Interagency Group on Insular Areas

2008 Annual Report

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1. INTRODUCTION AND BACKGROUND ON THE IGIA

The Interagency Group on Insular Areas (IGIA) was established by Executive Order 13299 (Executive Order) May 8, 2003. Through the Executive Order, the Secretary of the Interior or the Secretary's designee convenes the IGIA, presides at its meetings and directs its work regarding American Samoa, Guam, the U.S. Virgin Islands (USVI) and the Commonwealth of the Northern Mariana Islands (CNMI). The Executive order was intended to improve the internal Executive branch management of insular issues. The Secretary's Office of Insular Affairs (OIA) coordinates, organizes and staffs the IGIA meetings.

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. For purposes of continuity and institutional memory, Interior welcomes and encourages the participation of career-level staff from each of the agencies.

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 White House 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 island 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 a year. All work under the IGIA is handled for the Secretary of the Interior by the Office of Insular Affairs.

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 actions implementing policy 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. 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 positions on legislation or policy matters on behalf of the Administration and cannot force action by any member agency.

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 cohesive and coordinated.

2. INTRODUCTION TO THE INSULAR AREAS

The Secretary of the Interior has administrative responsibility for coordinating Federal policy in the territories of American Samoa, Guam, the USVI, and the CNMI. Puerto Rico is the only U.S. territory not included in the IGIA and DOI jurisdiction. The Secretary also has responsibility to administer and oversee U.S. federal assistance provided to the freely associated states of the Federated States of Micronesia, the Republic of the Marshall Islands, and the Republic of Palau under the Compacts of Free Association. The authority of the IGIA extends only to issues in the U.S. territories and not the freely associated states.

Each of these insular areas is unique in its own right. However, they have a number of important characteristics in common. Each is an island community located a substantial distance from the mainland U.S.— Guam, locally known as "America in Asia," and the CNMI, both part of the Micronesia region are located in the western North Pacific and cited as the most western point of the U.S., sit within a few of hours by flight from Japan and Asia; American Samoa, in the Polynesian South Pacific, would be the southernmost point of the U.S., and furthest from any continent whether American or Asian; the U.S. Virgin Islands, located in the heart of the Caribbean, is America's southeastern-most point in the Western Hemisphere. Each territory has a small land mass, a small population, and a limited pool of expertise. Each is located in an area that is prone to typhoons, cyclones, or hurricanes. Each is relatively new to self-government. Persons born in the territories are citizens or nationals of the United States of America.

Island residents are patriotic Americans who serve in disproportionately high numbers per capita in all branches of the United States armed forces. These island territories represent a significant portion of waters under U.S. jurisdiction and are home to some of the most extensive and biologically diverse coral reef ecosystems in the world. In early 2009, President Bush named two important Marine Monuments in the CNMI, home to the deepest known point in the world today and Rose Atoll in American Samoa, named for its uniquely rose hue. In short, the U.S. insular areas are an important part of the American family, are important for U.S. national interests and encompass important environmental assets.

The insular areas have unique challenges. Because of their distance from the U.S. mainland and limited resources, each faces high transportation costs to import basic necessities. The cost of fuel is often double or triple the prices found on the U.S. mainland. Each of the insular areas is heavily reliant on air links to the outside world, and these links, especially in the Pacific, are often characterized by a lack of competition, high prices, and unreliable service. With the exception of Guam, each of the insular areas faces the challenge of providing a full range of government services that cover multiple islands. These services are provided through the efforts of a limited pool of trained and experienced personnel. There are no nearby communities from which to supplement the talent pool. The low wages paid in the territories are a disincentive for attracting outside expertise. Each insular area has a fairly limited private sector that is dominated, in most cases, by one or two major industries. Each has a standard of living that is lower than most of the 50 states, yet minimum wages rising at a rate that makes it difficult for businesses to compete.

While the U.S. Constitution does not fully apply in any of the U.S. territories, its most important provisions do. With the inclusion of the territories in much Federal legislation the number of legal issues distinguishing the insular areas from the 50 states has been reduced:

- In 2007, the CNMI and American Samoa were the last two territories to be brought under U.S. minimum wage law requirements; which are now being gradually applied.
- In 2008, Federal legislation put the CNMI on track for application of Federal immigration law in 2009. In the same legislation, the CNMI became the last populated U.S. insular area to gain a non-voting delegate to the U.S. House of Representatives.
- Residents of the insular areas generally pay the equivalent of the Federal income tax, but the proceeds go to each territory. As a constitutional matter, territorial residents do not vote for President.
- All persons born in the territories are United States citizens, except American Samoa, where they are United States nationals, who, like citizens, owe full allegiance to the United States.

