Interagency Group on Insular Areas
2006 Annual Report

Office of Insular Affairs
Department of the Interior

1. **Introduction**

President George W. Bush established the Interagency Group on Insular Areas (IGIA) by signing Executive Order 13299 (Executive Order) at a White House ceremony on May 8, 2003. The IGIA was established to obtain information and provide advice regarding American Samoa, Guam, the Commonwealth of the Northern Mariana Islands (CNMI), and the U.S. Virgin Islands (Insular Areas).

Although each of the Insular Areas is unique, they have a number of important characteristics in common. Each is an island community that is remote from the mainland U.S.— Guam, known as "America in Asia," and the CNMI are the easternmost places in the U.S.; American Samoa, in the Polynesian South Pacific, is the southernmost place in the U.S.; and the U.S. Virgin Islands, in the Caribbean, is America's southeasternmost point in the Western Hemisphere. Each has very limited land resources, a small population, and a limited pool of expertise. Each is located in an area that is highly prone to destructive typhoons, cyclones, or hurricanes. Each is relatively new to self-government.

The foregoing factors, taken together, present the Insular Areas with unique challenges. Because of the remoteness and resource poverty of each Insular Area, each faces high transport costs to import basic necessities. Each of the Insular Areas is heavily reliant on air links to the outside world, but these links, especially in the Pacific, are often characterized by a lack of competition, high prices, and unreliable service. Each of the Insular Areas faces the challenge of providing a full range of government services that must cover, with the exception of Guam, multiple islands. These services must be provided with a very limited pool of experienced, trained personnel and no nearby communities from which to supplement the pool of talent and resources. Each of the Insular Areas has a fairly limited private sector that is dominated, in most cases, by one or two major industries. Each of the Insular Areas has a standard of living that is lower than most of the 50 states, yet minimum wages in each of the Insular Areas are at a level that can make it difficult for businesses to compete in the low-wage regions of the world in which they are located.

A number of important legal issues distinguish the Insular Areas from the 50 states and from one another. Two of the Insular Areas are subject to Federal immigration laws and to the standard Federal minimum wage; two are not. The U.S. Constitution does not fully apply in any of the Insular Areas, although most provisions do apply. All of the Insular Areas are outside of U.S. customs territory. All of the Insular Areas other than the CNMI have non-voting delegates to the U.S. House of Representatives. Residents of the Insular Areas generally do not pay Federal income taxes, cannot vote for President, and do not have full voting representation in the U.S. Congress.[1] People born in American Samoa are U.S. nationals, not citizens, at birth.

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[1] Guam, American Samoa, and the U.S. Virgin Islands all have elected non-voting delegates. These delegates, along with the delegate from the District of Columbia and the Resident Commissioner from Puerto Rico, do have votes on committees; two of the delegates are subcommittee chairs in the current

All of the factors cited above indicate that there are important differences between the Insular Areas and the 50 states. It follows that often there may be unintended consequences when policies designed for the 50 states are applied to the Insular Areas. (An example was the Federal legislation that required all airport screeners to be U.S. citizens, which prevented American Samoans from being screeners at their own airport; this has since been corrected.) Just as Federal policy can apply to the Insular Areas in an inappropriate manner, so too can the Insular Areas be inappropriately excluded from Federal policy, usually as an oversight. In addition, the special circumstances faced by the Insular Areas will sometimes merit policy initiatives designed especially for one or more Insular Area. It is also important that the various departments and agencies of the Federal Government properly coordinate their activities that affect the Insular Areas, avoiding the incoherence of policy that results when different parts of the Federal Government are working at cross purposes.

The IGIA consists of the heads of the executive departments and the heads of such agencies as the Secretary of the Interior may designate. A head of a department or agency may designate another official to carry out his or her functions with respect to the IGIA, but that designee must be a Presidential appointee or a member of the Senior Executive Service.

The Secretary of the Interior is tasked with convening and presiding over meetings of the IGIA, determining its agenda, directing its work and, as appropriate, establishing and directing subgroups.

The Executive Order directs the IGIA to provide to the President and the Secretary of the Interior advice on the establishment or implementation of policies concerning the Insular Areas. The IGIA is further directed to obtain information and advice concerning the Insular Areas from Insular Area governors, other elected officials, and other appropriate parties. The IGIA is required to hold a meeting at least once a year, and meet with the governors of the Insular Areas once per year.

Additionally, the Executive Order provides that the Secretary of the Interior may, as the Secretary deems appropriate, make recommendations to the President, or to the heads of agencies, regarding policy or policy implementation actions of Federal agencies that affect the Insular Areas.

