The importance of structural reforms in the updated Fiscal Plan

December 5th, 2017

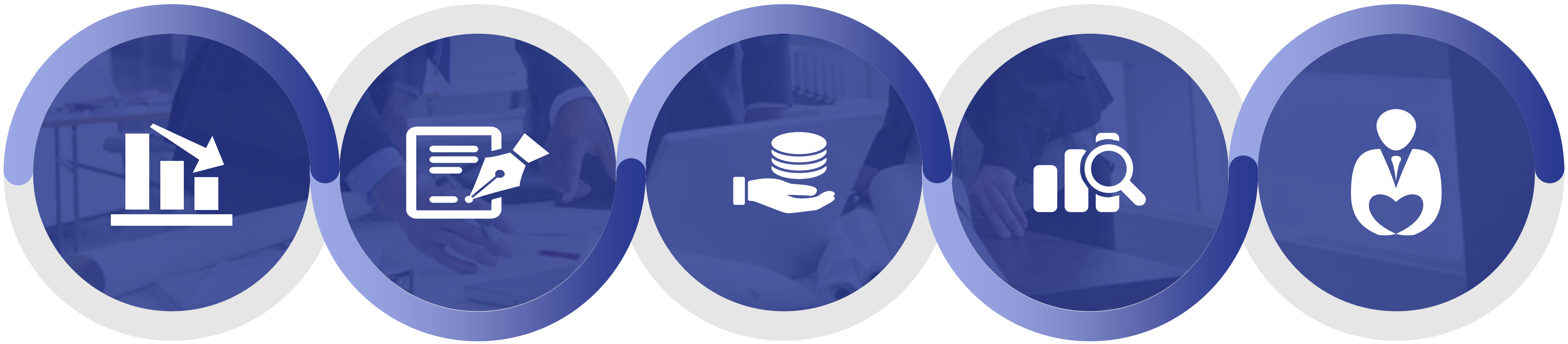
The Board will look for certain key principles to be followed when certifying the Feb 2 fiscal plan

Principles

1. Reflect updated macro & demographic trends	Reflect current demographic & macroeconomic trends, federal disaster funding, and implied size of government
2. Use five year timeline	Cover five fiscal years (FY18 to FY22)
3. Reflect scenarios of potential federal recovery funding	Plan should reflect a variety of scenarios of federal recovery funding, including one assuming no additional federal support beyond that which is established by law
4. Provide emergency response efforts & metrics	Include resources / metrics for immediate emergency response and recovery effort
5. Prioritize structural reforms	Prioritize structural reforms necessary to improve the business climate
6. Provide cap ex plan focused on long term recovery	Provide capital expenditure plan that offers basis for a long-term economic recovery plan, including focus on critical infrastructure
7. Achieve consolidated audited financial statements	Complete FY15 CW audited financial statements by December 31, 2017, and FY16/FY17 by June 30, 2018 (and thereafter, six months after FY end)
8. Achieve structural balance by FY22	Structural balance should be achieved as soon as possible and no later than FY22 (after taking into account time to stabilize post humanitarian crisis)
9. Include debt sustainability analysis	Include long-term debt sustainability analysis (DSA) and detailed economic projections over 30 year period

To get to a revised Fiscal Plan, there are five key steps

Focus for today



Understand the impacts of the hurricane on the macroeconomic outlook

Integrate macroeconomic drivers to develop new revenue and expense projections

Adapt fiscal measures based on feasibility and recovery timeline

Determine the opportunity for structural reforms to drive long-term economic growth

