MEMORANDUM

May 1, 2007

Subject: Federal Fund Going to Puerto Rico

The purpose of this memorandum is to provide basic information on the flow of federal funds going to Puerto Rico. In order to provide some perspective from which to appraise the volume of these funds, Puerto Rico is compared with the fifty states and Washington, D.C. Also, some observations are offered on the economic impact of the funds going from Washington to Puerto Rico, the fifty states, and D.C. Data from FY2004 are used, as this is the most recent year for which comprehensive information is available.

Examination of the data leads to the following basic observations:

- On a per capita basis, Puerto Rico receives less funds from the federal government than does any state or DC. This is not only the case overall, but is also true in most major categories of funds. In those categories where Puerto Rico is not at the bottom of the list, it is not far from the bottom.

- When the funds coming from Washington are viewed in relation to per capita personal income, Puerto Rico ranks relatively high among the states because income in Puerto Rico is only about one-third of the average in the states. However, even by this measure, Puerto Rico is not at the top of the list. Overall, Puerto Rico ranks 4th.

- Although Puerto Ricans do not pay federal income tax (on Puerto Rican source income), if Puerto Rico, the fifty states and DC are ranked by per capita net receipt of federal funds (i.e., funds from the federal government less all taxes paid to the federal government), Puerto Rico ranks 19th.

- In terms of economic impact, the federal funds coming to Puerto Rico provide a substantial stimulus – but not as great as that provided to several states. While there may be problems with the structure of implementation of particular programs, the data examined here – either the aggregate flow of fund or the flow of funds in individual broad categories – do not suggest that Puerto Rico presents a special case, a case of extreme overall reliance on federal funds in a manner that would undermine work incentives.

Greater detail on each of these basic observations follows.

The Flow of Funds Per Capita

In fiscal year 2004, Puerto Rico received $15.475 billion from the federal government, including funds in all categories of federal expenditures. This amounted to $4,003 per person on the island. This was less than the per capita amount received from the federal government by any state or DC. In 2004, the average per capita funds going to the states, DC and Puerto Rico was $7,273. Thus, in per capita terms, Puerto Rico received 55 percent of the average.

What was true overall was also true in almost every broad category of funds that go from the federal government to the states, DC and Puerto Rico: in per capita terms, Puerto Rico was at the bottom or near the bottom of the list. A summary of Puerto Rico's position for fiscal year 2004 is shown in Table 1.[1] Regarding the various categories of funds shown in Table 1:

- In the largest category, which includes social security, disability and Medicare, in fiscal year 2004 Puerto Rico received $1,903 per capita, less than any state or DC; this was only 58.6 percent of the average. As with people elsewhere in the country, Puerto Ricans pay the payroll taxes that finance these receipts.

- In the category "other direct payments," which includes food stamps and other welfare-type payments, Puerto Rico's position rises to 49th. Its receipts per capita of $331 in fiscal year 2004 were 72.9 percent of the average. It should be noted in passing that all payments in this category amounted to 2.6 percent of per capita personal income in Puerto Rico in 2004. (See footnote 2 for more on the content of this category.)

- In the large category of "grants" – second to social security, disability and Medicare – Puerto Rico received $1,373 per capita and rose to 38th on the list (89 percent of the average). This category includes several programs that are designed – either by formula or discretionary policy – to support low-income areas. (See footnote 4.)

[1] Data in the tables for this report are from the following sources: *IRS Data Book, FY 2004*; *Consolidated Federal Funds Report for Fiscal Year 2004*, U.S. Census Bureau; *Bureau of Economic Analysis: Regional Economic Accounts*; Government Development Bank for Puerto Rico.

Table 1: Federal Government Payments to Puerto Rico Per Capita; Rank of Puerto Rico Among States, DC, and Puerto Rico; and Payments to Puerto Rico as a Percentage of Average to States, DC and Puerto Rico, Fiscal Year 2004

Category of Payments	Amount per capita	Rank	Percent of Average
Retirement, Disability & Medicare	$1,903	52	58.6
Other Direct Payments[2]	331	49	72.9
EITC and CTC[3]	13	52	5.3
Grants[4]	1,373	38	89.0
Salaries and Wages	265	52	35.6
Salaries and Wages w/o Defense	180	52	41.0
Procurement	119	52	11.1
Procurement w/o Defense	46	52	11.6
Total	**4,003**[5]	**52**	**55.0**

- Puerto Ricans are generally not eligible for the Earned Income Tax Credit or the Child Tax Credit. (The main exception is that Puerto Ricans may claim the latter when they have three or more children.) Thus for this "tax expenditure," Puerto Rico is not only at the bottom of the list, but receives only 5.3 percent of the average.

