



COMMONWEALTH OF PUERTO RICO  
**FISCAL UPDATE**

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## BUDGET TO CORRECT STRUCTURAL DEFICIT IMBALANCE PRESENTED

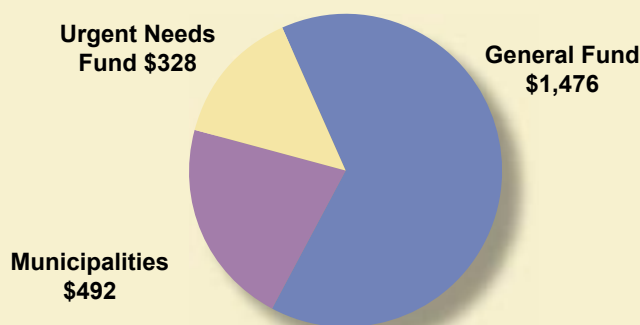
### First Time Ever Expenditures Unchanged from Prior Year

The Governor of Puerto Rico on April 3, 2006 presented to the Legislature a balanced general fund budget of \$9.68 billion for the fiscal year beginning July 1, 2006 that calls for:

- No increase over the previous year's expenditures,
- A broad-based, 7 percent sales tax,
- Elimination of the structural deficit in three years, and
- Maintaining the credit quality of the Government's outstanding balance of \$15.1 billion in bonds.

Governor Aníbal Acevedo-Vilá made it clear that previously proposed tax and fiscal reform measures, including the 7 percent sales tax, must be enacted for the fiscal 2007 budget to work. A bi-partisan group of mayors has thrown their considerable support behind the 7 percent sales tax.

**How 7% Sales Tax Will Be Allocated  
(\$in Millions)**



*The sales tax is estimated to generate \$2.3 billion annually and to be allocated as follows:*

- 4.5 percent, or \$1.48 billion, would be applied to the general fund to cover Government expenditures and eliminate the structural deficit in fiscal 2009,
- 1.5 percent, or \$492 million, would be earmarked for municipalities, and
- 1.0 percent, or \$328 million, would be designated for a new "urgent needs fund," first proposed by Speaker of the House, Jose Aponte. This fund would pay down 80 percent of the outstanding Commonwealth appropriation debt of approximately \$6.3 billion, which consists of appropriation bonds (PFC) and loans advanced by the Government Development Bank to various agencies. The \$6.3 billion is expected to be refinanced into a 30-year loan.

*In addition to generating revenue to cover Government expenditures, the tax is viewed as a means for achieving:*

- Important tax relief for middle income tax payers,
- A fairer tax structure for Puerto Rico, including elimination of a 6.6 percent excise tax, and
- Countering income tax evasion.



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*As matters currently stand, the Government will require approximately \$400 million to cover the current year's budget deficit.*

- The funds could come from a loan by the Government Development Bank, but first the Legislature would have to enact a measure authorizing the financing, and GDB's Board of Directors would have to approve it.
- However, GDB policy is that all financings must have an identified source of repayment for its approval. In this case, the Legislature adopting tax reform and the 7 percent sales tax would provide a source of repayment, enabling the GDB Board to be able to authorize the financing. Nonetheless, meeting interest payments on outstanding General Obligation debt has a Constitutional priority over any other expenditure, including wages.
- Both the presidents of the House and Senate are aware of the Government's fiscal situation and budget deficit, and have expressed that their chambers will take appropriate measures.

*The Governor's budget proposal was praised by Alfredo Salazar, Chairman and Interim President of GDB.*

- "The proposal is consistent with the understanding reached November 2005 between the Government and the Legislature on a program of fiscal and tax reform, to deal with the Commonwealth's structural deficit and prevent downgrading of Puerto Rico bonds by the credit agencies," Mr. Salazar said.
- Mr. Salazar concluded, "In light of an expanding economy and rising tourism, by adopting this budget, Puerto Rico has an opportunity to show the financial markets our commitment to financial and fiscal responsibility for the good of all our people."

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