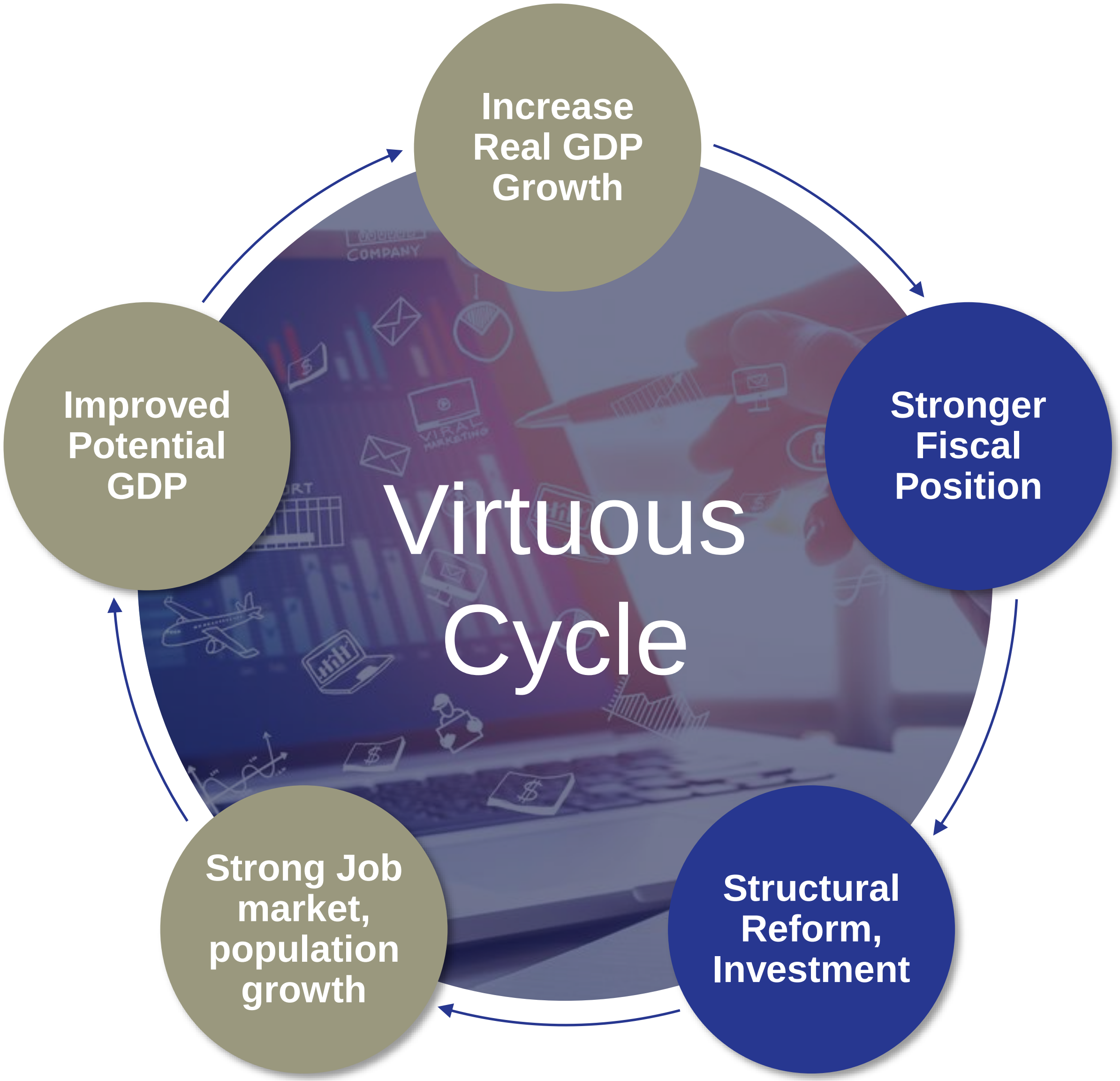
Integrate recovery funds and reimbursement timing with capital plan

Global examples of disasters provide context for the potential devastation Puerto Rico may face in the wake of a fiscal crisis and major storm event

Key characteristics	Major crises	Relevance to Puerto Rico
Deep fiscal crisis	**Greece Debt Crisis**	▪ Faced with debt crisis, with similar **fiscal and monetary constraints** given currency union ▪ Emigration **doubled from 2010 to 2012, and ~60% had post-graduate degrees**
	Ireland Debt Crisis	▪ Saw financial losses comparable to Greece, and has a similar GNP to GDP ratio as Puerto Rico ▪ **Irish citizens lost more wealth per person** (18,000 Euros), than any other country in Europe during the financial crisis mainly due to **significant losses in property values**
	US Great Recession	▪ The most devastating financial crisis since the Great Depression ▪ Significant long-term economic impacts. For example**, immigration and labor force participation fell far below projected trends**
Unprecedented and damaging storm	**New Orleans Hurricane Katrina**	▪ One of the most devastating and costly storms in American history ▪ About 5 years after Katrina, **~25% of households had never returned to New Orleans**
	Haiti Earthquake	▪ 2010 earthquake destroyed several regions ▪ 1.5 million people were displaced immediately, and **6 years later over 55,000 of those people remained displaced**
	Grenada Hurricane Ivan	▪ Saw major loss of life and damages exceeding 2x its GDP in 2004 ▪ World Bank project to rebuild the island's critical infrastructure (power grid, hospitals, and schools) **was not completed until 2009, a full 5 years after the hurricane**