The Executive Order makes it clear that the IGIA is not to act as a decision-making body. The group is directed to obtain advice and information "in a manner that does not involve collective judgment or consensus advice or deliberation." Furthermore, the Executive Order provides that "[n]othing in this order shall be construed to impair or otherwise affect the functions of the Director of the Office of Management and Budget relating to budget, administrative, or legislative proposals." The IGIA does not, therefore, act as a deliberative body and does not make collective decisions. The IGIA does not take

Congress. These delegates also have votes when the House of Representatives meets as the Committee of the Whole; however, their votes may not be the margin by which an action item is passed.

positions on legislation or policy matters on behalf of the Administration and cannot demand any member agency to take any action or adopt any position.

The purpose of the IGIA is not to circumvent existing channels of authority for the formulation of Federal policy. Rather, the purpose is to provide a mechanism for ensuring that the circumstances of the Insular Areas are taken into account in the formulation of Federal policy, and that the various agencies of the Executive Branch work together to ensure that Federal policy towards the Insular Areas is properly coordinated.

From the perspective of officials from the Insular Areas, the IGIA can be a valuable tool for ensuring that their concerns are recognized. Insular Area officials have long encountered difficulties in getting the Federal bureaucracy to focus on situations where the application of Federal policies to the Insular Areas has had unintended consequences, or where the Insular Areas have been inadvertently excluded from Federal programs.

The IGIA is intended to help to ensure that the Insular Areas' concerns are brought to the attention of the appropriate parties in policy-making positions.

2. Major Issues Affecting the Insular Areas

a. Economic Issues

i. Background

The Secretary of the Interior has stated that this Administration's top priority for the Insular Areas is to help them realize their economic potential through private sector growth. As noted above, the Insular Areas face certain special challenges in their private sector economic development efforts. Set forth below are certain major issues that Insular Area representatives have raised with the IGIA and efforts that IGIA members have undertaken to promote economic development in the Insular Areas.

ii. Private Sector Development Efforts

The Department of the Interior, in partnership with several other agencies, including the U.S. Department of Agriculture (USDA), the Small Business Administration (SBA), and the U.S. Department of Commerce's Minority Business Development Administration (MBDA), has continued its efforts to stimulate private sector-led economic development in the territories as well as the Freely Associated States.

A fiscal and economic crisis in any of the Insular Areas would weaken the effect of investments that United States taxpayers have already made in the areas of housing, education, health, social welfare, fiscal management, and other areas. For example, the U.S. taxpayer has already made sizeable investments in the Insular Areas to ensure that housing needs for the poor are addressed, that schools have the resources to retain accreditation, that minimum health and environmental standards are met, that critical infrastructure is constructed, and that basic standards of social welfare are satisfied. Federal agencies that have been active in these efforts include the Departments of the Interior, Housing and Urban Development, Education, Health and Human Services, Agriculture, Transportation and Homeland Security, and the Environmental Protection Agency.

In 2006, building on successful Conferences on Business Opportunities in the Islands held in 2003 and 2004 as well as the Department of the Interior's first-ever Business Opportunities Mission (visiting Guam, Saipan, and Palau), the Department of the Interior sponsored and led Business Opportunities Missions to

American Samoa and the U.S. Virgin Islands and the Secretary of the Interior hosted the third Conference on Business Opportunities in the Islands in Honolulu. Representatives of several other agencies also participated in these events; USDA Administrator for Rural Utilities James Andrew accompanied the Mission to American Samoa in May of 2006, and representatives of USDA, SBA, MBDA, the Environmental Protection Agency (EPA), and the Overseas Private Investment Corporation (OPIC) assisted in the preparation for or participated in the Conference, held in November.

As a result of the facilitation efforts of the Office of Insular Affairs, a number of business opportunities in the Insular Areas have either been consummated or are being actively pursued. The most important result of our program, however, is the realization by leaders of the Insular Areas that there is no alternative to this type of effort to strengthen the private sector, and that they need to be leading it themselves.

Because of the special fiscal and economic challenges faced by the Insular Areas, several successive administrations, including this Administration, have supported tax and trade provisions that help the Insular Areas generate sufficient economic activity and tax revenue to meet the most basic needs of their people. Notwithstanding these incentives, each of the Insular Areas continues to experience economic and fiscal difficulties.

Longstanding special tax provisions for the Insular Areas manifest an important underlying principle of Federal territorial policy, namely, the Federal Government does not treat its territories as sources of revenue. The Federal Government has a strong interest in maintaining and enhancing the economic and fiscal well-being of the Insular Areas.

