FISCAL CAPACITY AND PERFORMANCE IN THE U.S. VIRGIN ISLANDS

BY

S. B. JONES-HENDRICKSON

INTRODUCTION: CONSTITUTIONAL AND ECONOMIC BACKGROUND

Fiscal capacity and performance are attempts at coming to grips with the quantification and qualification of resource transfer and utilization (1) from the private to the public sector and (2) from federal to local government or from agency to sub-agency. In this study of the fiscal capacity and performance of the U.S. Virgin Islands, the focus will assume, in addition to the above, a time dimension.

The islands under discussion were originally territories of Denmark. Denmark's role in the economic development of the islands was partially creditable. The West India Company [1] was chartered by the Kingdom of Denmark in 1671 specifically to undertake a widescale programme of colonization of St. Thomas and St. John. In 1733 France sold St. Croix to the Danes. During the Napoleonic Wars, there was a brief British occupation. Save for that period, the Danes ruled the islands until 1917.

TABLE 1 LAND AREA AND POPULATION

Island	Area	Population (1975)	Density
St. Croix	217.6 sq. Km	46,330	212.9
St. John	72.6	2,190	30.2
St. Thomas	51.8	43,910	847.7

Virgin Islands:

Year	Population	Per Capita Income
1940	24,489	n.a.
1950	26,665	$242
1975	92,430	$4,458

Sources: Bureau of Vital Statistics, V.I. Department of Health for Population Statistics; Per capita income data are from Jerome McElroy's *The Virgin Islands Economy, Planning Alternatives*, C.R.I., 1974, p. 8. See full data in our Table 4.

The United States Virgin Islands (Virgin Islands) are approximately 65 Km east of Puerto Rico, and about 320 Km west of St. Kitts-Nevis. Of the 50 cays which comprise the islands, only three islands – from the point of view of size and development – are significant. These are St. Croix (217.6 sq. Km), St. Thomas (72.6 sq. km), and St. John (51.8 sq. Km). From 1950 to 1976, population and income growth have been remarkably high in this 342 sq. Km region. As Table 1 indicates, the population rose from 24,889 in 1940 to 92,430 (1975); per capita income rose from US $242 in 1950 to $4,458 (1975). Several circumstances were responsible for this growth.

When World War 1 began to spread over the world, and the Germans were becoming confident of victory, the United States of America worked out a deal with Denmark to sell the islands. To prevent the Germans from establishing a U-boat stronghold in the Caribbean, the United States purchased the islands from Denmark in 1917 for (US) $25m.

On 31 March 1917 the United States Navy was authorized to administer the islands. This administration continued until 27 February 1931, when, by executive order from the White House of the U.S.A., administrative jurisdiction was transferred to the Interior Department of the U.S.A. This transfer signalled the appointment of the first civilian Governor of the islands.

A fundamental change swept the governance of the islands in 1954 with the passage of the Revised Organic Act of 1954.[2] This Act empowered the Congress of the United States to permit the establishment of distinct and separate branches of government: executive, legislative and judicial. A certain degree of self-government was permitted too.

Up to November 1970, the Governor of the Virgin Islands was appointed by the President of the United States of America. The appointment had to be in concert with the views of the U.S.A.'s Senate. The Governor served at the pleasure of the President, and under direct supervision of the Secretary of the Interior Department. The Governorship in this capacity was different, and still remains different from the Governorship of the Commonwealth Caribbean countries.

"Government from Washington" was partially terminated on 26 August 1968 when President Lyndon B. Johnson affixed his signature to the Elective Governor Bill for the Virgin Islands.[3] The Act made provisions for the people of the Virgin Islands to elect their own Governor and Lieutenant Governor. The Bill also involved substantial revisions to the Revised Organic Act of 1954.

Fifty three years after the islands were purchased by the United States of America, the electorate was given permission to vote. On 7 November 1970, the first popularly elected Governor became the chief Executive and decision-maker in the Virgin Islands of the United States of America. By and large, the Administration which took office following the November election adopted the same principles and adhered to the same tenets of economic development as the earlier administrations. Today there is a change of administration, but the same capitalist ideology remains.

REGIONAL MONETARY STUDIES CONFERENCE 1976

TABLE 2 TOURISM – MAJOR ASPECTS IN THE U.S.V.I.

Fiscal Years	Visitors By Air	Cruise ships	Total	Total Tourist Expenditure	Per Capita Tourist Expenditure
	(000s)			$000	$
1960	124.0	56.0	180.0	24,780	$137.63
1961	146.0	58.1	204.1	25,817	126.49
1962	187.7	57.6	245.3	35,145	143.24
1963	215.8	64.2	280.0	41,070	146.65
1964	285.6	100.6	396.2	48,158	121.54
1965	354.6	109.3	436.7	54,014	123.69
1966	436.8	117.7	554.4	59,456	107.24
1967	516.3	133.4	649.6	75,037	115.50
1968	651.1	166.1	817.2	100,894	123.46
1969	772.5	213.5	986.0	112,268	113.86
1970	669.8	251.1	920.9	100,480	109.11
1971	657.0	253.9	910.9	91,131	100.04
1972	742.8	364.6	1,107.5	108,715	98.16
1973	681.9	473.5	1,155.4	100,018	86.56
1974	580.6	495.8	1,076.4	95,000	88.26
1975	531.0	450.5	981.5	144,478	147.20
1976	357.0	471.1	828.0	162,291	195.99

Source: Division of Trade and Industries, Department of Commerce, U.S.V.I.

Structurally, the economy is a mono-service, open dependent economy. Tourism is the single most important industry in the Islands. As can be observed from Table 2, tourist expenditures during fiscal year 1976 totaled $162.3m rising from $24.8m in 1960; in per capita terms, the increase is slight.

Although there may be some questions about the statistical accuracy of the data, the information is sufficiently adequate to offer useful guidelines. Over the years efforts have been devoted to the large scale attraction of light industries and a few large manufacturing complexes. Industries came in the form of watches, construction, banking, oil and alumina, to name a few. Rum distilling is of major importance to the islands.[4]

Currently there are 13 watch assembly companies in the Virgin Islands. In 1975 they exported watches and watch movements to the U.S.A., valuing $25.3m. The year-round watch companies' labour force is about 650 persons.

Alumina Oxide and Petrochemical Products are the major revenue generators in the Virgin Islands. Martin Marietta Alumina Inc., (once called Harvey Alumina) and Hess Oil Company of the Virgin Islands (HOVIC) shipped nearly $2,000 million worth of merchandise from the Virgin Islands in 1975. Nearly 90 per cent of this value

originated-in Hess Oil Corporation. Unfortunately the revenue contributions of these two manufacturing concerns to the V.I. economy, are small. This weakness developed as a result of the extremely liberal tax incentives granted to the two firms.

As of 1975, there were 68 manufacturing concerns in the Virgin Islands with a work force of approximately 3,000 persons, and with a pay package of about $1.9 billion. However, the value of tax exemptions in 1975 exceeded $100m. It has been established by some estimates that the V.I. stand to gain a quantum of revenues exceeding $100m commencing in 1979 when Martin Marietta Alumina exemption expires, and definitely by 1982 when Hess Oil Company exemption expires.[5]

Given the peculiarities of the Islands' economic system and given their proximity to the Puerto Rican economy, the Virgin Islands engaged in large scale liberal tax exemptions, subsidy benefits and other fiscal incentive programmes to attract industries to locate there. There are various types of incentives for private investment in hotels, guest-houses, industrial parks, condominiums and other housing complexes. Tax exemptions vary up to 16 years and provide for a rebate of more than 75 per cent of income taxes in the form of subsidy.

Added to the host of incentive legislations, Virgin Islands manufacturers of goods that contain 50 per cent of foreign raw materials are allowed duty-free into the U.S.A.[6] The products enter under Section 301 of the U.S.A. Tariff Act.

Given this liberal-oriented, open, dependent, tourist economy, what public finance structure exists, and where did it start? How do these answers keynote our analysis of the fiscal capacity and performance in the U.S. Virgin Islands?

