

## Puerto Rico – Dependence on Federal Transfers?

April 2022

- Is Puerto Rico too dependent on funds from the federal government? Some commentators have suggested that the federal expenditures going to the island create a dependency that undermines economic growth and well-being.
- But the support from Washington is not especially “generous” compared to several states.
- By a reasonable set of principles, Puerto Rico should receive *even more* funds from the federal government. These principles include:
  - *Federal funds should be directed to low-income areas of the country to improve living conditions in those areas.*
  - *Federal funds should be directed to promote economic growth in low-income areas of the country.*
  - *Fairness.*

Application of these principles might be called creating “dependency,” but it could also be called creating better well-being, economic growth, and fairness for Puerto Rico.

- Especially important, by comparison with states, Puerto Rico does not receive a “generous” or especially large amount of federal funds. In 2019 (the most recent year for which full data are available), six states received a greater amount of net federal expenditures per capita than did Puerto Rico. Net federal expenditures (NFE) are federal expenditures going to a state or Puerto Rico minus taxes paid to the federal government from a state or Puerto Rico.

(Puerto Rico residents pay federal payroll taxes.)

- In fiscal year 2019, the NFE coming to Puerto Rico was \$7,087 per capita, while Kentucky received \$14,153 per capita. Kentucky was at the top of the list, but the NFE to Alaska was \$10,144, and \$8,261 went to Maryland; West Virginia and New Mexico received \$7,681 and \$7,179, respectively. Mississippi and Alabama were just below Puerto Rico, at \$7,007 and \$6,737, respectively.
- Moreover, fiscal year 2019 was unusual for Puerto Rico because of federal assistance for recovery and reconstruction after the hurricanes of September 2017. If Puerto Rico’s NFE for fiscal year 2019 is adjusted downward by estimating and eliminating much of federal transfers and FEMA grants to Puerto Rico that was hurricane related, most states received a larger NFE per capita in 2019 than did Puerto Rico.
- Aggregate data, however, can be misleading. Most of the federal funds Puerto Rican individuals receive (more than two-thirds in most years) are for Veteran Benefits, Medicare, and Social Security, returns on what Puerto Rican’s have paid, financially or in military service—not some form of “welfare.”
- If anyone persists in viewing Puerto Rico as excessively dependent on federal funds, they should acknowledge that many states are similarly dependent. Better yet would be to drop this simplistic rhetoric entirely.

\*\*\*\*\*

As is well known, the level of income in Puerto Rico on average is well below that of any state. In fiscal year 2019, prior to the impact of the Covid-19 pandemic, per capital personal income on the island was \$21,341. That year, per capita personal income in Mississippi, the lowest income state, was \$39,062; and in West Virginia, the second lowest income state, the figure was \$43,500.

While federal expenditures to the states are determined by various factors, one of those factors is the needs of the states, which tends to mean that federal expenditures to low-income states will be relatively high. Also, states with low levels of personal income pay low amounts of taxes to the federal government. Accordingly, it would be expected that states with low personal income would have relatively high levels of net federal expenditures (NFE) – that is, federal expenditures minus federal taxes. This point is illustrated by the fact that in 2019, six of the ten states receiving the largest NFE per capita were among the ten lowest income states in the country: Mississippi, West Virginia, New Mexico, Kentucky, Alabama—the five lowest income states, and South Carolina, the seventh lowest income state. These low-income states rely heavily on funds from the federal government, for the operation of their economies and the well-being of their residents. They are, one might say, dependent on those funds.

Where would Puerto Rico stand if it were placed among the states? In 2019 with an NFE of \$7,087, Puerto Rico would be number 7 (displacing South Carolina to number 11), as shown in the table below. Thus, Puerto Rico would rank below six states in terms of NFE per capita, *in spite of the fact that Puerto Rico's per capita personal income was so much lower than any of those nine.*

Moreover, fiscal year 2019 was unusual for Puerto Rico in terms of the funds coming from the federal government because of federal assistance for recovery and reconstruction after the hurricanes of September 2017. If Puerto Rico's NFE for fiscal year 2019 is adjusted by estimating and eliminating the amount of the \$7,087 NFE that was hurricane related, the island's NFE for that year would be \$1,390 per capita. This adjusted NFE was lower than the NFEs of thirty-five states. Again, see following table. (The adjustment yields only a rough estimate and some states also received disaster relief in 2019. Yet, the large change in Puerto Rico's position relative to states due to the adjustment, even if not precisely accurate, seems valid.)

