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U.S. ASSISTANCE TO MICRONESIA AND THE MARSHALL ISLANDS: A QUESTION OF ACCOUNTABILITY

HEARING

BEFORE THE

SUBCOMMITTEE ON ASIA AND THE PACIFIC

OF THE

COMMITTEE ON
INTERNATIONAL RELATIONS
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U.S. ASSISTANCE TO MICRONESIA AND THE MARSHALL ISLANDS: A QUESTION OF ACCOUNTABILITY

Wednesday, June 28, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ASIA AND THE PACIFIC,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 2:25 p.m., in room 2172, Rayburn House Office Building, Hon. Doug Bereuter (Chairman of the Subcommittee) presiding.

Mr. BEREUTER. The Subcommittee will come to order.

I regret we have had a delay because of a series of House votes. It is a hectic day, and we will do our best to try to give the subject of today's hearing the rapt attention it deserves, but we will undoubtedly be interrupted. I myself am involved in a Banking Committee markup and will have to leave at least briefly for one of the votes.

Today we meet in open session to receive testimony on the impact of U.S. financial assistance to the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) in view of the ongoing negotiations to renew the financial provisions of the Compact of Free Association which expires in 2001.

In 1986, the U.S. Government entered in a Compact of Free Association with the FSM and the RMI. The Compact granted these former U.S. trust territory districts their independence and provided a framework for future governmental relations, including the provision for 15 years of U.S. direct payments made by the Department of Interior to the bank accounts of the FSM and the RMI. The direct payments from Interior were to be used for such purposes as capital construction projects, energy production, communication capabilities, and recurring operational activities such as infrastructure maintenance. Nineteen U.S. Federal agencies have provided aid through grants, loans, equipment, and technical assistance.

Title II of the Compact, regarding economic relations, and Title III, regarding the defense veto and additional base rights but not the right of strategic denial or the use of Kwajalein Atoll, will expire in 2001. The United States is already engaging both Micronesia and the Marshall Islands in a new round of negotiations to extend these Compact titles. However, before negotiations proceed much further, I believe it is incumbent on us to examine carefully and objectively the record of the Compact since 1986 in order to

provide a more accurate and acceptable direction for relations in the future.

It is in this context that the Chairman of the Senate Committee on Energy and Natural Resources, Senator Frank Murkowski (R–AK) and I tasked the General Accounting Office (GAO) to undertake a two-part review of the Compact.

The first report, which was issued last month, examines, one, the cost to the U.S. of providing assistance to the FSM and the RMI from fiscal years 1987 through 1999; and second, funds provided prior to the Compact for the effects of nuclear weapons testing on what is now the RMI. According to the GAO, more than $2.6 billion—yes, this is "B" for billion—in financial and other assistance has been provided to the FSM and the RMI during this time period.

Of that, approximately $2 billion has been through quarterly cash payments with minimal or no oversight to the islands' bank accounts. The remaining $500 million was provided by 19 Federal agencies in various services such as education, Head Start and Pell grant funding, weather forecasting support, preventive health services, Job Training and Partnership Act aid, and the like.

This translates over the past 13 years into approximately $1.5 billion to the FSM, a nation of 131,500 people, and $1.1 billion to the 50,500 inhabitants of the RMI.

The GAO found significant inaccuracies and inconsistencies with the data being used by the Department of the Interior to supervise and monitor Federal assistance programs. In fact, Interior is still unable to document $27 million in reimbursements. As the GAO reports, "Collectively, therefore, Interior's ability to accurately report on assistance provided is called into question."

This Subcommittee's own initial investigation revealed that Interior has assigned only one mid-level individual, only one individual in the field to simply monitor, not to manage, these vast sums of American aid. His responsibilities are extended even further to also include the distant, Freely Associated State of Palau, also a former trust territory, and its $14 million annual aid program. In other words, one individual has a jurisdiction extending over an area of 2,400 miles in length and four time zones. I am told there is only one other individual identified in the Office of Insular Affairs with exclusive responsibilities for the FSM and RMI, and this person is in Washington DC. The neglect and indifference of the Interior Department is nothing more than a failure by our own government to fulfill its basic responsibilities to the American taxpayer. That is my conclusion.

Before another dollar is blindly committed, we need to get the U.S. Government's own affairs in order. Given what the GAO has revealed, I have serious concerns about the Interior Department's ability to manage U.S. assistance and advance economic development in the FSM and the RMI. Indeed, Interior's only other experience in this field is with the Bureau of Indian Affairs, and we are all too aware of the billions of dollars in missing Indian trust fund moneys and the deplorable conditions in and the vast number of failed economic development programs on America's own Indian reservations.

We need to examine the following question: should some other agency have primary responsibility?

The second part of the GAO review focuses on the use and the impact of U.S. financial assistance to the FSM and the RMI. Where has the $2.6 billion gone? I would say very candidly that when I visited our four trust territories in the Pacific in the early 1980's as a very junior member of the Interior and Insular Affairs Committee I saw endemic waste, mismanagement, and massive corruption in at least one of those territories. Unfortunately, as the GAO will report, it is evident that corruption, waste, mismanagement, and misuse of funds continues. The abuse continues to divert a significant amount of the resources that ought to have gone to the people of the region but didn't.

America's investments in Micronesia and the Marshall Islands seem to have disappeared or to be rusting away in perpetuity. Most economic development projects have failed. The squalor I saw on Ebeye almost 20 years ago apparently still remains there today, perhaps even more intolerable despite $1.1 billion in overall assistance to that area.

Sixty million dollars have gone into fishing fleets and processing plants in the FSM, yet the ships are rusting in the harbor. They were never appropriate for the kind of fishing that would make sense, or they are smashed up on the reef and the plants are empty and closed with little or absolutely no operational time resulting from those expenditures.

With the renewal of Title II of the Compact, significant changes are needed to stop this deplorable, outrageous example of the fleecing of the American taxpayer and to ensure that our assistance does, in fact, lead the FSM and the RMI on a successful path to economic self-sufficiency in which all islands, not just the chosen few, benefit.

A successful Compact with genuine and sustainable economic development in these Freely Associated States is certainly in America's short-term and long-term national interest. The mismanagement and waste of Compact financial assistance is not a partisan issue; this financial and human tragedy has transpired through Republican and Democrat Administrations in Washington, and many different governments in Palikir and Majuro, largely without public notice.

I am encouraged, although guardedly so, with a few positive reforms that have already occurred or are being proposed in both the FSM and the RMI under the new governments. However, actions speak much louder than word and significant actions are still needed.

With the current negotiations, both the United States and the Freely Associated States have a special opportunity to reformulate our financial relationship. The FSM and the RMI should recognize that both the world and the U.S. Congress have changed since 1986. While our special defense relationship certainly remains of important strategic value—and in no way is this special defense relationship in question or even on the table—the Soviet Union and the threats it posed no longer exist.

In our successful effort to balance the U.S. Federal budget, certain domestic programs and constituencies have endured painful

cuts. The FSM and the RMI cannot expect to continue to be shielded from similar experiences. Much, much more will have to be done with less.

But the good news is that this can be done with no hardship if the funds are no longer spent in such a scandalous fashion. The challenge for the negotiations ahead is to determine how best to do more with less.

I am pleased today to have the opportunity to hear from both the GAO and the Administration on the Compact's record and to begin to understand where our government should go from here. I am going to work with Mr. Lantos and other Members of the Subcommittee because I think there are tasks beyond this for the GAO where they can be helpful.

Mr. Lantos, I will introduce our witnesses in a moment but I want to give you a chance to make any comments at this stage before I go to introductions.

I would yield to the distinguished gentleman from California, Mr. Lantos, the Ranking Member.

Mr. LANTOS. Thank you very much, Mr. Chairman. Before making a few comments, I want to pay tribute to my Chief of Staff, Dr. Bob King, who recently returned from the area, who has provided me with an invaluable analysis of developments in this region.

Mr. Chairman, I want to commend you for holding this hearing. This is not an issue that is at the top of the headlines, but it represents an area of enormous strategic interest for the United States. This hearing reflects your typical thoughtful and responsible approach to dealing with an issue, an area of importance to our Nation.

The United States has had a long-standing relationship with the people of Micronesia and the Marshall Islands. For over four decades, these areas were trust territories of the United States. When they became independent states in the mid-1980's, we established a special relationship through a Compact of Free Association with both the Federated States of Micronesia and the Republic of the Marshall Islands.

Our particularly close relationship has been very beneficial to the United States and to these two countries. This area has great strategic importance for us.

These islands cover a huge area of the Pacific Ocean. During World War II, American military personnel gave their lives to gain control of these strategically significant areas. We continue to maintain a critical military facility at Kwajalein Atoll in the Marshall Islands. This facility, which we have leased under an agreement with the Republic of the Marshall Islands, has great importance for our national missile defense system testing and for testing other missile and missile defense systems. This facility is also important in tracking space activities. It continues to be in our interest, Mr. Chairman, to maintain close and friendly relationships with the Marshall Islands and Micronesia.

This doesn't mean that there are not problems in the way in which the United States' assistance to these two countries has been administered.

I want to commend you for requesting the GAO report this hearing will consider. Over the past 15 years, since the full independ-

ence of Micronesia and the Marshall Islands, the United States has provided some $2.6 billion in assistance under terms of the Compact of Free Association with these two countries. This assistance has been very important for both countries, and the American taxpayers have recognized the importance of doing this. At the same time, the GAO report clearly indicates that the handling of these funds has been seriously deficient.

There is plenty of blame to go around. The Department of Interior has been seriously deficient in its oversight of these programs. The governments which have received this aid also have not exercised the oversight that should have been done. The assistance has not achieved its intended benefit s for the people of Micronesia and the Marshall Islands.

I want to strongly emphasize, Mr. Chairman, the point you made. This is not a partisan issue. The Compacts of Free Association with these countries have been associated with and administered by Republican and Democratic Administrations over the course of more than 20 years, during the Reagan, Bush and the current administration. The problems that are evident are not the responsibility of any particular administration or any particular party.

It is my sincere hope that we can continue to deal in a constructive and bipartisan fashion with the matter of reconsidering some of the provisions of these two Compacts.

Mr. Chairman, I appreciate the serious and responsible way you have approached this matter, and I want to assure you that I will work with you in the same manner to work out solutions that are in the best interest of our Nation.

Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you, Mr. Lantos. I can assure you we will attempt and we will, without a doubt, work constructively in a bipartisan fashion; and I appreciated your assurance, although I knew that it would be there without you mentioning it.

I want to welcome to the panel today the Delegate from Guam, Mr. Robert Underwood, and I would just tell him that as far as this hearing is concerned, today he can consider himself a Member of the Subcommittee and fully participate.

I will turn now to Mr. Royce, the Vice Chairman of the Subcommittee, for any comments that he might make before we introduce our witnesses.

Mr. ROYCE. Thank you, Mr. Chairman. I will take only a minute, but let me just say that this Subcommittee is now doing some very important oversight work, and I want to thank the Chairman for calling this hearing.

The fraud and the waste and the abuse that the GAO has managed to uncover here at the direction of the Chairman is frankly, very troubling. We are not talking about a small sum of money here, as mentioned; as you go through that GAO report, item after item is identified as poor planning, poor management, inadequate construction, inadequate maintenance, misuse of funds.

Just to tick off a couple here, $180,000 in funds intended for economic infrastructure upgrade used instead to build a dock in front of the mayor's house; 600,000 of heavy equipment purchased for a

$1.3 million road used instead for—at the mayor's personal dock for activities unrelated to road maintenance.

There is little accountability in these expenditures, and the Interior Department's reports of these expenditures are a mess.

This is more than an accountability problem, though, as we go through it. The GAO has found that the money we have sent to these countries has done little to promote economic development, which is the stated purpose of the aid. While this aid failure is common throughout the world, what is different here in this case is the amount of money we are spending per person.

Here is $760 per capita in Micronesia and $1,095 in the Marshall Islands. Now if you compare that to Africa for a minute, we are spending some $1 per person per year on the African continent, and in these islands, we have fostered a dependence mentality that counters economic development and it counters independence.

We have, yes, a very strategically important relationship with the Marshall Islands and with Micronesia, and as we look forward to renewing this Compact, it is very important that we understand the problems we have had and it is very important that we remedy this situation; our failure to do so would hurt our interests there and would hurt support for American engagement elsewhere in the world.

That is why I want to thank the Chairman for holding this important oversight hearing and for the steps that we will be taking to remedy the situation.

Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you very much, Mr. Royce.

Mr. Underwood, do you have an opening statement? If so, you are recognized.

Mr. UNDERWOOD. Thank you, Mr. Chairman. I appreciate your leadership on this particular issue and bringing attention to what is not ordinarily understood in the halls of Congress, our relationship with the Compact States of the Federated States of Micronesia and Republic of the Marshall Islands. I have a statement that I would like to enter into the record.

Mr. BEREUTER. Without objection.

Mr. UNDERWOOD. At the same time, I just want to relate two perspectives on this particular issue.

First, is that while we certainly have an obligation to the American taxpayer to ensure that money is spent wisely and to make sure that the Federal agencies which are responsible for monitoring and accounting these funds should do their job—and there is much evidence that perhaps they haven't—we should bear in mind that this is a very important relationship. This is a very strategic area. This is an area of the world which will continue to grow in importance. It represents a significant part of the Pacific Ocean, and we should bear that in mind lest we have any difficulties in the future.

Second, I want to also raise the issue, although it is not entirely within the context of this, to understand that in the region there live Americans, Americans in Guam and Americans in the Commonwealth of the Northern Mariana Islands, and that the nature of the programs that we have in place in the Compact States of the FSM and RMI have a direct impact on these two territories, as well as the State of Hawaii—a very dramatic impact in terms of the uti-

lization of resources. Those of us in Guam, in particular, want to be helpful to our island brothers and sisters and neighbors in the region; but at the same time, we also want to make sure that any negative effects of lack of economic development which are translated into dramatic out-migration into a place like Guam, which I represent, should be considered in the context of the negotiations.

Again, I want to thank you for your efforts in this regard. Thank you.

Mr. BEREUTER. Thank you very much, Mr. Underwood. We will try not to neglect a consideration of those impacts, and, of course, we have the people of American Samoa in the region as well.

Without objection, additional questions for the record will be submitted by Mr. Burr of North Carolina.

[The information referred to appears in the appendix.]

Mr. BEREUTER. The Subcommittee has also received testimony from the Commonwealth of the Northern Mariana Islands, a letter from the Minister of Foreign Affairs and Trade of the Republic of Marshall Islands, which will also be included in the record, without objection.

Hearing no objection, that will be the order.

[This information is available for viewing in the Subcommittee's office]

Mr. BEREUTER. Testifying first, if she will come to the witness table—and anyone she would like to bring The International Relations and Trade Division with her—is Dr. Susan Westin, Associate Director for the U.S. General Accounting Office. In this capacity, she has led a number of cross-cutting assignments on competitiveness, in addition to heading GAO's assessment of the U.S. response to Mexico's financial crisis and the second part of the GAO's review of the FSM and RMI. Before joining the GAO, Dr. Westin held faculty positions at the University of Toronto, Northwestern University, and Southeastern University in Washington.

We will then have a distinguished second panel of witnesses, which I hope we will get to today if we have any kind of cooperation from our colleagues on the Floor, and I will introduce them at that time.

Dr. Westin, I am not placing you under time restraints here. I know that you will use the time judiciously. This is something we are not going to cut you short on. You and your team are the primary witness here today, and we want to listen and hear you in a very thorough fashion.

You may proceed as you wish.

STATEMENT OF SUSAN S. WESTIN, Ph.D., ASSOCIATE DIRECTOR, INTERNATIONAL RELATIONS AND TRADE DIVISION, U.S. GOVERNMENT ACCOUNTING OFFICE

Ms. WESTIN. Thank you, Mr. Chairman. I am pleased to be here today——

Mr. BEREUTER. Are you short some lights that you need to see?

Ms. WESTIN. I see I do need my little flashlight that I brought with me, so I will go ahead and use it.

I am pleased to be here today to provide information regarding economic assistance provided by the United States from 1987 through 1998 to the Federated States of Micronesia and the Repub-

lic of the Marshall Islands under the Compact of Free Association. The Compact represents a continuation of U.S. financial support that had been supplied to these areas after World War II under the United Nations Trust Territory of the Pacific Islands.

Specifically, my testimony will address four main objectives:

First, how have the FSM and RMI used Compact funding?

Mr. BEREUTER. Would you excuse me for just a second? This is the first time we have used some of this audio-visual equipment, and I realize that for people here in attendance the best screen is the one that is behind you. If you want to crane around or slightly move your chairs, please feel free to do that.

You may proceed.

Ms. WESTIN. Right. Mr. Chairman, the same thing will be televised on the two screens on either side.

Second, what progress has been made by both nations in advancing economic self-sufficiency?

Third, what has been the role of Compact funds in supporting economic progress?

Fourth, how much accountability has there been over Compact expenditures?

I will also provide observations on several issues that need to be resolved during the ongoing negotiations to renew Compact economic assistance to both countries.

The main message of my testimony this afternoon is that both the Federated States of Micronesia and the Republic of the Marshall Islands remain highly dependent on U.S. assistance. Furthermore, Compact expenditures have led to little improvement to date in economic development for the FSM or the RMI. Many Compact-funded projects have failed due to poor planning and management, inadequate construction and maintenance and misuse of funds. In addition, there has been limited accountability over Compact funds.

Let me first give a little background on the two countries. The FSM is a grouping of 607 small islands in the Western Pacific about 2,700 miles southwest of Hawaii, lying just above the Equator. The FSM has a total land area of about 270 square miles that occupies more than 1 million square miles of the Pacific Ocean. The FSM is composed of four states—Kosrae, Pohnpei, Chuuk and Yap—with an estimated total population of 131,500.

The RMI is located in the central Pacific about 2,100 miles southwest of Hawaii and about 2,300 miles southeast of Japan. The country is made up of more than 1,200 islands, islets and atolls with a total land area of about 70 square miles, about the same as the District of Columbia. The RMI occupies about 750,000 square miles of the Pacific Ocean and has a total population of approximately 50,500 people.

In 1986, the United States entered into international agreements—called the Compact of Free Association—with the FSM and RMI. The Compact granted independence to these former trust territory districts, following U.S. administration since 1947, and enabled the newly formed countries to participate in world affairs as sovereign nations. The Compact provided 15 years of direct U.S. payments to the countries through the Department of the Interior, to assist them in their efforts to develop self-sustaining economies. This assistance expires in the year 2001, although there is a pos-

sible 2-year extension. The Compact also gave other U.S. Federal agencies the authority to provide assistance such as grants, loans, equipment and technical assistance.

Turning to the first issue regarding how Compact funds were spent, we found that the FSM spent over $1 billion and the RMI spent over $500 million in direct funding provided by the Compact. There were three types of expenditures made by both countries: general government expenditures, which supported salaries and supplies; capital expenditures which supported infrastructure projects, business ventures and debt service; and expenditures targeted to support specific sectors such as energy, communication, health and education. In the RMI, Compact funds were also spent to compensate landowners for use of land on the Kwajalein Atoll by the U.S. military.

Each government has used the money differently. The largest area of expenditures in the FSM was general government operations, which accounted for over 47 percent of the total Compact expenditures. In the RMI, the largest amount of total expenditures, or 45 percent, went to support capital fund activities.

One of the priority areas under the Compact was spending for capital projects. The FSM and the RMI together spent $484 million in this area to build infrastructure and government buildings and to support economic development such as fishing boats and processing plants.

The Compact does not provide guidelines to control the timing of expenditures. The FSM and the RMI decided to gain access to funding primarily in the early years of the Compact by issuing $389 million in Compact revenue-backed bonds. This funding was used to retire existing debt, fund capital projects and make financial investments.

This strategy has not paid off for the RMI, which in recent years has had to use a high percentage of Compact funding to repay debt. For example, in 1998, RMI used 64 percent of its Compact funds to service its debt, severely limiting the amount available to support new capital investment or general government operations.

The second issue we reviewed was the progress made by the FSM and the RMI in advancing economic self-sufficiency. The FSM and the RMI have made some progress in this area, but both countries remain dependent on U.S. assistance to maintain artificially high standards of living.

We chose dependence on U.S. assistance as our indicator to gauge economic self-sufficiency. Total U.S. assistance, which includes Compact and all other U.S. program assistance, still accounts for at least half of total government revenue in both countries, although government dependence on U.S. funds has fallen from 1987 levels due to, among other things, increases in local revenues.

As to the third issue, we found that Compact expenditures of $1.6 billion have led to little progress in economic development. Substantial Compact expenditures have supported general government operations that have maintained high levels of public sector employment and wages, and have acted as a disincentive to private sector growth.

The FSM and the RMI also spend Compact funds for physical infrastructure improvements. Both countries viewed these areas as critical to improving quality of life and creating an environment attractive to private businesses. For example, Compact funds of at least $97 million have been spent to operate and improve energy, including electrical systems. Some of the power-generating facilities we visited are quite small. For example the Tonowas power plant runs daily from 5 p.m. To 5 a.m. Provides electricity to 53 households.

The countries have spent $22 million to operate and improve communications, including telecommunications systems. Access to and dependability of these services have increased. However, such improvements have not been sufficient to promote significant private sector growth, although we identified one tuna processing plant in the RMI that located to that country in part as a result of dependable electricity.

Both countries have also spent Compact funds to provide subsidized transportation systems. These efforts have been targeted at improving transportation between main population centers and outer islands. In the FSM, cargo ships purchased prior to the Compact have been maintained with Compact capital account funds. In the RMI, the national airline has received about $30 million in Compact assistance.

Another important government investment has been in the FSM where the College of Micronesia has received $12.8 million in Compact funds over the last few years. The college provides the FSM with its only post-high school educational institution.

I would now like to discuss some examples of unsuccessful government investment of Compact funds to support business enterprises.

Government officials from both countries told us that investing in business ventures had been a bad strategy. During our visit government officials reported that virtually no Compact-funded business ventures were operating at a profit, if at all. One example of a failed business venture is the $60 million in capital account funds the FSM spent on fisheries activities. The FSM has undertaken an unprofitable fishing investments in each of the four states.

We visited storage and processing facilities in all four states of the FSM. Not one of the facilities was operating during our visit. As you can see, the warehouses are virtually empty. Officials from all four states of the FSM said that ventures in fisheries were failures due to inexperience and poor business judgment.

In Pohnpei, the state government spent $870,000 to develop a pepper exporting industry. As part of this effort, the government started a pepper processing plan to provide farmers an alternative buyer to the one successful private sector pepper company already in operation. The intent of the project was to provide an opportunity to pepper farmers to purchase, process, market and export their pepper at higher prices than paid by the private sector company. As a result of the government effort, the private sector company went bankrupt. Subsequently, the government effort failed and there is no longer any pepper industry at all in Pohnpei.

In the RMI, almost $2.4 million in Compact funds were expended to build a garment factory. This facility was a 1993 Marshallese-

Chinese joint venture which was to manufacture and export clothing using Chinese workers. However, management disagreements ensued and no clothing was ever sold. The facility has closed.

The RMI used over $11 million in Compact funds to build a major resort hotel. This hotel was built so that the RMI could host a meeting of the South Pacific Forum in 1996. The hotel now operates at a loss and receives government subsidies. For example, in 1998, subsidies amounted to more than $1 million.

We visited more than 80 projects undertaken with Compact capital account funds in both countries. We determined that numerous Compact-funded projects, both infrastructure and business ventures, experienced problems as a result of poor planning and management, inadequate construction and maintenance, or misuse of funds. Let me provide examples of all of these problems, but keep in mind that these countries had just emerged from over 40 years of U.S. Administration under a U.N. Trusteeship, they had few planning and management skills and little experience in managing projects.

Poor planning and management were evident for several failed projects we visited. One example was Pohnpei Coconut Products, a company involved with the production and distribution of soap and other products made from island-grown coconuts. Based on a 1996 contract with a foreign national, the soap company requested and received $133,000 in Compact funding to purchase new equipment to increase production. The foreign national disappeared shortly after the equipment was installed, and the company is currently losing money. As you can clearly see, the expensive new machinery on the right sits idle and rusting, while soap is made using the old technology.

The Pohnpei state government, in conjunction with national government, spent over $21 million in Compact funds on fishing boats and processing facilities that were not compatible. Because of poor planning and management, the boats never returned to profit and the processing plant currently is idle. According to a Pohnpei government official, the government knew nothing about the fishing industry when it made the investment and was duped into paying too much for three 25-year-old boats that were too small for the Pacific environment. In addition, the processing plant was intended to process high-grade tuna not the lower-grade tuna caught by the three boats.

