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COMPACT OF FREE
ASSOCIATION

An Assessment of Current
U.S. Proposals to Extend
Assistance

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to testify on the Compact of Free Association between the United States and the Pacific Island nations of the Federated States of Micronesia, or FSM, and the Republic of the Marshall Islands, or RMI.¹ In 1986, the United States entered into this Compact with the two countries after almost 40 years of administering the islands under the United Nations (U.N.) Trust Territory of the Pacific Islands. The Compact, which consists of separate international agreements with each country, has provided U.S. assistance to the FSM and the RMI in the form of direct funding as well as federal services and programs for more than 15 years. Further, the Compact allows for migration from both countries to the United States and establishes U.S. defense rights and obligations in the region. Provisions of the Compact that deal with economic assistance were scheduled to expire in 2001; however, they will remain in effect for up to 2 additional years while the United States and each nation renegotiate the affected provisions.²

Today I will discuss our review of the current U.S. proposals to extend economic assistance to the FSM and the RMI. Specifically, I will discuss the potential cost of assistance to the U.S. government, the amount of per capita assistance for the FSM and the RMI, and the projected earnings of proposed trust funds. Further, I will identify accountability measures that are in the proposals and discuss whether the proposals address past GAO recommendations in this area. It is worth emphasizing that all of the above issues are still under negotiation, and therefore final Compact assistance levels and accountability measures could differ from those I will discuss today.

Summary

Current U.S. proposals to the FSM and the RMI to renew expiring assistance would require the Congress to approve about \$3.4 billion in new authorizations.³ The proposals would provide decreasing levels of annual

¹The FSM had a population of about 107,000 in 2000, while the RMI had a population of 50,840 in 1999, according to each country's most recent census.

² Other Compact provisions are also due to expire in 2003 if not renegotiated and approved. These include (1) certain defense provisions, such as the requirement that the FSM and the RMI refrain from actions that the United States determines are incompatible with U.S. defense obligations (defense veto); and (2) federal services listed in the Compact.

³Our analysis is based on U.S. proposals submitted to the FSM and the RMI governments in May 2002.

grant assistance over a 20-year term (2004 through 2023). Simultaneously, the proposals would require building up a trust fund for each country with earnings that would replace grants once those grants expire. Per capita grant assistance would fall during the term of Compact assistance, particularly for the RMI. At the Department of State's assumed trust fund rate of return (6 percent), the RMI trust fund would cover expiring assistance at the 2023 level, while the FSM trust fund would not achieve this goal. Further, at this rate of return, neither trust fund would build up buffer funds that could be used during years of low or negative trust fund earnings.

The U.S. proposals include strengthened accountability measures, though details of some key measures remain unknown. The proposals have addressed many, but not all, recommendations that we have made in our past reports regarding assistance accountability. For example, proposals call for grant terms and conditions and eliminate a pledge of "full faith and credit" for funds. Proposals also allow for the withholding of funds and give the United States control over the annual consultation process and trust fund management. The details of grant and trust fund management will be addressed in separate agreements that remain in draft form or have not yet been released. Some of our recommendations, such as those calling for a review of program assistance and ways to specifically target health and education grants to address the adverse impact of migration, have not been addressed at this point.

Background

In 1986, the United States and the FSM and the RMI entered into the Compact of Free Association.⁴ This Compact represented a new phase of the unique and special relationship that has existed between the United States and these island areas since World War II. It also represented a continuation of U.S. rights and obligations first embodied in a U.N. trusteeship agreement that made the United States the Administering

⁴At the time that the Compact was negotiated, the United States was concerned about the use of the islands of the FSM and the RMI as "springboards for aggression" against the United States, as they had been used in World War II, and the Cold War incarnation of this threat—the Soviet Union. In addition, the economic viability of both nations was uncertain at the time the Compact was negotiated.

Authority of the Trust Territory of the Pacific Islands.⁵ The Compact provided a framework for the United States to work toward achieving its three main goals—(1) to secure self-government for the FSM and the RMI, (2) to assure certain national security rights for all the parties, and (3) to assist the FSM and the RMI in their efforts to advance economic development and self-sufficiency. The first two goals have been met through the Compact and its related agreements. The third goal, advancing economic development and self-sufficiency, was to be accomplished primarily through U.S. direct financial payments (to be disbursed and monitored by the U.S. Department of the Interior) to the FSM and the RMI. However, economic self-sufficiency has not been achieved. Although total U.S. assistance (Compact direct funding as well as U.S. programs and services) as a percentage of total government revenue has fallen in both countries (particularly in the FSM), the two nations remain highly dependent on U.S. assistance. In 1998, U.S. funding accounted for 54 percent and 68 percent of FSM and RMI total government revenues, respectively, according to our analysis. This assistance has maintained standards of living that are artificially higher than could be achieved in the absence of U.S. support.⁶