While these rankings are interesting and important, aggregate data do not tell the whole story. It is useful below to look at the composition of federal funds coming to Puerto Rico. Also, as will be explained shortly, it is reasonable to avow that Puerto Rico should receive even more federal funds. More funds might be called “creating dependency,” but it could also be called “creating better well-being, economic growth, and fairness” for Puerto Rico.

Net Federal Expenditures Per Capital (Expenditures Minus Taxes),  
States, Puerto Rico, and Puerto Rico Adjusted, FY 2019

	Net Federal Expenditures Per Capita (NFE)	NFE Rank		Net Federal Expenditures Per Capita (NFE)	NFE Rank
Kentucky	\$14,153	1	Wyoming	\$2,796	26
Virginia	\$13,096	2	Oregon	\$2,684	27
Alaska	\$10,144	3	Indiana	\$2,445	28
Maryland	\$8,261	4	Michigan	\$2,419	29
West Virginia	\$7,681		Florida	\$2,375	30
New Mexico	\$7,179	6	Georgia	\$2,337	31
<b>Puerto Rico</b>	<b>\$7,087</b>		Kansas	\$2,160	32
Mississippi	\$7,007	7	South Dakota	\$2,037	33
Alabama	\$6,737	8	North Dakota	\$1,607	34
Hawaii	\$6,116	9	Iowa	\$1,492	35
South Carolina	\$5,479	10	<b>PR Adjusted*</b>	<b>\$1,390</b>	
Arkansas	\$4,761	11	New Hampshire	\$1,363	36
Maine	\$4,705	12	Wisconsin	\$1,227	37
Oklahoma	\$4,638	13	Nevada	\$1,217	38
Louisiana	\$4,534	14	Texas	\$673	39
Delaware	\$4,284	15	Nebraska	\$397	40
Arizona	\$4,246	16	Illinois	\$342	41
Montana	\$4,221	17	Washington	\$45	42
Tennessee	\$4,108	18	Utah	-\$130	43
Vermont	\$3,984	19	California	-\$168	44
Idaho	\$3,951	20	Colorado	-\$239	45
Missouri	\$3,837	21	Minnesota	-\$336	46
Ohio	\$3,593	22	New Jersey	-\$1,163	47
North Carolina	\$3,379	23	New York	-\$1,172	48
Pennsylvania	\$3,243	24	Massachusetts	-\$1,439	49
Rhode Island	\$3,205	25	Connecticut	-\$1,614	50

\* Adjusted to eliminate the especially large and unusual federal funds coming to Puerto Rico for recovery and reconstruction after the hurricanes of September 2017.

Source: Rockefeller Institute of Government, *Giving or Getting? New York's Balance of Payments with the Federal Government* (January 2021), Table 4; the principal author of that report provided the Puerto Rico figure in an e-mail. For Puerto Rico adjustment, calculated from data in *Apéndice Estadístico del Informe Económico al Gobernador 2020*, Tablas 20, 21, and 22.

## **A “Welfare Island”?**

In 2006, *The Economist* magazine published an article dubbing Puerto Rico a “Welfare Island.” The U.S. government was, according to *The Economist*, being too “generous” to Puerto Rico, supplying the island so much in funds that work incentives were undermined, an exceptionally large bureaucracy developed, and the island’s economic growth was retarded. Sixteen years later, this view of Puerto Rico persists.

The data in the table above do not support this view of “generous” federal support for Puerto Rico. Indeed, while the data indicate that, in general, the NFE to low-income states is relatively large (“generous”), this practice does not appear to be applied with much force to Puerto Rico. At the very least, if Puerto Rico deserves the title of “welfare island,” several states should be dubbed “welfare states.” Better yet would be to drop entirely such simplistic rhetoric.

There is a measure by which federal economic support for Puerto Rico might be judged as excessively high. When NFE is compared to a state’s or Puerto Rico’s per capita personal income, Puerto Rico moves to the top of the list with a 2019 NFE at 33.2% of personal income – roughly on a par with the figure for Kentucky of 32.3%. However, with the adjusted NFE, Puerto Rico falls far down the list with the NFE only 5.4% of per capita personal income. Furthermore, there are several states, most of them low-income states but not as low income as Puerto Rico, for which the NFE per capita is relatively high as a proportion of per capital income. For example, on the basis of these aggregate data, West Virginia, Mississippi, New Mexico, and Alabama appear to be highly reliant on the funds they receive from Washington. (In these four cases, the NEC is between 15% and 19% of per capital persona income.) These states, like Kentucky, are relative low-income states, though not nearly as low-income as Puerto Rico. There is no reason to single out Puerto Rico as reliant on “generous” support from the federal government. (And see below regarding why Puerto Rico and low-income states receive, and should receive, high levels of support from the federal government.)

