

Leveling the Playing Field

Providing Fair Treatment for Puerto Rico in Federal Programs

President Obama has focused his efforts on improving the positions of the poor and the middle class, expanding programs and providing tax relief that will help the great majority of the population. These actions can be furthered and strengthened by extending three federal programs to Puerto Rico: the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), and the Supplemental Security Income program (SSI). Puerto Ricans are currently not eligible for the EITC, except on income from sources in the states, and are eligible for the CTC only if they have three or more children. Puerto Ricans are also excluded from the SSI program.

Puerto Rico, now in its third year of recession, is experiencing an economic situation that is worse than that of the mainland United States. While various factors have contributed to the island's economic woes, the extreme fiscal irresponsibility of the Puerto Rican government over the last eight years has greatly exacerbated the situation. The new government is beginning a process of change, but, in order to re-establish strong economic growth in Puerto Rico, Washington must fully include the island in federal programs. Moreover, as a simple matter of fairness, Puerto Ricans, as U.S. citizens, must be included in these income support programs.

While it will be possible to make progress towards improving Puerto Rico's position with regard to federal programs, success will require a choice of priorities. On which programs should Puerto Ricans first attempt to obtain full and fair treatment?

The Earned Income Tax Credit and the Child Tax Credit

The Earned Income Tax Credit and the Child Tax Credit, taken together, provide the best starting place because:

- The exclusion of Puerto Ricans from these programs is in conflict with the rationale on which they were established;
- This exclusion creates glaring inequities;
- The full extension of these credits to Puerto Rico would have a substantial positive impact on the island's economy;
- These programs are fully in line with the federal government's emphasis on encouraging people to participate in paid labor and are fully consistent with President Obama's principle of "making work pay;" and

- These credits, designed to encourage participation in paid work, would improve Puerto Rico's very low labor force participation rate.

The EITC and CTC credits were implemented to alleviate poverty, provide a work incentive, and offset the burden of payroll taxes for low income families. Yet Puerto Ricans are effectively excluded in spite of the facts that:

- the poverty rate in Puerto Rico is higher than anywhere in the states;
- the labor force participation rate in Puerto Rico is extremely low; and
- Puerto Ricans are subject to payroll taxes.

Thus, the exclusion of Puerto Ricans from full eligibility from these two income support programs is in conflict with the rationale that led to their implementation. Moreover, this exclusion results in glaring inequities. In the current situation, for example, a single-parent family in Puerto Rico earning \$25,000 before taxes would end up with \$4,200 less after federal taxes than would the identical family in the states; Puerto Ricans' exclusion from the EITC and CTC accounts for the difference.

Had the EITC and CTC fully extended to Puerto Ricans in 2008, the total credits would have been \$1.19 billion. With a multiplier of 1.5, the total direct and indirect impact on the island's GNP would have been \$1.785 billion, raising GNP by about 3%. Assuming that three-quarters of the increased consumption expenditures would be subject to the 7% sales tax, the tax receipts for 2008 would have been increased by about \$85.6 million. (The attachment provides details regarding the estimation of the total credits.)

The EITC and CTC are not "welfare" programs, tied as they are to recipients' participation in the paid labor force. Their full extension to Puerto Ricans would fit well with the efforts of President Obama to relieve poverty, bolster the middle class, and engage people in remunerative work. In Puerto Rico the labor force participation rate has been below 50%, while in the states the comparable figure is 66% and the average for the OECD countries is 62%. (These figures pre-date the current economic crisis.) The EITC and CTC programs could significantly alter the structure of incentives in Puerto Rico's labor markets and thus have a long term impact on labor force participation and overall economic well-being.

Opposition to extending EITC and CTC to Puerto Rico is based in part on the argument that Puerto Ricans do not pay federal income taxes. EITC and CTC are directly connected to the income tax, as the credits are computed as part of individuals' income tax filings. However, this connection is simply administrative, and the fact that Puerto Ricans do not pay federal income tax is not relevant to the substance of these programs. The justifications (noted

above) for extending the EITC and CTC to Puerto Rico are far more substantial than this tax technicality. Moreover, at present the Puerto Ricans with three children or more can obtain the CTC by filing a federal tax return but not paying any tax, demonstrating the irrelevance of the tax argument.

Supplemental Security Income (SSI)

The Supplemental Security Income (SSI) program should also be reformed so that Puerto Ricans would be included. SSI is designed to help aged, blind, and disabled people who have little or no income; the program provides cash to meet basic requirements for food, clothing and shelter. The need for this support is at least as great for U.S. citizens in Puerto Rico as it is for citizens in the states.

