Unfair!
The Treatment and Economic Condition of the U.S. Territories

The five territories of the United States are treated unfairly. The result: low income levels, high poverty rates, and poor to terrible economic growth. The U.S. government could allocate its spending more fairly and establish fair tax policies to greatly improve economic conditions. The territories themselves have no voice in U.S. affairs, no power to make significant change. Action must come from the Congress and the President. They must put the territories on a level playing field with the states. Indeed, inaction, could lead to a worsening of economic conditions, which, in turn, could ultimately generate social conflict and political instability.

The Five Territories and Their Status

The United States has five territories: American Samoa; Guam; the Northern Mariana Islands; Puerto Rico; and the U.S. Virgin Islands. Puerto Rico is by far the most populated and largest of the territories, with 91% of the territories' people and 85% of the land area. Puerto Rico, Guam, the U.S. Virgin Islands, and the Northern Mariana Islands are now considered "part of the United States," and persons born in these territories automatically become U.S. citizens (as is the case with persons born in any of the states or the District of Columbia). Persons born in American Samoa, however, are considered "U.S. nationals," but are not U.S. citizens. Citizenship for residents of territories is not full citizenship in the sense that they are not able to vote in U.S. national elections. Thus they cannot vote in presidential elections and they do not elect members of congress. Moreover, while they do elect their own local governments, these governments are constrained by the U.S. Constitution and U.S. laws (enacted by a congress in which the people in the territories have no voting representatives), and are ultimately under the authority of U.S. courts. (If citizen residents of the territories move to and establish residence in one of the states, however, they can vote and hold office like any other citizen.)[*]

Economic and Social Condition

In all five territories, income levels are low, poverty rates are high and economic conditions are not improving—and in some cases have been seriously deteriorating:

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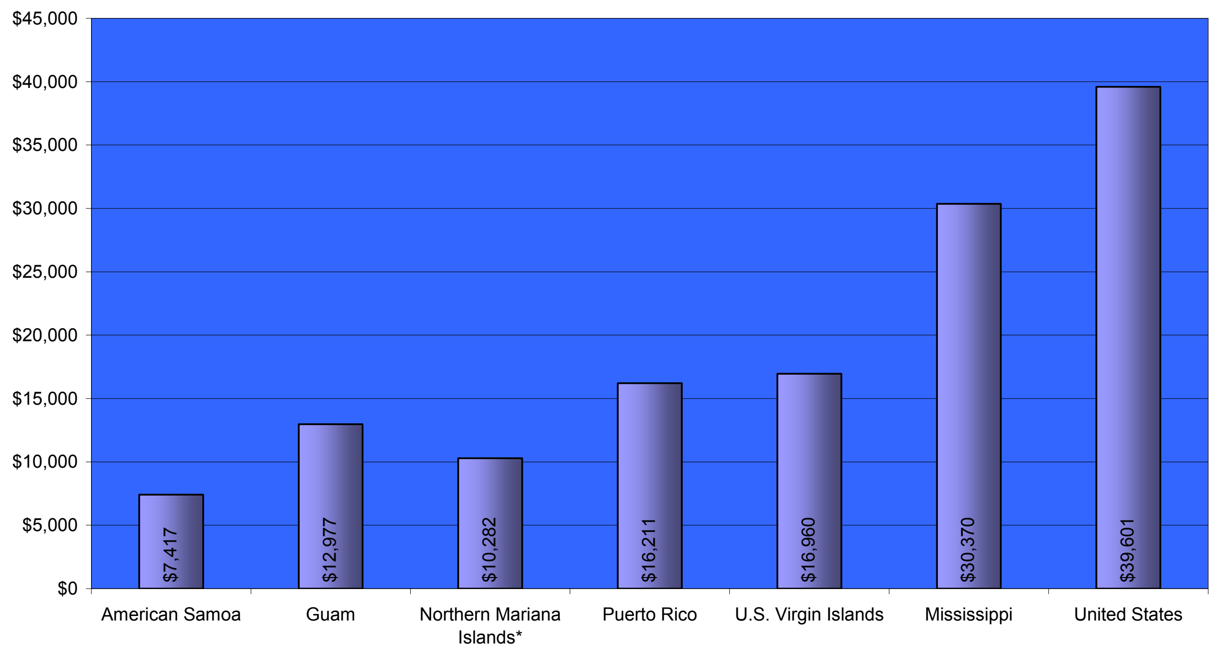
[*] In addition to these five territories, the U.S. holds nine island territories that have no permanent populations. A U.S. national can carry a U.S. passport and can enter and reside in the states without restriction. Nationals cannot vote in U.S. elections or hold U.S. political office. Citizens residing in the other U.S. territories also cannot vote in U.S. elections (for the president or members of Congress). If they move to and establish residency in one of the states, however, they can vote and hold office like any other citizen. Thus, for virtually all practical purposes, there is no difference between being a U.S. national resident of American Samoa and a U.S. citizen resident of one of the other four territories; the difference with regard to full political participation arises only when a person shifts residency to one of the states. If one then views residents of the other territories as "second class citizens," residents of American Samoa might be viewed as "third class."