- In the categories of federal wages and salaries and procurements, Puerto Rico is again at the bottom of the list, receiving 35.6 percent of the average in the former category and 11.1 percent in the latter.

Thus when the dispersal of federal funds is viewed in terms of payments per capita and Puerto Rico is compared to the fifty states and DC, Puerto Rico receives a small amount from the federal government. Even when focus is placed on those categories of funds that are usually classified as social welfare or as directed toward low income regions, Puerto Rico does not stand out as a large recipient in terms of the per capita receipt of funds from the federal government. In terms of federal procurements and federal payments of wages and salaries, Puerto Rico's ranking is especially low.

[2] Other Direct Payments consist primarily of direct payments for individuals, other than retirement, disability and Medicare. Major categories of such payments include unemployment compensation, food stamp payments, federal employees' life and health insurance and agricultural assistance.

[3] Tax credits under the Earned Income Tax Credit and Child Tax Credit Programs. Puerto Ricans are generally not eligible for either of these credits with regard to income earned on the island; they are eligible for the Child Tax Credit if they have three or more children.

[4] Grants include both Formula Grants (allocation of money to states and subdivisions according to a distribution formula prescribed by law and not related to a specific program) and Project Grants (funding of either specific projects or the delivery of specific products and services). Principal funders include the departments of Health and Human Services, Transportation, HUD, Education and Agriculture.

[5] Parts do not equal total due to rounding.

The Flow of Funds in Relation to Income

In 2004, per capita personal income in Puerto Rico was only slightly more than one-third of per capita personal income in the states, DC and Puerto Rico taken all together – \$11,844 as compared to \$32,620. Thus, when the flow of federal funds is compared to income, Puerto Rico's relative situation changes significantly.

Table 2 shows that in relation to personal income, in 2004 Puerto Rico ranked fourth in terms of the amount of funds it received from Washington. For Puerto Rico, in 2004 total funds per capita coming from Washington amounted to 33.8 percent of per capita personal income. DC (132.8 percent), Alaska (38.1 percent) and New Mexico (40.2 percent) each received more in relation to per capita personal income than did Puerto Rico; Virginia (33.8 percent), West Virginia (32.8 percent), North Dakota (32.5 percent), and Mississippi (31.8 percent) received only slightly less. In some of these states, and especially DC, wages and salaries and procurement play an especially large role.[6]

Table 2 also shows that in no broad category was Puerto Rico receiving the largest amount of funds per capita in relation to per capita personal income. With regard to the largest category – retirement, disability and Medicare – West Virginia ranked higher, receiving an amount in this category of 17.3 percent of per capita personal income, as compared to Puerto Rico's 16.1 percent. In the other large category, grants, Puerto Rico ranked third behind DC and Alaska. In the "other direct payments" category, including food stamps, Puerto Rico was seventh. And in the procurement category, Puerto Rico is almost at the bottom; and of course with regard to CTC and EITC, Puerto Rico is last on the list.

[6] It should be noted, however, that federal wages and salaries and procurement expenditures, whatever their ostensible purposes, are also used to support jobs and incomes as are other categories of funds.

Table 2: Federal Government Payments to Puerto Rico Per Capita as a Percentage of Per Capita Personal Income; Rank of Puerto Rico Among States, DC, and Puerto Rico; and Payments to Puerto Rico as a Percentage of Average to States, DC and Puerto Rico, Fiscal Year 2004[7]

Category of Payments	Percent of Per Capita Personal Income	Rank	Percent of Average
Retirement, Disability & Medicare	16.1	2	161.6
Other Direct Payments	2.8	7	201.1
EITC and CTC	0.1	52	15.7
Grants	11.6	3	245.2
Salaries and Wages	2.2	27	96.5
Salaries and Wages w/o Defense	1.5	16	111.5
Procurement	1.0	51	30.3
Procurement w/o Defense	0.4	49	32.9
Total	**33.8**	**4**	**153.6**

Much of federal payments to states, DC and Puerto Rico is intended and justified precisely on the basis that those payments are a means to provide support where incomes are low. This is true not only of such programs as food stamps and the large category of "Grants," but it is also to some degree the case for procurements and various other forms of federal spending. Thus, many of the states that rank high in terms of the funds they receive relative to personal income are the states with low personal income per capita. Puerto Rico has a per capita personal income well below that of any state (in 2004, 48.3 percent of that of Mississippi, the lowest income state). Still, Puerto Rico is not at the top of the list, not overall and not in any category.