All of the factors cited above indicate 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, as in the recent law on minimum wage. Just as Federal policy can apply to the insular areas in an inappropriate manner, so too the insular areas are sometimes excluded from Federal policy, usually as an oversight. In addition, special circumstances faced by an insular area will sometimes merit specific policy initiatives. It is also important that the various departments and agencies of the Federal Government properly coordinate their activities that affect the insular areas, avoiding conflict and overlap or incoherent policy that results if different parts of the Federal Government are working at cross purposes.

From the perspective of officials from the insular areas, the IGIA can be a valuable tool for ensuring that concerns are recognized and brought to the attention of the appropriate persons in policy-making positions within the Administration. The IGIA is also a valuable tool which enables Federal agencies to share information with respect to the insular area enabling consistency and harmony in application of Federal policy in the insular areas.

3. MAJOR ISSUES AFFECTING THE INSULAR AREAS

a. Guam Military Build-Up

The Guam military build-up is estimated to cost in excess of $10 billion. The financing for the transfer of marines is a unique combination of direct funding from both the United States and Japan and public sector financing instruments. Financing issues between the U.S. and Japan have not been finalized.

The meetings of the IGIA Task Force Group on the Guam Military Buildup co-hosted by OIA and the Joint Guam Program Office (JGPO) held in 2008 and smaller related meetings of various agencies have raised awareness of the importance of Guam's infrastructure needs related to the build-up.

The challenge facing Guam and the Federal government is immense. The planned and expected growth on Guam can be seen as the functional equivalent of moving a half a million people into Manhattan over a three-year period, in the midst of major redevelopments of whole swaths of the business districts and major construction involving public services and transportation on the island. The following are expected actions and events:

- An Environmental Impact Statement (EIS) must be concluded prior to commencement of construction. A Social Impact Assessment has been proposed as part of EIS.
- Massive construction activity will take place on Guam, both directly and indirectly tied to DOD projects. In 2008, DOD's Office of Economic Adjustment provided a little over $4 million to the Government of Guam for port assessment, capacity building, a port feasibility study, community outreach and consensus building, and an integrated waste management study, all in preparation for the build-up.
- Local land and housing prices will likely rise.
- Construction materials and consumer goods will be imported in significantly increased quantities.
- The supply of labor and its costs will increase significantly. Congress passed legislation allowing a temporary waiver of H visa limits for Guam (and the CNMI) through 2014.
- The IGIA subgroup on Labor has been working with Guam and the U.S. Department of Labor to promote the development of local workforce capacity in the territories and freely associated states.
- Water, power, and solid waste infrastructure, which are already inadequate, will be burdened with significant increasing demand.
- In addition to a through-road from the seaport to northern part of the island, Guam's general transportation infrastructure will have to be improved and expanded.

The Interagency Taskforce on the Guam Military Build-up continues to seek ways to identify financial resources, loan guarantees, tax incentives and other program assistance for the civilian aspects of the Guam expansion. Despite JGPO and OIA efforts and accomplishments through the IGIA Taskforce, it is not clear if construction of supporting infrastructure will commence in 2010 as earlier announced. To date, no Federal budgets for 2009 or 2010 have included moneys for the Guam military build-up.

Although included in the draft legislation, the final passage of the American Reinvestment and Recovery Act did not contain any specific moneys for the Guam Military Build-up.

Recommendation: The Department of Defense and the Government of Guam need to agree on facility needs and costs, and perhaps methods of financing.

Recommendation: The Administration at the OMB and White House levels must begin to consider funding for civilian facilities on Guam related to the Guam Military Build-up.

b. Impact of Minimum Wage Increases in American Samoa and the Northern Mariana Islands (CNMI)

In addition to the developments on Guam, two major legislative initiatives first advanced in 2007, continue to have profound implications for the economies of the affected territories. Enactment of Public Law 110-28 in May of 2007, not only raised the Federal minimum wage rate in the 50 states, but, for the first time, the Congress took direct action to increase the minimum wage rates in American Samoa and CNMI by 50 cents per hour on July 24 and 25, 2007, respectively. The law also scheduled additional annual 50-cent increases until the two territories reach the Federal minimum wage, and required that the U.S. Department of Labor (DOL) report on the effects of the minimum wage increases. Under this new law, American Samoa will reach $7.25 per hour across all industries in 2014, and the CNMI will reach $7.25 in 2015.