Poverty

- Each of the territories has a level of *per capita personal income* less than half that of the United States, far less in some cases. Income in the territories is not even close to that of Mississippi, the lowest per capita income state. (See Figure 1.)

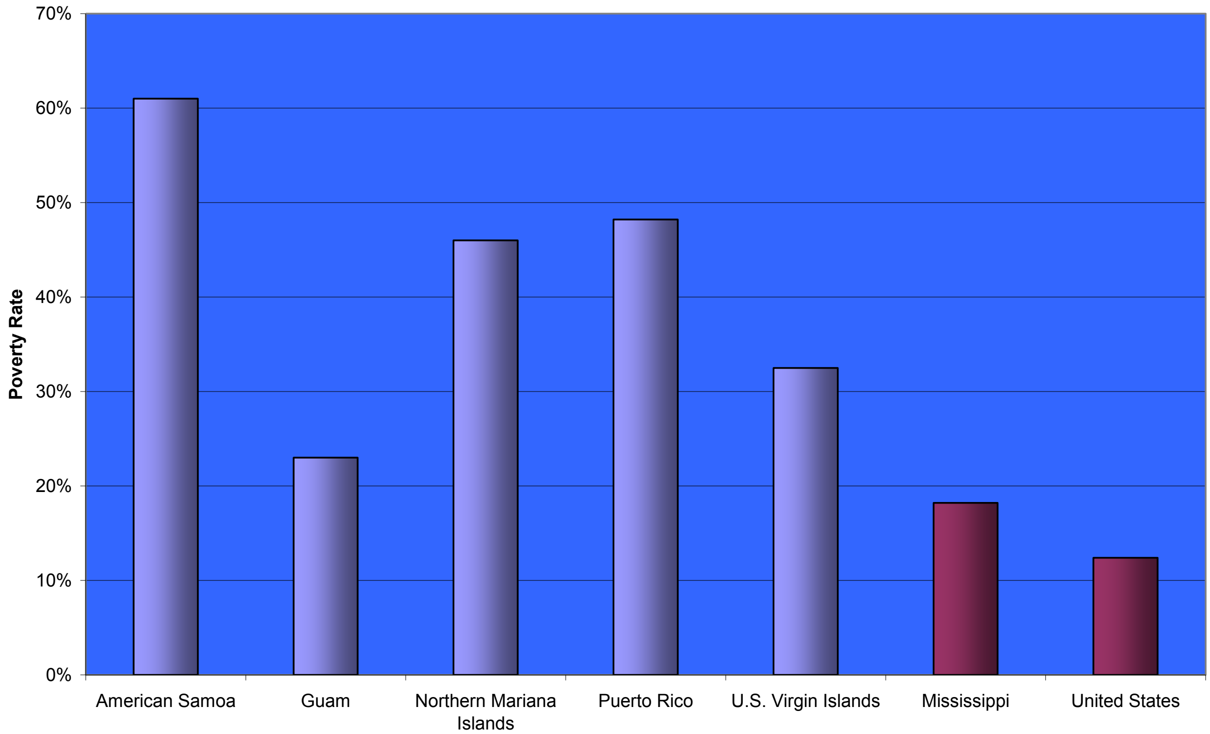
- Data for 1999 reveal *poverty rates* for each of the territories as substantially higher than the rates for any of the states. (More recent figures are not available, except for Puerto Rico.) Guam's poverty rate of 23% was the lowest among the territories, but was twice as high as the rate for the states and 25% higher than that of Mississippi, the state with the highest poverty rate. In the other territories, the poverty rates were: American Samoa, 61%; the Northern Marianas, 46%; Puerto Rico, 48%; and the U.S. Virgin Islands, 33%. (See Figure 2.) Furthermore, these poverty rates would be substantially higher if the cost of living in the territories were taken into account. According to estimates of the U.S. Office of Personnel Management, the cost of living in Guam, the Northern Marianas, and the Virgin Islands is 25% higher than in Washington, D.C., and is 14% higher in Puerto Rico. (No figure is computed for American Samoa.)

