have not changed the burden on businesses in any meaningful way.

To date, Government agencies have reduced expenditures but generally not in an effective fashion, as included in the certified fiscal plans. Rather than achieving budget savings by improving the way services are delivered or discontinuing duplicative or unimportant services, the Government has enacted broad-based early retirement programs to reduce headcount, creating major gaps in capabilities and functionality and potentially putting services at risk. Agencies should rethink their business processes and priorities, instead of relying on attrition and voluntary transition programs.

Across many areas, the Government has struggled to implement changes, with even new investments often not driving the intended use. For example, salary raises provided for teachers were improperly implemented, bringing new litigation costs, while police officers' enrollment in Social Security was delayed by six months. Despite efforts by members of the Government, the Board, and the Federal Government – which has increased oversight over federal funds, installed federal monitors in certain agencies, and managed expectations via consent decrees – the Government has been unable to meet the increasingly urgent need for real change.

The 2020 Fiscal Plan includes dozens of practical actions that the Government must take to create a more accountable, affordable, and transparent government, with resources focused on improving the front-line services that matter. Given the global COVID-19 pandemic, the 2020 Fiscal Plan pauses most government right-sizing measures for a year, so that the full focus of Government may focus on recovery and implementation.

Implementing the structural reforms and fiscal measures included in the 2020 Fiscal Plan fully on a timely basis will enable the Island to achieve low-cost and reliable energy, robust infrastructure, greater labor participation, an improved regulatory and permitting environment, and a more effective and efficient public sector. That said, these reforms are insufficient to return the Island to prosperity, nor do they allow Puerto Rico to avoid future deficits, which begin again in fiscal year 2032. Thus, in the near future, the Government will be required to take incremental measures, such as improving labor market flexibility through repealing restrictive laws and pursuing meaningful tax reform to broaden the base of collection and lower rates. These incremental structural reforms go beyond the five-year framework of this 2020 Fiscal Plan and are required to return the Island to prosperity. Many of these reforms – which would reduce deficits and therefore make funds available for a variety of potential uses, most importantly to invest in the people of Puerto Rico – have been proposed by the Board, but the Board cannot implement them without the support of Puerto Rico's elected Government.

IV. <u>Debt Restructuring</u>

To date, the Board has: (1) developed and the District Court has confirmed a Title III Plan of Adjustment for COFINA; (2) authorized and the District Court has confirmed a Title VI Plan of Adjustment for GDB; and (3) supported a nearly $1 billion loan restructuring agreement for PRASA with EPA and USDA.

The Board proposed an amended Plan of Adjustment (the "Plan") in February 2020 to restructure $35 billion of debt and other claims against the Commonwealth of Puerto Rico, the Public Building Authority, and the Employee Retirement System, and more than $50 billion of pension liabilities. The Plan significantly reduces $35 billion in debt liabilities to $11 billion, or about 70%, and ensures that almost 75% of current and future pensioners are not cut. The Plan also provides predictability to public employees via updated collective bargaining agreements and restores over $1.3 billion of withheld employee contributions to Sistema 2000.

The Plan has been supported by the Official Committee of Retirees representing retired government employees, current government employees represented by the Public Service Union as the Puerto Rico chapter of AFSCME, and the Lawful Constitutional Debt Coalition, a group of investors and funds holding Puerto Rico's general obligation bonds and PBA bonds. The Board also has been seeking broader active public employee support and feedback, including from teachers represented by the Puerto Rico chapter of AFT.

The Board's Special Investigations Committee hired the law firm Kobre & Kim to provide a complete, independent review of the Government's debt, ultimately receiving a comprehensive investigative report. Following on Kobre & Kim's findings, the Board undertook review of potential infirmities of debt issued by Puerto Rico and its various agencies and instrumentalities. Through its Special Claims Committee, the Board objected to the validity of over $11 billion of general obligations bonds and filed several hundred complaints against entities to recover their payment related to issuance of that debt. That committee also filed complaints against over 20 banks, law firms and other parties to recover fees earned in issuance of nearly $9 billion in bonds.

Given the considerable uncertainty about the effect of COVID-19 on Puerto Rico, however, the Board continues to believe that the primary focus of the Government and the Board should be to minimize and contain the pandemic. Furthermore, even with implementation of far reaching growth-inducing structural reforms, the 2020 Fiscal Plan projects that the Government cannot afford to pay the public debt as originally contracted.

Recognizing the importance of the ongoing Title III cases, but taking into account these realities, on March 23 the Board presented a motion requesting the Title III court to adjourn consideration of the proposed Plan of Adjustment's disclosure statement hearing until further notice. The amended proposed Plan of Adjustment, presented to the Court on February 28, 2020, is now on hold and the next status report is due on July 15. As to PREPA, the Board and the Government filed a motion seeking to adjourn the hearing and all deadlines related to the PREPA restructuring support agreement Rule 9019 motion. On May 15, the Board and the Government provided a required update, stating that all briefing and hearing deadlines relating to the 9019 motion should continue to be adjourned.

