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**Letter from Secretary Lew to the Puerto Rico Financial Oversight and Management Board**

**By: Dan Watson**

11/18/2016

​This week, ​Secretary Lew sent the following letter to the Puerto Rico Financial Oversight and Management Board regarding Puerto Rico's fiscal and economic crisis:

November 16, 2016

The Honorable José B. Carrión III

Chairman

Financial Oversight and Management Board for Puerto Rico

Dear Mr. Carrión:

I write in response to your letter dated October 29, 2016, requesting the U.S. Treasury Department’s assessment of the Fiscal Plan proposed by the Commonwealth of Puerto Rico. The Commonwealth submitted its proposed Plan to the Financial Oversight and Management Board for Puerto Rico (Board) on October 14, 2016.

***Actions Taken to Date***

First, I commend the actions taken by the Board to advance the process established by the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA).  This critical legislation has provided Puerto Rico with the time and tools necessary to promote recovery from the ongoing fiscal and economic crisis.  I am pleased that the Board has begun its important work, including holding two meetings, planning its third meeting in Puerto Rico, and requesting stakeholder input on the Commonwealth’s proposed Fiscal Plan.  In addition, the Board’s decision to require coverage of all Commonwealth-level entities in the proposed Fiscal Plan represents an appropriate, holistic approach to the crisis.  Furthermore, I am pleased that the Board has adopted bylaws with transparency provisions to facilitate public oversight of its work.

For its part, the Commonwealth has moved quickly to fulfill its responsibilities under PROMESA.  I commend the Governor for his timely submission of the Commonwealth’s proposed Fiscal Plan, which is now under review by the Board and a broad base of stakeholders.

While these actions are encouraging, more remains to be done.  Time is of the essence.  The Board and the Commonwealth must act with urgency to carry out their responsibilities as outlined in PROMESA.  We urge the Board and Commonwealth to work together quickly to certify a Fiscal Plan.  This is a vital next step in order to allow the commencement of restructuring negotiations with creditors.

***Fiscal Plan Assessment***

You asked for our assessment of the proposed Fiscal Plan, which we have undertaken with the benefit of Treasury’s experience with economic crises across the world.  In that context, I believe that PROMESA’s 14 Fiscal Plan requirements, together with the comprehensive approach that the Board has taken to cover all tax-supported entities in the proposed Plan, provide a credible framework to guide the Commonwealth’s policy choices.  In particular, I highlight several important lessons learned that can be applied to Puerto Rico’s fiscal planning:

1.Achieve a sustainable debt level:  A credible debt restructuring is necessary to remove the overhang of uncertainty on the economy, and to create breathing space for Puerto Rico to implement growth-enhancing reforms.  Conversely, the absence of a credible debt restructuring will lead to excessive reliance on fiscal austerity that proves self-defeating to growth and debt sustainability.  The proposed Fiscal Plan does not include a formal debt sustainability analysis, although one must be included in the certified Fiscal Plan as required by the PROMESA legislation.

2. Do not unduly rely on fiscal austerity: As we have emphasized from the beginning of Puerto Rico’s crisis, austerity alone is a self-defeating remedy.  In the aftermath of an economic crisis, fiscal discipline is often necessary but, during an extended period of economic contraction, there are limits to the scale and pace of budget cuts and tax increases that can be achieved without further damaging growth.  Given this reality, the proposed Fiscal Plan’s adequate funding for vulnerable constituencies and the delivery of essential services are both critical.  In addition to providing support to the economy, these efforts can also help to curb outmigration and preserve the tax base, both vital to stabilizing fiscal balances and lifting GDP over the medium-term.

3.Lay the foundation for sustainable and broad-based growth: Sustainable economic recoveries require an appropriate balance of fiscal stimulus in the short-term to lift confidence and investment, coupled with efforts to promote growth potential over the medium-term.  The latter effort should include a well-sequenced agenda of structural measures and governance controls that attract capital back to the Island.  Puerto Rico must make it easier to do business, increase workforce participation, and create the conditions that will allow Puerto Rico to compete in the global economy.  As a general matter, the Commonwealth’s proposed Plan recognizes the need for stimulus and reforms to improve growth outcomes.  Additional detail and clarity on the proposed measures would allow for a more thorough assessment of their feasibility and potential impact on growth.

4. Assume realistic macroeconomic projections: Credible macroeconomic assumptions are essential underpinnings of any successful plan.  In other recent debt crises, overly ambitious growth assumptions often did not materialize as forecasted.  These assumptions led to insufficient debt restructuring at the outset and eventually resulted in successive rounds of growth-reducing fiscal austerity.

The proposed Plan’s macroeconomic projections, with respect to both real growth and inflation, are higher than levels that have been realized in Puerto Rico in more than a decade.  The plan that is ultimately certified by the Board should include an analysis of downside risks to growth so as to avoid the material risk of overstating the amount of debt that can be sustained by the economy’s future performance.

5. Work with Congress to enact urgently needed legislation:The Commonwealth and Congress must work together to resolve Puerto Rico’s long-standing structural healthcare inequities and strengthen incentives to promote economic development on the Island.  The projected exhaustion of Affordable Care Act (ACA) funds in early 2018 will materially reduce the Commonwealth’s revenues and impair access to health care for up to 900,000 Americans living in Puerto Rico.  The Treasury Department also strongly supports federal legislation that would give Puerto Rico healthcare parity with the states and pro-growth tax measures such as the Earned Income Tax Credit (EITC).

***Continued Swift Action is Paramount to Resolving the Crisis in a Timely Manner***

While PROMESA’s automatic stay provides breathing room for the Board’s deliberation of numerous outstanding issues, its February 15, 2017 expiration is quickly approaching.  The Board should make maximum use of the powers given to it by Congress to pursue consensual negotiations and, if unsuccessful, Title III filings before the stay’s expiration.

Timely certification of the Fiscal Plan will promote voluntary negotiations and should be the Board’s top priority; additionally, prompt certification of a fiscal plan will also permit Puerto Rico to begin its annual legislative budgeting process.

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Resolving the crisis in Puerto Rico remains a top priority for the Treasury Department.  We will continue to provide the Board with any technical assistance necessary to assist it in this endeavor.  In that regard, we would be pleased to discuss directly with the Board more specific assessments of the proposed Plan at its convenience.

                                                                                    Sincerely,

                                                                                    Jacob J. Lew

cc:        The Honorable Carlos García

            The Honorable Andrew Biggs

            The Honorable Ana Matosantos

            The Honorable Jose Ramón González

            The Honorable David Skeel

            The Honorable Arthur González

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