## **Beyond Aggregates**

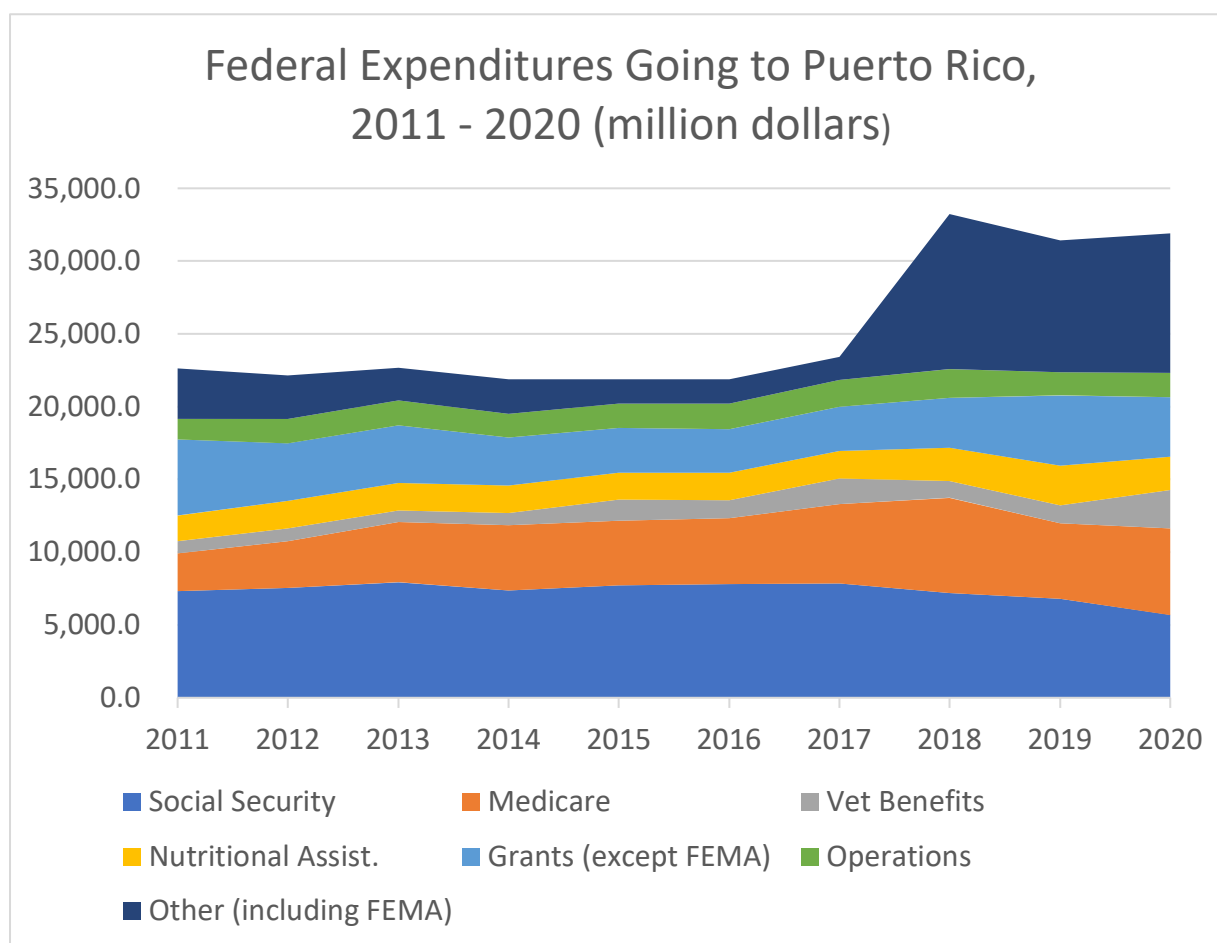
It would be an error, however, to characterize the extent and implications of federal economic support for Puerto Rico – or any of the states, for that matter – simply on the basis of aggregate data. The composition of funds coming to Puerto Rico from Washington tells a more complex story.

In fiscal year 2019, \$21,750 million of federal transfers went to Puerto Rican individuals. Of this total, 73.3% was in four categories: Veteran Benefits (5.6%), Medicare (24.0%), Social Security (31.2%), and Nutritional Assistance (12.5%). (If funds for hurricane relief are excluded, the total of these four categories rises to 85.5%). Puerto Ricans, like people living in the states, pay Medicare and Social Security payroll taxes, so the funds in those categories are simply returns on those payments. And Veteran Benefits are returns for service in the U.S. military. Of these four categories,

only the Nutritional Assistance funds fit under the rubric “welfare” as the term is generally employed. (Moreover, federal Nutritional Assistance funds are provided to Puerto Rico as a block grant, yielding less support that would be provided were Puerto Rico treated in the same manner as the states—i.e., in terms of need. See below.)