Chuuk State spent Compact funds on a tuna cannery that was never built. Chuuk spent $2.6 million on engineering designs, specifications, site plans and other preparatory work for the cannery. The objective was to plan, design and eventually construct and operate a cannery on the island of Tonowas. However, when we visited the island, we found that no cannery had ever been built.

In the RMI, the government spent $9.4 million in Compact funds to build a causeway from Ebeye, an extremely crowded island in the Kwajalein Atoll, to a planned development on the nearby island of Gugeegue. This causeway was meant to relieve population problems on Ebeye by allowing residents to move to Gugeegue. However, the causeway remains unfinished and residents have not moved. Ebeye officials told us that the causeway is still covered with water in places during high tide, and is considered an inad-

equate and unreliable connection. Further construction has been halted.

Another example of poor planning we identified was in the FSM state of Kosrae. The state has used $9.3 million in Compact funds since 1988 to construct a road around the island. When we visited, the road was in obvious disrepair, as you can see in these pictures, and we were told that the road surface had been largely removed. In reviewing the project file for road construction, it was revealed that an inferior, although cheaper, paving technology had been used. Kosrae had been informed prior to construction that the cheaper paving technology would not hold up. Kosrae chose the cheaper method and is now preparing to pave its roads again.

Inadequate construction and maintenance were also evident during our site visits. In Chuuk, we saw an example of a partially Compact-funded, poorly constructed dirt road that was an extension of a concrete road built more than 50 years ago; and you can see the concrete road as marked in the photograph. The concrete road is still in good shape while the dirt road has many potholes.

During our visit to a courthouse in Kosrae, completed in 1998 with $550,000 of Compact funds, large stains were evident in both courtrooms due to water leaks.

The capitol building in Majuro, RMI, built during the 1990's using $8.3 million in Compact funding, has visible signs of deterioration. Metal stairs are rusting, elevators are inoperable and roof leaks appear throughout the building.

We visited schools and hospitals in all four states in the FSM, which spent $80 million under the Compact health and education block grants. In Pohnpei and Chuuk, we toured schools where sections of ceilings were missing, bathrooms were in disrepair and electricity had been disconnected. Many schools appeared poorly maintained in these two states. Salaries consumed 97 percent of the elementary education budget in Pohnpei and 100 percent in Chuuk, leaving almost no funds for educational materials or facility maintenance.

At the Pohnpei Hospital, the director told us that the hospital lacked adequate funding, drugs and supplies. He said that the entire health care system would collapse without Compact funds, in part because collection fees cover less than 20 percent of health care costs. As a cost-cutting measure, the hospital no longer provides sheets to patients. The director said patients who cannot afford sheets simply lie on hospital mattresses where their infections seep into the mattresses and infect future patients. The U.S. embassy reported in January 2000 that because the hospital lacked funding for cleaning products, infectious viruses had been found in 37 locations, including 10 sites in the operating and emergency rooms.

In the Ebeye Hospital in the RMI, water leaks were evident in the surgery ward, as you can see, and the supporting roof beams were crumbling from rust. The new Ebeye Hospital which is at least 2 years away from opening will need to have support beams replaced before construction can continue. The support beams were not adequately protected from the corrosive environment and are already rusting away. You can see that in the photograph on the left.

We identified Compact expenditures that appeared to be a misuse of funds. For example, in Chuuk, the Udot road and dock project was intended to upgrade basic social and economic infrastructure in Udot. The project cost $188,000 in Compact funding. When we visited the site, we noted that the dock was built directly in front of the mayor's house. We were told that the crane used to build the dock would be left to rust after the dock was completed. The road led from the mayor's house through the jungle to a small village with few other houses along the road.

In contrast, at the end of a road was a junior high school that had received $2,8000 in Compact funding to repair the one-room schoolhouse. There were no desks or chairs for the students. Further, we were told the students did not have their own books and were read to by the teacher who used the one set of available textbooks.

As another example of misuse of funds, the FSM used funds in what the U.S. embassy described as "cars and boats for votes." The FSM public auditor reported that $1.5 million was spent on cars and boats that were simply given away to individuals for their personal use. Furthermore, the U.S. embassy reported another 187 cars arrived in May 1999 and were used for reelection assistance.

The fourth issue we examined was the accountability over Compact expenditures. We found that all three governments, the FSM, the RMI and the United States, provided limited accountability. Planning and reporting documents of the FSM and the RMI intended to identify development goals and progress in meeting these goals were incomplete and insufficient. Both countries have failed to fully control and account for Compact expenditures. For example, both countries have not addressed management weaknesses and misuse of funds identified in financial and program audits.

In addition, the U.S. Government did not meet many accountability requirements. For example, required annual consultations with the FSM and RMI did not take place until 1994, 7 years after the Compact went into effect. Since that time, four additional consultations have been held with the FSM and three with the RMI. According to a Department of the Interior official, the talks have been cordial diplomatic meetings with little serious discussion of economic growth or compliance with Compact spending requirements.

Further, we found numerous disagreements between the Departments of State and the Interior regarding oversight responsibility of the Congress. These disagreements have led to limited monitoring efforts. As one example, disagreements between the Departments regarding which agency has authority over Interior staff posted in the countries have contributed to the fact that there are no Interior staff posted in the RMI to monitor U.S. assistance.

Finally, we have some observations to offer. Throughout the course of our work, officials from the RMI, the FSM and the United States identified five issues that they feel need to be resolved during the course of the negotiations.

First, the objective of future economic assistance needs to be defined. Should economic self-sufficiency continue to be an objective? Should funding have more specific objectives and only be targeted to specific sectors such as education or health?

Second, the level and duration of assistance need to be established. How much U.S. funding will be required to meet the objectives established for future economic assistance? Does the United States want to enter into another 15-year commitment to provide economic assistance?

Third, the funding mechanism for assistance must be determined. What are the costs and benefits of block grants, the funding mechanism used in the current Compact versus other options such as loan guarantees, project funding or a trust fund? Should countries be allowed to use funds as collateral for issuing bonds? How does the choice of a funding mechanism affect the cost of program administration and the degree of accountability?

Fourth, the degree of accountability over expenditures must be established. Should spending of assistance across time be more tightly controlled by the United States? Should traditional grant conditions be applied, such as the ability to withhold funds if performance requirements are not met? Should there be more specific controls over the eligible uses of funds rather than the broad categories of allowable expenditures currently permitted? How could incentives for accountability be built into future assistance?

Fifth, the administrator of future U.S. assistance should be determined. Which agency or agencies should be responsible for administering assistance? How should staffing issues be resolved? How should the costs of administration be budgeted? Should all Federal agencies provide assistance independently, as they do today, or should there be a central fund?

Mr. Chairman, this concludes my prepared presentation. I will be happy to answer any questions you or other Members of the Subcommittee have.

[The prepared statement of Ms. Westin appears in the appendix.]

Mr. BEREUTER. Thank you very much, Dr. Westin. I want to thank you and all of the staff who assisted you in the field activities and the investigations that were conducted in the preparation of your report. As I mentioned to you in a preview examination of this, it seems quite apparent to me that we have more work to do and that we will be requiring some additional assistance from the GAO.

I am not, a person easily given to overstatement, but I am outraged by what I see in terms of the use of the funds that have been provided. I am saddened because I have some idea, about how these funds could have brought great benefit to the people living in the Federated States of Micronesia and the Marshall Islands. Of course, we are concerned about what has happened to our other two trust territories as well. One is the Commonwealth of the Northern Mariana Islands and the other, with which we have a Compact which came into effect later, in Palau.

I recall thinking my first visit there—and this is before the Compacts were signed, when they were still indeed trust territory—about how many foreign firms took advantage of trusting people in those areas, provided inappropriate kinds of inducements for business contracts and made off with an extraordinary amount of money.

Second, I thought how inappropriate the buildings were that were being built with U.S. Government aid, inappropriate kinds of

constructions for tropical environments. I saw that the buildings built many years earlier by the Japanese, appropriate for a tropical environment, were, despite their age, much better suited to the environment.

When I looked at the rust already taking place on those beams, 2 years before the hospitals opened; when I saw those barren classrooms in that junior high school, where we had spent the grand sum of some $2,000-plus; and when I saw the trucks and cars that were obviously misused—I saw the worst-case scenario, or examples of it at least.

It is hard to know where to proceed with questions, and I do hope and expect that you, Dr. Westin, will be able to stay around as we go to our next panel because I think it could, in fact, lead to some dialogue between the two of you under questioning from myself or some of the Members.

I wanted to ask whether or not you have been able to investigate whether or not there are other significant donor sources to the Federated States and to the Republic of the Marshall Islands, such as multilateral institutions, such as nonprofit organizations or any other foreign aid, other countries providing foreign assistance?

The second question: would you indicate to me, based upon that examination of debt structure, and I think the example you gave us was from the Marshall Islands, with debt servicing leaving only 15 percent of this Compact expenditure available to support new capital investments, general government operations and so on, when would the RMI have paid off its indebtedness?

Ms.WESTIN. To answer your first question first, yes, of course, I will be willing to stay around after the other panel.

To answer the question on foreign assistance, there are a few other donors to these countries such as Japan, Australia, China and Taiwan. But we are not able to identify any figures in the financial statements that would let us know what these amounts of assistance are. We do know that some countries provide assistance for particular projects; for example, Japan might be asked, and it will be agreed that they will plan and build and help with the operations of a particular project. Officials have told us that some of these are quite successful.

Mr. BEREUTER. Is it tied aid then, in effect, in some cases?

Ms. WESTIN. Yes, that is correct, because they do take into account the planning all the way through, but it is not aid in the sense of giving the money to the government. The whole project is done, so the money never shows up in the financial statement. With regard to the multilaterals, the Asian Development Bank has provided technical assistance to both countries. We haven't looked specifically at the nongovernment organizations that are there, but we did meet people who worked for them; but we haven't looked specifically at how much money they have spent there.

Your other question was on looking at the debt structure of the RMI, giving that example. The bonds that they issued earlier in the life of the Compact, I believe, are structured to be paid off by the year 2003. So given that the Compact has room in it for a 2-year extension, those bonds will be paid off at the end of the time of the current Compact, plus the 2-year extension.

Mr. BEREUTER. Dr. Westin, have you looked at it enough to know whether this is a normal pay-down process or if this has balloon retirement at the end?

Ms. WESTIN. I think that it is a normal pay-down process. One of the things we did try to get after though is how were the proceeds of the bond issue spent.

Mr. BEREUTER. That is my next question.

Ms. WESTIN. The idea was to get the money earlier in the life of the Compact and make good investments. We are actually not able to answer that question in any great detail because the bond proceeds would, in general, be transferred into the general government fund and then not tracked any further as expenditures coming from the specific bond proceeds.

Mr. BEREUTER. Dr. Westin, what are the specific, "interagency disagreements in the United States on levels of and responsibilities for oversight" which have, "limited the U.S. Government's ability to meet its accountability requirements"? Can you at least give some examples of those kind of interagency disagreements?

Ms. WESTIN. I am sure you will want to pose that question to the next panel, as well, but it is our understanding that there is not complete agreement between the Departments of State and the Interior, for example, who had the responsibility to actually call the annual consultations every year; and as we noted, we think that this lack of having these annual consultations for the first 7 years of the Compact really had an impact on these countries. In our view, that is the time that these annual consultations could have provided the most help to the countries in terms of discussing what the money was going to be used for, and in terms of discussing progress and economic development.

Another disagreement, as I mentioned, seems to be about who is going to have authority over the person posted in-country; and so there is no Interior staff person posted right now to the RMI, and as you mentioned, the one Interior person who has responsibility, has responsibility for overseeing the program assistance, not the direct Compact assistance that we have been talking about.

Mr. BEREUTER. That is for the Marshall Islands and Palau?

Ms. WESTIN. Exactly.

Mr. BEREUTER. Finally, and then I will move to my colleagues for some questions you mentioned that there are perhaps 17 or 19 other agencies that are providing direct assistance in accordance with the Compact. That is a significant amount of money, but it is, overall, a minor percentage of the money.

To what extent are they more or less effective in overseeing expenditures? Do they have the same kind of accounting and documentation requirements or difficulties that you seem to demonstrate in the Department of Interior or have you had adequate amount of time to investigate their stewardship?

Ms. WESTIN. We didn't focus on the program expenditures. If you will allow me, let me check with my colleagues on this to see if we have a more specific answer.

Mr. BEREUTER. If they are speaking directly, just have them identify themselves.

Ms. WESTIN. I will have Leslie Holen address this. She was the project manager on the job.

Ms. HOLEN. The one comment that might be made is that by the end of fiscal year 1998 these two countries wrote off over 50 million in questioned costs. We were not able to determine precisely which of those costs were direct Compact funding versus program funds. But we were told that a significant amount of it is program funding from other agencies, and they took no action to try to resolve the questioned costs.

Mr. BEREUTER. I will turn now to Mr. Royce for questions he may have, and then go to Mr. Underwood.

Mr. ROYCE. Thank you, Mr. Chairman. I guess I would start by just noting that you stated that the country spent $1.6 billion in Compact funds, and the earlier GAO report identified $2.6 billion in Compact assistance. So there is a billion dollar difference there. What makes up that figure?

Ms. WESTIN. What makes up that figure is in our work we just looked at the $1.6 billion in direct Compact funding. We didn't look at the part that goes for the nuclear compensation, and we didn't look at the funding from the 19 U.S. agencies. Nor did we include Fiscal Year 1999 in our analysis.

Mr. ROYCE. I see.

Ms. WESTIN. So these three things make up the other billion.

Mr. ROYCE. One of the questions I would have is, to your knowledge, has the U.S. Government done anything at this point to try to recover any of the funding in these cases? Is there a provision in the Compact to accomplish collection from the government in some way where governments—where these governments in the Marshall Islands and Micronesia have misspent the money?

Ms. WESTIN. We do know that within the U.S. Government these cases of misuse or misspending were certainly known. We are not aware of any organized effort on the part of the Departments to address this problem, and it can be difficult to track and verify the money. Even in cases where the annual audits conducted by an independent auditor identified possible misuse, we didn't see evidence that the U.S. Government was taking action.

But it is unclear whether the U.S. Government can recover funds that are misspent. Most direct funding is guaranteed under the Compact and it appears that the Compact itself, the way it is written, makes it difficult, if not impossible, for the U.S. Government to withhold funding in cases of misuse.

Mr. ROYCE. Might make it impossible to withhold funding in cases of misuse?

Ms. WESTIN. Yes.

Mr. ROYCE. The State Department—in the testimony that they are going to give later today, they will announce that they are exploring a policy that no new Federal program would be extended to the Marshall Islands or to Micronesia unless, in their words, "it directly advances the goal of economic self-sufficiency."

Now, I am not sure exactly how you define "economic self-sufficiency." I mean, self-sufficiency in this case might be a somewhat meaningless term. Is the United States, for instance, self-sufficient? Were these islands self-sufficient previously?

So there is an ambiguous term that the State Department is using there in terms of setting its own goal; I wanted to make that point. My real question is, are there Federal programs that we are

extending today that we should terminate today regardless of the State Department's view of this economic self-sufficiency argument in your view?

Ms. WESTIN. Mr. Royce, I think that is probably a question that you should put to State Department and Interior. We looked at the way that the funds have been used.

Your point on self-sufficiency, I think is well taken. When we were asked to look at the progress made in achieving self-sufficiency, we looked at the Compact; and in the Compact itself, self-sufficiency is not defined, and that is why we had to choose an indicator to use. As I said, we chose the indicator of reliance on the U.S. as compared to the percentage of government revenues they raised. They have made some progress in that area. For example, FSM, I think in 1986, 83 percent of its government revenues were from U.S. assistance. It is down to something like 53 or 54 percent now.

Mr. ROYCE. I see. Dr. Westin, what is the share of the economy there locally that is expanding or where do those revenues—where are those revenues that displace in the private sector? Where are those revenues?

Ms. WESTIN. They are raising revenues from local taxes and also from fishing licenses.

Mr. ROYCE. I see. Dr. Westin, I thank you for a very thorough report; and again, I thank the Chairman for this hearing.

Mr. BEREUTER. Thank you very much.

Mr. Underwood, you are recognized for 5 minutes.

Mr. UNDERWOOD. Thank you, Mr. Chairman; and again I want to thank you for the courtesy you have extended to me.

Dr. Westin, I was not here for your entire testimony, but as I understand it, you did give some graphics on the nature of rusting in the tropics. I just want to point out a little—just to give some balance to the picture, a little ditty that I used to hear as young man in Guam, that people in Navy used to say, and that is, "In God we trust, in Guam we rust," and by that, meaning that the tropical environment is a very punishing environment.

I just last year bore witness to a Seabee project, and this is—represents some of our best engineering that we can think of, a Seabee project for a recreational facility that had to be redone in Guam because the rebarbs were not done appropriately and they were not taken care of. So it is a punishing environment and at times it is true that maybe sometimes the best thinking and the best engineering does not go into it.

In the nature of, I wanted to ask a question, I guess that is developmental in nature. These nations are relatively young nations. We are talking about a timeframe in which, if we made comparisons to the United States' growth from 1776 to 1789 we barely had a Constitution out 13 years after independence. So now we have these countries that are in a period of rapid change and rapid development and, in a sense, trying to find their sea legs as they deal with the issue of whether there is such a thing as economic self-sufficiency, the question asked by Mr. Royce, or perhaps more appropriately, the notion that there is some kind of at least economic stability, some kind of stable economic structure, some kind of rule of law, some kind of process whereby we can actually begin to

think of serious economic development in the future. So I have two questions that are kind of predicated on that.

First of all, let us say for the sake of argument that every dollar was spent appropriately and every dollar was accountable—we could track where every dollar went. Would there be—would we be closer to, "economic self-sufficiency," or is the challenge so daunting in these areas that we would still have a ways to go? That is the first question.

The second question is that, as you examine—perhaps the question was, when you do a GAO study, sometimes these questions are not asked in the developmental way, "Is it better in 1980 than it was in 1990," as opposed to saying, "Well, where are we in 1999?".

So would you venture any commentary on whether things have actually been on the upswing, that things are getting better; that perhaps they are not where we would like them to be, but would you venture any commentary on the developmental nature of where we are going with this economic assistance?

Ms. WESTIN. You have certainly posed some very weighty questions, and the first one is the challenge, I think as you put it, if every dollar had been spent appropriately and accounted for, would it still be a ways to economic self-sufficiency?

I don't think that I can answer that definitively based on GAO's work, but it seems to me that, yes, we probably would not see these island countries at self-sufficiency.

What we focused on, though, was really to look and see whether we thought the dollars had been spent appropriately; and I think what I would like people to take out of our work as the next Compact is restructured is to think about what accountability measures need to be built in, so the dollars are spend more appropriately and accounted for.

With regard to the second one, has there been improvement, yes; and in the photographs that I provided, I did show examples of the power plants, there have been infrastructure improvements, including telecommunications.

The difficulty, though, is—from what we have heard is that although these companies are not losing money, if the United States' assistance didn't supply incomes to many of the citizens of these countries, there wouldn't be people to pay for the electricity; and it is not clear that they could be self-sustaining companies in that sense.

But, yes, there have been infrastructure improvements that have taken place.

Mr. BEREUTER. Would the gentleman yield?

Mr. UNDERWOOD. Yes.

Mr. BEREUTER. Talking about the power plants and seeing some of the equipment, I want to remind you of what you and your staff told me about the almost total lack of maintenance and how the infrastructure there and equipment is going to have a very short life unless there is an allocation for maintenance.

I hope I am not misstating what you said, but that is my recollection.

Ms. WESTIN. Yes, sir. But also that we did visit power plants where they do understand the problem of maintenance, and in some examples are really paying attention to this.

Mr. BEREUTER. Thank you for yielding. If you have——

Mr. UNDERWOOD. No, I think that takes care of it.

Mr. BEREUTER. Mr. Rohrabacher, the gentleman from California, is recognized.

Mr. ROHRABACHER. Thank you very much.

I am a little disturbed by a mind-set that I am reading into some of the things that are happening here, Mr. Chairman. It just seems to me it is like we are not talking about people who are free and independent and have their own country, but about people who have some relationship with the United States, and that we have some responsibility to tell them how to run their lives.

When you treat people like Indians on a reservation, they are going to end up like a lot of Indians ended up in the United States on reservations. Our reservations were a national disgrace, where the American Indian tribes were dependent on our government running their lives for them. It seems to me what we have got here is the same thing.

By the way, people treated Indians as if they couldn't run their own affairs and, thus, they ended up being unable to run their own affairs. I am very proud now that the American Indians are emerging from that dependence and declaring their independence from these Federal programs. They want to be independent now in the United States, and they are making great progress in our country, in California especially. I know the Pechanga Indians are making substantial progress, and just 50 years ago they were living in squalor.

Micronesia and the Marshall Islands are located halfway in the Pacific between Asia and the United States, and I would say they are a very important piece of territory for the world. Especially the Kwajalein missile range, which was developed, Mr. Chairman, at a cost of $4 billion to the United States, is even more important now than perhaps it was a few years ago. We have to recognize that. We know how many lives it took to free these islands—not just these but the others in the Pacific during World War II—and we also know that these islands have been used for weapons testing.

There have been 67 nuclear weapons tests on these islands in which a large number of islanders were irradiated and many were displaced. So there have been major problems to overcome, and it just seems to me—from what you are telling us, it looks like a mess out there right now.

I am especially alarmed because I have always been ringing the alarm bell about what the Communist Chinese are doing. The Communist Chinese are involved in the Pacific. The largest Chinese land satellite tracking system, electronic spy station, in the Pacific, built by the Chinese army, is located on Tarawa, which is 500 miles south of this missile testing range in Kwajalein. So there are other Chinese activities going on in other islands throughout the Pacific, and we have to be concerned about this. If the Communist Chinese are acting the way the Japanese acted before World War II, they could pose a strategic threat to us.

Furthermore, we need to develop an antimissile system which means we will need the Kwajalein range. So these things we are

discussing today are not things that we should just shrug our shoulders and say, so what.

Apparently, what you said, we have grants of over $1.5 billion to these islands, and there are only 130,000 people on the islands; and take a look at—for what we got, it is clear that that money was pretty much wasted, at least a large hunk of it was wasted.

So let me just state my gut reaction to this, and then get your reaction: When you treat people like children, they are going to act like children. If you are going to treat people like they are not responsible, they are not going to be responsible.

The Marshall Islands now have a new government that is committed to honest government—at least they say they are—and I will put in the record, a letter that Chairman Bereuter received from the new head of the government there, who is the Minister of Foreign Affairs and Trade for the Marshall Islands, making his commitment to reform; I will put that in the record with your permission, Mr. Chairman.

Mr. BEREUTER. It is already in.

Mr. ROHRABACHER. Thank you.

It seems to me that we have got to reexamine the fundamental relationship that we have and have had with these islands for the last 10 to 15 years.

They say that insanity is doing more of the same and expecting different results. Well, perhaps it is time for us to do just this, and that is, figure out how much Kwajalein is worth, really worth, because they—we have been—it sounds to me like we have been giving them these grants. We haven't just been paying them the rent which they are due and giving them tremendous responsibility of handling their own affairs.

What about a system of just giving them the money that would be a fair rent for Kwajalein and the use of their islands and letting them run their own affairs, rather than having such oversight and such involvement of the U.S. Government and the rest of their affairs?

Ms. WESTIN. As I had previously mentioned, we look at the payments to Kwajalein as part of this $1.6 billion. The option to renew the lease on Kwajalein has already been extended for 15 years, and I think some of your questions will probably be better directed to the next panel, to the representative from DOD.

With regards to just letting these people run their own affairs, I think that is something that needs to be determined in the next negotiations. There are different strategies; do you just decide that you are going to set up a trust fund and not have accountability? The last point——

Mr. ROHRABACHER. I don't understand what we have to decide. Aren't we talking about sovereign entities, yes?

Ms. WESTIN. Yes.

Mr. ROHRABACHER. What are we deciding this for?

Mr. BEREUTER. Will the gentleman yield?

The Compact under which we were providing financial assistance will basically be completed in most respects, as I understand it, next year—and there is already pressure to extend these Compacts, and so the question—indeed, we need to basically reexamine this

relationship and financial accountability here. You are absolutely right; I think we have a task ahead of us.

Mr. ROHRABACHER. I am no expert on this. I stopped in the Marshall Islands once several years ago, so I am no expert. But my gut instinct tells me that, give people their due, treat them like adults, and give them a fair price for Kwajalein, and they will have to look and find out exactly what agreement was made.