V. <u>Municipalities</u>

On April 15, 2020, the District Court held invalid and unenforceable Puerto Rico Act 29-2019, which had eliminated the municipalities' obligation to reimburse the Commonwealth for hundreds of millions of dollars in pension and health care cost for their own retirees. Contrary to what some mayors have said, the reversal of Act 29-2019 is not expected to have a significant impact on municipalities' finances in the near term. The repeal of Act 29-2019 represents a deficit of 3% of the total municipalities' budgets for fiscal year 2020, and the Board outlined a process for municipalities to repay these fiscal year 2020 obligations from incremental unbudgeted revenues, thus not affecting municipalities' operating budgets.

Better budgetary practices, reduction of expenses through consolidation or shared-services arrangements and increased own-revenue streams should help municipalities remain sustainable for the benefit of the people of Puerto Rico. Moreover, a new partnership model between the Government and municipalities needs to be developed in order to deliver important services. That is why the Board is working with Mayors to develop potential solutions, as well as with the Municipal Revenue Collection Center ("CRIM" by its acronym in Spanish) on initiatives aimed at modernizing and improving the management of the property tax system and increasing the collection rate of such taxes. In addition, the Board is directly working with ten municipalities to assist them with cost reduction and economic development measures. Further, and as explained earlier, the Commonwealth's 2020 Fiscal Plan maintains the level of support to the municipalities for the next fiscal year at the same amount as in fiscal year 2020. Moreover, the 2020 Fiscal Plan provides an annual fund of $22 million during the next five fiscal years (for a total of $110 million) to incentivize municipalities that achieve cost savings through cost sharing or consolidation of services.

As a result of the extension of time granted to taxpayers for filing their personal property tax returns from May to August 2020, CRIM is facing a cash shortfall that has affected its ability to make the monthly remittances of May through August to the municipalities. To assist with this situation, the Board approved a Commonwealth liquidity facility for CRIM of up to $185 million to help with monthly remittances through July 2020. To date, CRIM has not accepted the terms of the liquidity facility.

VI. Transformation of PREPA

The Board continues to work with Government on the transformation of PREPA to ensure reliable energy for the residents, more effective and efficient management, and lower fuel costs.

This transformation is important to every individual, every business, and every potential investor. The people of Puerto Rico deserve a power system that can withstand hurricanes to ensure they are safe in their homes, and Puerto Rico's businesses deserve to open every day without relying on back-up generators to ensure they can serve their customers. Puerto Rico deserves manufacturing and service industry jobs created by investors who don't turn away because its electric power system is unreliable and antiquated.

The Board and the Government are in full agreement that private generation and private management of the transmission and distribution system are key to these improvements. The Board is working with the Government on the pending public private partnership process for selection of a private transmission and distribution operator and strongly supports the Government's efforts to secure FEMA funding to help with the cost of restoration and reconstruction of an affordable, resilient, and reliable power system that is environmentally compliant and that serves as a driver of economic growth. Selection of this operator and securing this federal funding are critical next steps in the modernization of PREPA and increased economic development on the Island.

VII. United States Government Matters

A. Supreme Court Decision

On June 1, 2020, the United States Supreme Court issued a unanimous decision that will allow the Members of the Board and the Board to continue their work under PROMESA. The Supreme Court confirmed that PROMESA established the Board as an entity within the Government of Puerto Rico and that the process for selecting and approving members of the Oversight Board without Senate confirmation does not violate the Constitution's Appointments Clause.

B. Amendments to PROMESA Act

I appreciate the opportunity to now comment on the Amendments to PROMESA Act recently introduced by Chair Grijalva and Members of the Committee.

As mentioned in my October 22, 2019 testimony on an earlier version of this proposed legislation, the Board has serious concerns that several of these provisions, while well-intended, will substantially hamper its ability to effectively negotiate settlement of claims at this very critical juncture in implementation of PROMESA. Moreover,

- The Board supports the legislative proposal of Rep. Velázquez in the bill to extend the disclosure requirements of the Federal Rules of Bankruptcy Procedure to professionals employed by the Board, court, or debtor to avoid conflicts of interest and its goal of greater transparency and disclosure. The proposal, however, needs to be interpreted or altered in a manner allowing its practical implementation. It currently requires disclosures of each professional's connections with all creditors, and in the Puerto Rico Title III cases over 165,000 creditors filed proofs of claim.

- The provision for a GAO report on expenditures and operation of the Board is understandable, and the Board looks forward to working with Congress on the details.