Figure 1: Personal Income Per Capita in the US Territories, Mississippi, and the United States, 2009



* A very crude, rough estimate

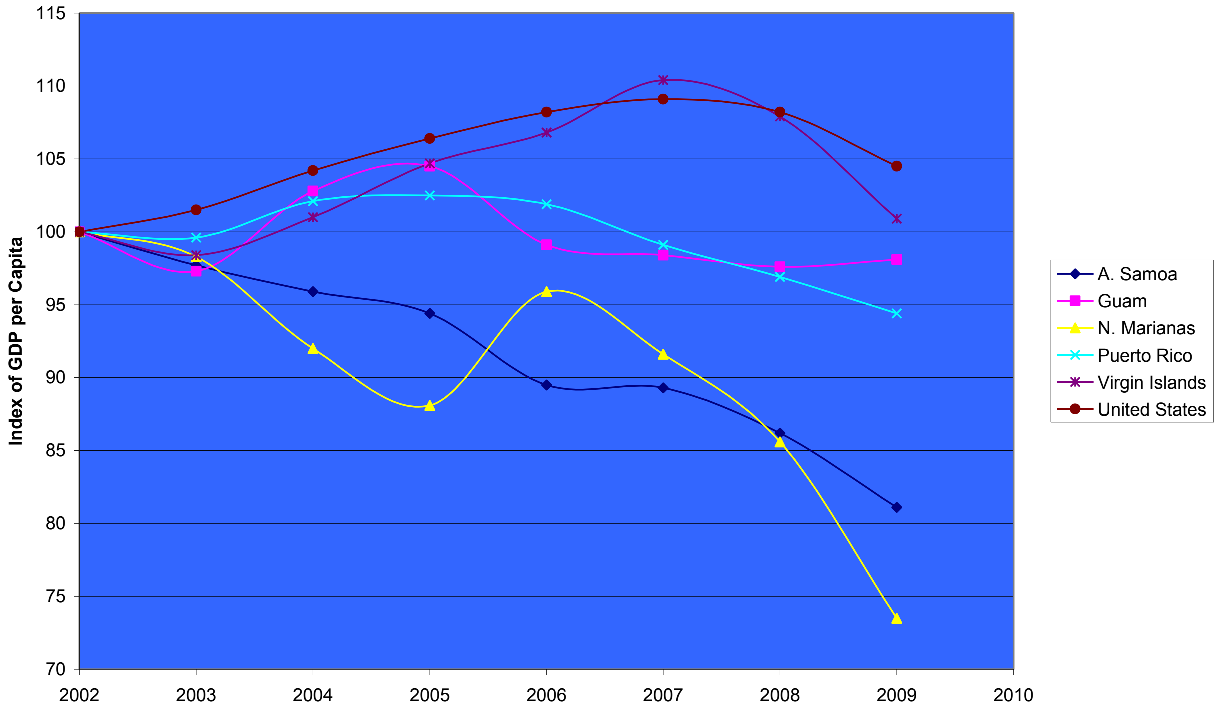
Figure 2: Poverty Rates in the U.S. Territories, Mississippi, and the United States, 1999



Economic Performance

- During the most recent decade, none of the territories has done well in terms of economic growth and some have done very badly. Even while the U.S. economy was doing poorly, and actually in recession in 2009, the economies of the territories were doing worse. Under these circumstances, the idea that they would somehow "catch up" with the states seems a mythical delusion. Only in the U.S. Virgin Islands was inflation-adjusted GDP per capita higher in 2009 than in 2002—but by only 0.9%. The other territories saw declines in GDP per capita in this period, from 1.9% in Guam and 5.6% in Puerto Rico to 18.9% in American Samoa and 26.5% in the Northern Marianas. For the United States in this same period, in spite of the recession in 2009, inflation adjusted GDP per capita was 4.5% higher in 2009 than in 2002. (See Figure 3.)