I hope we are giving them market value, because we need that facility; and if we need it, we should give them a fair price for it and then let them run their own affairs. People will always surprise you if you expect them to be responsible and treat them as adults.

So thank you very much, Mr. Chairman.

Mr. BEREUTER. I agree with a lot of what the gentleman said, but I wanted to mention this—of the $2.6 billion that has been provided to the two Freely Associated States that are the subject of the hearing today, approximately $2 billion of the $2.6 billion has gone in direct quarterly cash payments, so basically they have been treated like adults.

I guess we did, like others that had a colonial relationship with African countries, do a good job of putting in place managerial skills ahead of time. We did protect them from the international scalawags that are out there that took advantage them in a whole lot of ways. I know if the gentleman had visited Ebeye with me, which is a small island right near Kwajalein where I stayed for 2 days, he would be very upset with the conditions that these people were living under and under an American flag.

Mr. BEREUTER. I do remember how money that was going to help the nuclear affected people in the Marshall Islands was being diverted and not going to the people that deserved it at that time. Now this is before the Compacts were concluded.

We have got a task ahead of us. In fact, I think there needs to be something of a special task force just to focus on this issue and work with every kind of expertise we can find to get the right kind of arrangements for an extension, if we have an extension, and I am counting on the gentleman. I think there is nothing better than to visit the place, though; and certainly my knowledge is obsolete but, having some background in design and construction, there is no excuse for what I saw of that new hospital. I would prefer a Japanese-built building of 40 years ago to what we are putting up there today.

Thank you, Dr. Westin. We are going to be in touch. If you can stay as suggested, I would appreciate it.

Ms. WESTIN. Certainly, Mr. Chairman, thank you.

Mr. BEREUTER. Now we would like to call our second distinguished panel.

Representing the Department of State is Mr. Allen Stayman, who has served since June 1999, as the U.S. Special Negotiator for the Compact of Free Association. Prior to this posting, Mr. Stayman was Director of the Office of Insular Affairs and Deputy Assistant Secretary for Territorial and International Affairs at the Department of the Interior. It was in these capacities that he has testified before this Subcommittee in previous years. From 1984 to

1993, Mr. Stayman was a professional staff member with the Senate Committee on Energy and Natural Resources.

Representing the Department of the Interior is the current Director of the Office of Insular Affairs, Mr. Ferdinand Danny Aranza. A native of Guam, he previously served as legal counsel to the former delegate from Guam, Congressman Ben Blaz, who served on this Subcommittee during his tenure in office.

We are also honored to have Mr. Frederick C. Smith, a Special Assistant to the Under Secretary of Defense for Asia-Pacific issues. For over 25 years, Mr. Smith has been actively involved in studying, formulating and implementing U.S. defense policy, first as a naval officer and now in a civilian capacity. Before his current posting, he served as a visiting professor at the U.S. Naval Academy and as Principal Deputy Assistant Secretary of Defense for International Security Affairs.

Gentlemen, thank you very much for making yourself available to us today to help us understand this current situation, then to begin, after today, to look for a proper course for the Congress. I understand you are going to testify in the order of your introductions. So any kind of statements—and I know—I think you all have written statements—they will be made a part of the record in their entirety, and if you would try to keep your oral comments to, say, 5 to 8 minutes each, then we will have time for questions.

Mr. BEREUTER. Mr. Stayman, we turn to you.

STATEMENT OF ALLEN STAYMAN, SPECIAL NEGOTIATOR FOR COMPACT OF FREE ASSOCIATION, BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. STAYMAN. Mr. Chairman and Members of the Subcommittee, let me begin by thanking you for requesting these two GAO reports. It is my intention as the special negotiator to consider them carefully in order to ensure the effective use of future U.S. assistance.

Let me summarize by touching on five topics.

First, in response to GAO, the Department concurs with the recommendations of the May GAO report that future Compact provisions, require that reliable data be maintained to ensure better accountability. We also generally agree with the second report regarding problems with the use of Compact funds in advancing self-sufficiency, and in accountability. My colleague from the Department of the Interior will speak in more detail to our understanding regarding these problems.

Second, the Department shares the assessment of the GAO that, notwithstanding these problems with the existing economic program, the Compact has successfully met two of its three primary goals, providing for a transition from trusteeship status and meeting U.S. security interests. The Compact was negotiated and implemented during the Cold War when political and security objectives were a more immediate priority for the United States than was advancing economic self-sufficiency. It was not until 1993 that a high priority was accorded to economic development.

Third, the United States has a continuing interest in these countries, which justifies some level of continued economic assistance. These interests include maintaining economic stability and our

support for their economic reform strategies; second, sustaining the political stability and close ties we have developed; third, assuring that our strategic interests continue to be met; and, fourth, developing a strategy for ending mandatory annual payments by the United States by a date certain. While we recognize the need to continue some level of financial assistance, I want to emphasize our belief in appropriate reductions in future assistance and to greater accountability.

My fourth topic is an update on our talks. We are negotiating with the FSM and RMI separately. The talks with the FSM are progressing smoothly. We have had two negotiating sessions, and our next round is scheduled for September. Formal talks with the RMI government have been delayed by a relatively recent change in government. We are pleased by the democratic transition to a new government and with their commitment to reform and accountability. The new government is currently updating its economic development strategy, and we plan formal talks after the update is completed.

Finally, I would like to share our general approach to the negotiations which has four elements:

First, financial assistance. We share GAO's view that there must be effective accountability in any future assistance. Accordingly, we believe that future funds should be provided through a limited number of grants, each with clearly defined scope and objectives. We also believe that the Administration must have the necessary authority and resources to ensure that reasonable progress is made toward these objectives.

Second, the Department is interested in the concept of the trust fund as a means to terminate mandatory annual financial assistance by a date certain. We are still analyzing what the appropriate trust fund design and the level of funding might be and what contributions should be expected from non-U.S. donors.

Third, regarding program and services assistance, for the same reasons that we believe some level of financial assistance should continue, we believe some program and services assistance should continue. Generally, these programs and services are targeted to priorities, social and economic objectives such as small business loans, supporting the postal system and assuring safe air transportation.

The fourth element in our approach deals with migration. The Compact currently provides that citizens of the Freely Associated States may freely enter the United States as nonimmigrants. Annual reports to Congress have documented the substantial impact of this migration to Hawaii, Guam and the Northern Mariana Islands. Of particular concern are migrants who have communicable diseases and criminal records. These conditions are currently grounds for inadmissibility to the U.S. under the Immigration and Nationality Act.

We are considering three responses to the migration issue. First, we believe our approach of committing substantial future assistance to improve health and education of potential migrants can significantly reduce Compact impact. Second, we are exploring several options for determining admissibility of FAS migrants prior to

entry into the United States. Third, we intend to increase compensation to Hawaii, Guam and the Northern Mariana Islands.

Thank you for this opportunity to present the Department of State's views today. Let me assure you that we will continue to take every opportunity to keep the Committee informed as negotiations proceed.

Mr. BEREUTER. Mr. Stayman, thank you very much for that succinct statement.

[The prepared statement of Mr. Stayman appears in the appendix.]

Mr. BEREUTER. Next, we would like to hear from Mr. Aranza. Mr. Aranza, you may proceed as you wish.

STATEMENT OF FERDINAND ARANZA, DIRECTOR, OFFICE OF INSULAR AFFAIRS, U.S. DEPARTMENT OF THE INTERIOR

Mr. ARANZA. Thank you, Mr. Chairman, Members of the Subcommittee. Thank you for having this hearing, and I am very pleased to represent the Department of Interior's view on the U.S. Compact with the Marshall Islands and Micronesia.

We concur with what has previously been stated by GAO and by my colleague at State Department. We concur that the primary U.S. political and strategic interests were achieved successfully by the Compacts. The Marshall Islands and Micronesia made a successful transition from trust territory wardship under U.S. supervision to fully functioning sovereign democratic governments, and also the U.S. obtained defense access rights and the right to deny access to other countries in those strategically located regions in the Pacific.

But with respect to accountability and economic objectives, we also concur that results thus far have, at best, been mixed. I would like to use my time this afternoon to summarize why we believe the current Compact is having limited impact in achieving FAS economic development and ensuring proper accountability in the use of Federal funds.

Despite 15 years of Compact financial support for the general operations of the FAS governments and a program of capital investment, the FAS are not yet self-sufficient. Part of the reason is that the Compact did not require a system of goal setting and accountability for results tied to receipt of funding. The Compact and its related agreements instead created a system that allowed financial assistance to flow uninterruptedly to these nations while limiting the United States' ability to affect the results of that spending.

The Federal assistance management regime described in the Compact of Free Association is unique and a Federal grant management practice. The negotiators created a system that bears little resemblance to established accountability measures that characterize the use of Federal funds. The result is a system of payments largely bereft of performance standards, cost principles and procurement rules found in OMB circular A–102, the "Common Rule" for grant management.

Mr. Chairman, I believe this is a critical point to understand a little more thoroughly. The Compact's current structure of direct flow-through financial assistance that is guaranteed by the full

faith and credit of the United States has a profound impact on the U.S. ability to effectively monitor and control these funds.

Compact financial assistance cannot be considered grants in the normal sense defined by the Federal Government. This distinction was first drawn by the Interior's solicitor, who opined that the only rules that could apply to Compact funds were those found in the Fiscal Procedures Agreement, the Compact Act and the laws of the Freely Associated States. This conclusion precluded application of normal Federal accountability rules.

For example, normal grant funds under normal Federal regulations are transferred only when needed for immediate payments. In addition, grant funds normally may not be invested. Grant funds normally are also subject to clear conditions and performance expectations. Allowable costs are also well-defined. Finally, normal grant funds can be withheld at any time for nonperformance by the U.S., and we also have the clear authority to recoup funds that were not used appropriately.

In contrast, the payment structure of direct financial assistance under the Compact is much more of a flow-through concept.

First, under the Compact, the Fiscal Procedures Agreement required the quarterly transfer of money to the Marshall Islands and Micronesia at predetermined dates rather than when funds are actually needed.

Second, Compact financial assistance is transferred to interest-bearing accounts, as opposed to the normal rule that Federal grant funds cannot be invested.

Third, the Fiscal Procedures Agreement is silent on most performance measures, and the Compacts themselves have no clear standards for what constitutes economic self-sufficiency or, for that matter, no clear goals or objectives for economic development in the Marshall Islands or Micronesia.

Fourth, the definitions of what constitute appropriate uses of Compact financial assistance for current account or capital expenditure uses are vague, broad and overlapping.

Finally and most importantly, Compact financial assistance payments are further guaranteed by a pledge of full faith and credit in a court of claims. This pledge of full faith and credit, in our opinion, removed one of the most important management accountability tools, the ability of the Federal Government to withhold funds for noncompliance.

However, even though we lack traditional grant management tools, at Interior we tried to address the roots of inadequate local management performance through our technical assistance program. We have a program with the USDA graduate school to provide a curriculum of management and accounting classes to meet the needs of individual government. We have also recently joined forces with the Asian Development Bank to provide in-country advisory teams to bolster the analytic capacities of the Freely Associated States. We have also consistently provided special attention and technical assistance to bolstering local audit capabilities.

It is the view of the Department of Interior that the economic goals of the Freely Associated States can be better met if future U.S. assistance is provided with clear expectations about results and with clear standards of performance. We would support the ap-

plication of the Common Rule and the Code of Federal Regulations to Compact grants. These rules, which are familiar to both the Marshall Islands and Micronesia as they administer domestic Federal programs, call for basic common-sense practices in government management. The rules require effective accounting and reporting, free and open competition in procurement, and define criteria for acceptable expenditures. Grants developed under these rules will require performance goals and standards and the approval of scopes of work and budget projects.

We have current examples of how normal grant procedures can work to protect the integrity of U.S. taxpayer dollars in the Marshall Islands and Micronesia. In 1994, for example, section 221-B health and education funding was withheld from the FSM until the State of Chuuk settled medical debts with Guam Memorial Hospital. Unlike the other provisions of the Compact, this was not a full faith and credit provision and therefore we felt we had the ability to withhold funds.

Furthermore, separate from Compact financial assistance, the Department of Interior has discretionary technical assistance grants to help them with capital infrastructure and operations and maintenance; and with respect to these funds, we have suspended these grants until certain performance standards were adhered to. For example, there was some mention about the hospitals and the utilities. We had some operations maintenance grants where we did force the local governments to adhere to hiring trained professionals to help them maintain their utility companies. We cite this as an example of where, if you have regular grant conditions, we can enforce better accountability. When effective enforcement tools are available, we believe we can ensure that Federal funds are used as intended.

Mr. Chairman, just one more minute, sir.

In addition to imposing more normal grant conditions to financial assistance under the Compact, we also often speculate how much more accountability would have been achieved if additional and more appropriate administrative and financial resources were devoted to the Department of Interior.

For example, in the waning years of the trust territory there were at least 43 FTE's, or full time equivalents, at Interior involved in monitoring and in controlling a $93 million a year program. Today, in contrast, we only have four full time equivalents devoted to Freely Associated States matters, including Palau, for a $145 million a year program. So we would suggest that one of the things that could be considered is also increasing our administrative resources to deal with monitoring and accountability.

Mr. Chairman, that concludes my oral statement. I would be glad to answer any questions you might have.

Mr. BEREUTER. Thank you. Your last point prompts questions, but we will wait on that.

[The prepared statement of Mr. Aranza appears in the appendix.]

Mr. BEREUTER. Next, we would like to hear from Mr. Frederick C. Smith. Mr. Smith, you may proceed as you wish.

STATEMENT OF FREDERICK C. SMITH, SPECIAL ASSISTANT TO THE UNDERSECRETARY FOR ASIA-PACIFIC ISSUES, U.S. DEPARTMENT OF DEFENSE

Mr. SMITH. Thank you, Mr. Chairman, Members of the Subcommittee. I appreciate this opportunity to appear today to talk about the significance of our security relationship with the Freely Associated States.

The Department of Defense has four basic interests in the Freely Associated States: access by U.S. military forces to utilize the territories of the FAS for transit, overflight and occasional emergency use; continued unimpeded operation of the Kwajalein missile range in the Republic of the Marshall Islands; the ability to deny military use of Freely Associated States territory to foreign nations, the so-called strategic denial clause of the Compact; and possible contingency use of land areas, air fields and harbors.

In return for these rights of military uses and access, we are committed to provide security to these nations and their peoples, "as the United States and its citizens are defended. This is an obligation greater than the United States has assumed under any of its mutual defense treaties. We seek peace in this area of the world. In time of peace, the Department of Defense seeks to shape a strategic environment that will sustain the peace and prevent unrest and conflict. We wish to dampen the sources of instability by maintaining a policy of forward engagement and military presence."

The Department of Defense has an extremely important interest in continuing the use of the Kwajalein missile range and the facilities of the Kwajalein Atoll. The requirements of our missile and space surveillance programs, together with our strong interests to maintain full range of military access and security engagement options provided by the Compact, make renewal of the Compact a high priority for the Department of Defense. Renewal of the Compact will help the United States achieve its security objective of maintaining peace and stability in this region.

Thank you very much, Mr. Chairman.

Mr. BEREUTER. Thank you very much, Mr. Smith.

[The prepared statement of Mr. Smith appears in the appendix.]

Mr. BEREUTER. We will move to the 5-minute rule, but we will proceed until we are interrupted by votes or we exhaust our questions, and I would like to begin with you, Mr. Aranza.

In your very last statement, you talked about the number of full time employees (FTE) you had. When we were still dealing with these areas as trust territories, 43 FTE were involved in monitoring and controlling only a $93 million program and two predecessor subagencies of the Department of the Interior. Now you are indicating you are unable to dedicate more for the Office of Insular Affairs and Interior than four FTE's to the Freely Associated States, including Palau, for a $145 million program. Do you have a reduction in administrative budget? You are suggesting an administrative budget increase, and why isn't this is a sufficient priority of Secretary Babbitt that additional resources, if needed, are devoted for this function?

Mr. ARANZA. Mr. Chairman, a few years ago, I believe in 1995, the predecessor of my office, the Office of Territorial and Inter-

national Affairs, was headed by an assistant secretary; and we had 45 FTE's. But at that time there were calls on the Hill for the dissolution of that particular office, and there were also reorganization efforts within the administration that resulted in a significant downsizing of the office from 45 to something like 25, and that downsizing has significantly impacted our ability to effectively oversee Compact funding.

Mr. BEREUTER. It sounds like a downgraded interest or sense of responsibility, and that is a judgment on priorities within the Department of Interior, isn't it?

Mr. ARANZA. Mr. Chairman, we are currently undertaking a very serious look at how we are organized as an office and how we should beef up our staffing to more adequately handle Compact funding, especially if the future Compact funding is restructured to be less of a pass-through and more of a grant type system.

Mr. BEREUTER. I will come back to you in a minute. I am sure you are happy to know.

Mr. Smith, I just wanted to know if you still have civil action (CAP) teams in the Freely Associated States or Federated States of Micronesia or any other former trust territories?

Mr. SMITH. Yes, I believe we do.

Mr. BEREUTER. I think they have played, for the amount of money, a significant role and that they are a good use of resources of the Department of Defense. As a matter of fact, they have saved a number of lives of people diving in the harbor. I can tell you one of my constituents was saved by a group there, and it has happened on several occasions.

Mr. Aranza, why is it that the Department of Interior didn't ensure the annual consultations with the FSM and the RMI were held during the first 7 years of the Compact? What was the impact of not holding those meetings?

Mr. ARANZA. Mr. Chairman, we would agree with GAO that not having those hearings did have a significant impact on the Federal Government's ability to track and monitor the developments in both the Marshall Islands and Micronesia. However, at the beginning of the Compacts my understanding is that the administration's policy was a lot more hands-off, and there was a lot less priority given to accountability and financial management issues than there is right now. In fact, it was under this administration that we initiated these annual consultations.

Mr. BEREUTER. Do you feel that the Department of Interior is now, even since 1987, adequately monitoring the Compact expenditures for the RMI and the FSM?

Mr. ARANZA. Mr. Chairman, I do not believe that we are adequately staffed and have the resources to monitor the sheer amount of money that is going out to these islands. So adequacy of resource is one issue.

The other issue, as I stated in my statement, is the flow-through nature of these funds and the lack of normal grant conditions and performance standards and other protections that we normally have in our normal programs.

Mr. BEREUTER. Am I to take that as a yes, we believe we have not adequately monitored the grant programs? You are giving me reasons.

Mr. ARANZA. Given the constraints that we have, Mr. Chairman, I wish we had had a more ideal situation, but I think the Department did the best it could under less than ideal conditions.

Mr. BEREUTER. My time has expired. Mr. Underwood.

Mr. UNDERWOOD. Thank you, Mr. Chairman.

I would certainly like to advise our good friend here, Mr. Aranza, that sometimes it is just better to take the lumps. On this particular issue it is rather obvious that Interior hasn't done the job that it could have done.

Just so that you know—and I would take a little bit of time to explain perhaps a little bit of perspective on the issue of the Compacts. It was a trust territory—a single trust territory of the United States given to the United States by the United Nations at the conclusion of World War II. But unlike all the other trust territories around the world, in the United Nations this was designated a strategic trust. As a result of that strategic trust, the United States was able to perform nuclear testing, wall off a significant part of Saipan, bring in troops from Nationalist China and train them there. They did a number of other things which, by any other definition of trust territory, would have been seen as inappropriate; and that relationship—I guess that relationship which—for a long time, the people in Micronesia would say, well, we have the trust and the United States has the territory.

That trust territory relationship has morphed into these Compacts, and there is a series of kind of tradeoffs, if you will. One is that it is not a, strictly speaking, relationship of one foreign country to another. There is strategic denial. The United States can deny that element of sovereignty to these Freely Associated States. The United States, in turn, allows migration as nonimmigrants into U.S. territory. Of course it would go without saying that Guam is disproportionately affected by that far beyond the State of Hawaii and far beyond the CNI which had a significant population to begin with of people from these areas.

So we have—and, in addition to that, you have these financial arrangements. Some are straight-up cash payments. Some are treated as domestic programs. I think it is incumbent on us here to make clear I think, you know—and, obviously, we are all going to have different points of view—to make clear what we expect at a minimum out of this next round or this ongoing round of negotiations.

It is clear to me that Kwajalein, it is indispensable. You can't replicate it. The people will say openly that they can replicate it, but you can't really replicate it. Would you agree with that, Mr. Smith? I mean, people can say we can move to Wake, but, in reality, you can't replicate what you do in Kwajalein in Wake.

Mr. SMITH. It is unique.

Mr. UNDERWOOD. Certainly we have to deal with the problems that are associated with accounting for the funds, and the Department of Interior may need a little assistance on that. But they certainly deserve a few lumps in this process.

But, most importantly, I just want to ask, and from my perspective I just want to make clear, that when these Compacts were negotiated there was a commitment made to the areas that were nearest to it—and Guam is the nearest to it—that if there were ad-

verse consequences that there would be what is referred to as Compact impact assistance. Since the beginning of these Compacts it has been—the total we think is over $70 million; and, to date, we have received probably about between 15 and $20 million from the Federal Government. What I certainly would like to see is that issue rolled into because the right to freely migrate as nonimmigrants into U.S. territory is a feature of these Compacts.

I think, because all of these things fit together in some way, I certainly am interested, Mr. Stayman, in your proposal. Maybe you could explain a little bit about what admissibility means in your proposal in discussions with the Freely Associated States and what is your impression as what would happen if we didn't deal with the issue of admissibility and Compact impact assistance and we severely restricted any kind of economic assistance in the future. What would happen in the region? What would happen in the State of Hawaii? What would happen in general?

Mr. STAYMAN. It is pretty clear, Congressman, that if there were to be a serious disruption to the economies out there, there would be an increase in migration. That is one of my concerns, is that while we develop a new program the temptation is to drastically reduce our level of assistance. I think we have to be cognizant of the social, economic and political consequences of a sharp reduction and also the migratory consequences. We have to get the FAS to develop their economies so there will be an incentive to stay at home. People come to Guam because there are better schools and better hospitals and better paying jobs.

The first part of your question was about admissibility. One of the problems we are trying to address is the fact that the Compact Act not only provided for free entry into the United States as a nonimmigrant, but it waived the passport and visa requirements. By waiving those requirements, the Compact Act made it very difficult for the Federal Government to make determinations on admissibility. What I mean by that is, under the current law, the U.S. has the right to not admit people into the United States for a number of reasons. The ones that are most obvious, as I stated in my statement, if they are criminals or they have a communicable disease.

Because there is no mechanism to enforce that law, one of the principles of my approach is to try to come up with a mechanism to do that. As I understand from the report which the Governor of Guam has filed with the Department of the Interior, the relative impact of these migrants on the communities of Guam and Hawaii is disproportionately large. One statistic that I remember is that nursing home care in Guam, 90 percent of it is for servicing this migrant population; and you have that occurring in many social programs.

So we think if we are able to establish effectively—I will call it screening, although that is probably not the right technical team. We hope we can determine admissibility and make sure that those people who have communicable diseases or who are likely to become a public charge as a result of chronic diseases, will be screened and we will be able to deal with this problem while preserving the general underlying intent of the Compact, which is to allow the people of FAS to come to the United States, in order to

strengthen our ties, and to provide education opportunities and employment opportunities.

Mr. BEREUTER. The time of the gentleman is expired on this round. The gentleman from California, Mr. Rohrabacher, is recognized.

Mr. ROHRABACHER. We certainly shouldn't be permitting people with communicable diseases to come into the U.S. and into our territory from anywhere.

Let me ask the panel. We have renewed the contract for Kwajalein for 15 years, is that right?

Mr. STAYMAN. This is correct.

Mr. ROHRABACHER. How much is being given and who is it going to?

Mr. SMITH. Mr. Congressman, I have a figure, that for the Kwajalein-related payments, there are currently $13 million per year.

Mr. ROHRABACHER. $13 million, and that is going to continue for 15 years?

Mr. SMITH. Yes, sir.

Mr. ROHRABACHER. Thirteen million a year for 15 years, and who is the money going to? I understand that is not going to the government of the Marshall Islands.

Mr. SMITH. Yes.

Mr. STAYMAN. I believe the breakout is roughly that about $7 million of that goes to the landowners. The rest goes to the local government.

Mr. ROHRABACHER. Local government meaning the government of the Marshall Islands.

Mr. STAYMAN. I believe it goes to the Kwajalein Atoll government.

Mr. ROHRABACHER. Nothing goes to the Marshall Islands government at all.

Mr. STAYMAN. In fact, all of this money is paid to the Marshall Islands government. The U.S. does not pay this money directly to any landowners. It is the responsibility for the RMI government to make distribution.