The Islands depend on three primary sources of revenue for capital and recurring expenditures. Local income tax is the dominant component of the revenue group. By an Act of Congress, the U.S.A. Federal income tax schedules are applicable in the Virgin Islands. Federal excise taxes collected in the United States on imports of Virgin Islands products are returned to the Virgin Islands as matching funds. The local economy must raise, through taxes, an amount of money which matches the quantum of excises to be rebated to the Islands.

The U.S. Federal Government also aids the territory by making earmarked and non-earmarked appropriations, and grant-in-aid allocations for a multiplicity of activities. These include activities in the areas of libraries and museums, public affairs (welfare assistance), health and disease services, conservation and environmental services, educational services and wildlife.

With this general overview, it is now appropriate to outline the structure of this study. We present the origins of the public finance structure of the Virgin Islands in section two. Section three reviews the major taxes in the Islands, highlighting their importance and impact in the economic system. In the fourth section we consider, against the background of work done on the subject matter, variations in the expenditure aggregates. Section five is devoted to an analysis of the revenue and expenditure efforts of the Islands over the period 1940-1975. The sixth section develops some thought about fiscal responsibility in the U.S.V.I.; the final section is a summary and conclusion.

ORIGINS OF PUBLIC FINANCE STRUCTURE

The fiscal provisions of the Revised Organic Act of 1954 provide substantial points of departure *vis-a-vis* the origins of the public finance structure in the Virgin Islands.[7] Three major provisions were:

(1) Permanent residents of the V.I. were considered as having satisfied their income tax obligations by paying in the Virgin Islands treasury, taxes on their income derivable from bases internal and external to the V.I. (2) A matching fund system was to be instituted whereby incomes from local revenues of commodities produced in the islands were to be turned over to the local government in an equal sum of local revenues generated. (3) A contingency fund of $1 million earmarked for emergencies and essential public goods and services was to be provided too. In any given fiscal year, the contingencies should not exceed $5 million.

Apart from these three main provisions, the Revised Organic Act (R.O.A.) had specific stipulations which improved upon the fiscal scene relative to the Colonial period, the conventional arrangements between Denmark and the United States, and the issues surrounding the V.I. Organic Act of 1936. Some of these specific stipulations were exhaustive in their public finance scope. For instance, the legislature was authorized to issue on behalf of the government revenue bonds for the improvement of public sector projects. The revenue derivable from the bonds was to be the sole medium of payment. A ceiling was set on each issue of these bonds. A time limit was also stipulated for the period of maturity with a stipulated rate of interest. This fiscal action was strict Keynesian economics, foisted upon the Virgin Islands economic system.

A number of other revenue bonds, similar in scope and dimension to those above, were permitted by the R.O.A.[8] A set of fiscal provisions were outlined in the R.O.A. too.

The fiscal provisions stipulated that

> the proceeds of customs duties, the proceeds of United States income tax, the proceeds of any taxes levied by the Congress on the inhabitants of the Virgin Islands, and the proceeds of all quarantine, passport, immigration, and naturalization fees collected in the Virgin Islands, less the cost of collecting all said duties, taxes and fees, shall be covered in the treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide. [Bough 1 p. 76, #22].

An Amendment of the United States Internal Revenue Code of 1939, specifically sub-chapter B of chapter 28 of the I.R.C. permitted a fuller expression of the disposition of internal revenue collections in the Virgin Islands.

Commencing in fiscal year 1954, and all other years thereafter, the U.S. Secretary of the Interior had the powers to determine "the amount of all taxes imposed by, and collected during the fiscal year under, the internal revenue laws of the United States (of America) on articles produced in the Virgin Islands and transported to the United States (of America)" [Bough and McCridis 1 p. 77].

The section went on to outline the mechanism of the matching funds in its transference and payments to the government of the Virgin Islands from the United States of America. Certification of the authenticity of the funds was under the jurisdication of the Government Comptroller of the Virgin Islands – a Federal financial watchdog. Matching funds transferred to the V.I. treasury constituted a special fund, disbursement of which was to be undertaken by the Legislature subject to the approval of the President of the U.S.A. or his designated representative.

In addition to the preceding, special provisions were made whereby a certain sum of money was to be turned over to the V.I. treasury after payments were made according to the previous set of payments.[9] This sum of money was to be lodged in another special fund, and earmarked for emergencies and essential public works projects.

Should the appropriations be unused at the end of a fiscal year, the monies should remain intact for subsequent usage but would be restricted to emergencies and public projects, as stated above.

Essentially, the public finance origins in the Virgin Islands are couched in (1) a set of antecedents from the Danish rudimentary excursions into public finance, and (2) a hodge-podge of United States fiscal policy prescriptions. The fiscal prescriptions were Keynesian in orientation but with more than a liberal sense of fiscal vulgarity. The distinct impression was being foisted on the Islands' economy that revenues would never be scarce: the Federal coffers would always solve the fiscal crises. How did the V.I. economy internalize its revenue generating capacity? To answer this question, let us now turn to a review of the major taxes of the V.I.

REVIEW OF THE MAJOR TAXES IN THE V.I.

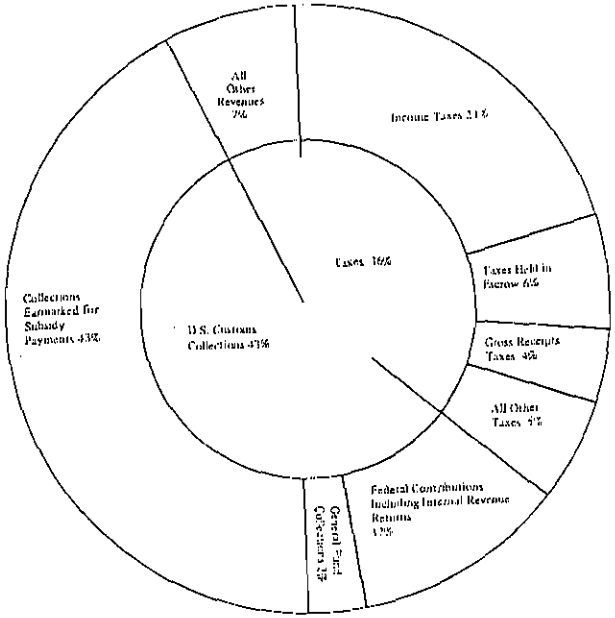
By and large the Virgin Islands public sector's fisc depends on revenues from six major sources: income taxes, gross receipts, trade and excise taxes, customs duties, real property taxes, and license fees. Over the years the contributions from these revenue generators have been fairly consistent in proportional terms. Where discrepancies exist in terms of share contributions, this may be as a result of definitional or aggregational problems. Figure 1 highlights the percentage importance of the various taxes. Although the picture pertains to 1975, it is sufficiently illustrative of the earlier years to warrant its presentation.

Income Tax

From Figure 1 it is observed that income tax is the dominant source of internal revenues in the Virgin Islands. The V.I. income tax is a United States Federal income tax applied to the tax base of the islands. By Congressional stipulations employees in the Virgin Islands have to pay income taxes from all sources into the Virgin Islands Treasury.

The continuous importance of the income tax in the V.I. is due primarily to a broadened base, and the elasticity of the tax to changes in GNP. Higher rates and

FIGURE 1:



Source: Department of Finance *Annual Report*, 30 June, 1975, p. 40, figure one.

improved administration have also been significant. This view of the V.I. income tax *vis-à-vis* the GNP seems to be in agreement with U.S. studies which indicate that for every 1.0 per cent increase in GNP the state individual income tax gives a yield of 1.7 per cent. [Netzer 16 p. 37-38 and Maxwell 14 p. 81].

Gross Receipts Tax

This is a tax levied on all receipts, money or accrued payments for services rendered, or payments obtainable from the transaction in trading, business or commercial venture, or such value that may accrue from transactions involving the sale of personal property or the rendering of service for a fee. Some factor payments are included, for example, rentals. However, no adjustments are permitted for the transactions of real property sold, material costs used in the transaction, labour costs, interests and so forth.[10] In many respects this tax approximates what is sometimes termed a production tax.