- The provision allowing the Legislature of Puerto Rico to cancel some of its unsecured financial debt will lead existing Puerto Rico bondholders to demand secured debt during ongoing negotiations, which is more expensive and restrictive than the unsecured debt. Moreover, this provision could render the issuance of future municipal debt in Puerto Rico and throughout the United States more expensive, and will cause purchasers of new debt to require that it be secured debt in all instances. The new discharge provision is also likely not to inspire creditor trust and confidence because no court is involved in the discharge accomplished by the Legislature and Governor. The Board's legal advisors also believe the criteria for the application of this new discharge may only allow Puerto Rico to qualify, in which case the statute will be subject to constitutional challenge as not being a uniform bankruptcy law. Additionally, the constitutionality of discharging the unsecured financial debt for nothing, while other debt is paid, will be challenged. It may well be that these new provisions will be upheld because they are being enacted under the Territories Clause, and not expressly the Bankruptcy Clause, but that too will be litigated.

- The proposed definition of essential public services specifies that public education, public safety, healthcare, and pensions are "essential public services", with the ostensible purpose to ensure their funding in the certified Fiscal Plan to the maximum extent possible. The Board believes that this provision could have the exact opposite effect, as it provides ammunition to those who have been arguing that the Board cannot fund services above and beyond their own highly restrictive interpretation as to what services are truly essential. The Board is facing this claim in Title III cases filed by creditors, who would welcome Congressional support for an essential service definition that could be used to advance their argument. The result could be substantially reduced funding for services that the Board and the Government consider essential but that other parties strongly believe otherwise.

- The prescribed funding for operation of UPR significantly expanding and locking in an $800 million annual allocation to UPR makes efficient and effective operation of the Commonwealth substantially more difficult and delays any strengthening or diversification of UPR's revenue base. To put it in context, an $800 allocation represents 70-80% of UPR's total budget, versus a 20-30% average for U.S. public universities. It is also diverts resources away from the critical services funded by the Commonwealth budget.

- The provision expanding the definition of investments for economic growth is consistent with the Certified Fiscal Plan and Budget. The plan and budget already include specific investments both in structural reform implementation and in the economic development tools necessary to reduce poverty, increase labor participation, attract quality jobs to the Island, expand workforce development programs – all leading to increased economic growth.

- The Board agrees with the importance of avoiding conflicts of interest. The proposed language on prevention of conflicts of interest as to the Board, however, significantly reduces the number and quality of people who can be Board members or Executive Director, which makes the Board far less effective at performing its critically important role and Congressional mandate to help improve Puerto Rico. The section further severely reduces the amount on which the Board can rely for legal, financial, economic, and operations external advisors, which strongly impairs the Board's ability to effectively defend Puerto Rico in court against creditors.

- The initiation of federal funding for operation of the Board and Title III could well lead to a new constitutional challenge to the Board's appointment without Senate consent. Moreover, it significantly limits the ability of the Board to determine how much money it needs to invest, research, and implement the critically important Title III work. It also makes the process harder, riskier for the Board, Puerto Rico, and the U.S. Government. Currently, the Title III fees are reviewed by the Title III Court and a fee examiner it appointed. That part of the system has worked well. If the federal funding is insufficient, then the Board would not have the financial resources to defend against the attempts of secured and unsecured creditors to obtain judgments awarding them Puerto Rico's various revenue streams. To date, the Board has been sued over one hundred times by creditors, and cannot afford to run short of funds to defend.

- The bill provides that any document, record, or information relating to the public debt of the Commonwealth of Puerto Rico is a public document and accessible to any interested party. Making public any document relating to the negotiations or restructuring of the public debt would be prejudicial and detrimental to the Board's effort to effectively and expeditiously secure the best debt deal possible for Puerto Rico and its people.

- In connection with the new disclosure obligations, the new provision for assessing attorneys' fees is problematic because it may deter highly qualified individuals from serving as Board members. Furthermore, it contradicts PROMESA's insulation of the Board and its staff from liabilities and obligations for acts undertaken in carrying out PROMESA.

- The section creating a Puerto Rico Public Credit Comprehensive Audit Commission disregards and duplicates the work of the Board almost two years ago based on the over 600-page Investigative Report prepared by Kobre & Kim. That independent report effectively served the purpose of a debt audit. The Board's Special Claims Committee is pursuing valid claims arising out of that report (subject to a stay on some of the proceedings), and the Debt Management Policy in the 2019 Fiscal Plan is designed to make sure these issues do not arise again.

The Board remains committed to working with the Chairman, the Ranking Member, and other Members of the Committee and the Congress as you continue oversight over implementation of PROMESA and consider any changes to the law.