Another aspect of the special relationship between the FSM and the RMI and the United States involves the unique immigration rights that the Compact grants. Through the Compact, citizens of both nations are allowed to live and work in the United States as “nonimmigrants” and can stay for long periods of time, with few restrictions.⁷ Further, the Compact

⁵From 1947 to 1986, the United States administered this region under a trusteeship agreement that obligated it to foster the development of political institutions and move the Trust Territory toward self-government and promote economic, social, and education advancement. In addition, the agreement allowed the United States to establish military bases and station forces in the Trust Territory and close off areas for security reasons as part of its rights.

⁶The economic growth potential of these countries and their ability to generate revenue to replace U.S. assistance was limited by factors such as geographic isolation, limited natural resources, and the large and costly government structure that the United States established. Major donors (such as Australia) to Pacific Island nations expect that most of these countries will need assistance for the foreseeable future in order to achieve improvements in development. In addition, achieving economic self-sustainability is seen as a difficult challenge for many of these island nations and an unrealistic goal for others. See U.S. General Accounting Office, *Foreign Assistance: Lessons Learned From Donors' Experiences in the Pacific Region*, GAO-01-808 (Washington, D.C.: Aug. 17, 2001).

⁷Typically, nonimmigrants include those individuals who are in the United States temporarily as visitors, students, and workers.

exempts FSM and RMI migrating citizens from meeting U.S. passport, visa, and labor certification requirements. Unlike economic assistance provisions, the Compact's migration provisions are not scheduled to expire in 2003. In recognition of the potential adverse impacts that Hawaii and nearby U.S. commonwealths and territories could face as a result of an influx in migrants, the Congress authorized Compact impact payments to address the financial impact of migrants on Guam, Hawaii, and the CNMI.

Finally, the Compact served as the vehicle to reach a full settlement of all compensation claims related to U.S. nuclear tests conducted on Marshallese atolls between 1946 and 1958. In a Compact-related agreement, the U.S. government agreed to provide \$150 million to create a trust fund. While the Compact and its related agreements represented the full settlement of all nuclear claims, it provided the RMI the right to submit a petition of "changed circumstance" to the U.S. Congress requesting additional compensation. The RMI government submitted such a petition in September 2000.

Current U.S. Compact Proposals Would Cost Billions and Create Trust Funds

Under the most recent (May 2002) U.S. proposals to the FSM and the RMI, new congressional authorizations of approximately \$3.4 billion would be required for U.S. assistance over a period of 20 years (fiscal years 2004 through 2023). The share of new authorizations to the FSM would be about \$2.3 billion, while the RMI would receive about \$1.1 billion (see table 1). This new assistance would be provided to each country in the form of annual grant funds, extended federal services (that have been provided under the original Compact but are due to expire in 2003), and contributions to a trust fund for each country. (Trust fund earnings would become available to the FSM and the RMI in fiscal year 2024 to replace expiring annual grants.) For the RMI, the U.S. proposal also includes funding to extend U.S. access to Kwajalein Atoll for U.S. military use from 2017 through 2023. In addition to new authorized funding, the U.S. government will provide (1) continuing program assistance amounting to an estimated \$1.1 billion to the two countries over 20 years and (2) payments previously authorized of about \$189 million for U.S. access to Kwajalein Atoll in the RMI through 2016.⁸ If new and previous

⁸ See U.S. General Accounting Office, *Foreign Relations: Kwajalein Atoll Is the Key U.S. Defense Interest in Two Micronesian Nations*, GAO-02-119 (Washington, D.C.: Jan. 22, 2002).

authorizations are combined, the total U.S. cost for all Compact-related assistance under the current U.S. proposals would amount to about \$4.7 billion over 20 years, not including costs for administration and oversight that are currently unknown.

Table 1: Estimated New U.S. Authorization and Total U.S. Contribution to the FSM and RMI under the Current U.S. Proposals (in millions of U.S. dollars)

	FSM	RMI	Total
Grants	\$1,637	\$643	\$2,280
Trust fund contributions	532	284	816
Compact-authorized federal services ^a	174	39	213
Option for extension of MUORA ^b	Not applicable	101	101
New U.S. authorization	\$2,343	\$1,066	\$3,409
Federal programs authorized separately	760	385	1,145
MUORA payments previously authorized	Not applicable	189	189
Total U.S. contribution	\$3,103	\$1,640	\$4,743

Note: Numbers may not add due to rounding.

