The Economic Conditions of U.S. Territories

April 3, 2012

I. The Forgotten People

Over four million U.S. citizens are forgotten people. They cannot vote in national elections. They live in economic conditions far below those in any of the states, and yet they are denied many of the important benefits that the federal government provides to other citizens. Year after year, their political and economic conditions—conditions that are of course connected—are largely ignored by the U.S. government. These forgotten people are the people of the U.S. territories.

II. What are the Territories?

The United States possesses five territories, islands (or groups of islands), with significantly large, permanent populations. These are American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands. By far the largest share of the population and land area of the territories is in Puerto Rico as shown in Table 1:[1]

Table 1: Populations of the U.S. Territories

	2010 Population	% of total Population	Land Area in Square miles	% of total Land Area
American Samoa	55,519	1.35	76	1.89
Guam	159,358	3.89	212	5.26
Northern Mariana Islands	53,883	1.31	184	4.57
Puerto Rico	3,725,789	90.85	3,421	84.93
U.S. Virgin Islands	106,405	2.60	135	3.35
Total All Territories	4,100,954	100.00	4,028	100.00

Source: Population-U.S. Census; Land Area-U.S. Department of the Interior

[1] In addition, the U.S. holds nine island territories that have no permanent populations. These are: Baker Island, Howland Island, Jarvis Island, Johnston Atoll, Kingman Reef, Midway Islands, Navassa Island, Palmyra Atoll, and Wake Island. As of 2008, none of the islands had any permanent residents. The only human population consists of temporarily stationed scientific and military personnel.

Puerto Rico and Guam became territories of the United States in 1899 after the Spanish-American war, as Spain ceded these islands to the United States in the Treaty of Paris. (Spain also ceded the Philippines to the United States, but the Philippines became independent in 1946.) In 1900, American Samoa was ceded to the United States by Great Britain and Germany in a Tripartite Convention. The U.S. Virgin Islands was purchased from Denmark in a Convention of 1917. The Northern Mariana Islands became a territory of the United States only in 1986, having passed from Spain to Germany (1899), to Japan after World War I, to the United Nations with the United State as Trustee after World War II, and then eventually to U.S. territorial status.[2]

Puerto Rico, Guam, the U.S. Virgin Islands, and the Northern Mariana Islands are now all 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). The situation with American Samoa, however, is different. Persons born in American Samoa are considered "U.S. nationals" but not U.S. citizens. 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.[3]

Citizenship for residents of the territories is not full citizenship in the sense that they are not able to vote in U.S. national elections. They cannot vote in presidential elections and they do not elect members of Congress.[4] 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. This lack of full citizenship by

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[2] For brief histories of all of the territories, see Ediberto Román, *The Other American Colonies: An International and Constitutional Law Examination of the United States' Nineteenth and Twentieth Century Island Conquests,* (Carolina Academic Press, Durham), 2006.

[3] For extensive discussion of the meaning of citizenship as it applies to people in the territories, see Román as previously cited. Román emphasizes that "citizenship" is not one thing, and that de facto in U.S. history there have been various classes of U.S. citizenship, with citizens residing in the territories having a status of "second class citizenship." He also suggests that, as Congress granted citizenship to people in four of the territories and this citizenship is not specified in the U.S. Constitution, it is possible, or at least conceivable, that Congress could withdraw the right of citizenship to people born in these territories.

[4] They do, however, elect non-voting representative to the U.S. House of Representatives.

residents of the territories appears to make a significant economic difference, as discussed below (to say nothing of a difference in social status and all of its implications).

III. Poverty in the Territories

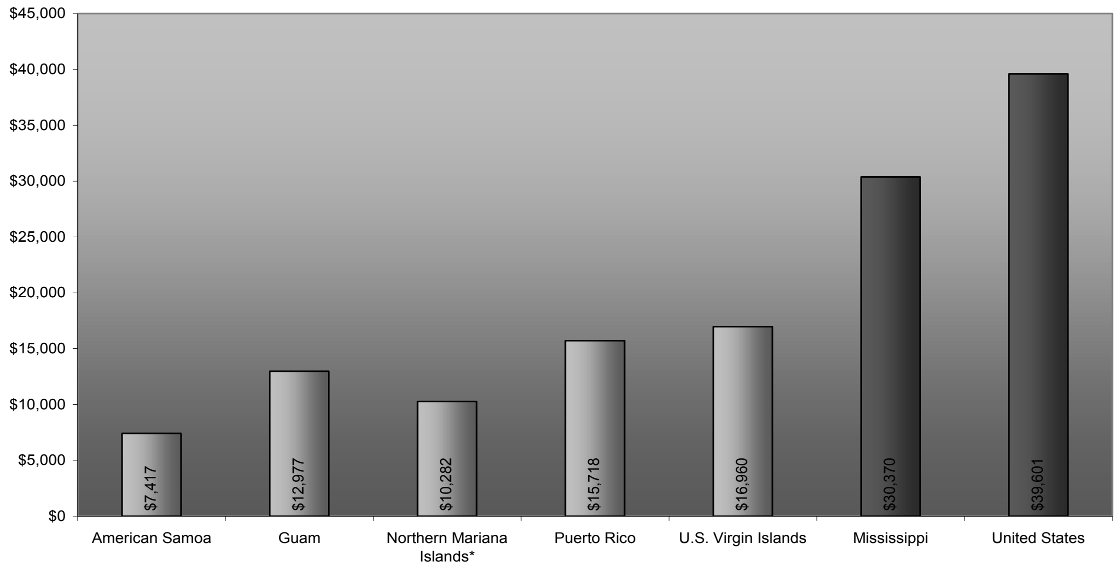
By standards of the United States, the residents of the U.S. territories on average have very low incomes. While reliable Personal Income data are not readily available for some of the territories, it is possible to develop the income estimates that are shown in Table 2 along with data on Gross Domestic Product. In Table 2, the data for the territories are presented along with U.S. data and data for Mississippi, the state with the lowest per capita Personal Income. The Personal Income data are also shown in Figure 1.