An analysis of the items on the excise would give another indication of the fact that the V.I. is a tourist economy. These rates have not varied too much over the years; the yields have been substantial over time. However, because excise, trade, corporation, and gross receipts taxes were under one aggregative heading, it is difficult to state the full impact of excise taxes on the local V.I. revenue system.[11]

TABLE 3 EXCISE TAX RATES

	%
Beer	10
Bicycle	10
Firearms and Ammunition	10
Marine Engine, Motor Boats, Launches	10
Self Propelled Vehicles and Accessories	10
Distilled Spirits	10
Tobacco, Cigarettes, Cigars	5
Inner Tubes and Tires	5
Perfumes	3
Projectors and Cameras	3
Soft Drinks	3
Watches, Silver and Jewellery	3
Leather Goods	3
Molasses	3
Outboard Motors	3
Electrical and Other Appliances	3
Rugs	3
Construction Material	3
Soaps, Detergents and Toilet Accessories	3
Other	3
Medicines and Drugs	2
Clothing	2

While the tourist aspect of the tax is evident, the traditional public finance aspect is also noticeable. Sumptuary taxes, i.e. taxes on liquor, tobacco, have high rates: 5-10 per cent. Motor boats, marine engines, launches attract a tax in accordance with the benefit and resource allocation concept.

The method of excise tax computation in the V.I. is based on the net invoice of the good or service including a 5 per cent mark-up factor on articles imported in the Islands for trade or business purposes. If, however, the articles catalogued in Table 3 are in transit to purchasers outside of the territorial confines of the V.I., or if the articles are purchased by the Virgin Islands Government, (agencies, departments, statutory boards, etc.), no excise tax is levied on the articles.[12]

Corporations, partnerships, proprietorships and persons who engage in the importation of goods or services into the V.I. are subject to the excise levy with the proviso the goods or services must be in the normal trade or business process, as inputs in a production process or be used for personal benefits.

There is no VAT in the V.I. If an article passes through several stages of resale, the excise tax is levied on the first seller in the V.I., the importer or manufacturer, as the case may be.

Import Duty (Customs Duty)

Cherished as the notion is in the Virgin Islands, the economy is not really a 'freeport'. In 1917 when the Danes sold the Islands to the U.S.A. a customs duties proposal was established whereby the level of duties would not increase, hence the V.I. were to be considered a freeport. The fact of the matter is, a 6 per cent across the board *ad valorem* import duty is levied on all non-U.S.A. imports into the territory.

In a general sense, customs duties are part and parcel of the developmental perspective in that they are "supplements to the prices of imported finished products and imported inputs." [Due 7 p. 27]. If there are certain exchange rate and world prices, and if there is no domestic production, prices to the V.I. consumers will rise by the dollar amount of the custom duty; this means that the duties will decrease the real income of the Virgin Islanders *vis-à-vis* consumption spending devoted to the goods or services subject to the duty. If exchange rates are flexible, the reverse situation could occur, and be beneficial to the V.I. However, the V.I. economy is dependent on the U.S.A. as far as its 'monetary policy goes', so for practical purposes, there is no flexible exchange rate in the V.I.

Due to the possible shortcomings of the customs duty, in terms of equity and administrative operations, adjustments are made in the implementation of the duty, which adjustments are geared to mitigating adverse impacts on the V.I. economy. The U.S. Federal Government collects and administers the duty. However, the proceeds are deposited in the treasury of the Virgin Islands, minus administrative and/or other management costs. If firms qualify, under the conditions of the Investment Incentives Law, they may be reimbursed of up to 90 per cent of the import duties paid on factor inputs, specifically raw materials.

In 1975, U.S. Customs collections amounted to 45 per cent of all revenues collected. Of this amount 43 per cent was earmarked for subsidy payments.

Property Taxes

Personal property is not taxed in the Virgin Islands, however, an assessment is imposed on real property. The assessment rates are on the order of 60 per cent of the market value. A standard 1.25 per cent is levied on the assessed value of the real property.

In general, the real property tax in the V.I. is a mediocre fiscal instrument. The tax is not administered with as much efficiency as is possible. It is not equitable in its incidence. By and large, the single most critical weakness of this tax is inaccurate assessment. Three main factors pervade this inaccuracy, (1) underassessment, (2) anomolies in individual property values *vis-à-vis* the general assessment ratio of the Virgin Islands, and (3) political gerrymandering in the institutionalization of assessing property.

Licenses

Any concern doing business in the V.I. is required to have a license; given the multitude of 'concerns', this category of revenues is similar to a miscellaneous category. In addition to the above, there are some other Federally related taxes which are applicable in the V.I. These include payroll taxes, estate, gift, and inheritance taxes.

Payroll Taxes

The payroll tax manifests itself in the form of the withholding of income tax. The format is the same as in the U.S.A., except that the revenues withheld are paid into the treasury of the V.I. This tax is closely linked to Social Security, U.S. Federal programme with the same requirements as in the U.S.A. The U.S. Federal Unemployment Contributions Act is not applicable to the V.I.; there is, however, a local counterpart which makes it requisite that employers pay a rate of 1.5 per cent of the first $4,200 annual earnings of each employee. [Danielson 3 p. 69].

Estate, Gift and Inheritance Taxes

Due to many misinterpretations of the law pertaining to estate, gift and inheritance taxes, a bill was passed by the V.I. legislature in October 1973, "To Establish a Virgin Islands Gift Tax and to Amend the Inheritance Tax". [Danielson 3 p. 69]. The law imposes a tax on all gifts exceeding $3,000 given to anyone in a calendar year. There are no provisions for split gifts. The rates are not progressive. They vary as follows:

	Per Cent
Spouses or lineal ascendants and descendants	5
Brothers, sisters or their issue	10
All others	15

This tax is applicable to gifts of all property. Its base is the Virgin Islands, regardless of the donor's resident or non-resident status.

The review of the major and other taxes in the Virgin Islands was necessary to get a broad view of the analysis that will be developed. The work done on the V.I. tax structure is minute. Gustav A. Danielson's "Taxation in the United States Virgin Islands" [3], Taylor and Oldman "Tax Incentives for Economic Growth in the U.S. Virgin Islands" [18], Jerome McElroy "The U.S. V.I. Tax Structure: An Overview of Recent Performance: [15] and Jones-Hendrickson [12] are the only substantial works on aspects of public finance in the U.S.V.I. In many respects these works have only scratched the surface. This analysis will now centre on expenditure, revenue, and tax preferences.

VARIATIONS IN EXPENDITURE AGGREGATES:

We now present expenditures in the V.I. from 1950-1975. The public finance *modus operandi* in these Islands do not permit an unequivocal statement that the years with high expenditures (or high per capita expenditures) have any significant explanation in terms of the level of service rendered for the expenditure incurred. As we observe from Table 4, expenditures moved from $2.1m (1950) to $296.1m (1975); this represents over 140-fold nominal increase within a quarter of a century. Data on inflation are inadequate hence we were unable to deflate the series and present a *real* series.

TABLE 4 COMPARATIVE SERIES OF EXPENDITURE 1950-1975 (RELATIVE, INDEX, PER CAPITA)

Fiscal Year	Total Expenditures $000	Time Expenditures	Mean Expenditure Relative
1950	$ 2,108.9	3	3
1951	2,530.6[e]	4	3
1952	2,699.3[e]	4	3
1953	2,710.6	4	3
1954	3,794.9[e]	6	5
1955	4,065.9[e]	7	5
1956	4,608.1[e]	8	6
1957	4,738.2	8	6
1958	5,848.0	10	8
1959	7,896.6	13	10
1960	12,095.0*	18	16
1961	15,662.9	26	20
1962	20,050.8	33	26
1963	18,111.9	30	23
1964	30,182.9	49	39
1965	34,903.3	57	45
1966	40,614.7	66	57
1967	61,197.9	100	79
1968	80,856.0	132	104
1969	96,331.6	157	124
1970	94,757.1	155	122
1971	124,353.9	203	160
1972	162,411.1	265	209
1973	204,206.8	334	263
1974	244,631.6	400	315
1975	296,180.7	484	381

e = Estimates

*This jump in revenues reflect, in part, a significant change in the V.I. fiscal history, as a result of the passage of *Public Law 517*. Section 28 of the Law provides for the return to the Islands, of taxes imposed by the Internal Revenue Laws of the U.S. on articles produced in the V.I. and transported to the U.S.A.