^aFederal services authorized in the Compact include weather, aviation, and postal services. Services associated with the Federal Emergency Management Agency have been excluded.

^bThe 1986 Military Use and Operating Rights Agreement (MUORA) grants the United States access to certain portions of Kwajalein Atoll in the RMI and provides funding for Kwajalein Atoll that is used for payments to landowners and economic development through 2016. The current U.S. proposal includes an option to extend MUORA for the years 2017 through 2023, with an additional 20-year optional lease at that point.

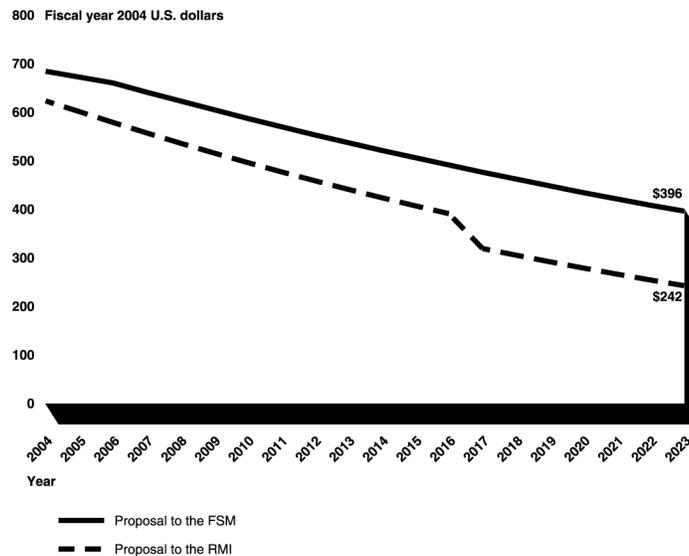
Source: GAO estimate based on current U.S. proposals adjusted for expected inflation.

Under the U.S. proposals, annual grant amounts to each country would be reduced over time, while annual U.S. contributions to the trust funds would increase by the grant reduction amount. Annual grant assistance to the FSM would fall from a real value of \$76 million in fiscal year 2004 to a real value of \$53.2 million in fiscal year 2023.⁹ Annual grant assistance to the RMI would fall from a real value of \$33.9 million to a real value of \$17.3 million over the same period. This decrease in grant funding, combined with FSM and RMI population growth, would also result in falling per capita grant assistance over the funding period – particularly for the RMI (see fig. 1). The real value of grants per capita to the FSM would decrease from an estimated \$684 in fiscal year 2004 to an estimated \$396 in fiscal

⁹While new authorization figures are provided in current dollars so that total costs to the U.S. government can be identified, grant assistance is provided in fiscal year 2004 constant dollars for comparative purposes. In addition to the reduction in grants, the real value of grants would be eroded over time by a partial, rather than full, inflation adjustment.

year 2023.¹⁰ The real value of grants per capita to the RMI would fall from an estimated \$623 in fiscal year 2004 to an estimated \$242 in fiscal year 2023.¹¹ In addition to grants, however, both countries would receive federal programs and services,¹² and the RMI would receive funding related to U.S. access to Kwajalein Atoll.¹³

Figure 1: Per Capita Grant Assistance Under Current U.S. Proposals



Note: This analysis excludes trust fund contributions, federal programs and services, and MUORA related payments to the RMI.

Source: GAO analysis of current U.S. proposals.

¹⁰Our per capita calculations assume FSM and RMI migration and population growth rates that are at the same level as in recent years.

¹¹The U.S. proposal to the RMI allocates \$4.1 million of grant assistance in fiscal year 2004 to the island of Ebeye in Kwajalein Atoll. As such, grants per capita to residents of Ebeye would be higher than grants per capita to the rest of the RMI population.

¹²For fiscal year 2004, federal programs and services, excluding federal emergency management assistance, are estimated to be worth \$36.4 million for the FSM and \$16.5 million for the RMI.

¹³For fiscal year 2004, Kwajalein landowners would receive \$16 million, and the Kwajalein Atoll Development Authority would receive \$1.9 million.