Table 2: Gross Domestic Product (GDP) Per Capita and Personal Income (PI) Per Capita in U.S. Territories, the United States, and Mississippi, 2009 (current dollars)

	GDP/capita	% of U.S	PI/capita	% of US	% of Mississippi
American Samoa	10,029	21.8	7,417	18.0	24.4
Guam	25,245	55.0	12,977	32.8	42.7
N. Mariana Islands	13,903	30.3	(10,282)*	26.0	33.9
Puerto Rico	25,555	55.6	15,718	40.9	53.7
U.S. Virgin Islands	36,265	79.0	16,960	42.8	55.8
United States	45,925	-	39,601	-	130.4
Mississippi	32,168	70.0	30,370	76.7	-

* An especially crude estimate; see text and source notes.
Sources: See notes at end of text.

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



* A very crude, rough estimate

The Personal Income per capita figures provide a direct indication of people's current economic well-being, and it is clear that the people in the territories do very poorly in comparison with people in the states. None of the territories has a per capita level of Personal Income even half of that of the U.S. average, and only the Personal Income levels in the Virgin Islands and Puerto Rico exceed half of the level of Mississippi, the state with the lowest per capita Personal Income. (The Personal Income figure for the Northern Marianas is very rough, but probably on the high side.)

Although the GDP data are more reliably accurate than the Personal Income data in Table 2 and Figure 1, they provide a misleading picture of the situation, a misleading picture of the well-being of the people in the territories. GDP is a measure of all economic activity that takes place within the area of a territory (or country). In the case of each of the U.S. territories, however, a large share of the economic activity within each territory goes as profits to foreign firms (including U.S. based firms). Thus the amount of income that goes to the people and firms of the territory is much smaller than the GDP figure. For example, in the case of Puerto Rico, for which the data are readily available,[5] income

[5] While readily available, Puerto Rican data are of questionable quality. For example, when calculating inflation adjusted figures ("real" figures), the Puerto Rican Planning Board uses 1954 as a base year. Also, the Consumer Price Index used until recently was thoroughly discredited and was replaced by a new index in late 2010, but only after much controversy. Additional problems with the Puerto Rican data include: discrepancies between different estimates of employment, implausible figures for retail sales, conflicts between different figures for value added in manufacturing, and a general lack of data on student performance in the schools. Accordingly, while much is available, the Puerto Rican data should be used with caution.

attributable to nationals (including firms) of Puerto Rico (measured by Gross National Product, GNP) is about two-thirds of GDP. Personal Income in Puerto Rico, which does not include the profits of either foreign or national firms, is somewhat less, about 61% of GDP. Available data, though of questionable quality, suggest that the difference between GDP and Personal Income for Guam and the Virgin Islands is somewhat greater than for Puerto Rico and not so great (though substantial) for American Samoa. In the case of the Northern Marianas, neither GNP nor Personal Income data are available for recent years, and data for earlier years are not useful because the exodus of foreign firms in the mid-2000s has greatly changed the relation of GDP to the other variables.

Yet, even in terms of GDP, the territories compare poorly with the states. Only the Virgin Islands level of per capita GDP exceeds that of Mississippi, and it is still less than 80% of the U.S. average. American Samoa and the Northern Marianas are far below Mississippi, and, at roughly half the U.S. level, both Guam and Puerto Rico are well below the Mississippi level of per capita GDP. (All of these per capita figures do not take into account the degree of income inequality. Insofar as there is substantial inequality, these data obscure the economic hardships of people at the bottom.)