Figure 3: Index of Real GDP Per Capita in Each of the U.S. Territories and the United States, 2002 to 2009 (2002 = 100)



- Given the lack of economic progress of the territories in the 2002-2009 period (actual decline in four of the five cases), poverty rates of recent years are likely to be as high as they were in 1999. (Data available for Puerto Rico indicate that over the 1999 to 2009 period, federal transfer payments lessened the impact on low-income families of the overall poor performance. Thus the Puerto Rican poverty rate was relatively stable in the past decade. In the various territories, direct federal transfer payments to individuals account for about 20% of personal income—with the exception of the Northern Marianas, for which reliable personal income data are not available.)

Distribution of Income and Quality of Life

- Among the territories, reliable income distribution data exist only for Puerto Rico. These data show that income in Puerto Rico is distributed more unequally than in any individual state and more unequally than in the states as a whole. Equally important, income is distributed much less unequally than is earnings because of federal transfer payments, amounting to about 20% of personal income, that go disproportionately to low-income people. Measured by earnings alone, Puerto Rico would have a degree of inequality matched by few countries.· In the other territories a similar disparity between income distribution and the distribution of earnings is surely the case.

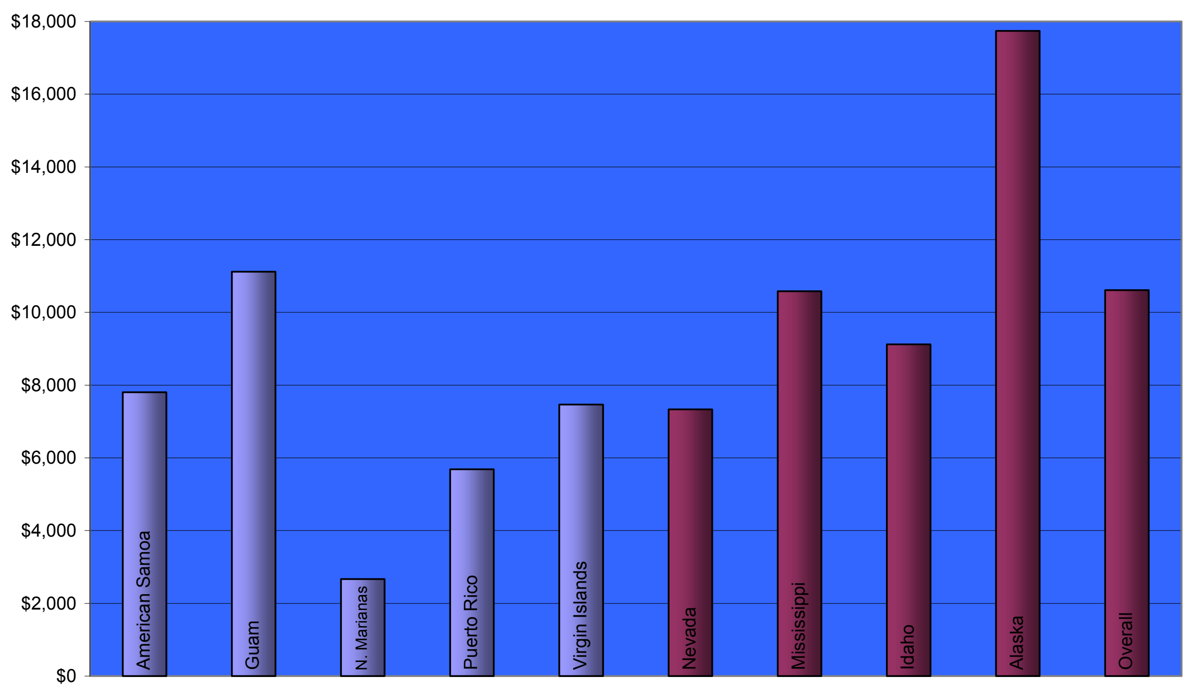
· For example, measured by earnings alone, inequality in Puerto Rico would be similar to that in South Africa, one of the world's most economically unequal countries. Indeed, by this measure, Puerto Rico would be more unequal than any of the countries of Latin America, a very unequal group.