Mr. ROHRABACHER. $13 million for the Kwajalein—for our Kwajalein base and that operation there and $7 million goes to the local people who used to own the land.

Mr. STAYMAN. The landowners.

Mr. ROHRABACHER. Six million goes to the local government. That is not the Marshall Islands government. What is left for the Marshall Islands?

Mr. STAYMAN. Of this $13 million, I don't believe any goes to the Marshall Islands government, the Federal Government. It would go to the equivalent of their state government, their Kwajalein government.

Mr. ROHRABACHER. I don't quite understand that. I mean, it seems to me when we are dealing with another country or trying to respect these people as another country we shouldn't be able to have a base there especially an important military base like this——

Mr. STAYMAN. Let me try to clarify, if I might. The 13 is not the total payment. There is a payment under section 211 which is paid

to the government of the Marshall Islands. Out of that amount they then have internal agreements to make payments.

Mr. ROHRABACHER. How much—the $13 million is being paid in one account or something from an account. How much is being paid altogether to these people for us to use this $4 billion missile testing range?

Mr. STAYMAN. The 2001 projected payment for 211 is $19.1 million.

Mr. ROHRABACHER. So $19.1 million; and of that I take it that $6 million is going—the Marshall Islands government is able to keep for themselves, is that right?

Mr. STAYMAN. I am sorry, it is a little more complicated. Of that $19 million, $11 million would be passed through for Kwajalein. The other two million we talked about is, in fact, in another account, section 213.

Mr. STAYMAN. It is very complicated.

Mr. ROHRABACHER. There is only 130,000 people on these islands, and it doesn't seem it would have to be complicated with that small a number of people.

Mr. STAYMAN. All I can say is that is what was negotiated.

Mr. ROHRABACHER. Tell me about it.

Mr. BEREUTER. Would the gentleman yield?

Mr. ROHRABACHER. Yes.

Mr. BEREUTER. I will give you more time.

It would be helpful to the gentleman, to me, and to all of us if we could have an identification of the money coming for the lease for Kwajalein, where it goes; and then, separate and apart from that, the Compact money that has gone to the Republic of the Marshall Islands. Would be what you would like to have?

I thank the gentleman for yielding. Go ahead.

Mr. STAYMAN. We will make that available, Mr. Chairman.

Mr. ROHRABACHER. You don't have that now?

Mr. STAYMAN. I have it in front of me.

Mr. ROHRABACHER. Tell me about it.

Mr. STAYMAN. Right now, the Marshall Islands receives a total of $40.2 million. There are——

Mr. ROHRABACHER. Before that, that is Compact money, right? Or whatever you want to call it.

Mr. STAYMAN. Right. Out of that, $13 million basically goes for Kwajalein.

Mr. ROHRABACHER. Thirteen million goes for Kwajalein. But of that $13 million, you are saying that $7 million goes to the local owners and $6 million goes to the local government. How much goes to the Marshall Islands, for Kwajalein? All of that $42 million has to be considered for the use of Kwajalein, is that what you are saying?

Mr. STAYMAN. No. That is our total Compact assistance. I think part of the difficulty may be here is that the United States does not generally associate a payment directly with military use.

Mr. ROHRABACHER. We have a $4 billion facility there. We are dealing with 130,000 people and, in their country, that is their only real asset, their only big asset, except maybe fish around the islands or something like that. I just want to know how much we are

paying those 130,000 people to use that $4 billion facility that is so important to our national security.

Mr. STAYMAN. We are paying $11.1 million under section 211 and $1.9 million under section 213.

Mr. ROHRABACHER. Say it again.

Mr. STAYMAN. Eleven point one million plus $1.9, so that is $13 million.

Mr. ROHRABACHER. Thirteen million. That is going to the landowners and the local government. You have 130,000 people who consider themselves a nation. How much are we paying that nation? The $13 million, nothing is going to the entity of the corporatized 130,000 people.

Mr. STAYMAN. It is question of whether or not you consider Kwajalein to be part of that country. It is the second largest city. It is where, I don't know, 30 percent of the population lives.

Mr. ROHRABACHER. Right. Kwajalein is definitely part of the Marshall Islands. All right, and you are saying——

Mr. STAYMAN. I am just describing the structure.

Mr. ROHRABACHER. How many landowners are there? Let me ask you that.

Mr. STAYMAN. I am afraid I don't know.

Mr. ROHRABACHER. Are we talking about a dozen?

Mr. STAYMAN. Dozens.

Mr. ROHRABACHER. So is it $7 or $6 million a year that we give to the dozens of landowners.

Mr. STAYMAN. The $7 million.

Mr. ROHRABACHER. $7 million. We are giving $7 million a year to dozens of landowners. We are giving $6 million a year to some local Kwajalein government, which I will have to learn about that. But we aren't giving anything to the rest of the Marshall Islanders specifically to rent this facility.

Mr. STAYMAN. That is my understanding.

Mr. ROHRABACHER. All right. Does that seem reasonable to you?

Mr. SMITH. If I may interject——

Mr.ROHRABACHER. Sure.

Mr. SMITH. Around the world with many different countries where we have military access and operating rights we give aid and assistance to that country, but it is never called rent per se for the facility, but we give—as part of the access agreement we agree to give a certain amount of level of aid or assistance.

Mr. ROHRABACHER. So you would assume that the rest of that $42 million—that is, basically what we are giving them, in order to have Kwajalein, otherwise, we wouldn't give them anything.

Mr. SMITH. I don't know if that is true. Because I am assuming that the rest of the $40 some million goes the other projects.

Mr. ROHRABACHER. Let me put it this way to you. If we consider $13 million as the basic payment there, and the price of constructing the facility was $4 billion, so that is $4 billion. I am not sure if that is the value is more than $4 billion. That is pretty low rent for $4 billion facility, OK.

Anyway, I just think that when we are trying to deal with what is going on in the Marshall Islands, we have to deal with people fairly. Yes, we have been the biggest guy in the block in the whole Pacific for a long time; and, if we are going to demand responsi-

bility we better make sure everything is based on fairness and equity.

I am not sure. I have not studied this. I don't know it. I can only go from gut instincts. It just seems like there is some incongruity in these numbers somewhere.

So, with that said, I am sure that Chairman Bereuter and I will eventually come to the bottom of this. But thank you very much.

Mr. BEREUTER. Thanks for your valiant effort, Mr. Rohrabacher.

I would like to start on a second round of questions here. I am back to Mr. Aranza, you will be happy to know.

In cases where the FSM and the RMI have outstanding debt to U.S. institutions such as hospitals, what action does the Department of Interior take to help resolve those problems? Do you feel you have a responsibility? If so, is it being discharged?

Mr. ARANZA. We have the authority, and we have, in at least one instance, actually, withheld funds under the Compact that were not full faith and credit until such time as one of the Chuuk States repaid one of the hospital debts. That was the Guam Memorial Hospital debt that I mentioned earlier.

Mr. BEREUTER. Guam Memorial.

Mr. ARANZA. Right.

With respect to other hospital debts, it would kind of depend on the source of the money or the debt. I think that if it is full faith and credit, direct cash payments, there is very little that the Department of the Interior or any other Federal agency could do in terms of using that money to leverage repayment of medical debt.

Mr. BEREUTER. Mr. Aranza, I remember how much difficulty the trust territories were having in getting professional medical care people at that time and how, in many cases, they relied on what you might call as medical missionaries who were doing works, church subsidized medical personnel. Is that a significant problem yet today? Is it one of the reasons why there may yet be so many people going away apparently to Guam for medical services?

Mr. ARANZA. Yes, that is true.

Mr. BEREUTER. Does program assistance expire in 2001?

Mr. ARANZA. Federal program assistance? Mr. Chairman, I believe that the different Federal agencies' programs have their own independent authority, and they are reauthorized at different times by Congress. They don't find their origins in the actual Compact.

Mr. BEREUTER. I am sure that would be true of some or most. Can you investigate this matter for us to see if there is any programs that will end automatically in 2001 at the end of the Compact or if all of the programs providing direct assistance in humanitarian housing and so on have their direct authorization?

Mr. ARANZA. Be glad to look into that.

[The following answer was submitted by Mr. Aranza.]

If any of the direct Federal programs, that is, grant expenditures authorized under the Compact Act, sections 105(h), 111, and 226, will end on September 20, 2000/2003, it will be a coincidence of their authorizing legislation. None of them is tied statutorily to the Compact or the Compact Act. Of course, the guaranteed Federal services provided for in Compact section 112 (foreign Service Institute training) and Compact section 221 (a) (Weather Service, audits, Postal Service, and FAA) will, if not renewed, end on Sep-

tember 30, 2001/2003. However, these are not programs from other Federal agencies, but rather reimbursements by the Office of Insular Affairs to other Federal agencies.

Mr. BEREUTER. Thank you.

Now the system of land tenure in both the FSM and RMI appear to be one of the greatest impediments to the development of private enterprise. That was a problem in Northern Marianas, too, but in some cases they took a better solution in the commonwealth. What kinds of specific assistance has the Interior Department provided to assist land title registration and reform of the land tenure system? Mr. Stayman, is it possible that State Department ought to be providing that assistance since you do that, I hope, very well in other parts of the world?

Mr. Aranza, first, do you want to tell me what you know about that problem and whether or not there is any effort to try to provide assistance?

Mr. ARANZA. In terms of land tenure, Mr. Chairman, I am not specifically aware of any technical assistance that my office provides specifically for that issue.

Mr. BEREUTER. We have land title registration problems which apparently are an impediment to development in these islands I am told. I know that has been the case elsewhere. Mr. Stayman, has the State Department ever thought about providing direct assistance to the Freely Associated States?

Mr. STAYMAN. Generally, Mr. Chairman, the State Department does not provide assistance to these two countries largely because of the amount of assistance they are getting from the Department of the Interior.

Mr. BEREUTER. I know you don't, but have you ever considered it?

Mr. STAYMAN. We have in some limited areas, particularly the public diplomacy area. We do have some spending there, although it is not a State department program.

Of course the Peace Corps is there, and that is important to their education system. So there are some other programs associated with State which are extended. We haven't looked at the specific example you are referring to, but we would be happy to do that.

Mr. BEREUTER. Apparently, staff asked a question of how much of the Kwajalein lease payment does the Kwajalein Atoll development authority receive. The question was asked about what has Kauta done with the resources? I understand they walked out of the room and refused to answer.

Given that 20 percent of the RMI population lives in Ebeye—and I tried to describe to you the squalor that existed with the highest concentration of population in the Pacific on that one island—what percentage of the RMI government resources are allocated to services and development? Got any rough idea, Mr. Aranza?

Mr. ARANZA. Not at this specific time, Mr. Chairman. I will be sure to get back to you on that one.

Mr. BEREUTER. You know why all those people are living in Ebeye, don't you? You want to tell us about that?

Mr. ARANZA. Because of Kwajalein.

Mr. BEREUTER. Because of Kwajalein and the extended family, 10, 12, or 15 people come to be supported by the one person who has the job across on Kwajalein.

Mr. STAYMAN. If I could just add, Mr. Chairman, I think that this goes to the heart of finding that the GAO made, that much of our assistance was used ineffectively because of bad planning and bad management. As I understand it, the RMI government provides very little money to Kwajalein because Kwajalein is, in effect paid through sections 211 and 213. There are a substantial amount of resources going into Kwajalein, but it is the poor planning and poor management on the island which results in many of these problems.

It is important to note the trend in Ebeye. In the early 1990's, when the Ebeye government had first been organized, they went out and hired professional city manager—they went out and hired professional managers for their utilities; and around the 1993-1994 timeframe the situation there had improved dramatically.

However, there were some political crises there. There was change in management; and we saw the use of resources revert to the old pattern, which was funds were generally put almost exclusively into payroll. So money was taken out of hiring professionals to run the services and the utilities. It was taken out of maintenance. It was taken out of supplies. I think we have to be cognizant of what GAO has said that many of the problems here were not due the a lack of resources but to a lack of planning and a lack of management. That is my view of what the problem is in Ebeye.

Mr.BEREUTER. Now in Enewetak, of course, these people are greatly affected by fallout from nuclear hydrogen bombs. Therefore, we moved them off the island, we scraped the entire surface of the island off and buried it or took it away, and we allowed them to move back. When I was there, it was like a large sand dune with foot-high palm trees and absolutely nothing for the people to do.

Then they decided that the levels of radiation were too high again, and they moved all of these people off again. When I saw them they were living in, for example, flimsy packing crates on other islands with no discernible way to make a living; and they had to depend upon the food coming in provided by the United States irregularly, sporadically, during that period of time, with absolutely nothing to do, with no way to make a living. Then they moved back again, and then they were taken off again. They decided it wasn't adequately safe for them to be there. So what has happened to the people of Enewetak?

Mr. STAYMAN. The people of Enewetak are now living on their atoll. I was not aware that that particular group had been moved off. The Bikinians had been moved off and moved back, and the Rongelaps had been moved off and have not moved back. As far as I recall, the Enewetak community was relocated after the cleanup.

But you are absolutely correct, Mr. Chairman. The conditions on the island were such that it was virtually impossible to grow foodstuffs.

Mr. BEREUTER. Like a sand pile. Absolutely sand pile.

Mr. STAYMAN. Yes, a concrete pile is better. Congress provided, in fact, just a couple of years ago, machinery to break up the surface. It is basically like concrete.

Mr. BEREUTER. It is Rongelap.

Mr. STAYMAN. Rongelap is one of the other four affected atolls.

Mr. ARANZA. Mr. Chairman, if I could just note, from the Department of the Interior, separate from the compact pact, we provide about $1.1 million a year for Enewetak support.

Mr. BEREUTER. Do you think it gets to the people?

Mr. ARANZA. Yes, I do.

Mr. BEREUTER. I hope that is right.

Mr. Underwood.

Mr. UNDERWOOD. Thank you, Mr. Chairman.

On the issue of Ebeye—and I am—actually, I did get a chance to visit Ebeye. It was early last year, and the conditions are appalling. It is very difficult to describe to people who have never been there.

I think it is about 10,000 people on one square mile. They have some community showers in some instances and, only a few palm trees, hardly any trees at all, nothing. It is kind of wall-to-wall people who take the water taxis to work in Kwajalein.

But that also presupposes a difficult question on what we propose to do in terms of whether we should monitor that more carefully or we should welcome at this as a sovereign to sovereign relationship and say, well, you get the money and this is basically what it is for and you decide how you want to handle that. That is a very difficult call.

So yet I feel as a person who has—certainly has traveled throughout the region continually over the past couple of decades that at times the situations are used to kind of create a lot of emotional support, but then sometimes you don't see the kind of infrastructure support which would go toward ameliorating it.

I do want to point out to Mr. Rohrabacher, I don't know, do you represent Costa Mesa? You should be proud to know that the largest community of Marshallese outside of Hawaii and the Marshalls live in Costa Mesa.

Mr. ROHRABACHER. We are trying to make sure they are all Republicans.

Mr. UNDERWOOD. Well, the interesting thing is they are nonimmigrants, so they don't become citizens. They just live there. But——

Mr. BEREUTER. Would the gentleman yield? Just a little bit of staff input back here. He contends that the largest group outside of Hawaii and Guam is employed by Tysons food in Iowa.

Mr. UNDERWOOD. There are a few hundred of them working at Tysons. That makes the chicken taste better, I guess.

Just going back to the issue of strategic denial—maybe Mr. Smith would like to answer the question. Strategic denial in the height of the Cold War seemed very critical and very crucial to the relationship of the United States to the region. How important is strategic denial as a concept today and what are we denying and to whom and potentially to whom and how important is it in the constellation of our strategic thinking?

Mr. SMITH. It is important. I would say that certainly the future is uncertain, and I am not aware right now, today, that we are denying any access to other countries, but it is something that we feel we—it is good to have for the future. There is probably any number

of scenarios you might develop, and I think Mr. Rohrabacher mentioned about the Chinese possibly being active in this region, and maybe for some reason we may want to exercise it in the future.

Mr. UNDERWOOD. I guess the strategic denials—we are not denying anybody. It is Micronesians that are denying it in response to this provision. But how critical is it to our thinking? I mean, what could conceivably happen? What about the issue of recognition of diplomatic recognition of different countries, as apparently happened in the case of the Marshalls where we switched between Taiwan and the PRC and kind of flip-flopped?

Mr. SMITH. As I understand, the strategic denial applies to military user access; and I don't believe it extends to the diplomatic.

Mr. UNDERWOOD. Maybe Mr. Stayman would have—is there any thinking about that in the State Department, any source of concern to that? Because I know that the Marshall Islands switched their recognition in the past year.

Mr. STAYMAN. The Compact doesn't provide for, I would say, nondefense. The U.S. does not have the right to object to actions by these governments that are not connected with defense.

Mr. UNDERWOOD. I understand that. I am just wondering whether there is any concern in the State Department. Has there been any discussion on this particular issue? It is rather obvious that, in this instance, it appears that the Marshall Islands switched from the People'S Republic of China, from recognizing the PRC to Taiwan in order to secure some financial advantage. So is that a source of concern? Is it an item for discussion? Or are you simply saying, well—I mean in the nature of State Department activities, trying to move people in a certain direction is part of it, isn't it?

Mr.STAYMAN. We recognize their right to exercise their sovereignty in this area.

Mr.UNDERWOOD. Thank you.

Mr.BEREUTER. Gentleman from California is recognized.

Mr.ROHRABACHER. You have to remember up until recently Communist China has been our strategic partner, according to this administration. I mean, how can you expect any answer except for the one you just received? In fact, the Marshall Islands and these other islands in the Pacific, in fact, their friendship and good relations with the United States and America's ability to be the dominant power in this arena is of incredible strategic importance to the United States of America. Otherwise, we have a potential enemy right on our doorstep. Instead, we can hold at bay any potential enemy because we have friends that are there in this vast Pacific area. Of course, when you have an Administration that bends over backward not to see a threat from Communist China, you are going to have that type of answer.

Let us talk about the Chinese in the Pacific. What about the listening post in Tarawa? Was that built by the Chinese military?

Mr.SMITH. I am not sure if it was built by the military or some other arm or agency of the Chinese.

Mr.ROHRABACHER. Is that aimed specifically at overseeing what we are doing in Kwajalein? Is that what they do in this big dish out there?

Mr.SMITH. I am not really familiar with this facility, but I assume that it is a space tracking station and——

Mr.ROHRABACHER. You are not familiar with the facility? Who is?

Mr.SMITH. Not that facility.

Mr.ROHRABACHER. Who is familiar with that facility if you are not familiar with it? It seems to me that would be something of interest to us. Of course, they are our strategic partner, so we don't have to worry about that. Who would be knowledgeable about that facility?

Mr.SMITH. I can find somebody who knows.

Mr.ROHRABACHER. All right. I would suggest that the fact that there is an ultramodern piece of technology sitting on an island 500 miles from our missile testing range, that that would be of some interest to the United States of America and what its capabilities are, what the purpose of it is and what type of visitation that it has from what branches of the Chinese Government. Is there some indication of more Chinese activity in these Pacific islands?

Mr.SMITH. Mr. Rohrabacher, with the Freely Associated States I specifically asked several people that question about possible Chinese military activity in this particular region, and I was not able—nobody knew of any specifically. There is certainly economic and trade activities there.

Mr.ROHRABACHER. Of course, we have a problem with Communist China in that they have taken all of their military people—not all of them, but a huge chunk of their military apparatus, and they have given them civilian clothing and started calling them businessmen. Like COSCO is really the merchant marine of the People's Republic of China, but they just took the merchant marine uniforms off, and now it is supposedly a private shipping company.

Li Ka-Shing, who is one part of the inner leadership in Beijing, is not just a billionaire whose people are conducting other types of businesses throughout Panama and elsewhere. So you don't see any threat, Chinese threat?

I guess we might as well not even proceed with that line.

Let me just say this, that I do perceive a threat from Communist China. That is where—and that is clear from what has been going on in this Congress and for the last 2 years. That is something that——

I believe the Communist Chinese have to be viewed in the same way that the Japanese were viewed in the 1930's. The Japanese viewed themselves as the dominant force in Asia, and they had a right to, the Japanese had a right to dominate all of Asia or at least their co-prosperity sphere, and the United States was the only thing that stood in their way. Thus, we were their enemy in their mind, long before we officially admitted that.

I think the same is true with the Chinese now. The Chinese believe they have a right to dominate all of Asia, or at least a huge hunk of Asia; and, just like the Japanese, the Pacific plays a major part in this strategic game. The Marshall Islands play an even greater part because they are not only part of a strategic positioning but the Kwajalein missile range will permit the United States to develop an antimissile system that will eventually save us and perhaps could deter aggression from the Communist Chinese in the future. Something of enormous value to our country because now we understand, after years of foot dragging, that a missile defense system is actually important.

Finally, let me just say this for the record and that is, Mr. Chairman, we should never underestimate the importance that the Pacific Ocean. The ocean itself is going to play to the nature of humankind. I am the Chairman of the Space and Aeronautics Subcommittee so I spend a lot of time studying about the future of space and America's position in space. I happen to believe that, as important as space is to us, we also have overlooked the fact that the ocean will be at least that important to the future of the human race.

The Marshall Islands and others, while they are going through a period now where they seem less significant than they did 50 years ago during World War II, there will be a time when these islands and mankind's commitment to the ocean will find these people in the forefront of developments that will affect life on this planet and will push their lives forward so that they don't live in squalor and they aren't taken for granted and that they are treated fairly.

So thank you very much, Mr. Chairman, for this hearing.

Mr. BEREUTER. Thank you very much, Mr. Rohrabacher.

Gentlemen, I want to thank you for your testimony, for your responses to our questions. We will need your input, your assistance for some time to come as we look at this subject.

We share jurisdiction with the Resources Committee. In fact, we offered an opportunity to have a joint hearing with them. It was not convenient at this time, so we embarked on study and investigation.

I would, in thanking you once more for your time and asking for your future assistance, ask Dr. Westin if she could come back to the witness table very briefly. I have one area to investigate with her, and I think it should be informative for everyone here. Thank you, gentlemen.

Dr. Westin, I would simply like to ask you to clarify for everybody's interest, for me, and for the Subcommittee what will happen now. What are the timeframes for reaction from the agencies with respect to the second part of your study, which I understand you hope to print—to release to the public in September? Can you lay out just what will happen at that point. How much time they will have to respond to some of the information that you presented today and for their input to be considered?

Ms. WESTIN. Yes, Mr. Chairman. Thanks for the opportunity to clarify that. Because I had mentioned that we do have a report based on our work coming out in September, a written report. In this report, we expect to have recommendations to the agencies. I know that we will have recommendation on accountability. There may be other recommendations as well. We are still working through those based on our findings. We also may have in the report matters for Congress to consider.

GAO procedures are that when we do a report involving agencies we give the report to the agencies and they have a chance to comment. We will print their written comments as part of our report with our responses. Or if they disagree with our findings we will also talk about that, and they will have about 30 days to answer.

Also, the Compact provides for 45 days for both the Republic of the Marshall Islands and Federated States of Micronesia to com-

ment, so we will provide that report to them as well. Once we have back their comments, we consider their comments and pull it all together, answer what needs to be answered. We expect the printed report to be available to the public about the end of September.

Mr. BEREUTER. Thank you very much. I think that is important to lay that out. So the two Freely Associated States will have 45 days, and those comments will be a part of the report, along with the 30-day notice comments.

Ms. WESTIN. For the agencies, yes.

Mr. BEREUTER. Very good. Thank you very much, Dr. Westin; and thanks to your staff for all of your work on this to this point.

The Subcommittee is adjourned.

[Whereupon, at 4:55 p.m., the Subcommittee was adjourned.]

A P P E N D I X

JUNE 28, 2000

Opening Statement

The Honorable Doug Bereuter
Chairman
Subcommittee on Asia and the Pacific

"Micronesia & The Marshall Islands: A Question of Accountability"
Wednesday, June 28, 2000

The Subcommittee on Asia and the Pacific meets today in open session to receive testimony on the impact of U.S. financial assistance to the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) in view of the on-going negotiations to renew the financial provisions of the Compact of Free Association which expire in 2001.

In 1986, the U.S. Government entered into a Compact of Free Association with the FSM and RMI. The Compact granted these former U.S. Trust Territory districts their independence and provided a framework for future governmental relations, including the provision for 15 years of direct U.S. payments made by the Department of the Interior to the bank accounts of the FSM and the RMI. The direct payments from Interior were to be used for such purposes as capital construction projects, energy production, communication capabilities, and recurring operational activities, such as infrastructure maintenance. Nineteen U.S. Federal agencies have provided aid through grants, loans, equipment and technical assistance.