In January 2008, the U.S. Department of Labor issued its report on the minimum wage increases, titled "*Impact of Increased Minimum Wages on the Economies of American Samoa and the Commonwealth of the Northern Mariana Islands*". The report notes that it was not possible to analyze the effect of annual minimum wage increases, given the short (eight-month) prescribed timeframe for the report and absence of timely labor market data for American Samoa and the CNMI. Nevertheless it raises concerns that future increases in the minimum wage rate in American Samoa and the CNMI will likely cause significant economic and financial harm in the territories.

Territorial leaders immediately raised concerns. The CNMI has already experienced a range of external economic shocks, and is concerned that the sharp increases in the minimum wage will stifle remaining economic activity. In American Samoa's case, there is serious concern that the minimum wage increases will force closure of the only major private sector endeavor in the territory, the tuna canneries.

The American Recovery and Investment Act calls for the Government Accountability Office (GAO) to conduct studies on the impact of past and future minimum wage increases in American Samoa and the CNMI. The first study is due no earlier than March 15, 2010 and not later than April 15, 2010. The law requires an annual report until the minimum wages in American Samoa and the CNMI attain $7.25 per hour.

Recommendation: The IGIA expects to form a subgroup including the Departments of Labor, Commerce and Interior to review and consider the impact of these minimum wage increases on American Samoa and the CNMI.

c. Federalization of Immigration in the CNMI

Title VII of Public Law 110-229 provides for Federal administration of immigration in the CNMI . Included in the law are provisions for (1) a five-year transitional foreign labor program, (2) a foreign investor program and (3) a Guam-CNMI visa waiver program.

The law contains a number of special exceptions and provisions relating to the CNMI that provide for the continued presence of aliens whose admissions were previously authorized. The new Guam-CNMI Visa Waiver Program includes the following countries: Australia, Brunei, Japan, Malaysia, Nauru, New Zealand, Papua New Guinea, Republic of Korea, Singapore, Taiwan, the United Kingdom and Hong Kong. Implementation of federalization in the CNMI is scheduled to begin on November 28, 2009.

The Governor of the CNMI requested a 180-day extension to address the continuation of the visa-less travel to the CNMI from China and Russia.

Recommendation: Federal agencies must give first priority to the CNMI economy and economic development as they craft Federal regulations affecting the CNMI.

d. Congressional Representation for the CNMI

Political representation in the United States Congress has been a significant issue for the Northern Mariana Islands since it joined the American political family in 1986 as a Commonwealth. The enactment of Public Law 110-229 ushered in a new era for the people of the CNMI, promising better representation, closer cooperation and greater consultation for the territory in the U.S. Congress and with the Administration. In November 2008, the people of the CNMI, elected their first delegate to the United States Congress: Representative Gregorio "*Kilili*" Camacho Sablan. In January 2009, Representative Sablan took office.

e. Gross Domestic Product (GDP) in the U.S. Insular Areas

Up until now the economic output of the territories has not been included in the nation's Gross Domestic Product (GDP) which the Commerce's Bureau of Economic Analysis (BEA) calculates and reports for each of the 50 states and the District of Columbia (DC). Neither is there a framework for GDP calculations and reporting in the territories. As a result of this exclusion, the value of territorial output is unknown. The absence of GDP data has also made it difficult to objectively measure changes in the standards of living in the territories and how they evolve over time. OIA has provided technical assistance to the territories and other Federal agencies in the past on some aspects of GDP accounting and other statistical matters, but engaging the BEA, the final arbiter of GDP methodology and accounting in the United States, has been OIA's ultimate objective.

In early 2009, OIA and BEA signed an agreement called the Statistical Improvement Program (SIP). It establishes a formal framework for GDP accounting in the territories, using BEA methods. It also provides training of local territorial personnel to gather the GDP statistics.

f. Visa Waivers for Business and Tourism

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.

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 (among other things) the hiring of 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 utilize medical facilities available in the U.S. Virgin Islands.