Extension of SSI to Puerto Rico would result in an inflow of federal funds of about \$1 billion annually. It is difficult to estimate the overall impact of the extension of SSI to Puerto Rico because detailed information would be required on the needs of the population. For example, information would be required on the extent of disabilities. However, judging from the SSI funds received in the various states, it appears that the amount of funds coming to Puerto Rico under SSI would be substantial, improving the condition of many individuals and families and having a significant impact on the island's economy. If, for example, Puerto Rico were to receive the same amount per capita as Mississippi, the total SSI payment to Puerto Ricans would be over \$800 million. As SSI payments are higher where income is lower, the payments to Puerto Rico should actually be substantially larger, of the same order of magnitude as the EITC and CTC funds.

SSI, however, is generally viewed as a "welfare" program. Indeed, the program was created in the early 1970s in an effort to reform the nation's welfare system, creating greater consistency across the states. To extend a welfare program to Puerto Rico would likely be more politically difficult than to extend a credit system tied to people's labor force participation. Thus there would seem to be strong political reasons to give priority to efforts to extend EITC and CTC.

Opposition to extending SSI to Puerto Rico, like the opposition to extending EITC and CTC to Puerto Rico, is in part based on the argument that Puerto Ricans do not pay federal income taxes. SSI is paid out of general federal revenues, not out of the Social Security Trust Fund. However, as with the EITC and CTC, this argument has no merit. Most recipients of SSI in the states do not pay any income taxes simply because their incomes are so low. Furthermore, the justifications for the existence of the SSI program – the needs of U.S. citizens who are aged, blind or disabled and who have little or no income – is as great in Puerto Rico as anywhere else in the country.

Once success has been obtained for Puerto Rico with regard to the EITC and CTC, there will be a firmer basis on which to advocate a similar extension of SSI to Puerto Rico. The politics of “welfare,” however, support giving priority to EITC and CTC.

Other Federal Programs

A level playing field must also be established with regard to other federal programs. Especially noteworthy, Puerto Rico is treated unfairly with regard to Medicare payments. Whereas for the states, the per capita Medicare expenditures in fiscal year 2007 were \$1,157 and for Mississippi they were \$1,219, for Puerto Rico they were only \$511. Likewise, Puerto Rico receives a disproportionately small share of federal grants – for example, while the Department of Health and Human Services (HHS) gives out almost \$1,000 per capita in grants, grants per capital from HHS to Puerto Rico are less than a third of this. Both for improving the overall functioning of the Puerto Rican economy and as a matter for fairness, many federal programs need attention.

Attachment: Estimating the Impact of Extending the EITC and CTC to Puerto Ricans

I. The Amount of the Credits

1. As a basis for the cost estimates, data were obtained from the Puerto Rican Junta de Planificación and the *Statistical Abstract of the United States*. These data for Puerto Rico included:

- total personal income
- population
- number of families
- average family size
- number of families with children under 18
- number of two families with two married parents present and two children under 18
- number of families headed by a female with two children under 18

Where data were data were not yet available for 2008, figures were extrapolated from earlier years.

2. From “Development and Income Distribution: The Case of Puerto Rico” by Orlando Sotomayor (*World Development*, 32:8, 2004), data were obtained on income distribution by deciles for 2000. It was then assumed that the distribution of income was the same in 2008. Sotomayor’s data are for households, they were used here as proxy for family income distribution.

3. It was assumed that families with two married parents present were spread across the income distribution in the same manner as families in general.

4. It was assumed that families headed by a single female parent were all in the bottom seven deciles of the income distribution, with one-seventh of these families in each of those decile groups.

5. With the data on total personal income and population, per capita income was calculated. Using data on average family size, average family income was obtained; this figure was multiplied by the number of families to obtain total family income.

5. Using the figure for total family income and the distribution data, the total income received by each decile of the families was computed. Then, dividing this figure by the number of families in each decile, the average income received in each decile group was obtained.

6. For each such decile average, TurboTax for 2006 was used to calculate the federal refund that would come to each family (two parent and one parent families separately), with the assumption that all families had had two children. This average federal refund figure was then multiplied by the number of families in each decile category to obtain the total refund for each decile group.

7. The total refunds for each decile group – two parent and single parent – were then added to obtain the total refund for the year.

8. Note that because Puerto Ricans do not pay federal income tax, the EITC and CTC credits they would have received would have been greater than the refunds received by identical families in the states. To maintain equity between families in Puerto Rico and the states, it was assumed that the refunds obtained by Puerto Ricans would be no larger than the refunds received by families in the states – i.e., the refunds were calculated as the credits less the federal income taxes that would have been paid by identical families in the states.

II. The Multiplier

To determine the indirect impact of the influx of funds, a multiplier of 1.5 has been assumed. This seems reasonable and in line with the structure of the Puerto Rican economy.

It has also been assumed that the entire influx of funds would be spent on consumption. This assumption is justified because the funds would be going to people with relatively low incomes. Thus the entire \$1.19 billion can be seen as an “autonomous” increase of consumption, subject to the multiplier.