- The Human Development Index (HDI)—calculated by the United Nations and taking account of literacy and education, health conditions, and income—is a widely recognized measure of the quality of life. The HDI shows the territories well below the United States, but still far from the bottom of the 234 countries and regions in the ranking. For 2008, the United States ranked 31, while Guam was the highest ranking territory at 55 and American Samoa was the lowest ranking territory at 104.

The Unlevel Playing Field

The most direct impact of the U.S. government on economic conditions in the territories is through the expenditure of federal funds. Yet, with the exception of Guam, which receives substantial federal expenditures because of the large U.S. military presence, the territories receive smaller amounts of federal expenditures per capita than do the states. For 2010, in relation to the U.S. per capita average, American Samoa's receipt of federal expenditures was 74%, the Northern Marianas received 25%, Puerto Rico 53%, and the U.S. Virgin Islands 70%. The average—weighted by population—per capita receipt of U.S. federal expenditures by the five territories was 56% of the average for the states; this average was 80% of the federal funds per capita going to Nevada, the state with the lowest receipt of federal funds per capita in 2010. (See Figure 4, which, in addition to showing federal expenditures in the territories, Nevada, and overall, shows expenditures in Mississippi and Idaho, the two lowest per capita income states, and in Alaska, the state receiving the highest federal expenditures per capita.)

Figure 4: Federal Expenditures Per Capita to the U.S. Territories, Selected States, and Overall, 2010



Within the United States, perhaps the most substantial programs reducing poverty are the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). The EITC was created to offset the regressive nature of the payroll taxes and to alleviate poverty. The CTC was established to address the concern that the tax structure did not adequately reflect a family's reduced ability to pay taxes as its size increased (i.e., with children); the CTC's design is such that it contributes to poverty reduction. Residents of the territories, however, are not eligible for these federal tax credits. (Puerto Ricans can receive the CTC if they have three or more children, though in the states the CTC is available for one or two children, as well as more.)

The unequal treatment of citizens residing in the territories and those citizens residing in the states is illustrated by the following example: In 2010, a married couple in one of the territories with two children and earning $25,000 before taxes ended up with $23,087.50 after paying federal taxes—i.e., Social Security and Medicare taxes. Yet the identical family in the states, after paying all federal taxes, would also receive an EITC of $4,285.00 and a CTC of $2,000.00, and would thus end up with an income after federal taxes and credits of $29,372.50—$6,285.00 more than the family in the territories, a difference of 27%.[·]

Things Could Be Different: Leveling the Playing Field

Things could be different. By moving the territories towards equal treatment with the states on major aspects of federal tax policy and federal expenditures, the U.S. government could substantially improve economic conditions in the territories.

- A relatively easy first step would be to make residents of the territories eligible for the federal EITC and CTC. By doing so, the federal government would be treating citizens in the territories the same as citizens in the states (and, in the case of American Samoa, treating nationals in a similar manner).
  - This action would be overwhelmingly justified on the basis of fairness (as indicated by the example above). Estimates for Puerto Rico indicate than over half of families would directly benefit from becoming eligible for these credit programs, and there is every reason to believe that a similar share of families in the other territories would also directly benefit.
  - Fairness aside, the overall economic impact would be substantial. The influx of these credit funds to the territories would provide a substantial boost to economic growth. Estimates for Puerto Rico suggest that the direct and indirect impact of this inflow of funds would raise national income by more than 3%.
  - It is sometimes argued that including people in the territories in these credit programs is not justified because people in the territories do not pay the federal income tax. This is a fallacious argument. Many EITC recipients in the states pay no federal income tax simply because their incomes are too low. Also, the fact that Puerto Ricans who have three or more children qualify for the federal CTC makes it clear that the non-payment of the federal income tax is not a barrier (technical or substantive) to receiving these credits.

[·] American Samoa, Guam, the Northern Marianas, and the U.S. Virgin Islands have income tax systems that "mirror" the U.S. system, meaning they have the same rules and rates but payments are to the local government and credits come from the local government. Thus the EITC and CTC exist in these territories and families are helped, but these programs do not entail any federal support and thus generate no major economic stimulus. Puerto Rico, with its own income tax system, has an earned income tax credit, but it is small and, also, entails no federal support.