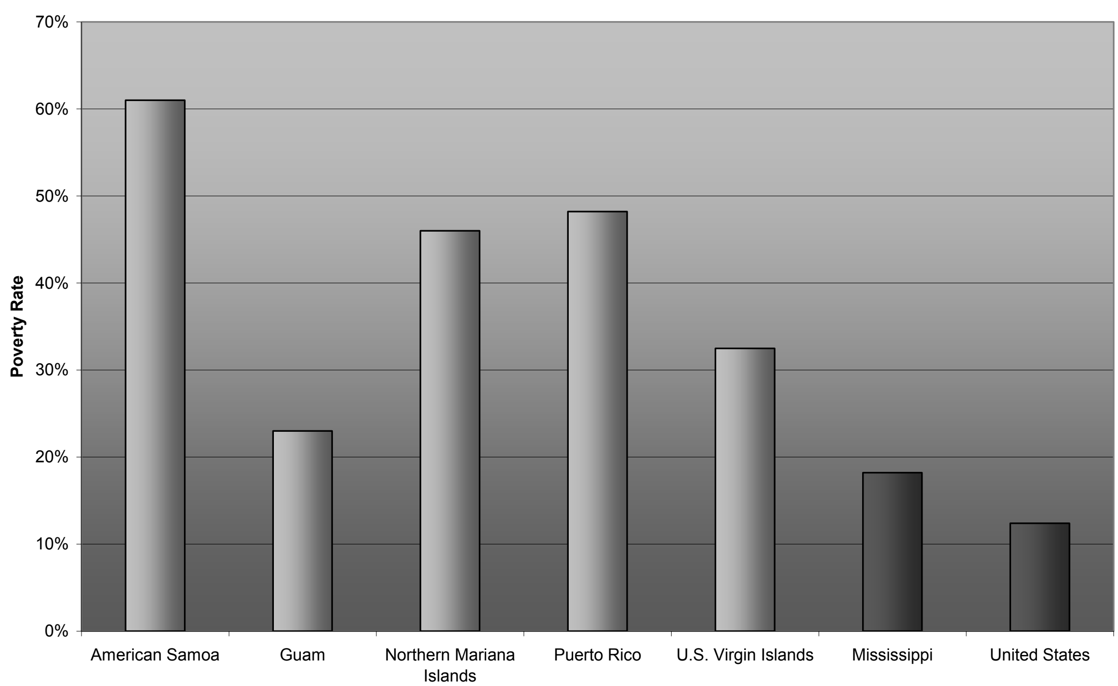
The Personal Income figures are reflected in estimates of the poverty rates for the territories (using the standard for the states) as shown in Table 3 and Figure 2—though, unfortunately, these poverty data are for 1999 because more recent estimates for most of the territories are not readily available.[6] The relatively low rate reported for Guam is puzzling, given the data in Table 2. However, all of the territories had poverty rates (and undoubtedly still do) higher than all of the states, and overall the poverty levels in the territories are much higher than in the states as a whole or in the highest poverty rate states.

[6] More recent data are available for Puerto Rico and indicate that, in spite of the poor overall performance of the Puerto Rican economy in recent years, the poverty rate has been relatively stable. This stability of the poverty rate can be explained by the federal transfer payments, some of which significantly boost the incomes of the poor and thus keep the poverty rate from rising as much as might be expected in the poor overall economic circumstances. It seems likely that experience in the other territories has been similar.

Table 3: Percent Poverty Rates in the U.S. Territories, 1999	
American Samoa	61.0
Guam	23.0
Northern Mariana Islands	46.0
Puerto Rico	48.2
U.S. Virgin Islands	32.5
United States	12.4
Mississippi	18.2*

* Figure is for 2000. West Virginia had a slightly higher rate, 18.6%
Source: Territories – U.S. Census as reported in "GAO-10-24OR Poverty Determination in U.S. Insular Areas," November 10, 2009 http://www.gao.gov/new.items/d10240r.pdf; U.S.-Alemayehu Bishaw and John Iceland, *Poverty:1999*, Census Brief, May 2003, http://www.census.gov/prod/2003pubs/c2kbr-19.pdf; Mississippi, Census as reported on http://www.chn.org/pdf/2008/ACStotalpov.pdf.

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



Because of the high cost of living in the territories, the data in Tables 2 and 3 probably understate the real income differences between the territories and the states and understate the extent of poverty in the territories. The U.S. Office of Personnel Management (OPM) calculates the cost of living in the territories relative to the cost of living in Washington, DC. The OPM calculations show Guam, the Northern Marianas, and the Virgin Islands having a cost of living 25% higher than Washington, and Puerto Rico's cost of living as 14% higher than

Washington's. (No figure is computed for American Samoa.)[7] Thus if the data in Tables 2 and 3 were adjusted for these cost of living differences, the relative position of the territories would be even poorer.

In terms of the United Nations' Human Development Index (HDI)—which takes into account literacy and education, health and longevity, as well as income—the territories are well below the United States, but not as much as one might expect based on the income data. The relatively high ranking of the territories compared to the states results from the fact that in HDI computations income plays a decreasing role as it gets higher. The territories are not included in the UN's official HDI calculations. However, a project at the United Nations Economic and Social Commission for Asia and the Pacific has estimated 2008 HDIs for 234 geographic areas, including the countries for which the UN makes its official calculations, additional small countries, territories, and some separately defined areas (e.g., Hong Kong and the Isle of Man). While these calculations are not exactly the same as those of the UN's official calculations (due to limits of the data) they are nonetheless useful. The results for the U.S. territories, the United States, and a few other countries (for comparison) are shown in Table 4.