The composition of federal expenditures going to Puerto Rico in the period 2011 through 2020 is shown in the figure below. A couple of points that stand out:

- The sharp rise in 2018 in the “other” category is explained by the influx of federal funds for hurricane relief and reconstruction. This high level of hurricane-caused funding continued into 2019 and into 2020. However, the rise in 2020 seems to be in part a result of the early phase of federal funding to states and territories in response to the Covid-19 pandemic. The high level of “other” funding in 2019 masks the low amount of NFE that Puerto Rico normally receives relative to states, and thus the adjustment shown in the table above.
- Without the “other” funding, federal expenditures going to Puerto Rico were almost flat between 2017 and 2020. If adjusted for inflation, the small rise would be eliminated.



Source: *Apéndice Estadístico del Informe Económico al Gobernador 2020*, Tabla 20, 21, and 22. The 2020 figures are preliminary.

## Does Puerto Rico Receive Too Much? Too Little?

Whether Puerto Rico receives too much or too little funding from the federal government depends, of course, on what standards for judgement are applied. When, however, Puerto Rico is compared to the states, particularly the low-income states, it is hard to argue that it is receiving too much. The suggestion in *The Economist* article of 2006 that the funds from Washington harm work incentives is undermined by recognition of informal (i.e., uncounted) work, the high amount of disability among Puerto Rican workforce, limited employment demand, and the opportunities that exist for work in the states. Moreover, if the high NFE going to Puerto Rico creates a negative work incentive, those states that receive even a larger NFE per capita would surely face a similar problem, but low labor force participation does not seem to be an issue in those states.

There are, furthermore, three principles that would seem to support the position that Puerto Rico receives too little funding from the federal government. One of these principles is that *federal funds should be directed to low-income areas of the country to improve living conditions in those areas*. The data in the table above (Net Federal Expenditures per capita) suggest that, to some degree, this principle is applied in practice among the states, but not to a substantial degree in Puerto Rico. Given the island's low level of income – and poverty rate hovering around 45% – Puerto Rico should rank at the top or near the top in the table.

The second and related principle is that *federal funds should be directed to promote economic growth in low-income areas of the country*, and even as a territory Puerto Rico is part of the United States. Puerto Rico, as is well known, has been in a recession for the last fifteen years, and, as both cause and effect of the recession, has been in a crippling debt situation. While the funds that have been regularly coming to Puerto Rico have promoted the well-being of families and individuals, funds are now needed to stimulate economic expansion directly. To promote private sector growth, some action must be taken by the public sector to create conditions favorable for private investment. Most important would be a major increase in public sector infrastructure investment—improvement and extension of roads and bridges, educational and health care facilities, stable energy capacity, public transportation, water supply, internet capacity, etc. Puerto Rico itself, however, does not have the necessary resources. It is only by major funding for this investment from the federal government that this foundation for private sector expansion can be created. Twenty billion dollars of spending, stretched over a decade, could put the Puerto Rican economy on a positive growth path. A reasonable settlement the debt situation could make much of the \$20 billion available in the Puerto Rican government's own budget. Also, or alternatively, \$20 billion could be provided over a decade from the U.S. Treasury without significant burden.

The third principle that would support more funds for economic growth is *fairness*. Over decades, Puerto Ricans, though U.S. citizens, have not been treated

equitably with U.S. citizens in the states. With regard to federal funds, \$6 billion additional federal funds would have come to Puerto Rico each year if Puerto Rico had been treated the same as the states in regard to the following six programs: the Earned Income Tax Credit, the Child Tax Credit, Medicare, Medicaid, Nutritional Assistance, and federal procurement. (In federal legislation to deal with the Covid-19 pandemic, fairness between Puerto Rico and the states in the areas of these programs were somewhat improved, but Puerto Rico still received far less support than if the funds had been distributed to states and territories in proportion to population.)

It is, however, hard to imagine that a major increase in the amount of federal expenditures going to Puerto Rico could be accomplished simply on the basis of these three principles. In the allocation of federal funding, principles may not be irrelevant, but they only play a role within a highly politicized process. It is a process in which Puerto Rico has no players and minimal influence. Not a state, Puerto Rico has no voting members of congress and no votes for president.

It would seem that for Puerto Rico's economic needs to be met, it will have to become as state.