Except for the U.S. Virgin Islands, Public Law 110-229 has addressed some of Guam's visa requests, including the CNMI.

Recommendation: The IGIA should establish a subgroup of officials from the Department of Homeland Security, the Department of State, and the Department of the Interior to consider the continuing visa needs of the Virgin Islands, Guam and CNMI.

g. Bond Bank/Infrastructure Financing

Adequate critical infrastructure is necessary for proper economic development, and each of the insular areas faces 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 makes extensive use of power purchase agreements to supply its power grid. 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 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 infrastructure in the insular areas under Federal programs 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 restricted by limited financial resources, although 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. 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 also explored whether it was 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.

Several options were considered. 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.

Congresswoman Madeleine Bordallo requested a drafting service for the establishment of a bond bank that would lower the cost of financing of capital improvement projects. Mrs. Bordallo introduced bond bank legislation in the 110th Congress as H.R. 1075.

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 had 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.

Extensive discussions on these and other options have taken place within the administration, including representatives of the Office of Management and Budget and the President's Council of Economic Advisors. OMB has raised questions about how to treat the Federal government's liability in any of the proposed structures, and these questions will require further discussion.

Recommendation: In light of the Guam military build-up and new Executive branch administration, the IGIA and Federal agencies should revisit these and other proposals for infrastructure financing in the territories.

h. Renewable Energy Assistance

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 in 2008 had a severe effect on local energy costs and (occasionally) the financial health of the local utilities, particularly in places where power rates are still partially subsidized by the local government. The 2008 spike in fuel prices created renewed interest in 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*, in which the local energy infrastructure was evaluated 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 economically feasible 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 updated report, and provide recommendations on courses of action that would serve to reduce the importing 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 local power infrastructure against the tropical cyclones that frequently strike all four territories.

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, although ultimately no moneys were appropriated. Officials from the Department of the Interior and other agencies should continue to explore how 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), as these agencies already expend considerable resources in both technical assistance and capital improvement funds on energy and energy-infrastructure-related projects.

In February 2008, OIA awarded a $500,000 technical assistance grant to conduct a geothermal resource assessment initially focusing on the islands of Saipan and Pagan. When finalized the assessment will be the first of three phases in a plan to develop an energy supply for the CNMI that is renewable, sustainable, and environmental friendly with substantial economic benefits.

Recent work done by the United States Geological Survey suggests there is potential for geothermal resources within the island of Pagan and to a lesser degree, on the island of Saipan. Recent visit to the islands by other experts revealed this potential is even more promising. Based on an over flight of the volcanic islands of the CNMI in October 2007, Pagan was determined to have the optimum combination of recent volcanic activity, topography, hydrology, to be a candidate for geothermal resources. A scientific assessment is required to identify areas of highest geothermal exploration and production wells in the second and third phase of the project. This assessment for geothermal resources is anticipated to be completed in the first half of 2009.

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 as practical.

i. Infrastructure Funding in the CNMI

A significant portion of the Interior CIP funds have been committed to helping address the power crisis in Saipan. The result of this funding and decisions of the Governor of the CNMI is an improving power situation with fewer blackouts.

Interior CIP funds will be used to continue large-scale improvements to potable water, power, solid waste management, and to continue promoting economic development.

The delivery of potable water to Saipan continues to be a main priority and would receive $2.3 million of the proposed CIP funding. Currently, the residents of Saipan do not have potable water available twenty-four hours a day. The CNMI formed the Water Task Force to coordinate this important effort for which CIP funds have been allocated since fiscal year 2004.

Funding History

Since the power crisis began, Governor Ben Fitial has requested the reprogramming of CIP funds from various projects for power rehabilitation activities 4 times:

Reprogrammed CIP Funding Approved by OIA	**Balance Remaining**	**Date**
$2,673,000	$537,395	August 2005
$250,000*	$169,049.07	March 2007
$4,607,367.97	$1,966,375.31	May 2007
$3,894,455	$3,984,455	Dec 2008
$11,424,822.97**	$6,657,274.38	

The goal of the most recent reprogramming of $3,894,455 is to provide enough power generation capacity to CUC by the time the temporary Aggreko units lease expires in September 2009, to avoid the rolling blackouts Saipan suffered in 2008.

Part of the funding was used to hire an experienced Deputy Director, Wallon Young, to oversee the power rehabilitation process.