Table 4: Human Development Index for the U.S. Territories, the United States, and Selected Countries, 2008

Area	HDI*	Rank (of 234)
American Samoa	.827	104
Guam	.901	55
N. Mariana Islands	.875	72
Puerto Rico	.905	53
U.S. Virgin Islands	.894	60
United States	.953	31
Luxembourg	.997	1
Norway	.982	6
Portugal	.907	51
Chile	.888	64
Costa Rica	.871	74
Turkey	.820	108
Sierra Leone	.318	234

*The HDI can run from 0 (low) to 1.000 (high).
Source: David A. Hastings, "Filling Gaps in the Human Development Index: Findings for Asia and the Pacific," United Nations Economic and Social Commission for Asia and the Pacific, UNESCAP Working Paper WP/09/02, February 2009.

[7] "GAO-10-24OR Poverty Determination in U.S. Insular Areas," November 10, 2009 http://www.gao.gov/new.items/d10240r.pdf.

All of the data on the territories presented so far are averages and do not take into account the distribution of income—though both poverty rates and HDI figures are connected to the distribution of income. Reliable data on income distribution for the territories are, unfortunately, sparse. Data are available for Puerto Rico, showing a degree of inequality higher than that for the states (overall or for any individual state) and more in line with the inequality of Latin American countries.[8] Data for Guam presented in one study, though limited, suggest a degree of inequality similar to that in the states (though the figures change substantially from year to year)[9], and the difference between mean and median per capita income do not suggest an especially high degree of inequality.[10] However, a 2000 study, without providing income distribution data, notes a dichotomy in Guam's development and suggests that there is a growing separation between those in the "mainstream" economy and those whose economic lives have remained relatively static.[11] As to the Virgin Islands, no reliable income distribution data seem to be available, but there is a history of slavery which would not portend a relatively equal distribution, even to the modern era.[12]

However, while data are generally lacking, one aspect of the Puerto Rican experience deserves emphasis and probably applies to the other territories as well. Because transfer income from the federal government is a substantial portion of Puerto Ricans' incomes, especially of those Puerto Ricans who have low incomes, the distribution of income is significantly less unequal than the distribution of earnings. Data for 1990 and 2000 indicate that while the actual distribution of income was relatively unequal (compared to the United States),

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[8] Amanda Noss, Household Income for States: 2009 and 2010, American Community Survey Briefs, U.S. Census Bureau, Issued September 2011, http://www.census.gov/prod/2011pubs/acsbr10-02.pdf.

[9] M. C. M. Ruane and Ning Li, "Guam's Income Distribution, 1981-2005," *Journal of International Business Research*, Vol. 8, Special Issue 2, 2009.

[10] Bureau of Labor Statistics, Department of Labor, Government of Guam, "Household and Per Capita Income: 2010," http://www.dol.guam.gov/BLS/Household%20Per%20Capita%202010.pdf.

[11] Joseph P. Bradley, "Guam's Political Status Options," Final Draft, Presented to the Guam Commission on Decolonization, June 12, 2000, http://www.senbenp.com/PDF/Decolonization/JoeBradleyRptPoliticalStatus.pdf. Bradley writes (p. 75): "The modern history of Guam's economic development has been one of dichotomy: one portion of society has progressed fairly rapidly in terms of participation in the 'mainstream' economy, experiencing rising standards of living and a "western" working environment. Another portion of society has remained relatively static, maintaining more traditional employment patterns and slower changes in its standard of living. Over time, the gulf between the two is observed to have been widening."

[12] Jannette O. Domingo, "Employment, income and economic identity in the U.S. Virgin Islands," *Review of Black Political Economy*, Vol. 18, No. 1, 1989.

were the distribution of income determined simply by the distribution of earnings, Puerto Rico would be one of the most economically unequal regions of the world. (More recent data are not available.)[13] Insofar as other territories receive substantial government transfers in relation to income, the actual measures of income distribution would be significantly less unequal than the distribution of earnings.

IV. Recent Economic Change in the Territories

Perhaps the economic conditions in the territories shown by the data in the preceding tables would not be so depressing if output and incomes were growing. Perhaps, if there were convergence of income levels in the territories with income levels in the states, a positive view of the territories' conditions would be warranted, in spite of their current circumstances. Reality, however, does not allow a positive view. There is no convergence. On the contrary, divergence is the reality.