- Medicare payments to the territories have been "capped," resulting in far lower payments for services covered by Medicare than in the states. For Puerto Rico the "cap" was raised substantially in the health care reform enacted in 2010, providing what appear to be sufficient funds for Puerto Rican payments to be on a level similar to those in the states. Yet the procedure of imposing a "cap" on payments to Puerto Rican and the other territories is still in place, and, as health care costs rise, it is likely that the funds for Puerto Rico will be insufficient. (Information on 2010 changes, if any, for the other territories has not been obtained.) To put the territories on a level playing field, the "cap" should be eliminated and citizens in the territories should be treated as are other U.S. citizens.

- Federal expenditures are often directed at low-income areas within the states as part of efforts to alleviate poverty and promote economic development. The territories could and should be treated in the same manner. There are numerous areas in which federal expenditures in the territories could be increased, thus ensuring equal treatment with the states. For example:

    - In the case of the largest territory, Puerto Rico, expenditures on federal procurement are extremely low compared to the states—on a per capita basis, only 16% of the amount for the states and below that of any state. An increase of per capita federal procurement expenditures to the per capita level received the by lowest recipient state (Delaware) would bring an additional $565 million a year to Puerto Rico. With the exception of Guam (because of the military presence), the other territories also receive very small amounts of procurement expenditures. Efforts to increase procurement in the territories would have the dual effect of increasing the inflow of funds and raising the level of employment.

    - In all the territories, there are numerous opportunities to increase grants from several federal government departments. Especially important could be grants to improve physical and social infrastructure, including support of information technology infrastructure.

    - Expenditure changes that would be relatively small from the perspective of the U.S. Treasury could provide substantial economic stimulus in the territories. For example, raising annual expenditures in the territories by $1.1 billion would have direct and indirect impacts that would raise annual GNP in the territories by roughly 3%. This $1.1 billion would amount to about three one-hundredths of one percent of total federal expenditures in 2010.

- Economic conditions in the territories are in many ways no different than economic conditions in low-income areas of the states. As part of creating a level playing field, programs directed toward those low-income areas of the states should also be applied to the territories. No special treatment of the territories would be involved. One such program was put forth in The National Enterprise Zone Act of 2007 (H.R. 1340), which would have provided realistic incentives for private investors to develop activities in low-income areas of the country. The Enterprise Zones proposed in this act would have provided a significant stimulus to economic activity in the most depressed parts of the nation, including, for example, urban areas such as the South Bronx and South Los Angeles, in rural areas such as Navajo County of Arizona and Washington County of Mississippi, and in towns such as Lawrence, Massachusetts, and Compton, California—and also in the five territories. The Act would have provided an incentive of a 12% tax rate on the income (including income from intangible assets) of firms that expanded their operations or initiated new activity in the Enterprise Zones—creating jobs, raising value added per job, and generating income.

Fairness: Poor Conditions Can and Should be Fixed

Outside of the territories—in particular, in the United States—their conditions go largely unrecognized. The Congress, the President, the Democrats, the Republicans, the press, and the general public, all generally ignore conditions in the territories. Yet, when the facts are presented, the weak economic condition of the five U.S. territories is clear. They suffer from high levels of poverty and poor economic growth or even decline.

The people in the territories themselves, however, are powerless to make the necessary changes to improve the situation. In addition to—and of course connected to—their poor economic condition, they are also in a poor political condition. As at best "second class citizens," they are disenfranchised and thus deprived of an effective political role in Washington. Thus, change must come from the U.S. government, from Congress and the President. Leveling the playing field for government expenditures and tax credit policy is the first step. Improved social programs, improved infrastructure, and effective federal investment incentive programs need to follow. What is needed most is the political will for change.

Some guidance could be taken from the U.S. government's commitment, contained in the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, signed into U.S. law in 1976:

> *The Government of the United States will assist the Government of the Northern Mariana Islands in its efforts to achieve a progressively higher standard of living for its people as part of the American community and to develop the economic resources needed to meet the financial responsibilities of local self-government. To this end, the United States will provide direct multi-year financial support to the Government of the Northern Mariana Islands for local government operations, for capital improvement programs and for economic development.*

This commitment has not yet been met, in either the Northern Marianas or the other territories, but it provides a useful standard for action now.