C. Legislation Expanding Manufacturing

The Board was established by law to create the conditions for fiscal responsibility in Puerto Rico and restore access to capital markets. One element of this mandate has been to take opportunities to support the Government of Puerto Rico in its efforts to pursue prudent actions to promote economic stability and create the conditions for growth.

In this context, the Board wrote to the U.S. President and Congressional leadership on March 18 stating that if federal policymakers consider actions to require increased manufacturing within the U.S., the Board strongly believes that Puerto Rico is a center of excellence within the nation and can play a leading role in the national portfolio of locations where this manufacturing re-locates. The physical infrastructure, human capital, and regulatory processes are already established and well positioned. Moreover, this is a valuable opportunity to expand investment, jobs, and ultimately prosperity on the Island.

We acknowledge there are a number of policy considerations that would need to be discussed. Should policymakers pursue actions to require additional manufacturing in the United States, we respectfully encourage proactive dialogue between the Government of Puerto Rico and federal policymakers to find mutually acceptable solutions to these issues. It is in this spirit that the Board will conduct a comprehensive study to update the facts and acquire the knowledge necessary for the private sector and the Government to define a comprehensive and actionable plan to reactivate the manufacturing sector in Puerto Rico. The Board would be proud for Puerto Rico to play a leading role in bolstering our national security and stand ready to assist however we can.

D. Legislation Supporting Puerto Rico

Finally, the Board continues to support legislative efforts of Chairman Grijalva, Ranking Member Bishop, Puerto Rico Resident Commissioner González-Colón, Representative Velázquez, Representative Soto, and many Members of this Committee and Congress to provide equitable distribution of federal funding and other federal programs for Puerto Rico.

For example, the Board continues to support the Government's request to receive equitable treatment in Medicaid and Medicare. Residents of Puerto Rico pay the same level of Medicare taxes as mainland residents, but the Island receives substantially lower payments. Moreover, the Board is supportive of Congressional action to provide enable Puerto Rico to participate in the federal Earned Income Tax Credit program, which would bolster Puerto Rico's own local Earned Income Tax Credit and create an even more powerful incentive to bring more workers into the Commonwealth's formal labor market. Likewise, the Board supports legislation that provides funding to extend the federal Child Tax Credit to more families with children in the Commonwealth. The Board also supports Governor Vázquez Garced's request to authorize Puerto Rico to participate in the Pandemic Electronic Benefits Transfer program created by the *Families First Coronavirus Response Act*, to ensure children on the Island have access to critically needed nutritional assistance benefits.

VIII. Conclusion

PROMESA is not perfect, but it has provided Puerto Rico with the protection of a stay on its debt payments while continuing to fund essential services. The compromise between both sides of the aisle to provide the Island with a novel mechanism to restructure its debt under a bipartisan Board allowed the Government to prevent complete chaos in 2016 when the debts became unpayable.

The fiscal planning and budgeting discipline spearheaded by the Board since its first certified fiscal plan has in fact allowed Puerto Rico to be resilient and strong, with the ability to respond with concrete actions to extraordinary natural disasters and the COVID-19 pandemic. The savings measures have been successful in driving some meaningful progress in rightsizing the Government and enabled it to immediately provide fiscal stimulus and economic support to those affected by the COVID-19 measures. Unlike other local governments in the United States, Puerto Rico was not forced to respond to lost revenues with urgent and drastic cuts to its expenditures and essential services. In fact, next year's budget will be higher than the current budget, unlike most U.S. states, in part to respond to the need for fiscal stimulus and economic growth drivers.

Since we began working with Governor Vázquez Garced, we have engaged in a collaborative working relationship. We must clarify, however, change can be hard. In accordance Section 405(m)(4) Congress' own finding states: "a comprehensive approach to fiscal, management and structural problems and adjustments that exempts no part of the Government of Puerto Rico is necessary, involving independent oversight." While we will *always* collaborate in the best interest of the people of Puerto Rico, it is in this same interest that sometimes the Board must disagree with the Government and utilize the tools in PROMESA to further its mandate. Simply stated, all efforts should be on implementing the reforms that the people of Puerto Rico need and deserve.

Since 2016, the Board has been carefully executing its mandate in law. The fact that both sides – creditors and politicians – have material disagreements with the Board means something. The Board is doing its job and PROMESA is working. As stated earlier, the Board has serious concerns that several of the proposed amendments to PROMESA, while well-intended, will substantially hamper its ability to effectively negotiate settlement of claims at this very critical juncture in implementation of the law. These amendments should not become a distraction from the real work we all have to do.

The Board appreciates this Committee's invitation to provide an updated on the status of the implementation of PROMESA and will continue to follow the path outlined in law to ensure Puerto Rico returns to fiscal responsibility and the capital markets.