Comparability of the expenditure is done from two points of view: in the case of the time expenditure relative, 1967 is assigned the value of 100, and an index is built based on that base year. In the case of the mean expenditure relative the average expenditure is taken over the period, and each year is related to the average as a base. In this regard it is observable that in 1957, the Virgin Islands was spending 93 per cent less than what it spent in 1967, and in 1975, it spent 384 per cent more than what it spent in 1967.

Likewise, in 1957 and 1975, the Islands spent 94 per cent and 281 per cent more respectively than the average expenditure for the period 1957-1975. These 'relatives' to average and time are inadequate statistical indicators in that they do not give any concrete reflection of income distribution or expenditure incidence in the Virgin Islands.

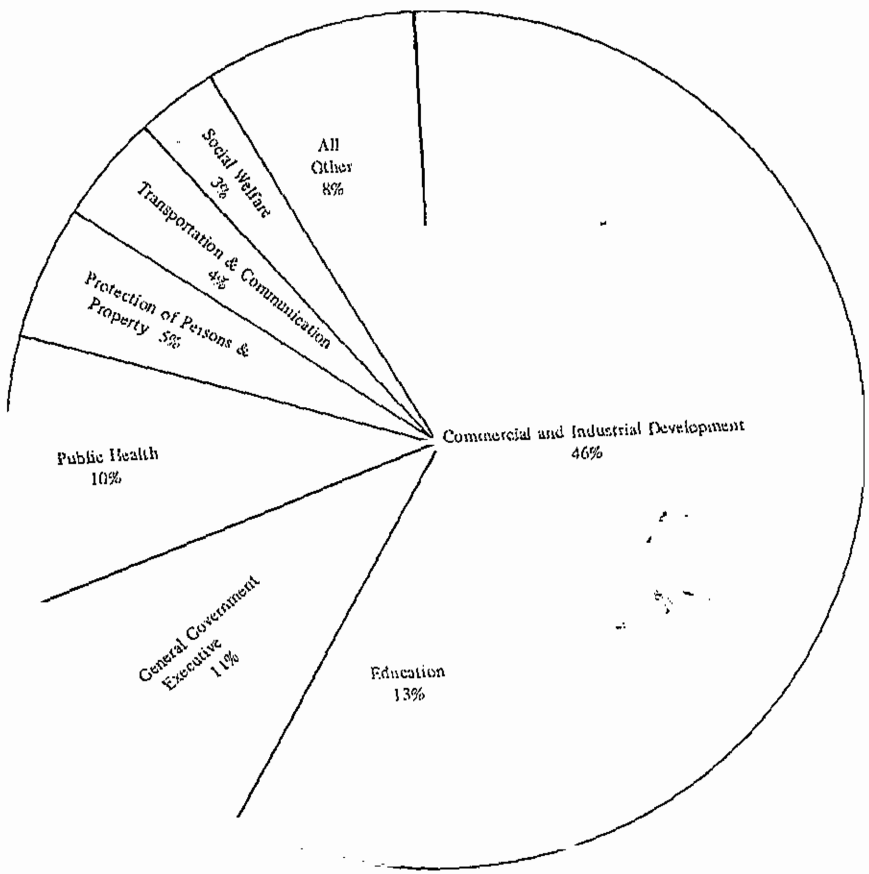
In Table 5, data are presented on a per capita income and per capita expenditure basis.

TABLE 5 PERSONAL INCOME AND PUBLIC SECTOR EXPENDITURE PER CAPITA, 1950-1975

Year	Personal Income-Per Cap.	Per Cap. Expenditure
1950	$ 412	$ 79.09
1951	423	93.33
1952	450	107.32
1953	465	125.56
1954	476	149.97
1955	480	178.46
1956	489	183.68
1957	502	196.63
1958	540	220.83
1959	594	270.33
1960	625	376.80
1961	627	454.66
1962	874	565.26
1963	900	561.26
1964	1,060	720.13
1965	1,122	701.69
1966	1,376	798.40
1967	1,674	1,079.35
1968	2,281	1,287.48
1969	2,496	1,383.10
1970	2,584	1,257.16
1971	2,820	1,571.12
1972	3,204	1,918.62
1973	3,524	2,278.59
1974	4,053	2,447.82
1975	4,458	2,961.80

Source: 1957-1975 data are adapted from Jerome McElroy [14] p. 8. (per capita income only)
Note: The other years are our *estimates* from various sources.

FIGURE 2: Overall View of the Expenditure Breakdown in 1975



Adapted from Department of Finance *Annual Report*, 1975, p. 41.

The rising income over time in the Virgin Islands may be seen as one of the causal determinants of expenditure increase. It has been estimated that for every 10 per cent increase in a state's per capita income, state-local expenditure rises, on average, by about 6 per cent. [Maxwell 14, p. 276]. In the Virgin Islands the elasticity of per capita public expenditure with respect to per capita income is 1.575. This relationship is very revealing when it is considered that the public sector in the Virgin Islands employs *a little over one in every five persons* of the labour force.

Maxwell [14], Fisher [8], Manvel [13], have explored other quantifiable variables which are causal in this public expenditure increase. In our work on "The Role of the Public Sector: A Caribbean Perspective" [11] we catalogued several causal factors. However, there is a great deal of controversy in the analyses of other factors. The relationship between per capita income and per capita public expenditure is strong, in terms of statistical replication.

Expenditure Distribution – A Functional View

In Table 6 data are presented on the functional distribution of expenditure from 1940-1975. Education ranks number one over the years (in terms of receiving the highest proportion of expenditures). It ranged from $116.885 in 1940 to $37.9m in 1975. Education is followed by Health, Public Works, Public Safety and Social Welfare.

In Table 7 we present the functional relative over time of the major social expenditures for the V.I., 1940-1975. Public Safety data are from 1962-1975. We set all of the series relative 1967 base year and took an average.

As we expected, the social expenditures have kept their ranking over time as much as they have within a given fiscal year. A percentage close to the average implies a high proportionate expenditure in terms of the average year. A percentage higher than the average implies a year different from the base year. Nineteen sixty-seven was selected as the base year because this was a threshold year in the V.I. development efforts.

Under the expenditure section, we now turn to a distribution of expenditures by Department from 1958-1975. Education holds the strongest position over the years. In 1975 a little over one-quarter of the public expenditures were devoted to education. Health was second, followed by Public Works, Public Safety and Social Welfare. In aggregate, these four components amounted to 63.8 per cent of total expenditures in 1975. This picture has been consistently true for the period of analysis. In the early years they accounted for 75 per cent and upwards.

The distribution is illustrated in Table 8. Included in the section 'Residual' expenditures are: (1) Executive Offices of the Governor -- (Department of Conservation and Cultural Affairs, Lieutenant Governor's Office, Property and Procurement Commerce, Budget Office, etc.); (2) Legislature; (3) Judicial; (4) Finance; and (5) All others.

TABLE 6 FUNCTIONAL DISTRIBUTION OF EXPENDITURE IN THE V. I. (1940-1975)

$000

Year	Education	Health	Public Works**	Social Welfare	Public Safety
1940	117	83	112	10	n.a.
1941*	117	110	127	12	"
1942*	122	145	146	9	"
1943*	184	202	161	11	"
1944*	233	268	165	13	"
1945	270	272	168	10	"
1946*	276	278	175	12	"
1947*	281	298	182	11	"
1948*	290	313	197	14	"
1949	297	337	290	15	"
1950	409	444	362	16	"
1951*	438	538	378	41	"
1952	460	583	413	64	"
1953	570	740	462	72	"
1954*	764	1,041	623	124	"
1955*	924	1,097	674	298	"
1956*	964	1,199	792	265	"
1957	992	1,202	801	386	"
1958	1,076	1,314	982	409	"
1959	1,387	1,479	1,343	443	"
1960	1,859	2,097	2,489	550	"
1961	2,917	3,160	4,695	1,308	"
1962	2,567	2,945	9,108	1,189	819
1963	3,026	2,919	5,896	985	830
1964	4,367	4,168	9,573	1,671	1,046
1965	5,004	5,384	10,100	1,944	1,242
1966	7,261	6,447	9,144	2,142	1,521
1967	9,985	8,351	13,889	2,614	1,893
1968	9,609	11,427	11,869	3,126	2,399
1969	12,718	13,527	13,913	3,837	3,771
1970	15,729	14,494	14,828	4,483	4,478
1971	19,824	18,373	19,451	5,295	5,853
1972	27,296	26,257	20,083	6,574	6,663
1973	31,440	28,060	22,259	7,800	9,919
1974	29,391	22,830	24,091	7,784	10,758
1975	37,977	23,585	26,126	9,490	11,800

Source: Department of Finance, *Annual Report*, various years.