Over the past several years the economic growth experience has been dismal. The least negative experience has been that of the Virgin Islands, where real per capita GDP rose by over 10% between 2002 and 2007 before falling back almost to its 2002 level over the next two years. In each of the other four territories, real output per capita in 2009 was lower than in 2002—see Table 5 and Figure 3. The Northern Marianas and American Samoa did particularly poorly, with GDP per capita dropping by 26.5% and 18.9%, respectively. In this same period, while the U.S. economy did not perform well and was in recession in 2009, U.S. output per capita was 4.5% higher in 2009 than in 2002.

Table 5: Indexes of Per Capita GDP in the U.S. Territories and the United States, 2002 to 2009, 2002=100

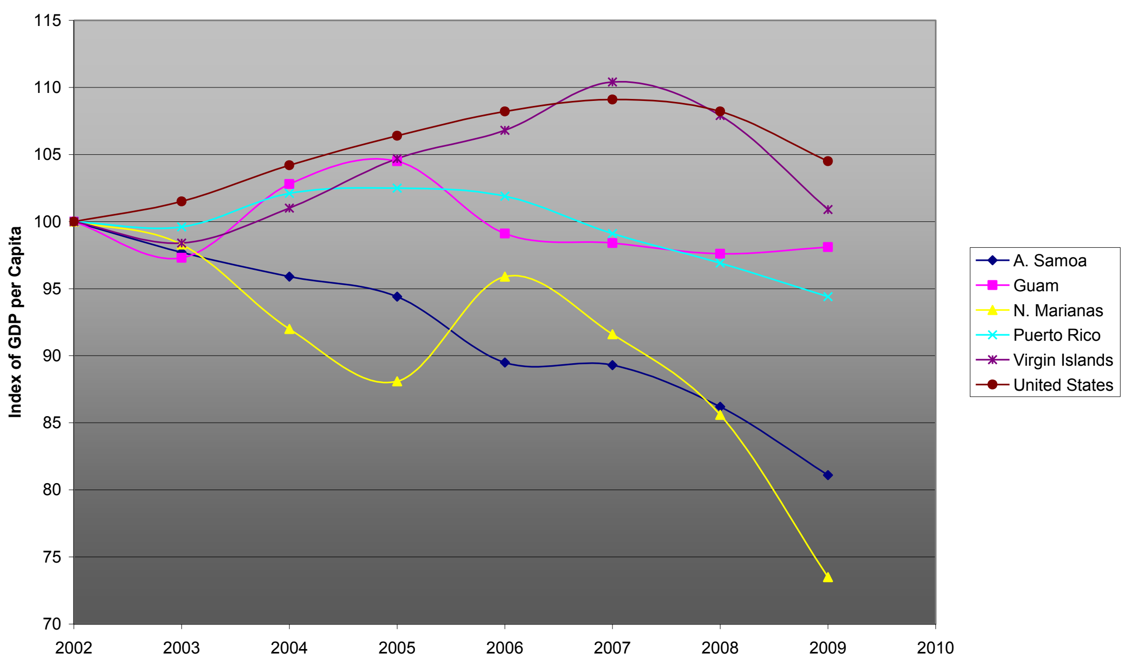
	2002	2003	2004	2005	2006	2007	2008	2009	change 02-09
A. Samoa	100	97.7	95.9	94.4	89.5	89.3	86.2	81.1	-18.9
Guam	100	97.3	102.8	104.5	99.1	98.4	97.6	98.1	- 1.9
N. Marianas	100	98.3	92.0	88.1	95.9	91.6	85.6	73.5	-26.5
Puerto Rico	100	99.6	102.1	102.5	101.9	99.1	96.9	94.4	- 5.6
Virgin Islands	100	98.4	101.0	104.7	106.8	110.4	107.9	100.9	0.9
United States	100	101.5	104.2	106.4	108.2	109.1	108.2	104.5	4.5

Source: See notes to Table 2 at end of text.

[13] See Eileen V. Segarra Alméstica, "What happened to the distribution of income in Puerto Rico during the last three decades of the XX century? A statistical point of view," *Ensayos y Monografías*, Numero 129, julio 2006, Unidad de Investigaciones Económicas, Departamento de Economía, Universidad de Puerto Rico, Recinto de Río Piedras.

As has been noted earlier, however, GDP is a poor measure of economic conditions in the territories because, in general, such a large share of GDP is profits of foreign firms and thus not a good indicator of economic well-being in the territories or of the territories' capacity for future expansion. Gross National Product or Personal Income would be a more useful indicator, but the data over time on these variables are not available. This is especially a problem in appraising the situation in the Northern Marianas where, because of changes in regulations implemented by the U.S. government, foreign garment firms, which had been a very large segment of the economy, pulled out in the middle of the decade. Also, there was an exodus of the garment factory workers (largely young Chinese women), reducing the population by 31% between 2002 and 2009. On the basis of the available data, it is possible to say little more than that the Northern Marianas experienced a severe economic shock during this decade.