The U.S. proposals are designed to build trust funds that earn a rate of return such that trust fund yields can replace grant funding in fiscal year 2024 once annual grant assistance expires. The current U.S. proposals do not address whether trust fund earnings should be sufficient to cover expiring federal services or create a surplus to act as a buffer against years with low or negative trust fund returns. At a 6 percent rate of return (the Department of State's assumed rate) the U.S. proposal to the RMI would meet its goal of creating a trust fund that yields earnings sufficient to replace expiring annual grants, while the U.S. proposal to the FSM would not cover expiring annual grant funding, according to our analysis. Moreover, at 6 percent, the U.S. proposal to the RMI would cover the estimated value of expiring federal services, while the U.S. proposal to the FSM clearly would not. At a 6 percent return, neither proposed trust fund would generate buffer funds. If an 8.2 percent average rate of return were realized, then the RMI trust fund would yield earnings sufficient to create a buffer, while the FSM trust fund would yield earnings sufficient to replace grants and expiring federal services.¹⁴

Current U.S. Proposals Contain Stronger Accountability Measures and Address GAO Recommendations, Some Key Details Remain Unknown

I now turn my attention to provisions in the current U.S. proposals designed to provide improved accountability over, and effectiveness of, U.S. assistance. This is an area where we have offered several recommendations in the past 2 years. As I discuss key proposed accountability measures, I will note whether our past recommendations have been addressed where relevant. In sum, many of our recommendations regarding future Compact assistance have been addressed with the introduction of strengthened accountability measures in the current U.S. proposals. However, specific details regarding how some key accountability provisions would be carried out will be contained in separate agreements that remain in draft form or have not yet been released.

The following summary describes key accountability measures included in the U.S. proposals that address past GAO recommendations:

- The proposals require that grants would be targeted to priority areas such as health, education, and infrastructure. Further, grant conditions

¹⁴An 8.2 percent average rate of return is the expected rate of return for a fund with a mix of equities and fixed-income securities based on historical earnings in the stock market and projected government bond rates.

normally applicable to U.S. state and local governments would apply to each grant.¹⁵ Such conditions could address areas such as procurement and financial management standards. U.S. proposals also state that the United States may withhold funds for violation of grant terms and conditions. We recommended in a 2000 report that the U.S. government negotiate provisions that would provide future Compact funding through specific grants with grant requirements attached and allow funds to be withheld for noncompliance with spending and oversight requirements.¹⁶ However, identification of specific grant terms and conditions, as well as procedures for implementing and monitoring grants and grant requirements and withholding funds, will be addressed in a separate agreement that has not yet been released.

- The U.S. proposals to the FSM and the RMI list numerous items for discussion at the annual consultations between the United States and the two countries. Specifically, the proposals require that consultations address single audits and annual reports; evaluate progress made for each grant; discuss the coming fiscal year's grant; discuss any management problems associated with each grant; and discuss ways to respond to problems and otherwise increase the effectiveness of future U.S. assistance. In the previously cited report, we recommended that the U.S. government negotiate an expanded agenda for future annual consultations. Further, the proposals give the United States control over the annual review process: The United States would appoint three members to the economic review board, including the chairman, while the FSM or the RMI would appoint two members.
- Recommendations from our 2000 report are being addressed regarding other issues. The U.S. proposals require U.S. approval before either country can pledge or issue future Compact funds as a source for repaying debt. The proposals also exclude a "full faith and credit" pledge that made it impracticable to withhold funds under the original Compact. In addition, the U.S. proposals provide specific uses for infrastructure projects and require that some funds be used for capital project maintenance.

¹⁵ Grant conditions will be based, in large part, on the U.S. Federal Grants Management Common Rule, as set forth in revised Office of Management and Budget *Circular A-102* (Washington, D.C.: Aug. 29, 1997).

¹⁶ See U.S. General Accounting Office, *Foreign Assistance: U.S. Funds to Two Micronesian Nations Had Little Impact on Economic Development*, GAO/NSIAD-00-216 (Washington, D.C.: Sept. 22, 2000) for a review of the first 12 years of direct Compact assistance.

We also recommended that Interior ensure that appropriate resources are dedicated to monitoring future assistance. While the U.S. proposals to the two countries do not address this issue, an official from the Department of the Interior's Office of Insular Affairs has informed us that his office has tentative plans to post five staff in a new Honolulu office. Further, Interior plans to bring two new staff on board in Washington, D.C., to handle Compact issues, and to post one person to work in the RMI (one staff is already resident in the FSM). A Department of State official stated that the department intends to increase its Washington, D.C., staff and overseas contractor staff but does not have specific plans at this point.