*Estimates

**In some years, Public Works and Fire Department Data were aggregated.

TABLE 7 FUNCTIONAL EXPENDITURE, RELATIVES U.S.V.I., 1940-1975 (1967 = 100)

	Education	Health	Public Works	Social Welfare	Public Safety
1940	1.17	.98	.80	.38	n.a.
1941	1.18	1.21	.92	.44	n.a.
1942	1.23	1.74	1.05	.36	n.a.
1943	1.84	2.42	1.16	.42	n.a.
1944	2.33	3.21	1.18	.49	n.a.
1945	2.70	3.26	1.20	.40	n.a.
1946	2.76	3.33	1.26	.48	n.a.
1947	2.82	3.57	1.31	.43	n.a.
1948	2.91	3.75	1.42	.53	n.a.
1949	2.98	4.03	2.09	.56	n.a.
1950	4.10	5.32	2.61	.61	n.a.
1951	4.39	6.44	2.72	1.57	n.a.
1952	4.61	6.99	2.97	2.45	n.a.
1953	5.71	8.87	3.33	2.77	n.a.
1954	7.66	12.47	4.48	4.74	n.a.
1955	9.25	13.13	4.85	11.42	n.a.
1956	9.65	14.35	5.70	10.13	n.a.
1957	9.97	14.40	5.76	14.75	n.a.
1958	10.77	15.73	7.07	15.66	n.a.
1959	13.89	17.72	9.67	16.93	n.a.
1960	18.62	25.11	17.92	21.06	n.a.
1961	29.21	37.85	33.81	50.05	n.a.
1962	25.71	35.27	65.58	45.49	43.24
1963	33.30	34.96	42.45	37.69	43.83
1964	43.74	49.92	68.91	63.92	55.22
1965	50.12	64.47	72.72	74.35	65.57
1966	72.72	77.21	65.83	81.93	80.36
1967	100	100	100	100	100
1968	96.23	136.84	85.45	119.60	126.71
1969	127.38	161.98	100.17	146.80	199.16
1970	157.53	173.57	106.76	171.51	236.49
1971	198.55	220.02	140.05	202.26	309.09
1972	273.38	314.43	144.59	251.48	351.89
1973	314.88	336.02	160.26	298.40	523.86
1974	294.36	273.40	173.45	297.78	567.17
1975	380.35	282.43	188.10	363.05	623.21

Source: Derived from Table Five

TABLE 8 TOTAL EXPENDITURES OF V.I. 1958-1975: DEPARTMENTAL PERCENTAGES

Fiscal Year	Education	Health	Public Works	Social Welfare	Public Safety	Residual	Total
58	19.1	23.3	18.9	6.9	7.4	24.4	100
59	18.0	19.6	18.6	5.8	5.8	32.2	100
60	28.0	5.5	19.5	8.7	8.4	29.9	100
61	22.6	14.9	24.4	6.7	7.4	24.0	100
62	17.5	10.0	21.7	8.4	8.4	37.0	100
63	13.5	12.6	20.1	7.9	6.4	39.5	100
64	17.0	10.4	22.4	7.9	6.9	35.4	100
65	19.0	18.4	20.0	6.0	5.0	31.6	100
66	19.0	18.0	18.0	6.0	5.0	37.0	100
67	17.0	17.5	18.0	5.8	5.1	36.6	100
68	17.6	18.3	15.6	5.7	5.4	37.4	100
69	18.4	18.4	15.9	5.6	6.6	35.1	100
70	19.1	17.4	15.5	5.5	6.8	35.7	100
71	19.9	15.4	15.3	5.8	8.0	35.6	100
72	22.8	17.4	12.1	5.7	7.2	34.8	100
73	24.7	16.4	13.0	5.5	7.6	32.8	100
74	24.2	16.0	13.1	5.9	9.7	31.1	100
75	25.1	15.9	12.3	6.0	9.9	36.2	100

Source: (1) 1958-75 – from Worksheets prepared by the Budget Section of the V.I. Office of the Budget, Aug. 1976

The four major categories are more detailed if they are viewed as in Figure 3.

REVENUE EFFORT

In Table 9 the data are depicting the revenue series from 1950-1975. The caveat must be made, again, that because of many adjustments some of the data may be inaccurate. What we present are the most often used and recorded series. Revenues rose from $2.055m in 1950 to $305.5m in 1975, an increase of 149 times.

Much of this rise could be attributed to inflation. This increase is due in large measure to the multitude of Federal funds which have filtered into the economy of the Virgin Islands. When the comparisons are related to a base year, a time relative revenue effort is obtained. The revenue effort used is not the traditional one. In the traditional usage a relationship is established between revenue per $1,000 of personal income divided by some given average. In our example we are relating the series over time.

FIGURE 3 A GRAPHIC ANALYSIS OF FOUR MAJOR COMPONENTS IN THE VIRGIN ISLANDS, 1958-1975

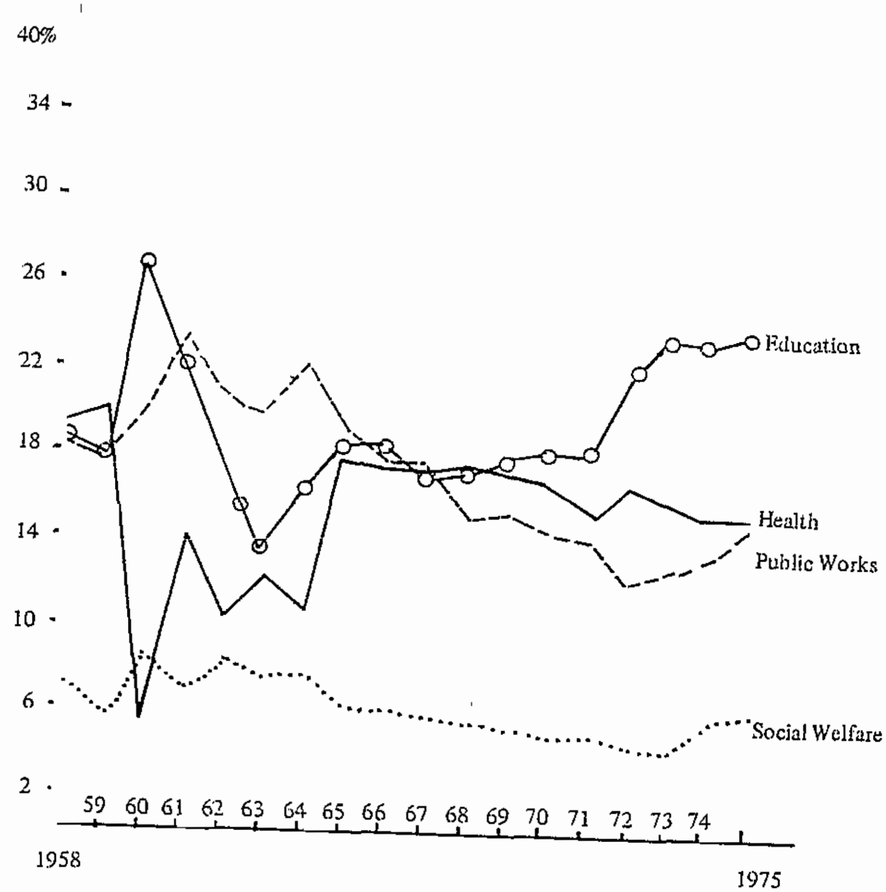


TABLE 9 TOTAL REVENUES OF V. I., 1950-1975

Fiscal	Total Revenues	Effort/Time	Mean Revenue Effort
	$000		
1950	2,059	3	4
1951	2,100	3	4
1952	2,313	4	4
1953	2,692	4	5
1954	3,157	5	6
1955[a]	6,678	10	13
1956	6,800	10	13
1957	7,063	11	13
1958	7,689	12	14
1959	10,068	15	19
1960	12,281	19	23
1961	17,430	26	33
1962	19,951	30	38
1963	23,124	35	44
1964	29,306	44	55
1965	39,977	61	75
1966	45,245	69	86
1967	65,960	100	124
1968	75,701	115	143
1969	94,503	143	178
1970	113,509	172	214
1971	145,050	220	273
1972	173,147	263	326
1973	168,309	255	317
1974	261,972	397	493
1975	305,542	463	575

Source: *Annual Report*, Department of Finance various years 1950-1975. Some of them changed from one report to the other due to auditing.