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



V. Fiscal Relations of the Territories with Washington

Federal Expenditures

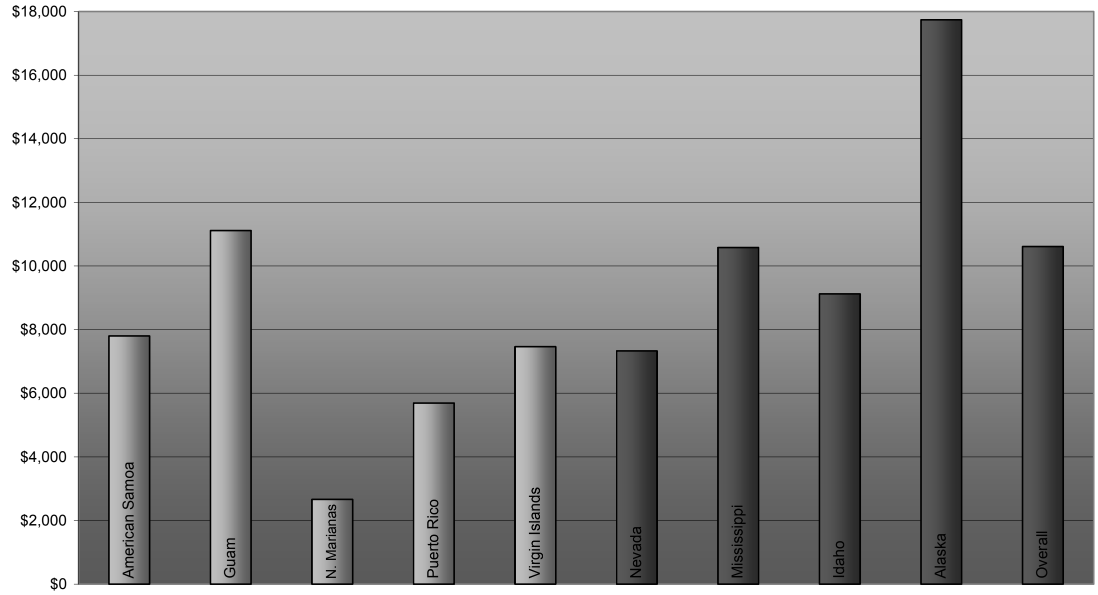
An important part of the economic relationship between the federal government and the territories is the disbursement of funds from Washington to the territories. These funds include payments for retirement and disability, other direct payments, grants, procurement, and salaries and wages. The total federal expenditures per capita to the territories, selected states, and overall for fiscal year 2010 are shown in Table 6; also shown are the federal expenditures in relations to Personal Income per capita in each case. (The relation to Personal Income per capita is shown for comparison purposes, but only part of the federal expenditures goes directly to individuals.) Figure 4 shows federal expenditures per capita to the territories, selected states, and overall. (Nevada is included as the state with the lowest receipt of federal funds per capita in 2010. Alaska was the state with the highest receipt of federal funds in relation to per capita personal income. Mississippi and Idaho were the states with the lowest per capita income.)

Table 6: Federal Government Expenditures Per Capita to the Territories and Overall, 2010

	Expenditure/capita	% Relative to Overall	As a % of PI/capita
American Samoa	$ 7,803	73.5	105.2
Guam	$11,116	104.7	85.7
Northern Marianas	$ 2,667	25.1	25.9
Puerto Rico	$ 5,668	53.4	35.0
Virgin Islands	$ 7,464	70.3	44.0
Overall (U.S.)	$10,612	100.0	26.8
Nevada	$ 7,332	69.1	33.9
Mississippi	$10,582	99.7	19.8
Idaho	$ 9,122	86.0	35.5
Alaska	$17,741	167.2	40.2

Source: Calculated from expenditure data in U.S. Census Bureau, *Consolidated Federal Funds Report for Fiscal Year 2010* and population data from *Statistical Abstract of the United States 2012.* See Table 2 notes for sources of Personal Income data.

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



Note: Nevada was the state with the least federal expenditures per capita; Alaska was the state with the highest. Mississippi and Idaho were the states with the lowest personal income per capita.

While the per capita federal disbursement of funds to the territories is generally much lower than the average to the states, the case of Guam stands out for a high level of disbursements. This is directly connected to the large presence of the U.S. military on Guam. Department of Defense procurement and wages and salaries account for 53% of the federal disbursements to Guam, while the comparable overall figure is 16%; and for Puerto Rico, the figure is 3%. Of course, regardless of what the disbursements are for, they still have a major impact on the Guam economy. Nonetheless, Guam's unusual military role explains the unusual level of federal disbursements.

The funds coming from Washington to the Virgin Islands and American Samoa are substantially lower than the overall average, and these two territories rank below all but one of the states (Nevada) in terms of federal expenditures per capita. Puerto Rico's position is far lower, and that of the Northern Marianas is far, far lower.