The Net Flow of Funds

Puerto Ricans do not pay federal income tax on income earned in Puerto Rico, though they do pay federal payroll taxes. Thus the payments by Puerto Rico to the federal government are small relative to other states. Yet, when Puerto Rico, DC and the states are ranked by net receipts per capita from the federal government – that is, receipts less federal taxes – Puerto Rico is far from the top of the list. For fiscal year 2004, when all categories of federal expenditures are taken into account, Puerto Rico ranks 19th. Alaska,

[7] See notes to Table 1.

the highest ranking state, received on net $8,005 per capita; Puerto Rico on net received $2,823.[8] Table 3 presents these data for the fifty states, Puerto Rico, and DC.

Puerto Rico's position may be surprising because, as noted, Puerto Ricans do not pay federal income tax on Puerto Rican source income. The very small amounts of federal wages and salaries and federal procurement expenditures received in Puerto Rico provide a large part of the explanation for its low (relative to expectations) ranking. Puerto Rico is near the top of the ranking only when retirement, disability and Medicare are considered alone. If the data on net federal receipts are viewed in relation to personal income, an approach that makes Puerto Rico's ranking relatively high, the island does not stand as an outlier, distinct from high recipient states.[9]

[8] The District of Columbia is at the top of the list, with net per capita receipts of $37,457, but it is clearly a special case. Several of the states, including Alaska and New Mexico (right behind Alaska with $7,348 per capita) owe their high rankings to large military expenditures relative to population; and Virginia, next on the list, ranks high because of its proximity to Washington. However, several of the states ranking higher than Puerto Rico are not "special cases" – for example, West Virginia, Mississippi, Alabama, Maine, South Carolina and Louisiana.

[9] The meaning of this net measure is not clear, and there is little rationale – if any – behind the idea that the payments of the states and regions to the federal government should balance their receipts. 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. There is no reason that for any state or region the payments should equal the receipts. Indeed, because of an implicit federal commitment to support regional income convergence, it is to be expected that low income-regions would necessarily have relatively large net receipts and relatively low payments.

Table 3: Per Capita Net Receipts of Federal Funds, 2004: States, Puerto Rico, and DC (dollars)*

	Net Receipts	Rank		Net Receipts	Rank
District of Columbia	37,457	1	Missouri	1,381	27
Alaska	8,005	2	Kansas	1,282	28
New Mexico	7,348	3	Indiana	1,019	29
Virginia	5,940	4	Oregon	916	30
West Virginia	5,562	5	New Hampshire	689	31
North Dakota	5,157	6	Pennsylvania	658	32
Montana	4,792	7	Washington	525	33
Mississippi	4,700	8	North Carolina	236	34
Alabama	4,629	9	California	-62	35
South Dakota	4,389	10	Nevada	-129	36
Maryland	4,383	11	Rhode Island	-188	37
Maine	4,175	12	Michigan	-225	38
South Carolina	3,586	13	Arkansas	-310	39
Kentucky	3,514	14	Georgia	-350	40
Hawaii	3,093	15	Texas	-380	41
Arizona	2,984	16	Wisconsin	-473	42
Wyoming	2,980	17	Massachusetts	-837	43
Louisiana	2,887	18	Colorado	-906	44
Puerto Rico	**2,823**	**19**	Ohio	-1,181	45
Vermont	2,596	20	New York	-1,370	46
Idaho	1,887	21	Nebraska	-1,385	46
Oklahoma	1,858	22	Illinois	-2,393	48
Utah	1,826	23	Connecticut	-3,223	49
Iowa	1,768	24	New Jersey	-4,025	50
Florida	1,677	25	Minnesota	-5,639	51
Tennessee	1,557	26	Delaware	-7,010	52

* Net receipts are all federal expenditures to the state, Puerto Rico, or DC less total taxes paid to the federal government from the state, Puerto Rico, or DC.