*Estimates

[a]This jump in revenues reflect a significant change in the V.I. fiscal history. This was the impact of Public Law 517. Section 28 of the Law provides for the return to the Islands of taxes imposed by the IRS on articles produced in the V.I. and transported to the U.S.

As is observed from Table 9, in 1957 the revenue effort of the Virgin Islands was 97 per cent lower than in 1967. On average this revenue effort was 96 per cent lower. By 1975, however, the relevant figures were 363 per cent and 475 per cent respectively. In other words, the revenue effort increased more than three and four fold respectively. It should be noted however, that this is simply a statistical comparison; other causal factors are not as evident in this comparison.

Comparatively speaking, we may now look at the revenue effort and the expenditure relative to get a partial picture of the deviations over time. Table 10 depicts the revenue effort, expenditure relative and the revenue/expenditure ratio. The R/E column indicates that in terms of percentages, the Revenue Effort and the Expenditure relative are not so different from each other. Over the 26 year period, there were ten years when the R/E ratio was less than 1.00; in other words, 38 per cent of the times, expenditures exceeded revenues. There was an overall deficit of 11 per cent.

TABLE 10 COMPARISON OF REVENUE EFFORT AND EXPENDITURE RELATIVE, V. I. 1950-1975 (1967 = 100)

	Revenue Effort	Expenditure Relative	R/E
1950	3	3	1.00
1951	3	4	.75
1952	4	4	1.00
1953	4	4	1.00
1954	5	6	.83
1955	10	7	1.43
1956	10	8	1.25
1957	11	8	1.38
1958	12	10	1.20
1959	15	13	1.15
1960	19	18	1.06
1961	26	26	1.00
1962	30	33	.90
1963	35	30	1.17
1964	44	49	.90
1965	61	57	1.07
1966	69	66	1.05
1967	100	100	1.00
1968	115	132	.87
1969	143	157	.91
1970	172	155	1.11
1971	220	203	1.08
1972	263	265	.99
1973	255	334	.76
1974	397	400	.99
1975	463	484	.96

Source: Calculated from original data in Tables 4 and 9.

TABLE 11 SELECTED REVENUES SOURCES, V.I. 1940-1975 (TAXES)
$'000

	Property	Income	G. Receipts	Trade. . b	Franchise. . c	Gasolene	Customs. . d
1940	100	110	39	27	3	15	14
1941*	105	416	31	33	3	16	14
1942*	109	917	26	43	4	16	12
1943*	114	1,116	22	50	5	18	11
1944*	118	1,201	21	57	2	18	11
1945	128	1,332	2	65	4	20	13
1946*	133	1,211	2	101	5	22	21
1947*	139	1,100	3	188	5	33	33
1948*	143	1,001	3	200	5	35	27
1949*	144	979	3	242	6	38	28
1950	153	471	4	232	7	47	18
1951*	182	490	4	245	8	56	21
1952	168	645	5	255	9	63	25
1953	206	720	2	546	8	81	53
1954	211	915	660[e]	e	55	95	66
1955	232	1,060	585	"	67	108	90
1956	218	1,549	394	"	43	110	151
1957	269	1,863	699	"	102	153	222
1958	279	2,239	720	"	260	155	295
1959	276	3,054	351	535	4	166	284
1960	373	4,329	433	753	16	207	487
1961	488	5,177	g	1,214	g	244	727
1962	499	7,221	"	1,676	"	259	747
1963	590	7,511	"	1,974	"	274	1,260
1964	760	10,707	"	3,435	"	294	1,375
1965	836	13,234	"	4,252	"	342	1,475
1966	959	17,462	"	5,318	"	582	2,100
1967	1,096	22,928	"	6,376	"	532	3,600
1968	2,286	24,759	5,013	3,929	52	627	4,804
1969	2,141	36,271	6,127	3,587	80	743	6,762
1970	2,603	43,462	7,130	4,021	57	829	10,438
1971	3,325	47,671	7,326	4,085	74	987	13,381
1972	4,335	56,629	8,365	4,292	101	2,002	26,462
1973	4,644	56,776	9,573	4,185	94	2,102	26,998
1974	4,387	63,281	10,272	3,998	83	4,719	55,789
1975	6,186	62,400	11,458	4,413	94	2,875	130,397

Selected Revenue Sources, V.I. 1940-1975 (Taxes).

Sources: Department of Finance, *Annual Report* various years.

*estimates. In the early years the Annual Reports were inadequate in data presentation.

a = Gross Receipts: c = Business Licenses and Corporation Franchises.

b = Trade and Excise.

d = Custom Duties.

e = Between 1954-58, Gross Receipts and Trade and Excises were combined according to the records.

f = The monies from 1957 were obtainable primarily from a Legislative Enactment in 1957. The sums include gasolene taxes, traffic violation fees and Highway Users taxes (the latter from 1972).

g = Between 1962-1967, Trade, Excise, Corporation (Franchises) and Gross Receipts taxes were under one heading. We did not find any explanation for the aggregation.

Revenues exceeded expenditures 62 per cent of the times for an average of 12 per cent. Given the fact that the deficit years were 11 per cent and the surplus years were 12 per cent, on average, it is not surprising that the coefficient of determination, between expenditure and revenue is r^2 = .998, and the correlation coefficient is r = .99.

Let us now turn to a select set of revenue sources over the period 1940-75 and observe some changes. Changes and aggregations were made because of the manner in which some of the data were presented in the original sources.

The growth of these selected taxes has been very high (see Table 11). Much more revenues could have been collected, but the fiscal agencies in the Virgin Islands are plagued with many weaknesses. Table 12 shows the rate of growth of the selected taxes. The table keynotes the dominance of income taxes.

Property taxes went from a low of −.8.1 per cent (1951-52) to a high of 108.6 per cent (1967-68). Income tax collections fell to −51.9 per cent (1949-50) from a high of 227.6 per cent (1940-41). Gross Receipts fell to −99.9 (1944-45) and had a peak of 77.6 per cent (1956-57). Trade and Excises had an overall high of 87 per cent (1946-47) and an overall low of −54.1 per cent (1967-68). Franchises fees were down to −51.2 per cent (1943-44), but moved up to 570.2 per cent (1953-54). Gasolene taxes registered a low of −56.4 per cent (1973-74) from a high of 51.0 per cent in 1946-47. U.S. Customs dues fell to −32.8 per cent (1949.50) and peaked at 133.7 per cent in 1974-75.

A few observations are in order regarding these growths. Property taxes had negative growth rates for five of the 35 observations. It had an average growth rate of 11.5 per cent over the period. We were unable to discover any substantial evidence for the peak growth in 1967-68. However, the methods of collection of property taxes in the V.I. have been very poor. The property tax in the Virgin Islands has always been a political issue and efforts to institute reforms have met with serious resistance from legislature and real estate interests alike. More revenues could be collected from this tax if it were possible to have accurate quantification in the uniformity of assessments and impartial implementations of the tax levy.

In the case of the income tax there were seven cases of negative growth. Five of these were in the years, 1945-52. All of the others showed steady growth, with an average growth over the period of 25.7 per cent. The peak growth rate was in 1940-41. This may be reflective of the novel introduction of the system or be representative of statistical errors in recording in the original sources. This tax has been the single most reliable indicator of economic growth in the Territory. With a certain degree of accuracy, a fiscal year's income tax collections are predictable from the first quarter's collection. In fact, this method is followed by the Territory's present Budget Office.