SOURCE: London School of Economics, NBER, NIST

As a result, post Maria, structural reforms are an even more important part of Puerto Rico's plan to bring fiscal balance and prosperity



There are six major areas of structural reform the Fiscal Plan should consider

Implement Private Sector Labor Reform

Incentivize formal employment by reforming welfare benefits
Reduce employment cost

Promote Job Creation and FDI

Generate new jobs by attracting FDI and developing sector plans to promote economic development, e.g., tourism

Enable Capital Efficiency

Expedite processes to obtain permits
Enable public and private investment in infrastructure for long-term growth

Reform Power Sector

Reduce and stabilize energy prices through promoting competition, resiliency and transforming key utilities

Increase Competition

Institute corporate tax reform
Allow more competition among businesses, and more economic activity

Improve Government Processes and Talent

Reduce transaction costs and modernize processes

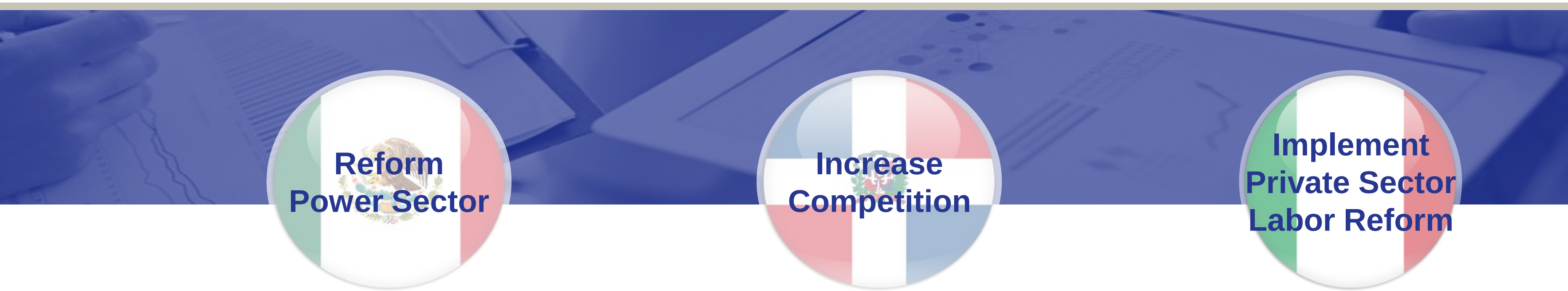
Increase employment per capita

Improve capital productivity

Enable and support market efficiency

Economic growth

There are several economies who have taken advantage of structural reforms post-crisis to drive major economic change and growth



Example	**Mexico**	**The Dominican Republic**	**Italy**
Structural efforts	Invested $244 million to improve performance: ▪ Modernized equipment and substations ▪ Implemented real-time power outage monitoring ▪ Created a geographic information system to predict the impact of natural disasters on the power grid, and prepare accordingly	Created an Initiative for National Productivity and Competitiveness with variety of efforts: ▪ Legal reforms to facilitate business creation ▪ Digital platform for import and export processes ▪ Changes in corporate tax structure ▪ More aggressive quality control procedures	Introduced a Jobs Act which: ▪ Reduced recruitment costs for firms ▪ Added conditionality for unemployment benefits ▪ Made tax deductions to promote female labor force participation ▪ Lessened stringent employment protections
Impact	Decreased yearly outages from 7.33 hours in 2010 to 55 minutes by 2014	Moved from 80th (2013) to 66th (2017) in WEF Global Competitiveness Index	Predicted to add 2.4% to GDP over the next 10 years

There are several economies who have taken advantage of structural reforms post-crisis to drive major economic change and growth (cont.)

Example	**New Orleans**	**Ukraine**	**Mauritius**
Structural efforts	To improve employment outcomes, enacted significant education reforms: ▪ Promoted school choice and charter schooling ▪ Eliminated attendance zones for schools ▪ Diminished local and state agencies' roles in education	Transformed its public procurement process: ▪ Mandated the use of an electronic procurement system ▪ Made government officials disclose financial interests ▪ Promoted the use of open data in procurement process	Instituted dozens of property reforms such as: ▪ Digitized land records over time ▪ Reduced property registration fee and related licensing charges ▪ Eliminated a property transfer tax between parties
Impact	Graduation rates rose from 54% in 2004 to 73% in 2015	Increased the number of unique suppliers by ~300%	Reduced registration time from 210 days to 14 days