Fiscal Situation Update

CENTER FOR THE NEW ECONOMY
CENTRO PARA LA NUEVA ECONOMIA

To: Restoring Growth Partners
Re: Use of Non Recurring Revenues
7 May 2007

Fiscal Year 2008 General Fund Budget

The proposed budget for fiscal year 2008 contains several items of non-recurring revenues that are being used to patch-up an expected shortfall. Among these we find:

- *Emergency Fund Deposit* – Act 91 of June 21, 1966 established the Emergency Fund. This fund is a reserve account to be used to cover unforeseen expenses resulting from hurricanes, earthquakes, droughts, floods and other similar events. The law states that this fund shall be capitalized in an amount equal to 1% of the previous fiscal year's general fund revenues but in no event shall the fund's balance exceed $150 million. This means that for fiscal year 2008 the budgetary fund should receive a deposit of $86.19 million. The governor, however, has presented a bill to exempt the administration from making that deposit this fiscal year. Instead the governor proposes to make a deposit of only $8 million into the Emergency Fund this fiscal year. The proposed bill also states that the OMB director can draw on $150 million credit line from the GDB in the event of any emergency and therefore the Emergency Fund is essentially redundant. The effect of the bill, if enacted, would be to liberate about **$78 million** to cover operating expenses.

- *Budgetary Fund Deposit* – Act 147 of June 18, 1980 created the Budgetary Fund. This fund is essentially a reserve account to be used whenever funds are not sufficient to (i) cover legislated budgetary allocations or (ii) pay the public debt. According to that law, the Budgetary Fund shall be capitalized every year in an amount not less than 1% of the previous fiscal year's general fund revenues and not greater than 6% of the amount allocated by the budgetary joint resolution for the fiscal year in which the deposit is going to be made. This means that for the next fiscal year the budgetary fund should receive a deposit of no less than $86.19 million and no greater than $334.96 million. The governor, however, has presented a bill to exempt the administration from making that deposit this fiscal year. The effect of the bill, if enacted, would be to liberate **$86 million** to cover operating expenses.

- *Sale of Idle Government Property* – The Governor also announced a program to sell idle government property, mostly old *Fomento* buildings and vacated schools. We believe this initiative is not likely to raise a significant amount of revenues because it will probably generate intense political opposition. In addition, we must question the wisdom of selling government assets to finance operating expenditures. Usually when a business enterprise sells assets it is for strategic reasons or for investment purposes, not to finance current expenses. The government expects to raise **$150 million** from these sales.

- *Use of Children Trust Fund* – During budget hearings last week administration officials disclosed that they are expecting to use approximately **$200 million** from the Children's Trust Fund to cover operating expenses. This trust fund receives annual payments made by the tobacco companies as part of their settlement of a large class action suit brought by several states and territories, including Puerto Rico. The Trust has issued bonds, the proceeds of which have been used by the government of Puerto Rico for various purposes. The bonds, in turn, are paid with the annual receipts from the tobacco companies.
- *CFC Payments* – According to the Treasury Department many former 936 companies that currently operate in Puerto Rico as Controlled Foreign Corporation (CFCs) owe it money that was supposed to have been paid upon conversion to that status. According to the Treasury Secretary, the Puerto Rico Department of the Treasury found about this liability when the IRS informed Hacienda of the results of its audits of CFCs operating in Puerto Rico. If these payments are made, Hacienda expects to realize **$300 million** in non-recurring revenues.

In conclusion, the proposed budget contains **$814 million** in non-recurring revenues that will have to be replaced next year. The breakdown of these funds is as follows:

- $78 million which were supposed to be deposited in the Emergency Fund;
- $86 million which were supposed to be deposited in the Budgetary Fund;
- $150 million from the sale of idle properties;
- $200 million from the Children's Trust Fund; and
- $300 million "owed" by the CFCs to Hacienda.