Gasolene tax receipts have been very consistent over the years. Three cases of negative growth rates were observed. The overall growth rate was 16.0 per cent. The peak growth rate in 1971-72 is quantifiable as a preview of the oil crisis, despite the fact that the Virgin Islands has the largest oil refineries in the Caribbean basin. The

TABLE 12 RATE OF GROWTH OF SELECTED TAX (%)

	Property	Income	G. Receipts	Trade	Franchise	Gasolene	Customs
1940-41	4.6%	277.6%	−21.8%	20.9%	−6.2%	4.1%	−6.1%
1941-42	4.3	121.6	−15.8	26.5	48.8	8.1	−8.5
1942-43	4.5	21.7	−14.1	11.5	24.0	7.4	−9.3
1943-44	3.8	7.6	−4.7	13.7	−51.2	4.2	−4.0
1944-45	7.8	11.0	−99.9	15.3	58.3	7.1	19.4
1945-46	4.4	−9.1	11.6	54.0	13.5	12.1	59.7
1946-47	4.1	−9.2	39.0	87.0	29.1	51.0	60.7
1947-48	6.0	−9.1	1.5	6.4	−2.6	5.8	−19.3
1948-49	1.1	−2.1	17.4	20.7	22.4	8.2	5.0
1949-50	7.5	−51.9	20.3	−4.2	11.5	23.4	−32.8
1950-51	19.2	3.9	−2.6	5.7	15.2	16.5	20.0
1951-52	8.1	31.8	26.1	4.0	12.6	13.0	19.1
1952-53	23.0	11.6	−51.4	114.5	−12.2	28.7	109.4
1953-54	2.4	27.0	a	c	570.2	17.7	23.0
1954-55	9.6	15.8	−11.3	"	22.4	13.2	36.8
1955-56	5.8	46.2	−33.7	"	735.0	2.3	68.0
1956-57	23.1	20.3	77.6	"	135.7	38.5	47.0
1957-58	3.7	20.2	3.0	"	153.7	1.7	31.5
1958-59	−.9	36.4	−51.2	"	99.3	7.0	−3.3
1959-60	34.9	41.7	23.4	40.6	270.0	24.7	71.5
1960-61	30.0	19.6	b	61.3	b	18.0	49.4
1961-62	2.4	39.5	"	30.1	"	6.1	2.7
1962-63	18.2	4.0	"	17.8	"	5.8	16.9
1963-64	28.8	42.6	"	74.0	"	7.3	9.1
1964-65	10.0	23.6	"	23.8	"	16.3	7.3
1965-66	14.8	32.0	"	25.1	"	70.1	42.4
1966-67	14.2	31.3	"	19.9	"	8.6	71.4
1967-68	108.6	7.8	"	−54.1	"	17.8	33.4
1968-69	−6.4	26.3	22.2	22.8	52.2	18.5	40.6
1969-70	21.6	19.8	16.4	12.1	28.2	11.6	54.4
1970-71	27.7	9.7	2.7	1.6	29.5	19.1	28.2
1971-72	30.4	18.6	14.2	5.1	35.8	102.0	97.8
1972-73	7.1	−5.0	14.4	2.6	7.5	−4.8	2.0
1973-74	−5.5	17.7	7.3	4.7	13.5	−56.4	105.6
1974-75	41.0	−1.4	11.5	−10.4	11.6	54.0	133.7

a = The years when aggregation of Gross Receipts Trade and Excises began. The percentage increase will be distorted, hence none was taken.

b = These are the years when Trade and Excises Corporation and Gross Receipts were aggregated. These will be a distortion of the percentages, if used.

c = No percentage given due to aggregation of several variables, and because of the bias this will cause.

years 1955 through 1967 were very strong years for the income tax collections. The erratic growth after this period reflects the impact on the V.I. of economic conditions in the U.S.A.

Finally, U.S. Customs dues revealed seven cases of negative growth rates. Like income taxes, U.S. Customs dues are Federally operated. Their collections reflect the conditions in the V.I. in a symbiotic relationship with the United States. The overall growth rate was 34.8 per cent. This very high growth details some of the returns to economies of scale in the collection operations, in addition to the low compliance costs. The strength of this revenue source lies in its organizational structure whereby it attempts to mitigate the harsh realities of the open economy of the V.I. The return of these U.S.A. collected revenues to the V.I., subject to certain requirements, is the method used to soften the impact of a high import-oriented economy.

In terms of total operating revenues, the V.I. relies on some other revenue sources which are significant. Topping the list is the Internal Revenue Return – the Matching Fund. The Matching Fund receives internal revenues collected in the United States of America on exports to that country from the V.I. This Fund is the predominant capital improvement fund. In 1975, there were $16.6m in the Matching Fund. *Taxes held in escrow* are also an important revenue source. These taxes are collected from the tax-exempt concerns in the Virgin Islands which are operating under the industrial incentive laws. The monies are held in escrow in the Tax Exemption Fund until the public sector meets its obligation (that is, the payments of subsidies to the businesses).

It should be recalled that the Virgin Islands investment incentive package commits the public sector to remit amounts to businesses "equal to 90 per cent of the customs duties collected by the Customs of the United States of America, and up to 75 per cent of the total tax liability of the businesses." [Department of Finance, 6, p. 24]. Taxes held in escrow in 1975 were $17.5m.

In addition, there are (1) Federal Grants-In Aid (outside of those mentioned before), (2) licences, fees, permits, and (3) since 1969, proceeds from royalties. The oil royalties are deposited in the Virgin Islands Conservation Fund. These royalties are paid into the Fund by Hess Oil, Virgin Islands Corporation (HOVIC) on 'final goods' petroleum products shipped to the U.S.A. This earmarked Fund had collections of $2.7m in 1975. Then there are revenues from the use of money and property; hospital service charges; and water supply charges; these are also significant revenue generators.

Table 13 depicts the growth of some of the other revenue sources, 1962-1975. Internal Revenue returns (Matching Fund) have dominated the growth in all the other important sources of revenues. In 1955 Matching Fund contributions were $2m and Essential Project Funds were $1.9m for a total Internal Revenue Returns of $3.9m. By the year 1961, Matching Funds were up to $6.5m. The other years are as recorded in Table 13. [10 p. 5].

TABLE 13 OTHER SIGNIFICANT REVENUE SERVICES IN THE V. I. EXAMPLES FOR 1962-1975

$000

Year	Internal Revenue Returns*	Federal Grant-in-Aid	Taxes Held in Escrow	Hospital Service Charge	Royalties	Licenses, Fees, . . .	Revenues for The use of Money and Property
62	$ 6,215	1,351	305	209	–	462	234
63	7,771	1,647	443	209	–	536	300
64	7,260	2,466	1,032	315	–	665	221
65	8,387	2,193	721	264	–	752	312
66	10,533	3,065	1,900	316	–	833	392
67	11,258	5,738	5,100	499	–	1,104	1,198
68	12,368	4,903	4,097	871	–	1,304	1,649
69	12,628	6,107	8,789	776	1,380	1,815	2,349
70	14,111	4,964	14,199	1,355	2,737	1,453	2,069
71	13,209	7,930	28,143	2,016	2,737	1,366	3,704
72	19,415	12,639	19,811	1,447	2,737	1,588	3,952
73	22,409	17,294	12,805	2,537	2,745	1,642	4,030
74	16,000	20,444	62,498	3,410	4,237	2,321	6,554
75	16,604	19,755	17,461	3,468	2,739	2,412	8,355

Source: *Annual Reports*, Department of Finance, Various Years

FISCAL RESPONSIBILITY IN THE U.S. VIRGIN ISLANDS

The structure of public revenues and expenditures in the Virgin Islands is similar to that of the wider Caribbean. However, whereas quasi-independent and independent micro-state economies of the Third World attempt to be frugal sometimes, this 'fiscal aspect' is not very evident in the Virgin Islands. An analysis, such as the present one, can only touch on some of these main issues, and identify some other salient ones.

The performance of the economy was not weak *vis-à-vis* other territories, because the U.S. Virgin Islands has been the beneficiary of significant amounts of United States of America federal funds. The funds entered the economy under various headings: earmarked, unrestricted loans and grants, special customs regulations, special income tax regulations, and so on. The large quantum of funds created an attitude in the Virgin Islands public sector that revenues will never be scarce: federal funds will be available always. Fundamentally, then, what seems like a very strong picture of fiscal capacity and performance in the Virgin Islands, is really a qualified position – qualified in the sense that the V.I. is an organic part of the U.S. While the economy did not demonstrate complete weakness over the period of study, the public sector indices merely reflect nominal growth.