The private sector economic development initiative continues to evolve. In 2006, the Interior Island Fellows program produced studies of the business climate of each Insular Area, providing suggestions and alternatives to local policymakers that could help streamline and strengthen local regulatory processes and generally improve the Insular Areas' attractiveness for private sector investment. These studies complement parallel efforts made by the Asian Development Bank in the Freely Associated States. In prior years, the Island Fellows, MBA candidates at U.S. business schools, focused much of their efforts on market research and groundwork for upcoming events. The events themselves continue to evolve as well; in 2007, the Department of the Interior, along with its partner agencies, plans to host the fourth Conference on Business Opportunities in the Islands, to be held for the first time on Guam. Interior also plans to support a similar event in the USVI.

Recommendation: The Department of the Interior should continue to make private sector economic development its top priority for the Insular Areas. The Office of Insular Affairs, in cooperation with other relevant agencies, should continue to promote private sector economic development in the Insular Areas through targeted outreach to companies that might consider doing business there. The program of economic and industry research, targeted marketing, conferences and business opportunities missions should continue. The Office of Insular Affairs should also continue to help Insular Areas political leaders to find ways to improve the business climates in their respective Insular Area. Other Federal agencies, including the Department of the Treasury, the Department of Commerce, the Office of the U.S. Trade Representative, and the Department of State, should work with the Department of the Interior to develop appropriate tax and trade incentives and other policies to help the Insular Areas overcome obstacles to economic development.

iii. **American Jobs Creation Act**

In 2001, the U.S. Virgin Islands expanded its tax incentive program for attracting new businesses to the U.S. Virgin Islands. In particular, the program was expanded to include service businesses, such as financial services providers, which were being sought to help diversify the economy. This incentive program, as enhanced in 2001, is operated by the territory's Economic Development Commission (EDC) and is commonly referred to as the EDC program.

The EDC program attracted many businesses to the U.S. Virgin Islands, which in turn resulted in increases in employment, tax revenue, construction activity (for both business and residential purposes) and other economic activity. The Government of the U.S. Virgin Islands credits the EDC businesses with bringing approximately $100–120 million annually to the Virgin Islands treasury. This is a significant portion of its approximately $600 million in total annual revenue. These figures do not include taxes paid by employees of these companies or by other businesses and employees that rely upon the economic activity generated by the EDC businesses.

Following reports that some taxpayers had abused the program, Congress passed the American Jobs Creation Act of 2004. The Act set forth new, stricter standards for determining whether a taxpayer was a "bona fide" resident of a territory and for determining which income was sourced in a territory. In the case of the U.S. Virgin Islands, the residency rules effectively determine which taxpayers are entitled to claim benefits under the EDC program and the sourcing rule effectively determines what income of those residents can be subject to tax benefits. The new, stricter standards appeared to disqualify many EDC beneficiaries, especially those that had relocated to the U.S. Virgin Islands after the program was expanded in 2001, from receiving the benefits of the program. (Although the EDC program exists under U.S. Virgin Islands law, Federal law sets the outside parameters of the program by setting forth which taxpayers will pay their income taxes to the U.S. Virgin Islands government rather than the Federal Government and by setting forth which tax the U.S. Virgin Islands government is entitled to reduce, notwithstanding the general Federal requirement that the U.S. Virgin Islands tax code is to "mirror" the U.S. Internal Revenue Code.)

The U.S. Department of the Treasury and the Internal Revenue Service were charged with promulgating regulations to provide further clarification on both the residency rules and the sourcing rules. They issued regulations on the residency rules in January 2006, and issued new regulations in November 2006 that provided greater flexibility to taxpayers seeking to claim bona fide residence in a U.S. territory. Treasury and the Internal Revenue Service are still working on the sourcing regulations, but did issue a notice in 2006 that provides helpful guidance to certain technology companies that might consider participating in the EDC program.

Recommendation: Appropriate officials from the Department of the Treasury (including the Internal Revenue Service), the Department of the Interior, and other relevant agencies and offices should continue their productive consultations to ensure that Federal tax policy towards the Insular Areas balances the important objectives of preventing fraud and abuse and promoting economic and fiscal health.

iv. **American Samoa Tuna Canneries**

American Samoa's economy is excessively dependent on its two tuna canneries. The canneries employ approximately a third of the work force, and are collectively the largest source of tax revenue for the local government, which also employs approximately a third of the work force. The remaining share of the work force is employed in businesses that typically rely heavily on the canneries, the local government, or both.