If the amount of federal expenditures going to the territories and the states is measured in relation to their per capita incomes, then the territories' situations do not look so poor. Guam and American Samoa receive far more in relation to Personal Income than do any of the states—Alaska being the state with the highest receipts in relation to Personal Income per capita. (It is not clear why American Samoa receives such a relatively large amount. However, it can be noted that, while 79% of expenditures going to American Samoa is comprised of grants from various federal departments, overall this figure is only 21% and is only 30% for Puerto Rico.) The figures for the other territories are not out of line with the figures for the various states (though the Virgin Islands figure is somewhat higher than that for any of the states).

Unfortunately, other than in the case of Puerto Rico, available data do not allow a comparison of the federal expenditures coming to the territories and the revenues (taxes) going from the territories to Washington. People in the territories do not pay federal income taxes, but they do pay federal Social Security and Medicare taxes. IRS data show these payroll taxes for the territories other than Puerto Rico aggregated together and along with revenues from U.S. military personnel abroad. In the case of Puerto Rico, while there is a net inflow of funds (i.e., federal expenditures to Puerto Rico are larger than revenues from Puerto Rico), this is the case for the great majority of the states. In 2010:

- Nineteen states and DC had a larger net inflow of federal funds than did Puerto Rico.

- Seventeen states and DC had a larger per capita net inflow of funds than did Puerto Rico.

- Even when the per capita inflow of funds is compared to per capita Personal Income, Puerto Rico, with a level of per capita Personal Income far below any state, still ranks behind New Mexico and DC. (In Puerto Rico, the per capita net inflow was 29.0% as large as per capital Personal Income; for New Mexico, the figure was 29.2%. Seven other states had inflows amounting to more than 20% of per capita Personal Income.)

There is of course no reason the dispersal of federal funds should be disbursed to the states (and the territories) in connection with the level of per capita Personal Income (Table 6) or that there should be some sort of balance between the disbursal of funds and federal taxes. Federal payments are designed to serve multiple functions, ranging from providing income and employment in relatively low-income regions to building infrastructure (e.g., highways) throughout the country to establishing military bases and purchasing military equipment. Because of an implicit federal commitment to support regional income convergence, it is to be expected that low-income regions would have relatively large receipts. Certainly by the standards of need and the commitment to income convergence, Puerto Rico—and probably the other territories as well—receives a relatively small amount of funds, below several states by various measures.

Tax Credits

The federal income tax system embodies two major tax credit programs. One of these, the Earned Income Tax Credit (EITC) was created to offset the regressive nature of the payroll taxes and to alleviate poverty; the EITC also provides an incentive for people to engage in the paid workforce. The other major credit program, the Child Tax Credit (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 design of the program is such that it contributes to poverty reduction.

Neither of these federal credits is available to residents of the territories, in spite of the facts that, one, they pay regressive payroll taxes and, two, as demonstrated above, they have high rates of poverty. The only exception, a partial exception, is that residents of Puerto Rico who have three or more children are eligible for the federal CTC (though residents of the states get the CTC if they have one, two, or more children); in none of the other territories are residents eligible for the federal CTC regardless of the number of children in their families. Puerto Rico has its own income tax system, which does include a small earned income credit (small relative to the federal EITC). This credit, however, is paid by the Puerto Rican government (or is provided as a reduction in an individual's tax liability) and involves no inflow of federal funds. The other four territories have "mirror" income tax systems, which means that the income taxes are calculated based on the U.S. tax code but are paid to the local governments. Thus both the EITC and CTC exist in these territories, but, as in Puerto Rico, they involve no inflow of federal funds. These credits, both the small one in Puerto Rico and the ones in the other territories calculated as in the states, are certainly helpful to many individuals, but from the perspective of the territories they do not offset the payroll taxes that go to the federal government. Moreover, were people in the territories to receive these credits from the federal government, there would be an inflow of funds to the territories, providing substantial economic stimulus, at relatively little cost to Washington. (Calculations for Puerto Rico suggest this stimulus would increase national income by as much as 3%.)

For Puerto Ricans, the exclusion from the federal EITC and CTC result in a very large discrepancy between U.S. citizens on the island and identical families in the states with regard to their fiscal relations with the federal government. Consider a married couple with two children in Puerto Rico earning $25,000 before taxes. In 2010, this family 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 a 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 Puerto Rican family.[14]

[14] In both cases similar disparities exist with other family structures and other levels of income. The figures here do not include the $550 "Making Work Pay" credit, which, it may be assumed, does not have the permanence of the EITC and CTC. These figures were obtained using TurboTax 2010.

For people in the other four territories, however, this discrepancy at the individual level with regard to federal taxes is offset by the EITC and CTC that are administered locally. Nonetheless, as in Puerto Rico, the exclusion of these other territories from the federal programs means that the payment of the credits provides no overall stimulus to their economies.