There are two sides to the contention: one is the local decision-makers' view relative to public spending, and the other is the U.S.A.'s view *vis-à-vis* fiscal maturity and responsibility in the Islands. Whenever the territorial economy was incapable of generating adequate revenues to balance the budget, the requisite funds were normally made available from the Federal Government. This is a paradoxical legal precept. By the Revised Organic Act of 1954, the Virgin Islands must have a balanced budget every fiscal year. However, the Federal coffers are usually the mechanism for creating the balance in the budget.[13]

Four qualifications could be made regarding the weaknesses in the fiscal capacity and performance in the Virgin Islands economy over the period 1940-75. In the first place there was no demonstrated concern in coordinating revenues and expenditures (the economy was not made to pay its way as it grew). Secondly, there was a misuse of tax incentives policies and the revenues derivable therefrom. Thirdly, there was an inadequate determination of the revenue/expenditure effect of the public sector dollar (the non-generation and implementation of specific policies to maximize that dollar); and fourthly, there was a failure to establish accountability in the public sector relative to public expenditures.

The problems of the Islands are not new. They go back a long time. In no recorded case, however, was the territory given the latitude to fend for itself, fiscally speaking. Except for recent years (1972-76) there are no recorded cases where there was a desire to implement fiscal tightening in the local economy. Excerpts from the Department of Finance Reports over the years illustrate the concerns expressed here.

From 1940 up to 1957 there was no unified statement of the financial condition of the Virgin Islands. The municipalities of St. Thomas-St. John, and St. Croix presented their respective budgets. By 1949 pronounced deficits were becoming features of the fiscal picture of the municipalities. St. Thomas-St. John had a budget leficit of $53, 000 at the end of fiscal year 1949. St. Croix had an unspecified deficit. At that time the U.S.A. Federal Government made substantial deficit contribution to the municipalities. St. Thomas-St. John received $194,000, and St. Croix received $325,000 [Department of Finance, 6 1949 p. 1].

> During the Fiscal Year 1950, both municipalities of the Government of the Virgin Islands received substantial contributions from the Congress, in order to meet the expenditures of the Government. In the case of the municipality of St. Thomas-St. John, the Federal assistance did not prevent a budget deficit of approximately $40,000 at the end of the fiscal year. The municipality received a Federal Deficit Contributuon of $279,000.
>
> The municipality of St. Croix received Federal Deficit Contribution of $465,000. The year ended with a budget deficit of $4,182. [Department of Finance 6 1950 pp 1-2].

By 1953, the fiscal picture of the Virgin Islands was on the up-swing. Revenues collected from local sources rose rapidly. Given the fact that the U.S. Navy was permitted to use the Islands at its liberty, this move aided in the Islands' tourism receipts. [Department of Finance 6 1953, p. 1].

The Federal Appropriations, Essential Public Projects Fund came on stream in 1955-56. This fund provided additional revenues for specific infrastructural development in the territory. The 1960s were a period when insufficient care was devoted to public spending. The Government Comptroller's Reports pointed to this view. Revenues were being eroded, but Federal funding was supporting the budgetary excesses.

Fiscal Year 1972 was the turning point in the fiscal capacity and performance of the Virgin Islands. The public sector felt for the first time the full impact of the erosion of certain revenues from the General Fund. Up to this point, gross receipts and excise taxes paid by *specific* businesses were not fully enforceable. This was revised. Further restrictions were placed, by the Congress of the U.S.A., on the use of Matching Funds. This stymied the use of those funds for operating revenues/expenditures – as was normally the case. [Department of Finance 6 1972 p. 2].

In addition to the many problems of fiscal irresponsibility, there were several cases of the utilization of loopholes in the tax laws, and the misuse of the Tax Incentive Laws. The Annual Reports of the Government Comptroller for the Virgin Islands [30 June 1971 and 1975], pointed out that there were many deviations from the letter of the law *vis-à-vis* he grants made to certain companies. The Reports stated that there is a need to. determine the amount lost due to loopholes in the system. Similar remarks were found in several of these reports.

In a general narrative of the 1971 fiscal year, the 1971 Report summarized the fiscal weaknesses of the U.S. Virgin Islands.

> Although we did not make a complete audit of the Government's accounts, our work was sufficiently thorough to reveal significant problems and to create serious doubts as to the adequacy of controls of all assets (of the government), and as to the accuracy of the records of revenues and expenditures.

> The principal reasons for our disclaimer, [continued the Report], of opinion on the financial statement of the Government for the fiscal year ended June 30, 1971, continues to be control over its assets, the lack of budgetary control over obligation and expenditure of funds, and the lack of control and condition of the financial statements derived from that source. These deficiencies were corroborated by a General Accounting Office, (G.A.O.) report issued in March, 1971. . . . Most of the conditions commented open existed in prior years and are the product of longstanding policies and practises which have not been corrected to date. [Government Comptroller 9 1971 pp 2, 5].

SUMMARY AND CONCLUSION

The primary concern of this study was to present an overview of the public finance perspectives in the United States Virgin Islands. Emphasis was mainly on the fiscal capacity and performance over the period 1940-1975.

The economy of the United States Virgin Islands is a capitalistic system operating under Keynesian fiscal policy prescriptions. By law, specifically the Revised Organic Act of 1954, the Budget of the Virgin Islands must balance every fiscal year.

The fiscal capacity and performance of the Virgin Islands economy as portrayed in this study, has some serious limitations in terms of fiscal responsibility and overall strength of the fiscal system. It cannot be argued that the revenue effort and expenditure relative were weak. However, care should be taken to assess the period objectively. What seems like a strong fiscal system, on the surface, is really a system which operated as if resources were never scarce. The full ramifications of the real fiscal capacity and performance were not apparent because Federal Funds always aided the fiscal operations of the territory.

In broad overview, the Islands' economy experienced definite statistical growth but due to the limited data on income distribution, and other factors, we were unable to come to grips with a deeper analysis of the system. Structural weaknesses underpin this system. The system performed with strength in the aggregate, but the capacity and performance was not wholly from internal catalysts.

Comparatively speaking, there are few lessons to be learnt from this fiscal system, so far as the rest of the Caribbean is concerned. The territory developed some internal strengths, but it is very difficult to isolate the impact and effects of the U.S. influence on the system. It is to be noted that there were no direct discussions pertaining to the questions of equity and overall governmental policies. These are *implicit* in the work. They were not made explicit because the socio-economic dynamics of the islands do not permit such a discussion within the current fiscal arrangements.

FOOTNOTES

[1] Today it is called the West Indian Company. It owns several businesses; it is a typical multinational corporation with several activities in the field of production and marketing.

[2] For a discussion of this Act, see Bough and McCridis [1 p. 6, 42].

[3] For a stylistic presentation of the facts surrounding this issue, see Bough and McCridis [1 p. 103].

[4] $10.50 is collected per proof gallon of V.I. rum exported to the U.S.A. The money is returned to the V.I. Treasury.

[5] Hess may obtain additional benefits starting in 1977 if it rescues the government from its fiscal crises.

[6] Ron DeLugo, the Virgin Islands Representative in the United States House of Representatives, is now requesting that the percentage moves up to 70 per cent.

[7] There were early colonial examples of public finance under, for example these based on franchise and the rent-tax, but these were critical in the public finance perspective. [See Bough and McCridis 1 pp. 20-21, # 21-22].

[8] Bough and McCridis [1 pp. 64-66] review the fiscal and financial stipulations.

[9] The amount of money was $1m after a period of years.

[10] "Facts About Doing Business in the Virgin Islands"; see [5], various issues, for a broadly based discussion of these matters.

[11] The aggregation was not done in the earlier years of the 1940s and 1950s.

[12] This provision has encouraged much abuse of the system.

[13] There will be an estimated $15-20m deficit in fiscal year 1977, and $30-35m in 1978. The odds are good that the Federal Government will come to the rescue. It must be noted though, that the present Budget Office, acting in consequence with the views of the Governor, is attempting to institutionalize some semblance of fiscal tightening in 1977.

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