If the canneries were to leave American Samoa, an economic and fiscal crisis would likely result. American Samoa officials are concerned about recent events that may cause the canneries to relocate. One of the territory's principal competitive advantages, duty-free access to the U.S. market, could be eroded as other countries gain comparable access to the U.S. market through free trade agreements. More immediately, the possessions tax credit, which provided several million dollars in tax benefits each year to the canneries, expired at the end of 2005 but was retroactively extended in modified form through the end of 2007. American Samoa officials fear that expiration of these benefits, compounded by the significantly higher wages that the American Samoa canneries must pay as compared to prevailing wages in other tuna producing nations, will cause the canneries to relocate.

Recommendation: Appropriate officials from the Department of the Treasury, the Office of the U.S. Trade Representative, the Department of the Interior and other relevant agencies and offices should consult with one another to ensure that the potential impact on the economy of American Samoa and the other Insular Areas is taken into account in the development of tax and trade policy. Appropriate officials from the Department of the Treasury, the Department of the Interior and other relevant agencies and offices should discuss the desirability of providing tax incentives to help American Samoa and the other Insular Areas overcome their obstacles to private sector economic development and, if appropriate, develop proposals for such tax incentives.

b. Infrastructure

i. Infrastructure Financing

Adequate critical infrastructure generally is necessary for proper economic development, and each of the Insular Areas face serious challenges in this regard. Guam and the U.S. Virgin Islands are both subject to consent decrees that require improvements in their water and wastewater systems. Saipan, the largest island in the CNMI and its civic, business and government center, does not have 24-hour access to potable water. All four Insular Areas face serious solid waste disposal issues. Guam, in particular, is under a Federal consent decree to shut down its current landfill and build a replacement.

Most of the power grids and generating systems in the Insular Areas are old, inefficient and vulnerable to the tropical cyclones that regularly occur in the Caribbean and the Pacific. Fluctuations in world oil prices have had a serious effect on costs for local utilities, all of which depend on diesel or bunker-fuel generators. Problems with maintenance and financial management have led to rolling blackouts on Saipan.

The Insular Areas are exploring alternative methods to improve and augment sources of power and water service. Guam, for example, has made some preliminary efforts towards privatizing its water system, and the CNMI has also explored public-private partnership options to reduce its energy costs.

Federal assistance is expected to address a small part of this list of projects. While the Insular Areas are currently eligible for some $80 million per year from various Federal agencies for funding environmental infrastructure, this amount includes funds that are available for other critical needs as well. Realistically, about $20 million can be expected annually to go to environmental infrastructure in the Insular Areas under Federal programs as they are currently in place.

The Insular Areas have often turned to the financial markets, especially the bond markets, to borrow money for portions of their environmental infrastructure projects, but they face various obstacles. Their ability to absorb debt service costs is limited by their limited financial resources, though this capacity varies widely from territory to territory. Currently, the U.S. Virgin Islands is the only territory that has succeeded in securing an investment-grade credit rating for all of its government-issued debt; though the U.S. Virgin Islands and the other territories have all received investment-grade or higher ratings on individual issues, usually through the purchase of insurance, which raises the cost of capital.

The IGIA formed a working group to explore ways for the Insular Areas to expand their options to finance their environmental infrastructure needs, particularly from non-governmental sources. Participants in the group include the Environmental Protection Agency, the Department of Agriculture, the Department of Defense, the Department of Homeland Security and the Department of the Interior. The group is also exploring whether it is possible for Federal agencies to better coordinate their environmental infrastructure assistance to the Insular Areas, both as an end in itself and as a means of improving the Insular Areas' access to non-governmental financing.

A private firm, Northbridge Environmental Management Consultants, was retained to study the issues and make recommendations for financing options. Northbridge initially conducted a survey of existing needs and funds available, and has done research on infrastructure financing. After studying various alternatives and after extensive consultations with Insular Area representatives, the participants decided to study the option of creating a "bond bank" through which the Insular Areas would possibly reduce borrowing costs by pooling their borrowings.

A bond bank for the Insular Areas would probably need to be established through Federal legislation, but would not necessarily require significant financial assistance from the Federal Government. While it would not necessarily directly increase the capacity of the territories to sustain external debt, it could decrease significantly the cost of borrowing, allowing the territories to apply a greater percentage of their overall debt capacity to actual construction, rather than interest payments.

The participating Federal agencies, the consultants and the Insular Area representatives have devoted several months of study and discussion to flesh out and evaluate the bond bank proposal. A draft operating model was completed, and a drafting service request for authorizing legislation submitted by Congresswoman Bordallo of Guam was also completed.