Title II of the Compact, regarding economic relations, and Title III, regarding the defense veto and additional base rights -- but not the right of strategic denial or the use of Kwajalein Atoll -- will expire in 2001. The United States is already engaging both Micronesia and the Marshall Islands in a new round of negotiations to extend these Compact titles. However, before negotiations proceed much further, I believe it is incumbent for us to examine, carefully and objectively, the record of the Compact since 1986 in order to provide a more accurate and acceptable direction for relations in the future.

It is in this context that the Chairman of the Senate Committee on Energy and Natural Resources [Senator Frank Murkowski] and I tasked the General Accounting Office (GAO) to undertake a two-part review of the Compact. The first report, which was issued last month, examines (1) the cost to the US of providing assistance to the FSM and RMI from Fiscal Years 1987-1999, and (2) funds provided prior to the Compact for the effects of nuclear weapons testing to what is now the RMI. According to the GAO, more than $2.6 billion (yes, that's *billion* with a "b") in financial and other assistance has been provided to the FSM and RMI during this time period. Of that, approximately $2 billion has been through quarterly cash payments, with minimal or no oversight, to the Islands' bank accounts. The remaining $500 million was provided by 19 Federal agencies in various services, such as education Head Start and Pell Grant funding, weather forecasting support, preventive health services, Job Training and Partnership

Act aid and the like. This translates, over the past 13 years, into approximately $1.5 billion to the FSM, a nation of only 131,500 people, and $1.1 billion to the 50,500 inhabitants of the RMI.

The GAO found significant inaccuracies and inconsistencies with the data being used by the Department of the Interior to supervise and monitor federal assistance programs. In fact, Interior is still unable to document $27 million in reimbursements. As the GAO reports, "Collectively, therefore, Interior's ability to accurately report on assistance provided is called into question."

This Subcommittee's own investigation revealed that Interior has assigned only one mid-level individual, let me repeat that – only one individual – in the field to just monitor, not manage, these vast sums of American aid. His responsibilities are extended even further to also include the distant freely associated state of Palau, also a former trust territory, and its $14 million annual aid program. In other words, one individual has a jurisdiction extending an area over 2400 miles and 4 time zones. I am told that there is only one other individual identified in the Office of Insular Affairs with exclusive responsibility for the FSM and RMI and this person is in Washington, D.C. The neglect and indifference of the Interior Department is nothing more than a failure by our own Government to fulfill its basic responsibility to the American taxpayer.

Before another dollar is blindly committed, we need to get the U.S. Government's own affairs in order. Given what the GAO has revealed, I have serious concerns about the Interior Department's ability to manage U.S. assistance and advance economic development in the FSM and RMI. Indeed, Interior's only other experience in this field is with the Bureau of Indian Affairs, and we are all too well aware of the billions of dollars in missing Indian Trust Fund monies and the deplorable conditions in and vast number of failed economic development programs on America's own Indian reservations. We need to examine the question: Should some other agency have primary responsibility?

The second part of the GAO review focuses on the use and impact of U.S. financial assistance to the FSM and RMI. Where has the $2.6 billion gone? I would say very candidly that when I visited our four trust territories in the Pacific in the early 1980s as a very junior Member of the Interior and Insular Affairs Committee, I saw endemic waste and mismanagement, and massive corruption in at least one of those territories. Unfortunately, as the GAO will report, it is evident that corruption, waste, mismanagement and misuse of funds continue. This abuse continues to divert a significant amount of the resources that ought to have gone to the people of the region from them. America's investments in Micronesia and the Marshall Islands seem to have disappeared or to be rusting away in perpetuity. Most economic development projects have failed. The squalor I saw on Ebeye almost 20 years ago apparently remains there today, perhaps even more intolerable, despite over $1.1 billion in overall assistance. Sixty million dollars has gone into fishing fleets and processing plants in the FSM. Yet, the ships are rusting in the harbor or smashed up on the reef and the plants are empty and closed with little or absolutely no operational time resulting from these expenditures.

With the renewal of Title II of the Compact, significant changes are need to stop this deplorable, outrageous example of the fleecing of the American taxpayer and to ensure that our assistance does, in fact, lead the FSM and the RMI on a successful path to economic self-sufficiency in which all islanders, not just a chosen few, benefit. A successful Compact with genuine and sustainable economic development in these Freely Associated States is certainly in America's short- and long-term national interest. The mismanagement and waste of Compact financial assistance is not a partisan issue; this financial and human tragedy has transpired through Republican and Democrat Administrations in Washington and many different governments in Palikir and Majuro -- largely without public notice. I am encouraged, although guardedly so, with a few positive reforms that have already occurred or are being proposed in both the FSM and RMI under their new governments. However, actions speak much louder than words and significant actions are still needed.

With the current negotiations, both the United States and the Freely Associated States have a special opportunity to reformulate our financial relationship. The FSM and RMI should recognize that both the world and the U.S. Congress have changed since 1986. While our special defense relationship certainly remains of important strategic value -- and in no way is this special defense relationship in question or even on the table -- the Soviet Union and the threats it posed no longer exist. In our successful effort to balance the U.S. Federal budget, certain domestic programs and constituencies have endured painful cuts. The FSM and RMI cannot expect to continue to be shielded from similar experiences. Much, much more will have to be done with less and this can be done with no hardship if funds are no longer spent in such a scandalous fashion. The challenge for the negotiations ahead is to determine how to best do more with less.

I am pleased today that we will have the opportunity to hear from both the GAO and the Administration on the Compact's record and to begin to understand where our government should go from here. Testifying for the GAO is Dr. Susan Westin, an associate director at the U.S. General Accounting Office. She is currently responsible for international trade issues. In this capacity, she has led a number of cross-cutting assignments on competitiveness, in addition to heading GAO's assessment of the response to Mexico's financial crisis and the second part of the GAO's review of the FSM and RMI. Before joining the GAO, Dr. Westin held faculty positions at the University of Toronto, Northwestern University, and Southeastern University in Washington.

Ms. Westin will be followed by a second panel of distinguished Administration witnesses. Representing the Department of State is Mr. Allen Stayman, who has served since June 1999 as the U.S. Special Negotiator for the Compact of Free Association. Prior to this posting, Mr. Stayman was Director of the Office of Insular Affairs and Deputy Assistant Secretary for Territorial and International Affairs at the Department of the Interior. It was in these capacities that he has testified before this Subcommittee in previous years. From 1984 to 1993, Mr. Stayman was a professional staff member with the Senate Committee on Energy and Natural Resources.

Representing the Department of the Interior is the current Director of the Office of Insular Affairs, Mr. Ferdinand Danny Aranza. A native of Guam, he previously served as Legal Counsel to the former delegate from Guam, Congressman Ben Blaz, who served on this Subcommittee during his tenure in office.

We are also honored to have Mr. Frederick C. Smith, the Special Assistant to the Under Secretary of Defense for Asia-Pacific Issues. For over 25 years Mr. Smith has been actively involved in studying, formulating, and implementing U.S. defense policy, first as a Naval Officer and now in a civilian capacity. Before his current posting, he served as a visiting professor at the U.S. Naval Academy and as the Principal Deputy Assistant Secretary of Defense for International Security Affairs.

We will begin with Dr. Westin who, I understand will be utilizing the new visual technology here in the committee room. Following this panel, we will hear from the Administration witnesses who are requested to limit their remarks to approximately 10 minutes each in order to allow sufficient time for Members' questions and discussion. Without objection, your written statements will be included in its entirety into the Record.

I now turn to the distinguished ranking member of the Subcommittee, Mr. Lantos for any comments that he may have.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Asia and the Pacific, Committee on International Relations, House of Representatives

For Release on Delivery
Expected at 2:00 p.m., EDT
Wednesday, June 28, 2000

FOREIGN ASSISTANCE

U.S. Funds to Two Micronesian Nations Had Little Impact on Economic Development and Accountability Over Funds Was Limited

Statement of Susan Westin, Associate Director, International Relations and Trade Issues, National Security and International Affairs Division

GAO/T-NSIAD/RCED-00-227

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to provide information you requested regarding economic assistance provided by the United States from 1987 through 1998, under the Compact of Free Association, to the Federated States of Micronesia and the Republic of the Marshall Islands. In 1986, the U.S. government entered into an international agreement, the Compact of Free Association, with each nation. This Compact represents a continuation of U.S. financial support that had been supplied to these areas for almost 40 years after World War II under the United Nations Trust Territory of the Pacific Islands. Specifically, my testimony will address (1) the use of Compact funding by the Federated States of Micronesia and the Republic of the Marshall Islands, (2) the progress made by both nations in advancing economic self-sufficiency, (3) the role of Compact funds in supporting economic progress, and (4) the amount of accountability over Compact expenditures. My statement will be accompanied by photographs of sites we visited that were funded with Compact money in the Federated States of Micronesia and the Republic of the Marshall Islands. In addition, we will publish a report discussing these issues in more detail in September 2000.

The information I will provide is based on our review of annual financial statements and audits, planning and reporting documents from both nations, and discussions with senior officials from the Departments of the Interior and State. We also visited the Federated States of Micronesia and the Republic of the Marshall Islands and discussed the Compact with government and other officials, visited projects funded by the Compact, and reviewed documentation related to Compact expenditures maintained by both countries.

U.S. direct financial assistance under the Compact, which ends in 2001, is intended to help the governments of the two countries in their efforts to advance their economic self-sufficiency. Direct payments, or transfers of Compact funds, to both island nations are made by the Department of the Interior, the agency responsible for providing and monitoring Compact assistance.[1] These payments can be used for general government operations; capital projects (such as building roads or schools) and to support targeted sectors, such as energy and communications, specified in the Compact. In addition to receiving direct payments, both countries are eligible to use numerous U.S. federal services and programs such as the U.S. Weather Service, Pell grants for higher education, and business or home loans. The FSM and the RMI also receive some assistance from other countries. In the fall of 1999, negotiations between the Department of State and the two nations began on how to renew economic assistance and certain national security provisions in the Compact that will expire in 2001.

In May, we reported that the United States had provided over $2.6 billion in total U.S. assistance to both countries from fiscal years 1987 through 1999, based on figures given

[1] The Department of the Interior's Office of Insular Affairs currently has two people that work exclusively with the two Compact nations, one in Washington, D.C., and one in the Federated States of Micronesia. No Interior personnel live in the Republic of the Marshall Islands. There are three to four additional Interior staff in Washington, D.C. that work with the Compact nations as needed.

to us by 19 U.S. government agencies.[2] This assistance included direct payments under the Compact for economic growth and compensation for nuclear testing, as well as U.S. program assistance. In our May report, we concluded that the U.S. Department of the Interior had not maintained reliable data on the amount of U.S. assistance provided to the FSM and the RMI by all U.S. agencies. We recommended that, should the Department of the Interior retain oversight responsibility as a result of the current negotiations, the Department develop a system to obtain and maintain data on all U.S. assistance by, for example, making agreements with other U.S. agencies to regularly report assistance provided to both countries.

In this testimony, I will discuss how the FSM and the RMI spent direct payments provided under the Compact by the Department of the Interior to both countries to promote economic growth during the years 1987 through 1998. I will, however, refer to total U.S. assistance, which includes program assistance provided by all U.S. government agencies, during my discussion of economic self-sufficiency.

SUMMARY

The Federated States of Micronesia and the Republic of the Marshall Islands spent about $1.6 billion in Compact funds on general government operations, capital projects, and targeted sectors, such as energy and communications, from fiscal years 1987 through 1998. The two countries have used the funding differently. The Federated States of Micronesia used about 47 percent ($510 million) of its $1.08 billion in Compact funds to support general government operations such as salaries and travel. The Republic of the Marshall Islands spent 45 percent ($230 million) of its $507 million in Compact funds on capital projects such as developing physical infrastructure, establishing businesses, and servicing debt. Both countries together issued $389 million in Compact revenue-backed bonds from the late 1980s to the mid-1990s in order to obtain more funding during the earlier years of the Compact. As a result of issuing these bonds, the Republic of the Marshall Islands has spent 42 percent ($217 million) of its Compact funds for debt service, leaving limited Compact funds available for current government operations and investment.

The Federated States of Micronesia and the Republic of the Marshall Islands have made some progress in achieving economic self-sufficiency since 1987, though both countries remain highly dependent on U.S. assistance which has maintained artificially high standards of living. We used dependence on U.S. assistance, or total U.S. funds[3] as a percentage of total government revenues in each country, as an indicator to gauge economic self-sufficiency. The reliance on U.S. funding as a percentage of total government revenue in the Federated States of Micronesia fell from 83 percent in fiscal year 1987 to 54 percent in 1998. The Republic of the Marshall Islands also reduced its reliance on U.S. funding somewhat, from 78 percent in 1987 to 68 percent in 1998. Scheduled decreases in Compact direct payments as well as increases in locally

[2] See Foreign Relations: Better Accountability Needed Over U.S. Assistance to Micronesia and the Marshall Islands (GAO/RCED-00-67, May 31, 2000).
[3] For our assessment of economic self-sufficiency we use total U.S. funds, which consist of all direct payments under the Compact as well as U.S. program assistance.

generated funds in areas such as fishing license fees are examples of why reliance on U.S. funding has decreased.

Compact expenditures to date have led to little improvement in economic development in the Federated States of Micronesia and the Republic of the Marshall Islands. Substantial Compact expenditures used to maintain high levels of public sector employment have acted as a disincentive to private sector growth. Both countries have also spent Compact funds on infrastructure projects, such as electrical power and telecommunications systems, that they viewed as critical to creating an environment attractive to private businesses. However, these projects have not generated significant private sector activity. Finally, investment of Compact funds in business ventures has been a failure. During our work, we found that many Compact-funded projects had experienced problems because of poor planning and management, inadequate construction and maintenance, or misuse of funds.

The governments of the Federated States of Micronesia, the Republic of the Marshall Islands, and the United States have provided limited accountability over Compact expenditures. Although the Compact established accountability requirements for all 3 countries, none of the governments fully used these mechanisms to ensure that Compact funds were spent effectively or efficiently. While the Federated States of Micronesia and the Republic of the Marshall Islands generally prepared planning and reporting documents required under the Compact, most of these documents could not be used to determine if Compact funds were being spent to promote economic development. Furthermore, neither nation provided adequate financial or programmatic control over Compact funds, as documented in audit reports since 1987. In addition, the U.S. government did not meet many of its oversight obligations. For example, it did not hold required annual consultations to assess progress under the Compact until 1994, losing a valuable opportunity to provide guidance on the goals and uses of Compact funds. Moreover, disagreements between the Departments of State and the Interior over Compact responsibilities, as well as Interior's view that the Compact contained restrictive provisions that impaired its ability to act, further limited oversight.

BACKGROUND

In 1986, the United States entered into a Compact of Free Association with the Federated States of Micronesia (a nation comprised of the four states ofKosrae, Pohnpei, Chuuk, and Yap), or FSM, and the Republic of the Marshall Islands, or RMI. These two small island nations are located just north of the equator in the Pacific Ocean with populations of 131,500 and 50,500, respectively, as of 1999. Through this Compact, the FSM and the RMI became Freely Associated States, no longer subject to U.S. administration under the United Nations Trust Territory of the Pacific Islands. The Compact, which consists of separate international agreements with each country, was intended to achieve three principal U.S. goals. These goals were to (1) secure self-government for each country; (2) assure certain national security rights for the FSM, the RMI, and the United States; and (3) assist the FSM and the RMI in their efforts to advance economic self-sufficiency.

The first two objectives have been met. The FSM and the RMI are independent nations and are members of international organizations such as the United Nations. (However, both countries maintain a special relationship with the United States through the Compact, and citizens of both nations are able to live and work in the United States as nonimmigrants.) Additionally, national security objectives were achieved. Under the Compact, the United States agreed to defend the FSM and the RMI, gained access to their territory for military use, and secured the right to deny military access to the region to other countries. These security provisions will continue indefinitely unless mutually terminated. In a 1986 Compact-related agreement with the RMI, the United States secured continued access to military facilities (a missile testing and space operations site) on Kwajalein Atoll for a period of 15 years and the right to extend the access for an additional 15 years (a right the United States exercised in September 1999).

The third objective of the Compact, promoting economic self-sufficiency (a term that is not defined in the Compact), was to be accomplished primarily through direct financial payments to the FSM and the RMI. The largest funding provision provides specific levels of funding for the FSM and the RMI over a 15-year period (1987-2001), with amounts decreasing every 5 years. These funds were provided to cover general government and capital expenditures. Additional Compact provisions target funding for use in specific sectors, such as energy, communications, maritime surveillance, health, and education. Most of this assistance is partially adjusted annually for inflation.

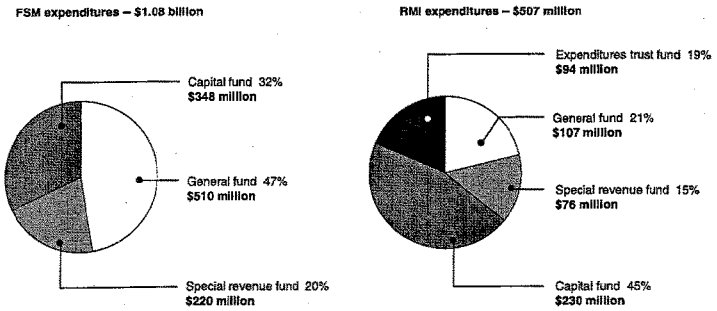
THE FEDERATED STATES OF MICRONESIA AND THE REPUBLIC OF THE MARSHALL ISLANDS USED $1.6 BILLION IN COMPACT DIRECT FUNDING

For fiscal years 1987 through 1998, the FSM spent about $1.08 billion and the RMI spent about $507 million in funding provided by the Compact (see fig. 1).[4] Each government has used the money differently. The largest area of expenditures in the FSM was for general government operations, which accounted for over 47 percent ($510 million) of total Compact expenditures. In the RMI, the largest amount of total expenditures, 45 percent or $230 million, went to support capital fund activities such as building infrastructure, supporting economic activities, and servicing debt.[5]

[4] When Compact expenditures are converted to constant 1999 fiscal year dollars (using the U.S. gross domestic product deflator), the FSM spent about $1.2 billion, while the RMI spent about $582 million. This report uses current dollars throughout.

[5] These figures report on the initial breakdown of Compact funds by government accounts. They may or may not indicate the final use of funds, as these figures for the FSM and the RMI include expenditures from, as well as transfers out of, the accounts. Details regarding the final use of transfers are unavailable in the FSM and RMI financial statements, with a few exceptions, such as the use of transfers for debt service.

Figure 1: FSM and RMI Compact Expenditures by Fund Type as a Percentage of Total Compact Expenditures, Fiscal Years 1987-98



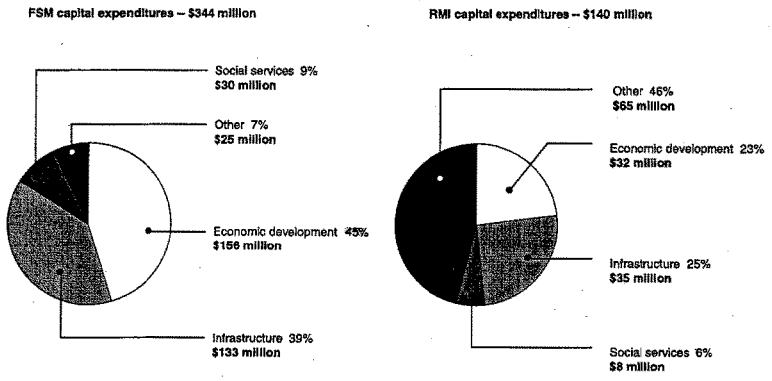
Note 1: The special revenues fund consists of Compact assistance earmarked for specific uses, such as medical referrals, scholarships, and marine surveillance.
Note 2: The expendable trust fund consists of Compact assistance that the RMI government uses to pay about 80 RMI landowners as compensation for the land used by the U.S. military on Kwajalein Atoll.
Note 3: Figures may not add to 100 percent due to rounding.

Source: GAO analysis of financial statements and audits of the FSM and the the RMI prepared by Deloitte Touche Tohmatsu for fiscal years 1987-98.

The financial statements of the FSM and the RMI list projects that were paid for from the capital fund.[6] Of these projects, the FSM and the RMI together spent $484 million from 1987-98 for purposes that included building infrastructure such as roads and schools, and supporting economic development. The FSM spent a total of $344 million in this area, with $156 million (45 percent) of these capital project funds going for economic development, such as for fishing boats or processing plants (see fig. 2). Expenditures on infrastructure, followed closely at $133 million, or 39 percent. For the RMI, 46 percent ($65 million) of total capital fund expenditures of $140 million are classified as "other" expenditures. Most of this amount ($54 million) was listed as unidentified capital expenditures in the RMI financial statements. RMI expenditures for infrastructure and economic development accounted for 25 percent ($35 million) and 23 percent ($33 million), respectively, of these capital funds.

[6] These expenditure data for the FSM and the RMI include only expenditures listed in country financial statements. Capital fund transfers and capital expenditures made from bond proceeds are not included.

Figure 2: FSM and RMI Compact Capital Account Expenditures, Fiscal Years 1987-98



Note 1: "Other" expenditures include land lease and acquisition, resource management, and unspecified uses of funds.
Note 2: "Social" expenditures include spending on health, education, housing, training, and social services projects.

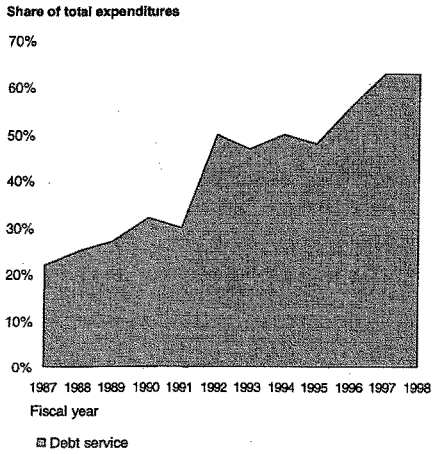
Source: GAO analysis of FSM data, compiled by the Joint Committee on Compact Economic Negotiations, and of RMI financial statements prepared by Deloitte Touche Tohmatsu for fiscal years 1987-98.

The Compact does not have guidelines to control the timing of the expenditures. Using this flexibility, from the late 1980s to the mid-1990s, the FSM and the RMI issued nearly $389 million in Compact revenue-backed bonds in order to obtain greater funding in the earlier years of the Compact. This funding was used to retire existing debt, pay for capital projects, and make financial investments. By fiscal year 1998, the FSM had repaid $119 million in bond debt, with these repayments accounting for 11 percent of total Compact expenditures. However, the RMI has used a higher percentage than the FSM of its Compact funding to repay bond debt (42 percent or $217 million) over the life of the Compact. This has limited RMI Compact discretionary spending options, particularly in recent years (see fig. 3). For example, in 1998, the RMI spent $39 million in Compact funds. Of this total amount, $25 million went to service debt. The RMI was also required to spend an additional $8 million to compensate landowners for U.S. military use of Kwajalein Atoll.[7] This left only $6 million (15 percent) in Compact expenditures to

[7] The legislation enacting the Compact recognizes that there is a lease agreement between the government of the RMI and Kwajalein landowners. The United States provides funding to the RMI, which is then used to compensate landowners, per the lease agreement, for the land used by the U.S. military on Kwajalein Atoll. According to an official at the U.S. embassy in the RMI, use of these funds, which are distributed based on acreage owned by each landowner, is at the discretion of each landowner. This official reported that four landowners receive one-third of the annual payment based on acreage owned, with one landowner receiving half of this amount.

support new capital investment, general government operations, or particular sectors identified in the Compact.

Figure 3: RMI Debt Service as a Percentage of Annual Compact Expenditures, Fiscal Years 1987-98



Source: GAO analysis of financial statements and audits of the RMI prepared by Deloitte Touche Tohmatsu for fiscal years 1987-98.