Economic Impact

There are at least two ways that the flow of federal funds to the states, Puerto Rico, and DC affect local economies. On the one hand, federal funds flowing to a region may have a negative impact. A heavy reliance on federal defense procurements, for example, could pre-empt the development of other types of business activity in a region. Or, an issue that is sometimes alleged to be the case with the flow of funds going to Puerto Rico, the flow of social welfare funds to a region might undermine work incentives. Indeed, Puerto Rico does have a low labor force participation rate – about 47 percent as compared to 66 percent in the states. On the other hand, clearly the federal funds are a stimulus to economic activity, creating jobs and raising incomes.[10] Indeed, it is reasonable to assume that there is a multiplier impact, with each dollar of federal funds going to a region creating more than a dollar of additional income in that region.

Regarding the potential negative impact of the flow of federal funds, the possibility of the pre-emption of other types of business activity because of federal procurement is not of significant relevance for Puerto Rico. A determination of the role of federal funds in affecting work incentives in Puerto Rico would require an examination of particular programs, how they are structured, and how they are implemented. Such an examination is beyond the scope of this memorandum. However, the data examined here – either the aggregate flow of funds or the flow of funds in particular broad categories – do not suggest that Puerto Rico presents a special case, a case of extreme overall reliance on federal funds in a manner that would undermine work incentives.

The per capita federal funds received by each state, DC and Puerto Rico are independent of the per capita amount of taxes paid by each of these entities. Therefore it is the variation of *gross* federal expenditures in relation to per capita income that would have an impact (if any) on work incentives. The gross figures are those of Table 2.

The data in Table 2 presenting **"**Federal Government Payments to Puerto Rico Per Capita as a Percentage of Per Capita Personal Income" do not show Puerto Rico as an outlier; it is not *the* exceptional region. Even looking at those categories of expenditure that might be associated with a negative work incentive – social security, Medicare and disability; other direct payments; and grants – in none does Puerto Rico rank at the top. Indeed, in the case of "other direct payments," Puerto Rico ranks 7th; this category includes foods stamps, often referred to as a major negative work incentive in Puerto Rico. The first category of Table 2, including disability payments, is one where negative work incentives might arise. Even here, Puerto Rico (16.1 percent) is not at the top of the list, ranking second to West Virginia (17.3 percent), and not far from Mississippi, Alabama and Arkansas (14.6 percent, 14.5 percent and 14.5 percent, respectively).

[10] The stimulus is at the margin, a stimulus resulting from an extra dollar of fund going to a region, given the amount of taxes or federal borrowing that comes out of that region. Whether or not the overall stimulus from the inflow of federal funds to a region is greater than the outflow of funds (federal taxes and borrowing) from that region is a separate and more complex question. In general, however, for those regions (Puerto Rico, DC and several states) where the inflow of funds is substantially greater than the outflow of taxes and borrowing, the stimulus would clearly be positive.

Turning to the positive economic impact of the federal flow of funds to the states, DC and Puerto Rico, the data suggest that several states receive a larger positive stimulus than does Puerto Rico. Table 4 provides a crude estimate of the impact by showing the decline (or increase) in GDP for each state, DC and Puerto Rico that would result from changing the net flow of federal funds to zero – that is by moving to a situation where the federal funds flowing to each region equaled the federal taxes flowing from that region, assuming a multiplier of 2. (That is, \$2 of GDP would be lost for every \$1 reduction in the net flow of federal funds. It should be emphasized that this is only illustrative, but the relative impacts in Puerto Rico and the various states would be the same regardless of the value of the multiplier that is assumed. In reality, however, the multiplier for the different states would vary depending on the nature of federal expenditures and local conditions.)

For Puerto Rico, the impact would be large, with a reduction of GDP of 27.7 percent (the right hand column of Table 4). Or, putting things the other way, the net flow of funds that come to Puerto Rico can be viewed as increasing GDP by 38.4 percent over what it would be without the net inflow of federal funds. However, for seven states (to say nothing of DC) the impact on GDP would be larger. In this crude case, New Mexico's GDP would be 43.9 percent smaller without the federal funds; West Virginia's, 40.5 percent smaller; and Mississippi's 35.4 percent smaller. Certainly Puerto Rico's economy is stimulated by the net inflow of federal funds, but not as much as the economies of several states.