Separately from the bond bank structure, the Department of the Interior, the Environmental Protection Agency, and the U.S.

Department of Agriculture's Rural Development office have been exploring ways by which existing USDA low-cost loan programs that support infrastructure projects could be expanded to provide enhanced services to the insular areas within existing appropriations limits. The agencies are exploring scenarios in which DOI or EPA budget authority could be transferred to USDA to meet OMB-established subsidy rates for loans over and above the existing amounts already issued by USDA. The loans would be administered by USDA, subject to USDA's normal underwriting and technical requirements, except for the requirements that define rural areas, which vary from program to program.

Recommendation: The relevant Federal agencies should finish refining these proposals and work within the Administration to develop the necessary Administration positions on these proposals.

ii. **Energy Issues**

The energy infrastructure in all four of the Insular Areas is heavily dependent on imported fossil fuels, primarily diesel and heavy bunker oil. The rapid increases in energy prices over the last year have had a severe effect on local energy costs and (occasionally) the financial health of the local utilities, particularly in areas where power rates are still partially subsidized by the local government. The expected future upward volatility in fuel prices has created interest in seeking more efficient or alternative sources of energy production.

In 1982, the U.S. Department of Energy, along with the Environmental Protection Agency, produced the *Territorial Energy Assessment*, which evaluated the local energy infrastructure in the U.S.-affiliated insular areas (including the Freely Associated States), and also evaluated the potential of certain alternative energy sources then under development. Although at the time, the report predicted that some of the areas could completely switch to renewable or alternative sources of energy by the year 2006, the technologies did not develop as anticipated or were not economical due to extremely low fuel costs over an extended period of time.

The Energy Policy Act of 2005 directed the U.S. Department of the Interior, in consultation with the Department of Energy and other agencies, to produce an update to the report, and provide recommendations on courses of action that would serve to reduce the imports of fossil fuels, reduce overall energy costs, and increase the use of renewable or alternative technologies, where practicable.

The report detailed current and projected demographic data, as well as the current status and capacity of the grids in the four territories (as well as those of the Freely Associated States), and made a wide range of suggestions for each area. These recommendations covered current management and maintenance practices that could be modified to increase system efficiency and reduce losses, technologies and systems that could be used by local consumers to reduce overall energy demand (particularly for cooking and heating water), and the possibilities offered by a range of renewable technologies. Separately, the team also evaluated a range of projects that would serve to harden the local power infrastructure against the tropical cyclones that frequently strike all four territories.

The Department of the Interior is working to clear the report through the administration clearance processes, and expects to have this completed and the report delivered at the end of February 2007. To comply with the requirements of the Act, drafts were circulated to the local utilities and made available for public comment in August and September of 2006.

A component of the Energy Policy Act of 2005 authorized funding for both feasibility studies and actual implementation of both new energy and hardening projects in the territories, though ultimately no monies were appropriated. Officials from the Department of the Interior and other agencies will continue to explore how as many of the recommendations presented in the report as possible could be implemented, either with existing resources or by the Insular Areas themselves (including through alternative financing mechanisms).

Recommendation: Appropriate officials from the Department of Energy, the Department of the Interior, and other appropriate agencies should continue their consultations to pursue implementation of as many of the report's recommendations.

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c. Travel/Transportation Issues

i. Introduction

Transportation links are absolutely vital to jurisdictions such as the Insular Areas. Small increases or decreases in flight or ship arrivals can have a dramatic impact on the local economies as well as the local standard of living. The Insular Areas do enjoy some advantages. Guam benefits from Continental Airlines' use of the Won Pat Airport as its hub in the region. American Samoa has one of the best natural deepwater harbors in the world, and (due to the presence of the tuna canneries) enjoys fairly brisk traffic in its port. The U.S. Virgin Islands has the advantage of proximity to major hubs throughout the U.S., and has direct flights from virtually every major hub east of the Mississippi. All of the Insular Areas have comparatively good transportation infrastructure; all of them have runways that can accommodate most large wide-body jetliners, and most have reasonably well-developed seaport infrastructure as well.