THE FEDERATED STATES OF MICRONESIA AND THE REPUBLIC OF THE MARSHALL ISLANDS HAVE MADE SOME IMPROVEMENTS IN ECONOMIC SELF-SUFFICIENCY BUT REMAIN DEPENDENT ON U.S. ASSISTANCE

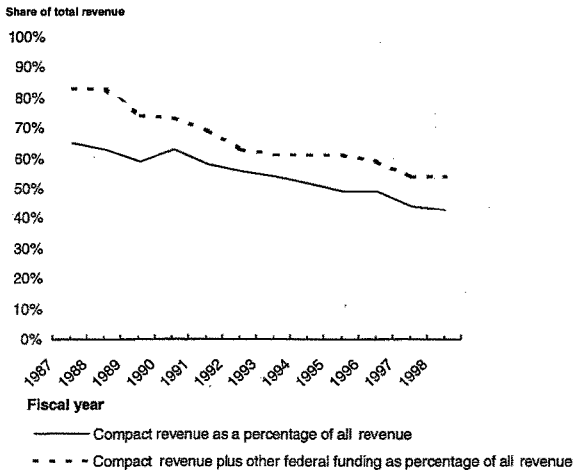
The FSM and the RMI are among the largest recipients of U.S. assistance worldwide on a per capita basis. In 1998, total U.S. assistance equated to about $760 per capita in the FSM and about $1,095 per capita in the RMI. This high level of per capita funding has maintained artificially high standards of living in both countries that would, according to the Asian Development Bank, collapse in the absence of U.S. assistance. The dependence of these two countries on total U.S. assistance, the indicator we have chosen to gauge economic self-sufficiency, is identified by calculating the percentage of total FSM and RMI government revenues accounted for by all U.S. funding. Total U.S. assistance (Compact and all other U.S. program assistance)[8] still accounts for at least

[8] Total U.S. program assistance outside of the Compact for fiscal years 1987-98 for both countries was $368 million. This was 19 percent of total U.S. funding provided to both nations, with the remaining 81 percent of U.S. funding provided as direct Compact payments.

half of total government revenue in both countries, though government dependence on U.S. funds has fallen from 1987 levels in both countries.[9]

While the United States is the main contributor to the FSM government's revenues, this dependence has fallen substantially since the Compact was enacted, from 83 percent in fiscal year 1987 to 54 percent in fiscal year 1998 (see fig. 4). This change is due to scheduled reductions in direct Compact funds, increases in locally generated revenue stemming from higher fishing license revenues, and a change in how government revenues are reported.

Figure 4: FSM Dependence on U.S. Assistance, Fiscal Years 1987-98



Note: Total FSM government revenues are comprised of direct Compact funds, U.S. program assistance, and local revenues.

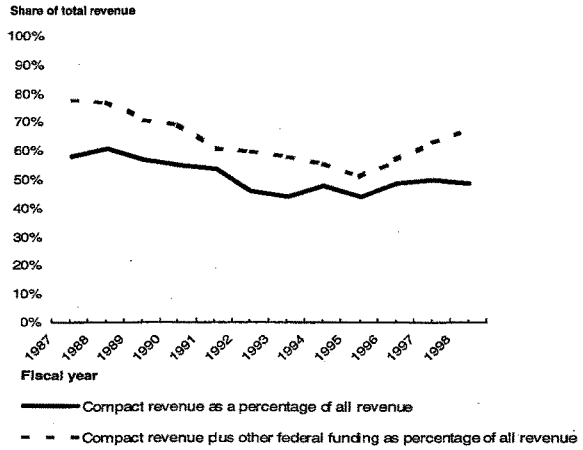
Source: GAO analysis of financial statements and audits of the FSM prepared by Deloitte Touche Tohmatsu for fiscal years 1987-98.

The RMI has also reduced its dependence on U.S. funding, though not as dramatically as the FSM, and its dependence remains higher than that of the FSM. In 1987, U.S. Compact

[9] These data understate the value of U.S. government contributions to the government of the Compact nations. U.S. government services provided in-kind, such as weather service, disaster relief, development loans, and national defense, do not appear as revenue in the FSM and RMI government financial accounts. A complete assessment of changes in self-sufficiency would include contributions of other external donors. To the extent that other external donor revenue is growing while U.S. assistance is decreasing, then self-sufficiency is not improving.

assistance represented 78 percent of RMI government revenue (see fig. 5). This figure fell to 68 percent by fiscal year 1998. However, the 1998 level of dependence represents an increase from 1995, when dependence on total U.S. funding reached a low of 51 percent. The increase since 1995 is due to decreased local fees, sales, and taxes, and to a change in how government revenues are reported.[10]

Figure 5: RMI Dependence on U.S. Assistance, Fiscal Years 1987-98



Note: Total RMI government revenues are comprised of direct Compact funds, U.S. program assistance, and local revenues.

Source: GAO analysis of financial statements and audits of the RMI prepared by Deloitte Touche Tohmatsu for fiscal years 1987-98.

COMPACT FUNDS HAVE LED TO LITTLE IMPROVEMENT IN ECONOMIC DEVELOPMENT

Expenditures of $1.6 billion in Compact funds during 1987-98 in both countries have contributed little to improving economic development. Three areas where Compact expenditures have not led to apparent improvements in economic development are government operations, physical infrastructure, and business ventures. We examined a

[10] In both countries changes in how social security revenues are incorporated into the government's budget have affected reported government revenue. In the FSM, Social Security Administration revenues have been included in the FSM financial statements since 1991. In that year, these revenues were almost $5 million. In the RMI, Social Security System revenues have been excluded in the RMI financial statements since 1996. RMI Social Security System revenues in 1995, the last year they were reported, were over $13 million.

wide range of projects funded under the Compact and determined that these projects experienced problems for many reasons, including poor planning, management, and construction.

Substantial Compact funds ($616 million in both countries combined) were used to support general government operations that have maintained high levels of public sector employment and wages and have acted as a disincentive to private sector growth. Public sector wages are higher than those in the private sector in bothcountries . For example, in the FSM in 1996-97, public sector wages were 82 percent higher than private sector wages. Higher public sector wages attract workers from the private sector and drive up private sector wages. These higher wages make the private sector less competitive in international markets.

The FSM and the RMI also spent at least $255 million combined in Compact funds for physical infrastructure improvements and operations. The FSM and the RMI viewed this area as critical to improving quality of life and creating an environment attractive to private businesses. For example, in both countries combined, Compact funds of at least $97 million and $22 million have been spent to operate and improve energy (including electrical power) and communications (including telecommunications) systems, respectively. Access to and dependability of these services have increased. However, such improvements have not been sufficient to promote significant private sector growth, although we identified one tuna processing plant in the RMI that located to the country in part as a result of dependable electricity.

We identified $188 million in Compact funds spent in the FSM and the RMI for business ventures. During our visit, FSM and RMI government officials reported that virtually no Compact-funded business ventures were operating at a profit, if at all. Government officials from both countries told us that investing in business ventures has been a bad strategy, and using Compact funds for this purpose had been a failure. One example of this strategy is the $60 million in Compact funds we identified that the FSM spent on fisheries activities. The FSM has undertaken unprofitable fisheries investments in each of the four states. A 1999 analysis of FSM fisheries ventures, prepared by a consultant for the FSM government, reported that the current valuation of the national and state fishing enterprises,[11] on the basis of expected future cash flows, was zero. We visited one storage and processing facility in each of the four FSM states; none of the facilities were operating at the time of our visit. Officials from Yap andChuuk said that ventures in fisheries were failures due to inexperience and poor business judgment.

After a review of financial records and/or project files for over 150 projects undertaken with Compact capital account funds, visits to 80 project sites, and numerous interviews

[11] Analysis of the National Fisheries Corporation and its Subsidiaries, W.H.G. Burslem, May 1999 [draft]. The study explains that the National Fisheries Corporation, an entity created to promote the development of the fisheries industry in the FSM, is a public corporation with five current subsidiaries incorporated under normal FSM company law: Yap Fresh Tuna, Chuuk Fresh Tuna, Kosrae Sea Ventures, the Micronesia Longline Fishing Company in Pohnpei, and the Yap Fishing Corporation (which is in receivership). The National Fisheries Corporation no longer has an interest in the Caroline Fisheries Corporation. All ventures are involved in longline tuna fishing for the fresh tuna markets.

in the FSM and the RMI, we determined that many Compact-funded projects (infrastructure and business ventures) experienced problems as a result of poor planning, management, construction, maintenance, and/or misuse. These problems have reduced the effectiveness of Compact expenditures. According to Department of the Interior officials, the ineffective use of Compact funds can be partially explained by the fact that neither the FSM nor the RMI governments had staff that possessed the skills necessary to plan and manage expenditures under the Compact.

Poor planning and management were evident for many failed projects we visited. One example occurred in the RMI, where the government spent an estimated $9.4 million in Compact capital funds to build a road, or "causeway," fromEbeye, an extremely crowded island in the Kwajalein Atoll, to a planned development on the nearby island of Gugeegue. This causeway was meant to relieve population problems onEbeye by allowing residents to move to additional islands connected by the road. However, the causeway remains unfinished due to an inability to budget additional funding to the project, little development has occurred on Gugeegue, and few residents have moved from Ebeye to Gugeegue. Ebeye officials told us that the causeway is covered with water in places during high tide and is considered an inadequate and unreliable connection between Ebeye and the other islands. Construction has been suspended.

Another example of poor planning that we observed was in the FSMstate of Kosrae. The state used $9.3 million in Compact capital account funding within the last 12 years to construct and pave a road around the island. When we visited, the road was in obvious disrepair, and we were told that the road surface had been largely removed. In reviewing the project file for road construction, we found that aninferior, though cheaper, paving technology had knowingly been employed. Kosrae had been informed, prior to construction, that a $800,000 grant from the U.S. Department of Commerce's Economic Development Authority would not be provided ifKosrae chose this inferior method of building a road. Kosrae chose the cheaper method, never received the Economic Development Authority grant, and is now preparing to pave its roads again.

We also identified instances of poor construction and maintenance. For example, the capitol building in the RMI, built during the 1990s using $8.3 million in Compact funds, has visible signs of deterioration. Metal stairs are rusting, elevators are inoperable, and roof leaks are evident throughout the building.

Finally, we identified Compact expenditures that appeared to be a misuse of funds. For example, in the FSM state of Chuuk, the Udot road and dock project was intended to upgrade basic social and economic infrastructure inUdot. However, Chuuk state officials indicated that in their opinion, this project would not meet this goal. The project cost at least $188,000 in Compact funding. When we visited the site, we noted that the dock was built directly in front of the Mayor's house and the road led from the Mayor's house through the jungle to a small village, with few other houses along the road. In contrast, at the end of the Mayor's road was a junior high school that had received $2,800 in Compact funding to repair the one-room schoolhouse. There were no desks or chairs for students. Further, we were told that students did not have their own textbooks and were read to by the teacher who used the one set of available textbooks.

In the FSM, the Public Auditor as well as officials from the U.S. embassy have cited other instances of misused funds, including the purchase of numerous boats and automobiles in Chuuk to distribute to individuals in what embassy officials have called the "cars for votes" and "boats for votes" projects.

THE FEDERATED STATES OF MICRONESIA, THE REPUBLIC OF THE MARSHALL ISLANDS, AND THE UNITED STATES HAVE PROVIDED LIMITED ACCOUNTABILITY OVER COMPACT EXPENDITURES

The FSM, the RMI, and the United States have provided limited accountability over the use of Compact funds. Although the Compact established accountability requirements for all three countries, they have not fully complied with the requirements. The FSM and the RMI have usually submitted the required development plans and reports, but these documents fell short of meeting their intended purposes. In addition, the FSM and the RMI have not demonstrated adequate control over the use of Compact funds. Finally, interagency disagreements in the United States on the level of and responsibility for oversight, as well as a Compact provision guaranteeing payment of Compact funds, have limited the U.S. government's ability to meet its accountability requirements.

Compact Required Accountability for Use of Funds From the Federated States of Micronesia, the Republic of the Marshall Islands, and the United States

The Compact required the FSM, the RMI, and United States to account for the use of Compact funds through development plans, annual reports, financial audits, and bilateral consultations. The FSM and the RMI were responsible for preparing overall economic development plans at least every 5 years. Among other things, the plans were required to serve as a program for annual development by identifying specific economic goals and also to identify specific projects and link them to development goals. The FSM and the RMI were also responsible for preparing annual reports on the implementation of the development plans and the use of Compact funds and for performing annual financial and compliance audits. The Compact required the United States to review the development plans for compliance and consistency with the Compact and to assist in identifying appropriate development goals. The United States was also required to meet annually with the FSM and the RMI to review the annual reports and discuss the use of Compact funds. The Compact designated the Department of the Interior to provide and monitor Compact funds. A 1986 executive order established an interagency group, chaired by the Department of State, to provide policy guidance on the Compact.

Planning and Reporting Documents of the Federated States of Micronesia and the Republic of the Marshall Islands Were Generally Incomplete and Insufficient

While the FSM and the RMI generally met the Compact requirements to submit national economic development plans and annual reports to the United States,[12] both types of

[12] The FSM and the RMI submitted economic development plans for the first and second 5-year periods, covering the period from 1987 to 1997. The FSM presented other development documents in lieu of a third

documents have been insufficient to meet the Compact requirements. Our analysis of the economic development plans, confirmed by Department of the Interior officials and an FSM government document, found that the plans gave inadequate attention to broad development goals and plan implementation, as required by the Compact. Department of the Interior officials said the plans focused on spending funds in specific sectors without tying projects to development needs. However, a Department of State official said an FSM planning document for the 1999-2001 period represents an improved effort. Further, Department of the Interior officials told us that the annual reports, which are required by the Compact as a means of assessing economic progress, were also inadequate at describing how Compact funds were used to achieve development goals. Without this annual assessment, Interior officials were unable to determine whether the use of Compact funds was contributing to Compact goals. Although State and Interior were generally critical of the quality of the reports, a State Department official noted that the quality of FSM annual reports has improved over time, while the quality of RMI reports has deteriorated.

In addition, the FSM and the RMI have failed to adequately control and account for Compact expenditures. According to their annual financial audits, the FSM and the RMI did not maintain or provide sufficient financial records to effectively audit Compact funds. Further, program audits by the FSM Public Auditor found inappropriate use of Compact funds and extensive management weaknesses in accounting for Compact funds. For example, an audit of Compact-funded projects for fiscal years 1997 and 1998 found that 37 of 42 project examined were not properly managed and had deficiencies such as improperly documented payments. An audit of Compact-funded projects for fiscal years 1992-96 found problems related to misuse of funds, as mentioned earlier. For example, the audit found that nearly $600,000 of heavy equipment purchased for a $1.3-million road improvement project in Tolensome, Chuuk was being used at a former mayor's personal dock for activities not related to road improvement. Finally, the independent audits showed that the two countries have taken little action to address management weaknesses and resolve questioned uses of Compact funds. For example, by fiscal year 1998, the two countries wrote off over $50 million in questioned uses of Compact and other program assistance that had been unresolved since the 1980s.[13]

The U.S. Government Did Not Meet Many Accountability Requirements

The U.S. government has not met many of the Compact's accountability requirements to review and consult on Compact expenditures. We found that the U.S. government concurred with and praised the initial development plans of both countries, although Interior officials informed us that U.S. concerns over the plans remained. Further, although the Compact requires the U.S. government to review each FSM and RMI overall economic development plan to, among other things, assess whether they include appropriate development goals, we found references that only two (the first plans for the FSM and the RMI) of the four submitted plans had been reviewed. In addition, the

5-year plan, which the United States has accepted. The FSM submitted annual reports each year from 1987 to 1998, while the RMI has submitted 7 of the 12 annual reports.

[13] While the FSM and the RMI were responsible for providing plans to address these questioned costs, the U.S. government never pursued final resolution of these costs.

United States did not initiate the required annual consultations with the two countries until 1994. The United States has held four additional consultations with the FSM and three consultations with the RMI since 1994. According to a Department of the Interior official, the talks have been cordial diplomatic meetings but have not included serious discussions of economic growth or compliance with Compact spending requirements. As a result, the FSM and the RMI were not required to demonstrate their progress in economic development and justify their Compact expenditures on a regular basis.

U.S. Oversight Limited by Interagency Disagreements and Interior's Belief That Compact Provisions Restricted U.S. Actions

Disagreements between the Departments of State and the Interior on the level of and responsibility for Compact oversight have led to reduced monitoring efforts. The following examples illustrate areas of disagreements:

- Although the Department of the Interior initially sought more accountability requirements in the Compact, the Department of State counseled Interior to be lenient in reviewing the use of Compact funds in the early years of the Compact because State placed high priority on maintaining friendly relations with the FSM and the RMI. According to a Department of State official, the Department did not place greater priority on oversight of Compact funds until the early to mid-1990s, after the Cold War had ended.

- Disagreements between the Departments regarding authority over Interior staff selected to work in the RMI, as well as where Interior staff would be located within the country, partially explain why there are currently no Interior staff working in the RMI.

- Disagreements over agency responsibilities help to explain the lack of consultations with the FSM and the RMI from 1987 to 1993. Department of the Interior officials told us that the Department of State is responsible for initiating discussions regarding Compact issues with the FSM and the RMI as part of its responsibility for "government-to-government relations" with the two countries and as chair of the interagency group that establishes policy regarding the two countries. However, Department of State officials maintain that the Department of the Interior, as the agency responsible for providing Compact funding, should have requested meetings with the FSM or the RMI regarding Compact expenditure issues. Consultations began in 1994 and are now supported by both Departments. By not holding the required consultations for the first 7 years of the Compact, the United States missed opportunities to discuss annual Compact expenditures and progress in economic development with both countries when the FSM and the RMI governments were in a formative stage and Compact assistance was at its highest level.

In addition, Department of the Interior officials believe that Compact provisions guaranteeing payment of funds to the FSM and the RMI limit the Department's ability to require accountability. They told us that while the Compact and a related agreement on

fiscal procedures refer to direct payments for economic assistance as "grant assistance," these payments are not the same as discretionary grant assistance as commonly understood in domestic U.S. programs where requirements such as performance measures can be applied to control the use of funds. Further, Interior officials told us that the Compact payments are expressly backed by the "full faith and credit" of the United States government and are intended to be an enforceable obligation. If the United States withholds funds or otherwise fails to make a payment, the FSM and the RMI can seek redress in court.

As a result, Department of the Interior officials told us that they are unable to withhold funding from the FSM and the RMI and essentially have no mechanism to ensure that funds are not misused. Department of State officials agree that withholding funds is impracticable. Interior and State officials also said that even if they could withhold funds, the broad range of acceptable Compact expenditures listed in the agreement on fiscal procedures would make it difficult to demonstrate that a questionable expenditure was not allowed.

OBSERVATIONS

Throughout the course of our work, officials from all three countries identified issues that they feel need to be resolved during the course of negotiations. These issues include (1) defining the objective of future economic assistance, (2) establishing the duration and amount of funding, (3) determining the funding mechanism (block grants, project funding, or a trust fund), (4) specifying the degree of accountability over expenditures, and (5) determining how this future assistance will be administered.

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Mr. Chairman and Members of the Subcommittee, this concludes my prepared remarks. I will be happy to respond to any questions you may have.

CONTACTS AND ACKNOWLEDGEMENT

For future contacts regarding this testimony, please call SusanWestin or Emil Friberg at (202) 512-4128. Individuals making key contributions to this testimony included Edward George, Jr., Leslie Holen, and Dennis Richards.

(711541)

STATEMENT

of

FERDINAND ARANZA

DIRECTOR, OFFICE OF INSULAR AFFAIRS

UNITED STATES DEPARTMENT OF THE INTERIOR

before the

SUBCOMMITTEE ON ASIA AND THE PACIFIC

COMMITTEE ON INTERNATIONAL RELATIONS

UNITED STATE HOUSE OF REPRESENTATIVES

regarding

THE U.S. COMPACTS WITH THE FEDERATED STATES OF MICRONESIA AND THE REPUBLIC OF THE MARSHALL ISLANDS

JUNE 28, 2000

Mr. Chairman and members of the Subcommittee on Asia and the Pacific, I am pleased to appear today to discuss the Compact of Free Association with the Federated States of Micronesia (FSM) and the Marshall Islands, also called freely associated states (FAS). As the Compact negotiations for further financial assistance proceed, we view this hearing as an essential part of the consultative process. We look forward to your input.

The Compact of Free Association has been very successful in meeting the well-defined political goals of the FAS and the United States. It ended the Trust Territory of the Pacific Islands and helped establish two[1] stable democratic governments in the western Pacific. The defense and security interests of the United States have been preserved in what remains a strategically important geographic area. In the economic arena, the goal of the Compact is "to assist the Governments of the Marshall Islands and the FSM in their efforts to advance the economic self-sufficiency of their peoples." The results of the Compact in this area are mixed. Despite almost fifteen years of Compact financial support for the general operations of the FAS' governments and a program of capital investment, the FAS are not yet self-sufficient. Part of the reason is that the Compact did not require a system of goal-setting and accountability for results tied to the receipt of United States' funding. The Compact and its related agreements instead created a system that allowed financial assistance to flow uninterruptedly to these nations while limiting the United States' ability to affect the results of this spending. It is the view of the Department of the Interior that the economic goals of the freely associated states can better be met if future United States assistance is provided with clear expectations about results and with clear standards of performance. We believe that a system of sectoral grants with agreed-upon goals and targets, coupled with the appropriate administrative tools to ensure compliance and provisions that will lead to a termination of annual payments by the United States, will make future United States Compact assistance more effective.

Political Goals Predominate in the Compact

The Compact of Free Association was implemented in the mid-1980s, when United States political goals in the western Pacific dominated other policy concerns. After forty years, the United States wanted to divest its responsibility for the neo-colonial Trust Territory of the Pacific Islands (TT), an increasingly anachronistic remnant of the Second World War. Cold War competition with the Soviet Union in the Pacific Ocean made the trustee relationship embarrassing, but the strategic needs of the United States still required a strong alliance with friendly area governments. The Compact provided solutions to both problems, and it has since been a successful underpinning with our relations with the FAS and the United States continuing presence in the western Pacific.

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[1]Palau became a freely associated state under a separate compact of free association.

Respect for New Political Status

Although the United States pledged large sums of money in the agreement, assuring results from Compact assistance was not the highest priority. More attention was paid to completing the agreement, which had been under negotiation since 1969. The costs to the United States, spelled out in detail in the Compact itself, were well known and viewed as fair and reasonable. Clearly, the decisions on how to use this money were largely in the hands of the new governments. Both the United States and the FAS recognized that the change of political status required new respect for the islanders' restored exercise of sovereignty. Under the TT, the United States administration was responsible for all domestic affairs within the islands. The decision of any local government was never final; it could be suspended by the American High Commissioner. The purpose of the Compact was not to create the TT under a different guise. The United States deliberately withdrew itself from FAS internal affairs and planned to treat the FAS with the same respect and deference to local affairs as it would with any sovereign nation. The arrangements of the Compact, especially in the Fiscal Procedures Agreement[2], reflect the desire of the FAS to minimize United States interference in its newly won independent status. This desire to enhance the new found exercise of sovereign status by limiting United States oversight ability was nobly wrought, but as it presented significant obstacles to oversight of United States assistance, it was not the best management policy.

Policy Overrode Management Concerns

The Department of the Interior was highly skeptical of the Compact's financial management regime as it was negotiated, and noted its concerns then. Interior was quite aware that the institutional abilities of the FAS were not developed enough to manage, invest, or plan the expenditure of the large amounts of Compact funding. The FAS governments had controlled their own bank accounts only since 1982. At the time of Compact implementation, neither FAS government had a single certified public accountant. More troublesome for Interior was the fact that financial management provisions of the agreement did not provide enforceable terms for accountability.

The management regime for United States assistance described in the Compact of Free Association is unique to Federal grant management practice. The negotiators created a system that bears little resemblance to established accountability measures that characterize the normal use of Federal funds. Interior Secretary Hodel protested this situation in a letter to Secretary of State Shultz in early 1986, but the final fiscal procedures are a reflection of policy considerations overriding management

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[2]The financial management provisions of the Compact of Free Association are found in the *"Agreement Concerning Procedures for the Implementation of United States Economic Assistance, Programs and Services Provided in the Compact of Free Association Between the United States and the Government of the Federated States of Micronesia"* and the *"Agreement.....between the United States and the Government of the Marshall Islands"*. Both agreements were signed in July 1986 after the enactment of the Compact Act. The shorthand for either Agreement is the "Fiscal Procedures Agreement."

interests. The result is a system of payments largely bereft of performance standards, cost principles, and procurement rules found in OMB circular A-102, the "Common Rule" for grant management.

Compact Assistance is Distinct from "Federal Grants"

The Public Law approving the Compact of Free Association assigned to the Department of the Interior responsibility for providing financial assistance under Compact section 211 (approximately 80 percent of Compact funding) and coordinate United States Federal programs (approximately 20 percent of Compact funding). United States Federal program assistance is subject to all rules and regulations of domestic Federal programs and are enforceable by the grantor agencies.