Table 4: Impact on Per Capita Gross Domestic Product of the States and Puerto Rico Assuming the Removal of All Net Federal Expenditures and a Multiplier Effect of 2, Fiscal Year 2004

	GDP Per Capita	State Rank	Net Expend. Per Capita	State Rank	Adjusted GDP Per Capita	State Rank	Change in Rank	% Change in GDP
Total U.S + P.R.	**39,438**		**528**		**38,383**			
District of Columbia	140,030	1	37,457	1	65,117	2	(1)	53.5%
New Mexico	33,439	41	7,348	3	18,744	49	(8)	43.9%
West Virginia	27,489	50	5,562	5	16,366	51	(1)	40.5%
Mississippi	26,561	51	4,700	8	17,161	50	1	35.4%
Montana	29,759	49	4,792	7	20,175	48	1	32.2%
Alabama	31,205	47	4,629	9	21,947	47	-	29.7%
Alaska	54,907	3	8,005	2	38,898	19	(16)	29.2%
North Dakota	35,771	34	5,157	6	25,457	43	(9)	28.8%
Puerto Rico	**20,355**	52	**2,823**	19	**14,708**	52	-	**27.7%**
Virginia	43,839	10	5,940	4	31,960	33	(23)	27.1%
Maine	32,840	42	4,175	12	24,489	45	(3)	25.4%
South Carolina	31,322	45	3,586	13	24,151	46	(1)	22.9%
South Dakota	38,526	22	4,389	10	29,747	38	(16)	22.8%
Kentucky	32,080	43	3,514	14	25,052	44	(1)	21.9%
Maryland	41,507	15	4,383	11	32,741	32	(17)	21.1%
Arizona	33,818	40	2,984	16	27,850	41	(1)	17.6%
Louisiana	35,473	36	2,887	18	29,698	39	(3)	16.3%
Hawaii	39,782	19	3,093	15	33,596	30	(11)	15.6%
Vermont	35,391	37	2,596	20	30,199	37	-	14.7%
Wyoming	47,563	6	2,980	17	41,603	13	(7)	12.5%
Idaho	31,228	46	1,887	21	27,453	42	4	12.1%
Oklahoma	31,740	44	1,858	22	28,025	40	4	11.7%
Utah	34,552	39	1,826	23	30,899	35	4	10.6%
Florida	35,027	38	1,677	25	31,674	34	4	9.6%
Iowa	37,303	28	1,768	24	33,767	27	1	9.5%
Tennessee	36,735	31	1,557	26	33,620	28	3	8.5%
Missouri	35,771	35	1,381	27	33,010	31	4	7.7%
Kansas	36,164	33	1,282	28	33,601	29	4	7.1%
Indiana	36,785	30	1,019	29	34,747	26	4	5.5%
Oregon	37,449	26	916	30	35,617	25	1	4.9%
Pennsylvania	37,380	27	658	32	36,064	24	3	3.5%
New Hampshire	40,080	18	689	31	38,702	20	(2)	3.4%
Washington	40,795	16	525	33	39,745	15	1	2.6%
North Carolina	37,929	24	236	34	37,457	22	2	1.2%
California	42,325	13	(62)	35	42,449	11	2	-0.3%
Nevada	42,464	12	(129)	36	42,722	10	2	-0.6%
Rhode Island	38,722	21	(188)	37	39,097	18	3	-1.0%
Michigan	36,252	32	(225)	38	36,702	23	9	-1.2%
Georgia	38,477	23	(350)	40	39,176	17	6	-1.8%
Texas	40,160	17	(380)	41	40,921	14	3	-1.9%
Arkansas	30,048	48	(310)	39	30,668	36	12	-2.1%
Wisconsin	37,709	25	(473)	42	38,655	21	4	-2.5%
Massachusetts	48,734	5	(837)	43	50,407	6	(1)	-3.4%
Colorado	43,768	11	(906)	44	45,580	9	2	-4.1%
New York	47,162	8	(1,370)	46	49,901	7	1	-5.8%
Ohio	37,104	29	(1,181)	45	39,465	16	13	-6.4%
Nebraska	38,913	20	(1,385)	47	41,682	12	8	-7.1%
Illinois	41,981	14	(2,393)	48	46,767	8	6	-11.4%
Connecticut	52,080	4	(3,223)	49	58,525	3	1	-12.4%
New Jersey	47,168	7	(4,025)	50	55,218	5	2	-17.1%
Delaware	62,982	2	(7,010)	52	77,001	1	1	-22.3%
Minnesota	44,035	9	(5,639)	51	55,313	4	5	-25.6%

Source: Bureau of Economic Analysis: Regional Economic Accounts (Gross Domestic Product by State)
Puerto Rico data from Government Development Bank for Puerto Rico
Consolidated Federal Funds Report for Fiscal Year 2004, US Census Bureau