There are several policy areas that have a significant impact on the utility of this infrastructure and the capacity for growth beyond the existing markets in the Insular Areas. Cabotage laws have occasionally limited options for territories seeking to increase air services to (and occasionally, within) their jurisdictions. A variety of differing visa rules covers each of the Insular Areas, which creates limitations for business and other travelers working in the region. Bilateral negotiations between the U.S. and other countries also complicate the air travel issue, particularly in the western Pacific; limited numbers of landing slots often induce airlines to choose higher-capacity, higher-revenue runs to hubs in the mainland or Hawaii rather than lower-revenue, largely tourism-based runs to the Insular Areas. Even minor changes in any direction in these policies can have a significant if unintentional impact on the economies of the Insular Areas; this is a matter of particular interest, given that the impacts are on industries (principally tourism) that are sensitive to external shocks.

ii. Visa Issues

Two of the Insular Areas (Guam and the U.S. Virgin Islands) have consistently raised a variety of visa-related issues over the last three years, mostly aimed at increasing levels of business and tourist travel. Guam has the benefit of a "Guam-only" visa waiver program, which is similar to the regular U.S. visa-waiver program, except that it allows for a stay of only 15 days (instead of 90) and includes some countries not on the regular U.S. list. It does not, however, include the People's Republic of China or the Philippines, as well as several other large growth markets in the region. The U.S. Virgin Islands has no such visa-waiver program.

Other types of waivers have also been proposed by the Insular Areas in the past, and have been considered by the relevant IGIA-member agencies. Guam has requested relief from nationwide quotas applicable to certain H-series visas, to allow the territory to attract more nurses and other badly-needed professionals. The U.S. Virgin Islands has also expressed interest in a similar type of relief, to allow for (among other things) hiring additional pilots for local airlines. The U.S. Virgin Islands also expressed interest in a specific "medical visa," to allow citizens of neighboring countries not on the national visa-waiver list to access medical facilities available in the U.S. Virgin Islands. Guam has also expressed interest in getting greater access to temporary labor, to meet expected demands of an expected increase in military construction on-island.

Interior has discussed these visa-related proposals from the Insular Areas with officials from the Departments of State and Homeland Security. Thus far, these officials have concluded that the requests are not consistent with existing policy.

Recommendation: Appropriate officials from the Department of Homeland Security, the Department of State, the Department of the Interior, and other relevant agencies should continue their discussions, to develop alternatives that could address the unique needs and situations that have developed in Guam, the U.S. Virgin Islands, and possibly the Commonwealth of the Northern Mariana Islands.

iii. Cabotage/Landing Rights

As isolated island communities, the Insular Areas are highly dependent upon air links to the outside world. American Samoa is the most isolated of the Insular Areas; it has only two to three flights per week to Hawaii, its only link with the U.S. mainland. Guam and the CNMI benefit from a much higher volume of air traffic, but face challenges of their own. In October 2005, Japan Airlines terminated its scheduled service to Saipan and significantly reduced its scheduled service to Guam. Guam was able to weather the disruption, in part because of consistent traffic on other airlines, and the increase in traffic from and through the

Republic of Korea. The CNMI, however, was hit harder by Japan Airlines' move. Northwest Airlines initially moved to increase its service to the CNMI following Japan Airlines' pullout, but then significantly scaled its service back.

Airline service to Guam and the CNMI is complicated by bilateral aviation agreements that the U.S. has with other countries, particularly Japan. Narita Airport, which serves the Tokyo area, has a limited number of slots available for all airlines, including U.S. airlines that serve or might be interested in serving Guam and the CNMI. The access of U.S. airlines to the airports serving Tokyo is an important bilateral issue between the U.S. and Japan, and has an important impact on the level of service that Guam and the CNMI receive.

The bilateral agreement also limits the number of chartered flights that can fly between Japan and the U.S., including the territories. Many of these chartered flights are used to serve Guam and the CNMI.

Each of the Insular Areas has requested some types of relief from air cabotage laws, which prohibit foreign aircraft from making non-stop trips between U.S. airports. Insular Area leaders contend that cabotage rules unfairly restrict service to areas that are far removed from the U.S. mainland, but U.S. air carriers argue that foreign carriers should not be granted access to U.S. territories that is significantly greater than the level of access that foreign governments afford to U.S. carriers. American Samoa received an emergency exemption from cabotage restrictions in recent years when the only local airline serving the Manu'a island chain was grounded by the FAA. Both Guam and the Northern Mariana Islands have made "open skies" proposals to increase the number of carriers available to provide air transportation service to those Insular Areas. Guam recently won a limited cabotage exemption for cargo only. The U.S. Virgin Islands has also sought a cabotage exemption in the past, to allow airlines operating in nearby jurisdictions to make inter-island runs between St. Thomas and St. Croix.