The financial assistance cannot be considered "grants" as usually defined by Federal government practice. The distinction was first drawn in a Department of the Interior Solicitor's opinion that concluded that the only rules that could apply to Compact funds were found in the Fiscal Procedures Agreement, the Compact Act, and the laws of the freely associated states. This conclusion precluded application of normal Federal rules to Title Two funding.

For example, the Compact Fiscal Procedures Agreement requires the quarterly transfer of money to the FAS into interest-bearing accounts. Grant funds, on the other hand, are transferred only when needed for immediate payments. Grant funds may not be invested. Grants are subject to conditions and performance expectation. Allowable costs are defined. The Compact is silent on most performance measures, and the seventeen definitions of "capital expenditures," for example, are not consistent with generally accepted accounting principles. Compact payments are further guaranteed by a pledge of the "full faith and credit" of the United States, enforceable in United States Court of Claims. Grant funds, of course, are not similarly guaranteed.

Limited Withholding Authority

The ultimate leverage a Federal agency has on grant funds is its ability to withhold or delay payments when compliance problems are discovered, and to require repayment when performance conditions are not met or funds are misspent. These tools are essentially absent from the guaranteed Compact funding with a few notable exceptions. Funding under section 221(b) - an annual amount of $10 million for health and education funding not subject to the "full faith and credit" provision - may be withheld for limited purposes if advance notice is given. The United States may also suspend its obligations to the FAS if they take actions incompatible with United States security and defense responsibilities, a provision that has not been tested. Notwithstanding these limited exceptions, there is nothing else in the Compact Act, the Fiscal Procedures Agreement, or FAS law that explicitly provides for delays in the payment of Compact funds. The lack of clear standards of performance expectations by another sovereign entity and government-to-government foreign policy considerations have overridden enforcement as a policy goal through most of the Compact's history.

Audits are a Limited Oversight Tool

The Compact's principal oversight tool is its audit provisions. Discussions of United States audit authority are found in the text of the Compact, the public law, and the fiscal procedures agreement. The executive branch inspector general, the General Accounting Office and public accountants under the Single Audit Act are authorized to perform audits of Compact funding. Negotiators of the Compact agreed to use the provisions of the Single Audit Act as a measure of financial performance. The Single Audit Act applies to all recipients of Federal grant funds throughout the United States, and was designed to coordinate and simplify auditing of grantees. It is the United States government's primary audit tool, and operates under the standard of the Comptroller General, under the supervision of the Inspectors General.

The Single Audit reports on the adequacy of the auditee's annual financial statement, its compliance with Federal laws and regulations, and its internal controls. Its scope, however, is generally limited to tests of financial transactions and the accounting systems. The Single Audit does not address performance – i.e., whether or not funds were spent effectively and efficiently. As in any audit, Single Audits review expenditures only after they are made. By the time a Single Audit is in the hands of the Inspector General for review, more than fifteen months have passed since the first dollar of a fiscal year was spent. Single Audits are a limited tool for oversight.

The Department of the Interior Inspector General has performed an occasional performance audit of Compact-funded programs. The office's resources are limited, and they have chosen to concentrate more efforts in areas where they can demand resolution and enforcement of audit findings. The General Accounting Office, despite a 1987 request from the Congressional oversight committee chairmen, has not undertaken the annual audits it is authorized to perform.

FAS Deficiencies Addressed by Technical Assistance

The deficiencies in the Compact's management schemes were recognized early by the Department of the Interior. Lacking normal grant management tools, we addressed the roots of inadequate local management performance through our technical assistance programs. Working in partnership with the FAS, we have seen steady improvements in those governments' technical skills in budget and financial management skills. Our program with the USDA Graduate School has provided a curriculum of management classes meeting the needs of individual governments.

Recognizing that advice from the United States, the former administering authority, was not always welcome, we also joined with the Asian Development Bank to provide in-country policy advisory teams (PAT) to bolster the analytical capacities of the FAS. The results of this have been very encouraging. On the advice of the PAT teams, the decisions made by the FAS regarding economic development strategies included substantial reductions in government payrolls.

We have consistently provided special attention to local audit capabilities, supporting the strong Public Auditor's office in the Federated States of Micronesia. The Single Audits are managed by the independent local audit agencies, making them a more visible and effective presence. In recent years, additional funding was given the FSM Public Auditor to provide for the hiring of trained law enforcement personnel as investigators.

Use of Available Enforcement Mechanisms

Interior has used the few tools available to it under the Compact. In 1994, section 221(b) health and education funding was withheld from the FSM until the State of Chuuk settled medical debts with the Guam Memorial Hospital. Interior non-Compact grant funds have been managed strictly by Federal regulations. Interior has suspended capital improvement and maintenance grants in the Marshall Islands and FSM until grant terms were met and professional personnel were put in key positions. When effective enforcement tools are available, we believe we can ensure that United States funds are used in the FAS as intended.

Sectoral Grants Part of the Solution

The Department's dissatisfaction with the Compact's management practices and our success with administering Federal grants leads directly to the current proposal to restructure future Compact assistance. We believe that limiting United States funding to well-defined sectoral grants subject to standard grant conditions will result in a much more effective Compact assistance package. The basic sectoral grant approach that the Office of Compact Negotiations is putting forward was fully developed in 1998 by the staff of the Office of Insular Affairs. We believe it plays to the strengths of the Office of Insular Affairs to manage United States funds in off-shore locations while respecting the political autonomy of the local governments.

Grant Rules Must Apply

The Office of Insular Affairs promotes the application of the Common Rule and the Code of Federal Regulations to Compact grants. These rules, which are familiar to the FAS as they administer domestic Federal programs, call for basic commonsense practices in government management. The rules require effective accounting and reporting, as well as free and open competition in procurement, and define criteria for acceptable expenditures. Grants developed under these rules will require performance goals and standards and the approval of scopes of work and project budgets. Federal funds will flow to the FAS when needed, but can be withheld to enforce compliance with terms and conditions. In short, these Compact grants will have the specificity and controls current funding lacks. It will be a much more effective system. We do not intend, however, to dictate the goals and purposes to which the FAS dedicate Compact funding. Those decisions are

properly the purview of the FAS governments. Once those decisions are made, application of grant standards will make success much more likely.

Oversight Resources Required

Despite the current Compact's limits on United States authority, we often speculate that a larger United States presence in the FAS may have produced better results through moral suasion and encouragement. Whatever those results might have been, the Office of Insular Affairs and its predecessor Office of Territorial and International Affairs has not had the resources to support full-time in-country field representatives. In the waning years of the TT, at least 43 FTE were involved in monitoring and controlling the $93 million dollar program. Over 20 positions were engaged in the administration of Federal programs. In comparison, the Office of Insular Affairs has been unable to dedicate more than 4 FTE to the freely associated states, including Palau, for the $145 million program. The reality of the budget process has been such that other priorities in the territories were funded while field positions were not. The current Office of Insular Affairs is a smaller version of OTIA after a reorganization in 1995. Despite fewer FTE's, the office's responsibilities have remained unchanged.

The new sectoral grant approach to Compact assistance funding will require additional resources to administer. Getting results will require more personnel in-country. Interior is currently studying how best to configure an administrative unit that will best balance United States interests in results with respect for the sovereignty of the FAS governments. We have no interest in reestablishing a new Trust Territory with a heavy United States presence. Our interest lies in establishing and enforcing a workable system of accountability for United States funds.

Interior Well-Suited for FAS Special Relationship

We believe it is appropriate for the Department of the Interior to continue administration of an assistance program for the two sovereign countries. The Compact of Free Association was intended to be, and is, a special relationship with countries that have unique historical ties to the United States. This relationship is of benefit to the United States in the still strategically important western Pacific. The Department of the Interior itself has strong ties to the government and people of the islands. Where Compact funds were structured by the negotiators as true "grants" that are subject to rules and regulations, rather than a pass-through, the Department has been careful to protect taxpayer interests. Maintaining Interior's relationship with the freely associated states, which we know works well, will complement the idea of future Compact sectoral grants that have discrete goals and requirements.

Statement of Allen P. Stayman
Special Negotiator for the Compact of Free Association
before the Subcommittee on Asia and the Pacific
Committee on International Relations
U.S. House of Representatives,
June 28, 2000

Mr. Chairman and Members of the Subcommittee,

Thank you for this opportunity to testify on the Compact of Free Association with the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI).

I would like to begin by thanking you and your colleagues on the Senate Resources Committee for requesting the two General Accounting Office (GAO) reports which I understand will be discussed by one of the panels today. This information will be extremely valuable in developing a better understanding of the successes and shortcomings of the Compact. It is my intention as the Special Negotiator to consider carefully these reports in order to assure that future U.S. assistance will be used more effectively to meet the objective of Title Two of the Compact: "to assist the Marshall Islands (RMI) and Federated States of Micronesia (FSM) in their efforts to advance the economic self-sufficiency of their peoples".

Let me clarify at the outset that neither the entire Compact, nor the relationship of free association, is up for negotiation. Only Title Two (Economic Relations) which provides for U.S. financial and program assistance, and the so-called "defense veto" and provisions regarding additional base rights under Title Three (Defense Relations) will expire in 2001. Two other important defense provisions, the United States' right of "strategic denial" and the agreement to use Kwajalein, are not among the expiring provisions. Finally, I have been given the authority to alert the FSM and the RMI that the United States is currently in the process of examining, in serious fashion, the desirability of amending the migration provisions of the Compact in the negotiations, even though they are not among the expiring provisions. Under the Compact, if the negotiations are not concluded by 2001, there is an automatic extension of assistance for two years.

There are five things I will do today: 1) respond to the two GAO reports (one published and one in draft form); 2) present our assessment of the Compact to date; 3) discuss the need for some level of continued U.S. assistance; 4) provide an update on the negotiations, and 5) share with you our general approach to the negotiations.

I. Response to GAO

The Department of State concurs with the recommendations of the published GAO report "that the Secretary of State negotiate provisions that require that reliable data be maintained to ensure better accountability of the assistance provided." We understand that the GAO will be testifying today on the findings of its draft report. Based upon the State Department's informal discussions with the GAO, we also generally agree with the draft findings presented to us regarding the use of Compact funds, the FSM and RMI's progress in advancing self-sufficiency, and accountability. We believe some of the reasons for problems in these areas can be attributed to the following causes:

- U.S authority to control financial assistance was limited because of the terms of the Compact Act and the terms of the so-called "Fiscal Services" subsidiary agreement. For example, the use of transfer payments instead of grants deprived Department of the Interior officials of the tools they would normally have available to control the use of funds.
- The standards for use of the funds were often so general as to make enforcement impracticable. For example, the largest payment, for the "current account" under section 211, can be for "uses having to do generally with the operation of the government…"
- Adequate resources were not provided to the Department of the Interior for monitoring and oversight. In fact, staffing levels in the responsible office were cut by 40 percent in fiscal year 1995.
- The local governments' capacities for planning, management and providing essential services were overestimated;
- There was inadequate infrastructure and an unfavorable business environment to support growth of the private sector.

II. Assessment and the Need for Continued Assistance

The Department of State shares the view of the GAO that, notwithstanding these problems with the existing economic assistance provisions of the Compact, the Compact has successfully met its primary goal of providing for a stable transition from United Nations Trusteeship status to sovereign self-government while, at the same time, protecting U.S. security and other important interests. The Compact has also been successful in transforming the relationship between these islands and the United States from one of trust Administrator and ward to being among our closest bilateral relationships.

We should remember that the Compact was negotiated and enacted during the Cold War, when the Soviet Union had a growing presence in the Pacific and our relations with the islands were strained. Political and security objectives were a more immediate priority for the United States than was advancing economic self-sufficiency and controlling the use of U.S. assistance. U.S. negotiators made the decision to accede to Micronesian demands for less U.S. control over U.S. assistance in order to obtain concessions in other areas that were relatively more important to the United States, such as the right of strategic denial.

We should also remember that the Cold War continued into the 1990s, and that the United States continued to need the active support of the Micronesians to secure United Nations Security Council approval to terminate the Trusteeship. Actual termination did not occur until December 1990 -- five years after the Compact was implemented. It was not until 1993 that a higher priority was accorded to advancing the economic self-sufficiency of these countries. This new emphasis resulted in the establishment of the new multi-lateral partnerships with these countries coordinated through the Asian Development Bank (ADB), and the holding of annual bi-lateral economic meetings with the FSM and the RMI.

III. The Need for Continued Assistance:

The United States has strong and continuing interests in these countries that justify some level of continued economic assistance. These interests include:

- Maintaining economic stability in these countries. We believe the United States should continue its commitment to the economic strategies that the RMI and FSM have developed with the support of the United States, the ADB, and our partners in the ADB Consultative Group, including Japan and Australia;

- Sustaining the political stability and close ties which we have developed with these two emerging democracies;

- Assuring that our strategic interests continue to be met, a point to which the DOD witness will speak more directly; and,

- Developing a strategy for ending mandatory annual payments by the United States to these countries by the end of the next Compact term.

Too sharp a reduction in U.S. assistance at this stage of economic development of the RMI and the FSM could result in economic instability and other disruptions, and could encourage an increase in the level of migration to the United States by citizens of those countries. We believe that maintaining substantial financial and other assistance for a limited, defined period of time will help to assure economic stability while the RMI and FSM continue to implement their respective economic reform strategies.

We recognize the progress made by both of these countries in implementing the first phase of their economic strategies: the implementation of needed reforms to their public sectors. These reforms included the very difficult task of reducing both governments' workforces by roughly 30 percent over the past three years. The two countries have informed me that they are now in the process of implementing the second phase of their economic strategies: reform of their private sectors to encourage investment and increase local revenue.

Again, while we recognize the need to continue some level of financial assistance at this time to avoid serious disruption of the FSM and RMI economies, I want to emphasize that the United States' interest remains in

terminating annual mandatory payments to these countries by a date certain. We believe that we can achieve these goals by committing to appropriate reductions in assistance over the next term of Compact assistance, and to greater accountability in the use of U.S. assistance.

IV. Update on the Negotiations:

We are negotiating with the FSM and the RMI separately. In general, the talks with the FSM are progressing smoothly. We have had two negotiating sessions with the FSM, the first in November 1999, and the second in April of this year. During the April session, the FSM made an initial proposal. Our next round is scheduled for September, at which time I hope to present a U.S. counter-proposal.

Formal talks with the RMI government have been delayed by a relatively recent change in government. We are pleased by the democratic transition to a new President, Kesai Note, and by the statements the President and his cabinet have made regarding the RMI government's commitment to reform, transparency, and accountability. The new government has informed us that it is currently working to update its economic development strategy. We anticipate formal talks after the new strategy is completed.

V. Our General Approach:

I would like today to share with you our general approach to our negotiations with the RMI and the FSM, and to give you a sense of the range of matters - including financial assistance -- on which we will ultimately be seeking legislative action. The approach we are considering has four principal elements: financial assistance, a trust fund as a mechanism to allow for the end of U.S. mandatory annual financial assistance at the end of the next Compact term, program assistance, and modifications to the current migration provisions.

Financial assistance: We fully share the view of the GAO that there must be effective accountability with respect to any future assistance to the FSM and the RMI. We believe it is time to cease pass-through funding in favor of assistance with accountability. In the future, we believe that financial assistance should no longer be made available through transfers that co-mingle U.S. funds with local funds, thereby rendering it difficult to track and

monitor their use in an effective manner. Instead, we believe that future funds should be provided through a limited number of targeted grants, each with clearly defined scope and objectives. We have proposed to the FSM that any future financial assistance be provided in the form of the following five sectoral grants: health, education, infrastructure, private sector development, and capacity building/good governance. Built into each grant would be regular planning, monitoring, and reporting requirements. We would further propose that the Administration be provided with the necessary authority and resources to assure effective oversight and to ensure that reasonable progress is being made toward the agreed objectives.

U.S. financial assistance provided during the next Compact term should contribute to continued economic stability, but should not continue at the level provided during the first Compact term. We believe this change is necessary in order to encourage private sector development and the increased use of locally generated revenue and other legitimate sources of funding.

Trust Fund: As I have noted, we believe that a primary goal of any new Compact should be to terminate annual mandatory payments to the FSM and the RMI by a date certain. In its initial proposal to the U.S., the FSM anticipated the U.S. interest in the eventual termination of mandatory annual financial assistance by proposing that the U.S. capitalize a trust fund over the next term of Compact assistance. The FSM proposed that U.S. mandatory annual financial assistance would terminate at such time as the fund generates sufficient revenue to replace the mandatory annual assistance.

Like the FSM, the Department of State is interested in the concept of using a trust fund as a means of achieving our objective of terminating mandatory annual financial assistance. We are still analyzing what the appropriate trust fund balance and level of funding would be. Further, the Department of State has not yet determined what restrictions should be placed on any such funds, or what level of contributions from other foreign sources should be expected to be deposited into any such trust funds.

Congress has previously authorized and funded the use of trust funds to achieve similar objectives, including one established under the Compact with the Republic of Palau, and three established in the Marshall Islands as a part of the United States' compensation for the damages resulting from the U.S. nuclear weapons testing program.

Program and services assistance: We believe that Federal program coordination under the existing Compact is ineffective, in part, because the Compact did not give the Department of the Interior the authority to require other departments to cooperate with Interior's monitoring and coordinating responsibilities. We are still considering how these important functions could best be carried out.

For the same reasons that we believe some level of direct financial assistance should continue until the end of the next Compact term, we believe some U.S. Federal program and services assistance should continue for the same term. Generally, these programs and services are targeted to priority economic objectives such as small business loans, supporting the postal system and assuring safe air transportation. Nevertheless, in order to move toward our goal of greater self-sufficiency, we are exploring the establishment of a policy that no new Federal program would be extended to the FSM and RMI unless it directly advances the goal of economic self-sufficiency. To the same end, we are considering a policy whereby the Administration would report annually to Congress, with recommendations, on actions that could be taken to increase the effectiveness of U.S. program assistance, including consideration of grant consolidation among federal programs. Such grant consolidation authority is currently authorized for federal programs operating in the U.S. territories.

Migration: Section 141 of the Compact currently provides that citizens of the RMI and FSM "may enter into, lawfully engage in occupations, and establish residence as a nonimmigrant in the United States." Section 104(e) of the Compact requires the President to report annually to Congress on the impact of the Compact. The annual reports have documented the substantial impact of FAS migration to the adjacent jurisdictions of the State of Hawaii, Guam, and the Commonwealth of the Northern Mariana Islands (CNMI). Of particular concern are migrants who have communicable diseases, criminal records, or are likely to become a public charge as a result of chronic health or

other problems. These conditions are currently all grounds for inadmissibility to the United States under the Immigration and Nationality Act.

One way to address the issue of Compact impact on Hawaii, Guam, and the CNMI is to increase the compensation to those jurisdictions for the negative impacts of migration, as authorized by section 104 of the Compact. This solution, while helpful, would not decrease the adverse impact of migration from the RMI and the FSM. It would instead, shift the general burden of meeting the costs of absorbing migrants from the RMI and the FSM to the Federal Government.

On the other hand, there are both direct and indirect ways to reduce the actual impact of migration under the Compact. One direct approach is to introduce mechanisms for determining that migrants from the FSM and the RMI meet basic admissibility requirements under existing immigration law. Because section 141 of the Compact currently exempts FSM and RMI citizens from the normal pre-admission documentation requirements applicable to most aliens seeking to travel to the United States, there has been no effective mechanism for determining admissibility before FSM and RMI migrants reach U.S. soil. Among other things, we are exploring the possibility of restoring the requirement, which existed prior to 1986, that FSM and RMI migrants be in possession of a valid passport. Additionally, we are looking at other mechanisms for ensuring admissibility to the United States, including pre-screening requirements or more rigorous port-of-entry inspections. While any such mechanism or mechanisms would impose some limited new burdens on FSM and RMI migrants, we wish to emphasize that the intent is merely to enforce existing law.

Compact impact can also be addressed, indirectly, in part, through our plan to commit a substantial portion of future U.S. assistance through sectoral grants to improve the general health and education of citizens of the FSM and the RMI. We believe that improving the quality of life in the FSM and the RMI, will reduce the incentive for many citizens of those countries to migrate to the United States. Further, it would ensure that those persons who do migrate would be healthier and more educated, and therefore in a better position to contribute to the communities where they choose to live within the United States.

In summary, we are considering three new responses to the migration issue. First, we are looking at ways to provide compensation to Hawaii, Guam, and the CNMI for the negative impacts of migration, as authorized by section 104 of the Compact. Second, we are exploring various mechanisms for improving our ability to ensure on a timely basis that RMI and FSM migrants to the United States are eligible for admission. Third, we believe our general approach of committing a substantial portion of U.S. assistance during the second Compact term through sectoral grants to improve the health and education of potential migrants from the FSM and RMI can significantly reduce Compact impact.

Conclusion

Thank you for the opportunity to present the Department of State's views today. Let me assure you that we will continue to take every opportunity to keep the Committee informed as negotiations proceed.

Compacts of Free Association

Statement of
Mr. Frederick C. Smith
Special Assistant for Asian and Pacific Affairs
Office of the Assistant Secretary of Defense for International Security Affairs
before a hearing of the
House Committee on International Relations
Subcommittee on Asia and the Pacific

June 28, 2000

The Department of Defense has a deep appreciation of the significance of our relationship with the Freely Associated States—the Republic of the Marshall Islands, the Federated States of Micronesia, and Palau. We cannot, and should not, forget the price we paid in liberating these islands in World War II and the role that the islands and peoples played in developing crucial US defense programs in the 1950s and 1960s. Our relationship is founded upon the unique role of US defense responsibilities to the sovereign nations of the Freely Associated States under the terms of the Compact of Free Association.

The Compact, and subsequent agreements, obliges the United States to provide for the defense of the Freely Associated States in perpetuity, unless mutually agreed upon to terminate the arrangement. We are committed to provide security to these nations and their peoples "as the United States and its citizens are defended." This is an obligation greater than the United States has assumed under any of its mutual defense treaties. In return, the United States has the right for certain military uses and access, as well as the right to veto access to third countries.

In the absence of the Compact or the Security and Defense Relations Title of the Compact, the Mutual Security Agreement still provides for defense obligations, military access, and denial of military access by third countries. The Mutual Security Agreement is indefinite in duration, remaining in force until terminated or amended by mutual agreement. The so-called "defense veto" and provisions regarding future base rights, however, are scheduled to terminate in 2001-2003. It is clearly in the best interests of the US to maintain the full range of military access and security engagement options the Compact provides.

In preparation for the upcoming Compact assistance negotiations, the Department of Defense last year conducted a study to determine our defense interests in the Freely Associated States for the post-2001 era. This study looked at issues such as continued access, current and future threats, and roles the Freely Associated States may play in future scenarios. The study found an overriding defense interest in continuing the use of the Kwajalein Missile Range and the facilities on Kwajalein Atoll. The requirements of our missile defense and space surveillance programs, combined with the uniqueness of

Kwajalein's location, infrastructure investment, and real world treaty restrictions, make renewal of the Compact in the best interest of the Department of Defense.

Access and operations at Kwajalein Atoll were negotiated under the Military Use and Operating Rights Agreement (MUORA) pursuant to, but separate from, the Compact. The MUORA had an original term of 15 years that was due to expire next year. Given the importance of the agreement, the US opted to extend the MUORA for an additional term of 15 years to 2016. This extension allows continued US access to Kwajalein Atoll, use of defense sites identified in the MUORA and subsequent agreements, and control of the Mid-Atoll Corridor.

While the Kwajalein lease can be extended under the MUORA separate from Compact negotiations, the two are inextricably linked for operational purposes. The daily routine at Kwajalein Missile Range and the facilities on Kwajalein Atoll depend upon a favorable working relationship with the people of the Marshall Islands and the work force on Kwajalein Atoll. Provisions of the Compact help provide the basis for the support of the Marshallese people, who in turn provide not only much of the labor force, but also a positive local environment which is critical for continued success at Kwajalein.

It would be unwise to assume that the end of the Cold War lessened the strategic importance of Micronesia to the defense of US national interests, for sources of potential unrest and military conflict continue to dot the Asia-Pacific landscape. Despite diplomatic progress on the Korean Peninsula, North Korea retains the offensive capability of inflicting massive damage on the South in short order. Territorial disputes in the South China Sea and Northeast Asia remain unresolved and provide potential flashpoints. Indonesia's road toward democracy faces challenges as calls for separatism grow in Aceh and other provinces, and communal violence continues throughout the archipelago. In recent weeks we have seen the violent abandonment of the constitutional process in Fiji and the Solomon Islands. Our inability to see into the future with perfect clarity, therefore, makes our right to strategic denial in Micronesia essential. Our right to prevent the basing of third country military forces in the Freely Associated States must be maintained.