VI. What Could and Should Be Done?

Economic conditions in the U.S. territories could and should be different. These conditions could be significantly improved were the territories treated differently by the federal government. Yet such positive change could be accomplished without special programs for the territories. Simply by moving the territories towards equal treatment with the states on major aspects of federal tax policy and federal expenditures—that is, by treating citizens (and nationals) the same way regardless of where they reside—the U.S. government could substantially improve economic conditions in the territories. The territories alone, because they are territories, do not have the power to repair their economic situations. Power for change resides in Washington, and it is up to the President and the Congress to put the territories on a level playing field with the states.

A relatively easy first step for the U.S. government in establishing a level playing field would be to make residents of the territories eligible for the EITC and CTC. 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 that 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 (as noted above) 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.

A further relatively easy step towards treating the territories fairly in relation to the states and thereby improving their economic conditions would be to change the way Medicare is provided in the territories. Medicare payments to the territories have been “capped,” resulting in 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, which may take more time to adjust, could also be a powerful lever in improving economic conditions in the territories—and, again, the issue is one of creating a level playing field. Federal expenditures are often directed at low-income regions within 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 leveling the playing field 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 by the 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.

None of these changes proposed here involve any special treatment for the territories—not those of the EITC and CTC, not the "uncapping" of Medicare payments, and not the adjustments in the allocation of federal expenditures. Special treatment is not needed. All that is being proposed is that the territories be treated on an equal basis with the states.

There is, in fact, much more the federal government could do to improve economic conditions in the territories without establishing special treatment of the territories. In particular, all federal programs directed towards low income areas, if applied to the territories as to the states, could make important contributions to economic progress in the territories. One potential example of such a 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.

VII. Fairness: The Need for Action

According to 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.*[15]

This statement with regard to the Northern Marianas may not have an explicit equivalent with regard to the other U.S. territories. It is, however, a statement

[15] From Article VII United States Financial Assistance, Section 701, http://www.cnmilaw.org/covenant.htm.

that could usefully provide the guiding principle for the relation of the U.S. government to economic conditions in all the territories. Furthermore, the statement is probably consistent with the way most U.S. officials—in Congress and in the executive branch of the government—would portray the U.S. government's relation to the territories. Yet, as the preceding discussion has demonstrated, it is a statement that does not describe reality, either in terms of the actions of the U.S. government or in the current, continuing economic conditions in the territories.[16]

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 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.

[16] Recall, in particular, that during the 2002 to 2009 period GDP of the Northern Marianas declined by 26.5%.

Source Notes for Table 2

American Samoa GDP: U.S. Department of the Interior, *OIA-BEA Announce Release off Gross Domestic Product (GDP) Estimates for American Samoa for 2008 and 2009,* May 31, 2011, http://www.bea.gov/newsreleases/general/terr/2011/pdf/guam_071711.pdf; PI for American Samoa: estimate based on PI to GDP ratio for 2000 available in *The American Samoa National Income and Product Accounts*, Prepared by the Americans Samoa NIPA Task Force March 2004. http://www.spc.int/prism/country/as/stats/Statistic/CPIPDF/nipareport.pdf

Guam GDP: U.S. Department of the Interior, OIA-BEA Announce Release of Gross Domestic Product (GDP) Estimates for Guam for 2008 and 2009, July 17, 2011, http://www.bea.gov/newsreleases/general/terr/2011/pdf/guam_071711.pdf; PI for Guam: assumed to be the same as reported for per capita income and taken as the average between 2008 and 2010 from *Household and Per Capita Income: 2010* and *Household and Per Capita Income: 2008*, both by Bureau of Labor Statistics, Department of Labor, Government of Guam, http://www.dol.guam.gov/BLS/Household%20Per%20Capita%202010.pdf and http://www.dol.guam.gov/index.php?option=com_content&view=article&id=390&Itemid=461, respectively.

Northern Mariana Islands GDP: U.S. Department of the Interior, OIA-BEA Announce Release of Gross Domestic Product (GDP) Estimates for the Commonwealth of the Northern Mariana Islands for 2008 and 2009, http://www.bea.gov/newsreleases/general/terr/2011/pdf/cnmi_071211.pdf; Northern Mariana PI: An estimate, really a rough guess, using the PI to GDP ratio for American Samoa.

Puerto Rico GDP and PI: Junta de Planificación de Puerto Rico, http://www.jp.gobierno.pr/, Apéndice Estadístico, and PI per capita calculated using U.S. Census population figure.

Virgin Islands GDP: U.S. Department of the Interior, OIA-BEA Announce Release of Gross Domestic Product (GDP) Estimates for the U.S. Virgin Islands for 2008 and 2009, June 13, 2011, http://www.bea.gov/newsreleases/general/terr/2011/pdf/vi_061311.pdf; PI estimate based on PI to GDP ratio for 2007, with 2007 GDP from same source as 2009 GDP and 2007 PI from *United States Virgin Islands Business Opportunities Report*, Prepared for the United States Department of the Interior, Office of Insular Affairs, http://www.doi.gov/oia/reports/USVIreport2008.pdf.

United States GNP and PI: *Economic Report of the President, 2011.*

Mississippi GDP and PI: *Statistical Abstract of the United States 2011.*