Recommendation: The Departments of State and Transportation should consider allowing representatives of the Insular Areas to participate as observers in bilateral aviation talks with countries that are important existing or potential tourist markets for those Insular Areas. Appropriate officials from the Department of Transportation, the Department of State, the Department of Commerce, and the Department of the Interior should continue

their discussions on other air transportation issues and attempt to address the concerns of the Insular Areas.

d. **Health**

i. **Introduction/Health study**

The Insular Areas are confronted with important health challenges. One problem is the lack of good, current information. The last comprehensive study on health systems and services in the Insular Areas was published in the mid-1990s. In spite of the absence of a more recent study, it is widely known that the Insular Areas have high rates of diabetes, hypertension, obesity, many types of cancer, and other diseases.

The Insular Areas face a number of obstacles that hamper their ability to deal with health problems. These include poverty and insufficient funds to build and maintain adequate health care facilities. The problems, in turn, lead to difficulties meeting national health and medical services standards. Isolation exacerbates these problems by making medical supplies and equipment costly to ship in, by making it difficult to attract qualified health care personnel, and by making off-island referrals costly.

The GAO performed a study in 2005 on Federal spending on health care in the Insular Areas, comparing it to spending on the mainland. The findings of the report indicated that the per capita Federal health care spending in the Insular Areas was significantly below that for the states. For example, Federal Medicare spending per beneficiary in the Insular Areas[2] is less than half the amount that it is in the states. Also, Federal Medicaid per capita spending in the poorest states is more than 12 times the amount received in any Insular Area, each of which has a lower average income than that of the poorest state.

In 2005 and 2006, the Department of Health and Human Services, in partnership with the Department of the Interior and the University of Michigan, undertook a major study of baseline health statistics in the U.S.-affiliated insular areas. The study was intended to serve both as a starting point for discussions of salient health disparities in the territories and also to identify and address current shortfalls in local health data maintenance.

[2] For the purposes of the GAO study, the Insular Areas also include Puerto Rico.

ii. **Medicaid Caps**

The lower per-capita Medicaid spending for the Insular Areas is not surprising, given that the Insular Areas are subject to a 50-50 cost-share for Medicaid costs while the Federal Government assumes 77 percent of Medicaid costs for the poorest states. Furthermore, the annual amount of the Medicaid reimbursement to each Insular Area, unlike that for the states, is capped. All of the Governors and Congressional delegates from the Insular Areas have supported moving to a 77-23 cost-share formula and lifting the caps as a means to ease the strain on Insular Area budgets and improve the delivery of health care to the poor. Any changes to the cost-sharing arrangements or lifting of the caps would require Congressional action.

In late 2005, the caps were raised, although the cost share formulas were not adjusted.

Recommendation: Appropriate officials from the Department of Health and Human Services and the Department of the Interior should consult as appropriate on this issue as it continues to develop.

iii. **Avian Flu**

The Department of the Interior's Office of Insular Affairs and the Department of Health and Human Services cosponsored a planning session for avian-flu pandemic preparedness for the U.S.-affiliated Pacific jurisdictions in Saipan in January 2006. Each of the Insular Areas' preparedness plans was reviewed at the meeting, and the Department of Health and Human Services announced at the meeting that it would award grants of approximately $100,000 to each of the Pacific Insular Areas and other participating jurisdictions.

The Insular Areas present unique issues for those planning to address the effects of a possible avian flu pandemic. Guam and the CNMI are located near the areas in Asia where many believe that a pandemic is most likely to commence. There is a great deal of travel between both of these Insular Areas and Asia: both territories receive a large number of tourists from Asia, and the CNMI has a large labor force from China, the Philippines, and other Asian nations. Guam is also a major transportation hub for Micronesia and has daily flights to and from Hawaii. It is therefore quite conceivable that the avian flu could spread from Asia to the U.S. mainland through the Insular Areas. The Insular Areas also face serious challenges in their ability to treat their own populations in the event of an avian flu outbreak. All of the Insular Areas have substandard health care systems and limited capacity to quickly identify the presence of avian flu within the population.

Recommendation: Officials from the appropriate agencies should continue to consult and coordinate efforts to ensure preparedness against a possible avian flu pandemic, consistent with government-wide efforts currently in progress.

e. **Financial Management**

Financial management has been repeatedly cited as an area for improvement throughout the Insular Areas, and a great deal of effort has been expended by many member agencies in this regard. Several agencies, including the Department of the Interior and the Department of Education, have issued "high risk" declarations on grantees in the Insular Areas. The Department of the Interior has also worked extensively to ensure that the Insular Areas are current on their required audits. OIA is very active in coordinating the oversight efforts of the various Federal agencies that provide significant levels of financial assistance to the Insular Areas.