Trust fund management is an area where we have made no recommendations, but we have reported that well-designed trust funds can provide a sustainable source of assistance and reduce long-term aid dependence.¹⁷ The U.S. proposals would grant the U.S. government control over trust fund management: The United States would appoint three trustees, including the chairman, to a board of trustees, while the FSM or the RMI would appoint two trustees. The U.S. Compact Negotiator has stated that U.S. control would continue even after grants have expired and trust fund earnings become available to the two countries; in his view, "the only thing that changes in 20 years is the bank," and U.S. control should continue. He has also noted that it may be possible for the FSM and the RMI to assume control over trust fund management at some as yet undetermined point in the future.

Finally, while the departments of State and the Interior have addressed many of our recommendations, they have not implemented our accountability and effectiveness recommendations in some areas. For example, our recommendation that annual consultations include a discussion of the role of U.S. program assistance in economic development is not included in the U.S. proposals. Further, the departments of State and the Interior, in consultation with the relevant government agencies, have not reported on what program assistance should be continued and how the effectiveness and accountability of such assistance could be improved.¹⁸ Finally, U.S. proposals for future

¹⁷ See [GAO-01-808](#).

¹⁸ See U.S. General Accounting Office, *Foreign Assistance: Effectiveness and Accountability Problems Common in U.S. Programs to Assist Two Micronesian Nations*, GAO-02-70 (Washington, D.C.: Jan. 22, 2002) for an evaluation of 13 U.S. domestic programs, including the largest programs that the United States provides to the FSM and the RMI.

assistance do not address our recommendation that consideration should be given to targeting future health and education funds in ways that effectively address specific adverse migration impact problems, such as communicable diseases, identified by Guam, Hawaii, and the CNMI.¹⁹

Current U.S. Proposals Also Amend Nonexpiring Immigration Provisions

I would also like to take just a moment to cite proposed U.S. changes to the Compact's immigration provisions. These provisions are not expiring but have been targeted by the Department of State as requiring changes. I believe it is worth noting these proposed changes because, to the extent that they could decrease migration rates (a shift whose likelihood is unclear at this point), our current per capita grant assistance figures are overstated. This is because our calculations assume migration rates that are similar to past history and so use lower population estimates than would be the case if migration slowed.

Proposed U.S. language on immigration stresses that travel to the United States by FSM or RMI citizens is intended to be temporary; the Compact is not intended to provide a stepping-stone for permanent residence or citizenship in the United States. Proposed U.S. changes to the Compact immigration provisions include

- a new requirement for FSM and RMI visitors to carry a machine-readable passport;
- a new requirement that FSM and RMI citizens visiting the United States have a specific purpose for their term of stay – such as employment, school, or tourism - that is listed in the provisions (under the original Compact, a specific purpose is not required for FSM or RMI citizens to enter or remain in the United States);
- a statement that FSM or RMI children entering the United States for adoption purposes are not eligible to do so under the Compact, as they are intending immigrants;
- a restriction that naturalized FSM and RMI citizens are not eligible for entry into the United States unless they are an eligible spouse or dependent of an admissible Compact migrant (under the original Compact, naturalized citizens are allowed into the United States 5 years after they are naturalized so long as they are a resident in the FSM or the RMI during that time); and

¹⁹ See U.S. General Accounting Office, *Foreign Relations: Migration From Micronesian Nations Has Had Significant Impact on Guam, Hawaii, and the Commonwealth of the Northern Mariana Islands*, GAO-02-40 (Washington, D.C.: Oct. 5, 2001).

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- a new ability for the U.S. Attorney General to promulgate regulations that could limit the ability of FSM and RMI visitors in the United States to stay in the country beyond 6 months.²⁰

Mr. Chairman and Members of the Committee, this completes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

Contacts and Acknowledgments

For future contacts regarding this testimony, please call Susan S. Westin or Emil Friberg, Jr., at (202) 512-4128. Individuals making key contributions to this testimony included Leslie Holen, Kendall Schaefer, Edward George, Dennis Richards, Mary Moutsos, Ron Schwenn, and Rona Mendelsohn.

²⁰Such regulations could take into account the ability of FSM or RMI citizens to support themselves and their immediate relatives. The option to reduce the ability of FSM and RMI visitors to stay in Guam and other U.S. territories was provided for in the original Compact. In 2000, regulations were put in place that required Compact migrants to be self-supporting after 1 year on Guam or be subject to removal. When we met with Immigration and Naturalization Service officials, they informed us that enforcing this regulation would prove difficult, since they did not have the necessary enforcement resources.