Generally, in this area of the world we see a region at peace. Our task is to dampen the sources of instability by maintaining a policy of robust forward engagement and military presence, while searching for new opportunities to increase confidence and a spirit of common security. In time of peace, our responsibility also extends to taking actions that shape a strategic environment that will sustain this peace and prevent conflict over time. This is both the challenge and the opportunity we face.

The goal of Compact assistance is to maintain a unique relationship with the Freely Associated States while helping them to become economically self-sufficient. Compact assistance will help to preserve access to key defense interests for our forces while denying potentially hostile forces access to US economic and defense interests in the region. Continued Compact assistance, in some form, is in the best interests of the

United States and the Freely Associated States. It will help the Freely Associated States continue to work toward their national goals, while serving our national defense interests.

Statement of Congressman Robert A. Underwood
Before the House International Relations Committee,
Asia and the Pacific Subcommittee
Hearing on U.S. Aide to Micronesia and the Republic of the Marshall Islands
2:00 p.m., 2172 Rayburn Bldg. June 28, 2000

Good morning Mr. Chairman and Members of the Committee:

Thank you for the opportunity to present this statement and speak on the importance of the unique relationship between my Pacific Island brothers of the Federated States of Micronesia and the Republic of the Marshall Islands and the United States.

From the outset, the importance of the unique relationship between the United States government, the Federated States of Micronesia and the Republic of the Marshall Islands, and that of Micronesia as a whole, must be emphasized. It is a strong relationship built on interdependence, hence requiring a great deal of patience, guidance, and mutual respect. Each is important and beneficial to the other in order to meet its needs and attain its desired goals, and as with any relationship, each has a responsibility and obligation to the other. Although foreign only by means of geographic location, the independent nations of the Federated States of Micronesia and the Republic of the Marshall Islands is in many ways domestic as it shares the same traits of what was once an emerging nation's ideals. Its leaders seek to improve the quality of life of their citizens by way of political independence, economic advancement, self sufficiency and fiscal autonomy. And in the same breath, our country, the United States, once an emerging nation itself but now a world leader, seeks to provide for the common defense and security of its citizens, its territories and the world over.

As a nation we cannot deny the importance of Micronesia as a region. Our's is a historic relationship since World War II when Micronesia served as an island hopping campaign to secure U.S. interests in the central Pacific. Many battles were fought in the waters of our blue Pacific to the soils of Micronesia, from Saipan to Palau, the atolls of Bikini and Enewetak to Rongelap and the lagoons of Truk. In the spirit of cooperation and partnership with the governments of these lands, our nation's defense interests were secured during and after WWII. During the Cold War the Kwajelen Atoll Ballistic Missile Testing Range and nuclear testing site on Bikini Atoll strengthened our nation's presence in the central pacific and served as an aversion to Soviet presence in the Pacific and Asia as well. Today, not only is Micronesia important for our national defense, it has become an important lesson in the American commitment to promoting democracy and a viable trading partner.

This relationship with the region of Micronesia is of greater importance with the signing of the Compact of Free Association. The Compact is not just a contract but a covenant between nations. It is an agreement and a promise, made of mutual need, and with it come the responsibilities and obligations to the parties involved, by the parties involved. To continue to preserve the principles of freedom and democracy, it is in our nation's interest, moreover, it is our duty, responsibility and obligation to guide and assist these new nations towards political

stability, greater self-government and economic viability, if not economic self-sufficiency. It would be a mistake to make comparisons between these new nations and our relationships with other foreign countries. No other foreign countries were treated as domestic entities for federal programs for nearly 25 years, no other foreign country allows us to deny them the right to have military relationships with third party countries, and no other foreign countries have the right to unrestricted migration into our country.

However, we must not forget our responsibilities to the use of taxpayer funds and be ever mindful of the effects this unique relationship extends to our fellow Americans in the territories, in my case Guam. The impact of migration is of great concern to our territory as resources are limited and often very scarce. Compact migrants to Guam totaled 7,280 from mid 1997 to mid 1998. Through out the duration, Guam has experienced a significant downturn in its economy resulting from the Asian economic crisis. Decreased economic activity in Guam's private sector, particularly tourism, and declines in government revenue, have placed a great burden to continue providing essential public services to Guam residents and migrants as well. The Government of Guam has estimated it has spent over $70 million in government services to meet the social and educational needs of FAS migrants and their families. Although the federal government understood this in the beginning and included in the compact law sections 104(e)(1) and 104(e)(4) to redress adverse consequences to the territories, it has been a requirement only partially met. Notwithstanding the lack of accountability and progress under the current Compact, the primary objectives of guiding the transition from trusteeship to self-government and meeting U.S. security goals to obtain base rights and strategic denial have been met. Although it remains that the U.S. has continuing interests in the Micronesian region including economic and political stability.

The migration of FAS and RMI citizens, Compact Impact Aid, the assistance we give to the freely associated areas, and the special relationship we have with the Micronesians and Marshallese are all part of the same construct. We must infuse our negotiations with the dual messages to be serious in the expenditure of our assistance and to be attentive and responsible for the migration of their citizens to U.S. areas. We should include compact impact aid as part of this package and failing that we should begin to discuss how to monitor and, if necessary, stem the flow of migrants to heavily impacted areas. It is incumbent upon us to secure these interests as the success of these negotiations and responsiveness of all the parties involved will benefit all.

NEWS FROM
U.S. Rep. Ed Royce
California's thirty-ninth district representative 1133 Longworth House Office Building, U.S. House, Washington, D.C., 20515

For Immediate Release
June 28, 2000

MEDIA Contact: Bryan Wilkes
(202) 225-4111

Statement of U.S. Rep. Ed Royce on U.S. Assistance to Micronesia and the Marshall Islands

WASHINGTON, D.C. - - The following is the statement by House Subcommittee on Asia and the Pacific Vice-Chairman Ed Royce at the beginning of Wednesday's hearing regarding U.S. accountability and assistance to Micronesia and the Marshall Islands.

"What the GAO has managed to uncover, at the direction of the Chairman, is very troubling waste, fraud and abuse.

"We're not talking about an inconsequential amount of money. Over the past dozen years, U.S. payments to the Marshall Islands and Micronesia have totaled $2.6 billion. This money has gone for Compact-funded projects that have experienced problems due to, as the GAO found, 'poor planning and management, inadequate construction and maintenance, or misuse of funds.'

"Here are a few examples: $188,000 in funds intended for economic infrastructure upgrade were instead used to build a dock right in front of the Mayor's house, and nearly $600,000 of heavy equipment purchased for a $1.3-million road improvement project was being used at a former mayor's personal dock for activities unrelated to road improvement.

"There has been little accountability over these expenditures. The Interior Department's records of these expenditures are a mess.

"This is more than an accountability problem though. The GAO has found that the money we have sent to these countries has done little to promote economic development, the stated purpose of this aid. While this aid failure is common throughout the world, what is different here is the amount of money we are spending: Some $760 per capita in Micronesia and some $1,095 in the Marshall Islands. By comparison, our aid to Africa is some $1 per person per year. In these islands we've fostered a dependence mentality that counters economic development and independence.

"We have a strategically important relationship with the Marshall Islands and Micronesia. As we look toward renewing the Compact, it's very important that we understand the problems we have had, and that we remedy the situation. Our failure to do so would hurt our interests there, and support for American engagement elsewhere in the world."

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Question for the Record
submitted to Allen P. Stayman
by the Honorable Richard Burr
June 28, 2000

1. The United States has provided in the neighborhood of $1 billion to the Marshall Islands under the terms of the "Compact of Free Association." Per capita, the Marshall Islands receives more US funding than any other nation. Has this had any measurable development impact on the country? Are the Marshall Islands any more or less self-sufficient that they were when they were a Trust Territory fifteen years ago?

A: The United States has provided, according to the GAO, $1.11 billion to the Marshall Islands over the 13 years through 1999. The U.S. has provided an additional $1.53 billion to the Federated States of Micronesia, for a total of $2.64 billion.

The Compact has successfully met its primary political goals of providing for a stable transition from United Nations Trusteeship status to sovereign self-government, and of protecting U.S. security and other important interests. Nevertheless, a third goal of the compact, assisting these countries "in their efforts to" advance economic self-sufficiency, as set forth in section 211, has not been met as successfully.

It was not until 1993 that the economic advancement and self-sufficiency of these countries were given a high priority. The renewed interest in the goal of economic

self-sufficiency resulted in establishment of multi-lateral partnerships with both the RMI and FSM coordinated through the Asian Development Bank (ADB). The RMI, under pressure from the U.S. and ADB, has made considerable progress in the first phase of its economic strategy by implementing much-needed public sector reforms, including reducing its public service workforce by approximately a third. It is now in the process of reforming the private sector to encourage investment and increase local revenues.

As GAO stated in its testimony, the RMI's reliance on U.S. financial assistance has declined from 78 percent to 68 percent in the period 1986 to 1999. Clearly much needs to be done. However, the new government in the RMI appears to us to be making structural adjustments that will, with time and carefully crafted U.S. assistance, significantly improve its economic viability.

Question for the Record
submitted to Allen P. Stayman
by the Honorable Richard Burr
June 28, 2000

2. There is a new government in the Marshall Islands, but apparently little has changed to ensure the independence of its Judiciary. Would it be in the best interests of the United States to continue to give aid to the Marshall Islands when the actions taken by its government are clearly undemocratic?

A: The new government in the Marshall Islands won power on an anti-corruption and reform platform that emphasized judicial independence. President Note, in his inaugural address, underscored his commitment to an independent judiciary. According to reports, the new Minister of Justice is reforming the judiciary to ensure its independence and professionalism. Plans call for, among other things, careful review, selection and training of judges, and for pay raises to attract high quality judicial applicants, many of whom are U.S. citizens. The Chief Justice of the Supreme Court, known for his earlier rulings promoting democracy in the Marshall Islands, was reappointed by the new government for another term. President Note, when swearing in the Chief Justice last May, reiterated his administration's support for judicial independence and ensuring that the courts are kept free "of any political influence that might hamper the courts'

duties to deliver fair and just decisions for the Marshallese people." We share your concern that the new government in the Marshall Islands continues to follow through on these commitments.

Question for the Record
submitted to Allen P. Stayman
by the Honorable Richard Burr
June 28, 2000

3. Does the Administration plan to use the negotiations over aid provisions of the Compact as leverage to press the Marshall Islands government to reform? Would the Administration consider withholding funding from the Marshall Islands until reforms are adopted? Would it be helpful to the Administration's negotiating position if Congress withheld funding for the Compact until reforms have been adopted?

A: The RMI is pursuing an ambitious program of public and private sector reform, coordinated through the Asian Development Bank. Ensuring that any future funds under the Compact go toward supporting such reforms will be a prime goal of U.S. negotiators, particularly in ensuring that there are adequate controls over and monitoring of U.S. assistance.

The ability of the U.S. Government, whether the Administration or the Congress, to control the use of, or to withhold funds from the Marshall Islands under the Compact is limited by the Compact Act and its subsidiary agreements. For example, mandatory financial assistance to the Marshall Islands, constituting approximately 77.7 percent of total U.S. assistance, is secured by the "full faith and credit" of the United States. While individual agencies could cut off funds for abuses or malfeasance of

their programs, those programs add up to only about 22.3 percent of U.S. funding under the Compact. We expect to propose that, in the future, U.S. financial assistance be provided through grants with the normal grant conditions and controls instead of the transfer payments used during this first term of assistance.

Questions for the Record
The Honorable Richard Burr
Subcommittee on Asia and the Pacific Hearing June 28, 2000

Question 1(a). The United States has provided in the neighborhood of $1 billion to the Marshall Islands under the terms of the "Compact of Free Association." Per capita, the Marshall Islands receives more US funding than any other nation. Has this had any measurable development impact on the country?

Answer: The economic statistics for the Marshall Islands are moving in a positive direction. According to Marshall Islands' statistics the nominal Gross Domestic Product (GDP) rose more than three fold from $30.6 million in 1982 to $102.1 million in 1996, and real GDP rose from $37.5 million to $70.2 million. Due to significant population increases, the per capita GDP rose from $1,093 to $1,195 during the same time period. Exports rose from $2.2 million to $18.9 million, and imports rose from $18.8 million to $76.2 million. Income flowing to the people of the RMI is sufficient to support increased expenditures.

Improvements in health and education are also indicative of progress. For example, the Marshall Islands' infant mortality rate in 1986 was 63 per 1000 live births. In 1998, the rate dropped to 25.85 per 1000 live births. Life expectancy has increased to 64 years. The contribution of private schools to education is especially significant in the Marshals. Today more than half of all high school students are enrolled in private schools.

Question 1(b): Are the Marshall Islands any more or less self-sufficient than they were when they were a Trust territory fifteen years ago?

Answer: While numerous Marshallese earn a subsistence living, the above statistics show that the Marshall Islands as a whole have made progress in economic self-sufficiency. With regard to self-sufficiency in government, the Marshall Islands during Trust Territory times was guided at high levels by officials from the United States. Today, the leaders and citizens of the Marshall Islands make the decisions and run the government.

Between 1987 to 1998, United States funding of the Marshall Islands budget decreased from 78 percent to 68 percent.

Question 2. There is a new government in the Marshall Islands, but apparently little has changed to ensure the independence of its Judiciary. Would it be in the best interest of the United States to continue to give aid to the Marshall Islands when the actions taken

by its government are clearly undemocratic?

Answer: It appears that Congressman Burr is referring to the inability to enforce United States judgments in Marshall Islands during previous Marshalls administrations. This issue has not arisen during the current administration of President Kessai Note. Before the United States takes fiscal action against the government of the Marshall Islands, holders of unsatisfied judgments should reassert their demands for payment on their judgments in the Marshalls courts. The outcome at this time may be different. If such renewed action fails, and only then, should more stringent action be contemplated by the United States.

Question 3(a). Does the Administration plan to use the negotiations over the aid provisions of the Compact as leverage to press the Marshall Islands government to reform?

Answer: The Department of State's Bureau of East Asian and Pacific Affairs is negotiating with the Marshall Islands Government according to the terms of the authority mandated by the Office of the Under Secretary of State for Political Affairs. The United States is seeking reforms in the negotiations. The authority of the United States negotiator, however, does not provide for using *Compact II* negotiations as leverage for *Compact I* reforms by the Marshall Islands Government.

Question3(b): Would the Administration consider withholding funding from the Marshall Islands until reforms are adopted?

Answer: The Administration may not withhold full-faith-and-credit funding from the Marshall Islands -- the Congress in 1986 prevented the Administration from doing so. The Administration frequently withholds, when necessary, mandatory funding and discretionary funding.

Question3(c): Would it be helpful to the Administration's negotiating position if Congress withheld funding for the Compact until reforms have been adopted?

Answer: In theory, the withholding of *Compact I* full-faith-and-credit funding might aid the Administration's negotiating position with regard to reforms. The people of the Marshall Islands, however, would suffer tremendously, and there would likely be an unprecedented out-migration of Marshall Islanders to Hawaii, Guam and California with consequent demands on exclusively locally funded social services in these three United States jurisdictions. The Federal government is prohibited from funding virtually all benefits for foreign persons, such as Marshall Islanders, who reside in the United States.

Answer to question on page 91 of the transcript:

The Marshall Islands *Nitijela* (legislature) determines the percentage of national resources allocated to services and development for all local atoll governments, including that for Kwajalein Atoll, which includes Ebeye Island. The following allocation, based on population, shows that Kwajalein receives $19,623 on a quarterly basis.

Quarterly Distribution of Funds (based on population) RMI Local Governments

Majuro	$21,072.00
Kwajalein	19,623.00
Arno	17,272.00
Alinglaplap	17,272.00
Jaluit	17,272.00
Maloelap	17,272.00
Mili	14,680.00
Namu	14,680.00
Namdrik	14,680.00
Ebon	14,680.00
Enewetak	13,712.00
Wotje	13,920.00
Ailuk	13,920.00
Likiep	13,160.00
Aur	13,160.00
Kili/Bikini/Eji	12,952.00
Utrik	12,192.00
Mejit	12,400.00
Ujae	11,640.00
Rongelap	11,432.00

JUL 12 2000

MINISTRY OF FOREIGN AFFAIRS
REPUBLIC OF THE MARSHALL ISLANDS
MAJURO, MARSHALL ISLANDS 96960

26 June 2000

Hon. Doug Bereuter
Chairman,
House Subcommittee on Asia and the Pacific
2184 Rayburn House Office Building
Washington, D.C. 20515-2701

Dear Chairman Bereuter:

I thought it might be useful to touch briefly on certain issues related to the Republic of the Marshall Islands (RMI) given that your Subcommittee is holding an oversight hearing on the Freely Associated States (FAS) on Wednesday, June 28, 2000. I respect that the relevant rules of the Committee preclude our participation in the hearing. However, I felt it might be helpful to share some of the views and thoughts of our government with you prior to the hearing.

As you are aware, my government served as the opposition to the former administration up until this January 2, 2000. In the few months that we have been in power, we have focused our efforts on determining the true state of government records, resources and plans. At the same time, we have also adopted a number of pro-active measures to recommit ourselves to the principles of democracy, and to ensure that we carry out our commitment to the Marshalleese people to have a government of openness, transparency and accountability. In that context, we have taken the following actions:

1. Established a Blue Ribbon Panel to review fiscal policies over the course of the Compact and make recommendations on future policy.
2. Established a Compact Review Task Force to do a comprehensive analysis of the progress and mistakes made under the Compact.
3. Established an Accountability Task Force to review and recommend to the Cabinet for action against improper acts as well as to appropriate offices to prosecute again criminal allegations.
4. Established a National Commission on Sustainable Development to put together a long-term, sustainable plan for economic and social development.

Our present government has resumed on work recommended under our Policy Reform Program, an initiative developed under the technical assistance of the Asian Development Bank. Two pieces of legislation were passed in our Nitijela (Parliament) Session of January 2000, and these pieces of legislation are targeted to enhance the growth and expansion of our private sector and foreign

telephone: 3181 telex: 0927 FRN AFS

investment. In fact, our Cabinet has just approved the RMI National Investment Policy Statement (NIPS)10 days ago. There will be more related bills to be considered in this upcoming August Session. One bill of considerable interest is the bill that will further strengthen existing measures against money laundering.

In addition to taking the above-mentioned actions, the new Government has spent significant time preparing for new Compact negotiations, advancing the Changed Circumstances Petition, and working with the respective GAO teams. Indeed, as the GAO will be testifying at the upcoming hearing, perhaps a few words about our work with them would be appropriate.

Firstly, we found all members of the GAO working groups to be very courteous, and we appreciated the opportunity to provide the first group with changes for clarification and accuracy in GAO/RCED-00-67 issued in May, 2000 (the "first GAO Report"). At the same time, we are greatly concerned that due to the timing of the hearing on June 28, the RMI has had no similar opportunity to assess the fairness and accuracy of the material being provided to members of the Subcommittee in conjunction with the second GAO report.

As is clear from the first GAO Report, the management and budget dealings of the U.S. with the entities that became the FAS is highly complex and attenuated, with a plethora of U.S. agencies having operational responsibilities for the same. Much of the complexity has to do with the fact that the former FAS was the only U.N. trusteeship to be designated a "strategic trusteeship," with a deliberate policy of the U.S. of keeping non-authorized persons out of the RMI in particular, limiting visitors and investment , and keeping expenditures opaque. As a result, capturing the complete picture of spending and development is extraordinarily difficult. Accordingly, the RMI requested numerous changes to the first GAO Report to ensure accuracy. The GAO accepted some of these changes for clarification and accuracy from the RMI. The fact that the RMI, therefore, has not had a similar opportunity to check the statements of the GAO to the Subcommittee for accuracy, and give context to the same, is especially troubling. We would respectfully request the opportunity to respond to these statements in due course.

Allow me, Mr. Chairman, to acknowledge the unique and special relationship that the RMI has with the U.S. The uniqueness of this relationship is not due necessarily to the fact of the nuclear legacy, the hosting of U.S. programs at Kwajalein, or the fact that the U.S. has the right of strategic denial over the territory of the RMI in perpetuity. There is more at stake than so noted in the foregoing. As the sad events in Fiji and the Solomon Islands show, our region is hardly free from internal strife and insecurity. However, the Compact of Free Association with the FAS has locked in place important and ongoing strategic benefits to the U.S. The first is the successful political transition of the FAS out of U.N. trusteeship status into secure democratic self-governing entities. The second is the creation of entities that have an ongoing strategic partnership and alliance with the U.S., with the same providing perpetual strategic denial over a mass of important sea-area. While the objective of creating economic self-sustaining entities is still emerging, the success of the relationship between the U.S. and the FAS to date cannot be underestimated.

Before closing, Mr. Chairman, I would once again point out that, under the guidance and support of the United States Government, the Republic of the Marshall Islands has actually progressed from

being a ward to a young developing country. Mistakes have been made, and much has certainly been learned as a result. RMI is a fast-developing13-year old that is trying to thrive in your world of adulthood. Whether a ward of the United States or a developing adult, however, our people have always been committed to the maintenance of democracy and the promotion of peace. We cannot bury and forget the ultimate goals of the US Nuclear Testing Program and the US Military testing program at Kwajalein. Integral to the commitment for democracy and peace is our true desire to improve accountability and promote sustainability.

Mr. Chairman, we appreciate the opportunity to share our thoughts with you at this time. We look forward to working with you and your colleagues on the Subcommittee, together with your staff, on these vital issues as we proceed forward.

Sincerely,

Alvin T. Jacklick
Minister of Foreign Affairs & Trade
Republic of the Marshall Islands

EMBASSY OF THE REPUBLIC OF THE MARSHALL ISLANDS
2433 Massachusetts Avenue, N.W.,
Washington, D.C. 20008
Tel. # (202) 234-5414
Fax # (202) 232-3236

June 29, 2000

The Honorable Doug Bereuter
Chairman
Subcommittee on International Relations
Asia and the Pacific
B359 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Further to the letter from Minister Alvin Jacklick, the Embassy would like to kindly submit for the record that attached Diplomatic Note No. US/26-00 that was send through the diplomatic channel. We have found that the direct intervention of the US Ambassador to the Marshall Islands in the review process undertaken by the GAO group headed by Ms. Susan Westin to be in direct violation of GAO rules and regulations.

Please do not hesitate to contact me or my staff at (202) 234-5414 should you have further inquiries regarding the diplomatic note. Thank you for your kind attention and continued support.

Sincerely,

Mattlan Zackhras
Charge d' Affaires, a.i.

Cc: Ambassador Banny deBrum

MINISTRY OF FOREIGN AFFAIRS AND TRADE
P. O. BOX 1349
REPUBLIC OF THE MARSHALL ISLANDS
MAJURO, MARSHALL ISLANDS MH 96960

US/26-00

The Ministry of Foreign Affairs and Trade of the Republic of the Marshall Islands presents its compliments to the Department of State and has the honor to draw the latters attention to the recent visit to Majuro of the delegation from the U.S. General Accounting Office (GAO) to conduct a review of funds provided under the Compact Agreement.

The Ministry wishes to make reference to the April 4, 2000 visit to the RMI Nuclear Claims Tribunal office by Dr. Susan Westin and Ms. Leslie Holen of the GAO. Considerable concern to the Ministry is that U.S. Ambassador Plaisted intervened in the discussion between the GAO delegation members and the Tribunal on several occasions, questioning the appropriateness of various Tribunal decisions, or the basis of the same.

The Ministry finds that the active participation of the Ambassador throughout most of the scheduled meetings to be extremely problematic for a number of reasons. Firstly, pursuant to 31 USC Sec. 702, the GAO is "independent of the executive departments". While the GAO may correctly request the views of Executive Branch personnel separately, it is highly inappropriate to have the latter interrupt any meetings between the GAO and an entity of a foreign government during an investigation. The Ambassador should have acted mainly as liaison between the GAO group and the RMI government agencies in the review process. Such interventions regrettably call into question the independence of the GAO investigation and irrevocably compromise the integrity of their effort. Considering the Tribunal is a judicial body, independent from the RMI Executive Branch, the interventions of the Ambassador serves both as an affront to the neutrality of its work and constitutes unacceptable interference into the internal workings of the RMI courts and government. Accordingly, immediately following the conclusion of the meeting, an officer of the Tribunal inquired with the RMI Ministry of Foreign Affairs as to whether the said interventions constituted a breach of protocol.

The Ministry of Foreign Affairs and Trade of the Republic of the Marshall Islands avails itself of the opportunity to renew to the Department of State the assurances of its highest consideration.

The Department of State
Washington, D.C., June 16, 2000

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