The Insular Areas frequently raised issues relating to financial management with the members of the IGIA. Guam asked for assistance at the 2006 IGIA meeting to help implement and expand a new financial management system, in part to comply with Department of Education requirements. OIA provided financial assistance to Guam in response to this request. The delegate from the U.S. Virgin Islands requested Administration support in 2004 for a bill that would establish an independent Chief Financial Officer for the U.S. Virgin Islands. Although the Administration ultimately elected to not support that legislation, several agencies remained engaged on the issue. In 2006, the Department of the Interior requested that it be designated as "cognizant agency" for single audits in the U.S. Virgin Islands, the only territory for which the Department is not the cognizant agency. Presently, all of the Insular Areas except the U.S. Virgin Islands are current on their audits.

The Department of the Interior has also continued to support training efforts conducted by the U.S. Department of Agriculture's Graduate School, which have been aimed at improving the technical skills of the local financial staff in the territories (as well as the Freely Associated States).

Recommendation: The Department of Education, the Department of Agriculture, the Department of Health and Human Services, the Department of the Interior, and other major program agencies should continue consultations as appropriate, and make every effort to improve financial management in the territories.

f. **Political Representation**

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i. **Congressional delegate for the Commonwealth of the Northern Mariana Islands**

The CNMI is the only U.S. territory that is not represented in the U.S. Congress. Each of the other territories, including a territory with a population smaller than that of the CNMI, has a non-voting delegate to the U.S. House of Representatives. At a hearing before the House Resources Committee on February 25, 2004, the Administration testified in favor of granting the CNMI a non-voting delegate to the House. The following is an excerpt from that testimony, which discussed the distinguished service in Iraq of two soldiers from the CNMI:

> Capt. Pangelinan and Specialist Sablan have put their lives on the line so that the people of Iraq can achieve the dream of a democracy, in which every community is represented in an elected national government. Other servicemen and servicewomen from the CNMI are fighting so that the people of Afghanistan can achieve the same dream.
>
> Mr. Chairman, these brave young men and women from Saipan, from Tinian, from Rota, have the same dream for themselves as they do for the peoples of Iraq and Afghanistan. They dream of being represented in the national legislature of their country, the country whose uniform they proudly wear, the country that they proudly defend. They dream that they will one day have the representation that has been afforded to every other state, territory and commonwealth in the American family.

Six soldiers from the CNMI have now been killed in action in Iraq.

Recommendation: The Administration should reaffirm its support for the granting of a non-voting delegate to the U.S. House of Representatives from the CNMI

ii. **Submerged Lands**

To the inhabitants of Micronesia, dominion over the seas surrounding their islands is an essential part of their cultural identity and heritage. The islands of Micronesia are small (Micronesia means “small islands”) and generally resource-poor; Micronesians have therefore traditionally relied very heavily on the sea for food, transportation, and resources. The primary importance of their relationship with the sea has become deeply ingrained into the collective consciousness of the Micronesian people. An understanding of this general cultural issue is helpful to understand the depth of emotion that underlies efforts by the CNMI to assert jurisdiction over the lands submerged off their shores.

Unlike the other three Insular Areas, the CNMI does not have rights to the submerged lands off the coasts of its islands. In 1997, the CNMI brought suit to assert ownership, sovereignty, and exclusive jurisdiction over submerged lands and marine resources extending offshore to a distance of 200 miles. The claim is of the type that sovereign political entities surrounded by water would make to assert rights over a 200-mile "Exclusive Economic Zone." The CNMI claimed that the U.S.-CNMI Covenant never transferred sovereignty of submerged lands to the United States. The Federal Government has disputed the claim, contending that the United States automatically obtained sovereignty over submerged lands when the CNMI came into being as a part of and under the sovereignty of the United States of America. The Federal District Court in Saipan ruled against the CNMI in August 2003, and this was upheld by the Federal Court of Appeals for the Ninth Circuit in February 2005. In March 2006, the U.S. Supreme Court effectively brought an end to the CNMI's case by declining to review it.

In 2005, the Administration testified in support of a bill that granted the CNMI jurisdiction over its submerged lands out to the three-mile limit applicable to the other Insular Areas. Supporting legislation was working through both houses of Congress, though these efforts were postponed following repeated requests by the CNMI to reconsider extending the limit beyond three miles.

Recommendation: Appropriate officials from the Department of Commerce, Department of State, and Department of the Interior should continue to consult as appropriate on this issue with one another and with the CNMI.