OIA has provided more than $11.4 million for power rehabilitation activities in the CNMI.

Oversight

In September 2008, OIA began a detailed review of how the $7.5 million previously provided for power rehabilitation activities has been utilized by the CNMI since CUC's power generation capacity seemed to be getting worse, not better.

The review did not reveal any misuse of funds. What was revealed is that the majority of the engines are in truly deplorable shape and suffer from multiple problems, thus making rehabilitation difficult. Frequently, a repaired engine is brought online only to break down again revealing a new problem.

j. Private Sector Development

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.

As a result of continued efforts of the Office of Insular Affairs, a number of opportunities for business development in the insular areas have either been consummated or are being actively pursued. In 2008, OIA created the Island Business Link (www.islandbusinesslink.com) a new web-based networking portal for businesses in the territories and freely associated states.   This new aspect of the program is being developed in response to feedback from recent Conferences, where participants indicated an interest in long-term networking tools such as these. The Island Business Link portal currently has 1100 actively registered members.

Since the inception of Island Business Link, OIA has regularly sent information and links to numerous public offices such as the U.S. Export Assistance Centers of the U.S. Department of Commerce, local economic development offices, and Chambers of Commerce on the Mainland and in other countries. At our request several of the Chambers in the islands have posted links to Island Business Link on their websites.

Recommendation: The Office of Insular Affairs should continue to help island political leaders to find ways to improve the business climates in their respective territory. 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 territories overcome obstacles to economic development. Initiatives for economic development are most successful when initiated by the insular areas themselves.

k. Cabotage/Landing Rights

Due to their isolated locations, cabotage and air service regulations, which limit foreign-flag sea- and airlines from making consecutive port calls at U.S. ports of entry, have a disproportionate effect on the economies of the insular areas. The CNMI and USVI have exemptions from the Jones Act, which governs sea commerce; Guam and American Samoa do not. Guam recently received an exemption from the Department of Transportation, allowing for transshipment of air cargo by foreign-flag air carriers, but did not receive a requested exemption for passenger traffic. American Samoa and the U.S. Virgin Islands have also expressed interest in air travel cabotage exemptions. The Virgin Islands' interest relates to inter-island air traffic and American Samoa's interest relates to travel to Hawaii, its only connection major U.S. hubs. The air travel issue is further complicated by bilateral landing rights negotiations; due to the limited number of landing slots allotted for regular service by foreign carriers, they tend to direct their service to higher-revenue routes.   The territories have frequently requested additional exemptions, and even proposed "open skies" policies that would remove flights to and from the territories from the totals calculated for national bilateral landing rights negotiations.

On a slightly separate but related issue, the Departments of State and Transportation have allowed representatives from Guam and the CNMI to participate as observers in bilateral aviation talks with Japan.

Recommendation: The Departments of State, Transportation and Interior should continue to allow representatives of the insular areas to participate as observers in

bilateral talks with countries that are important existing or potential tourist markets for the insular areas.

Recommendation: 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.

l. Inclusion of the Territories in Future Free Trade Agreements

Governor Felix Camacho of Guam has requested that the four territories be explicitly included in future free trade agreements negotiated by the United States, citing a recent agreement with the Republic of Korea that included the fifty states and Puerto Rico but did not mention the other territories.

The insular areas have often noted that trade agreements implemented by the United States can have unintended consequences for the U.S. territories, and have requested the ability to participate in the process leading to these agreements. American Samoa and the CNMI, are most vulnerable in trade negotiations, because they are dependent on one or two manufacturing industries and are extremely sensitive to changes in the world trade environment.

In 2004, the USTR provided a written outline of ways the territories could weigh in on pending trade agreements (e.g. USTR invited insular areas to participate in the Inter-Governmental Policy Advisory Committee).

OIA has raised the question whether the International Trade Commission (ITC) could do a report on trade opportunities/issues with respect to the freely associated states and include the four U.S. territories. Any request to the ITC must be submitted by a Cabinet Secretary or Member of Congress.

Recommendation: USTR, the Department of Interior, the Department of Commerce, should consider a mechanism for inclusion of the territories' views in trade negotiations.

m. Medicaid Caps

Currently, Medicaid assistance to the territories is capped, and the Federal-local cost-sharing ratio is set at 50/50. The territories also operate under an older payment scheme that also limits per-patient spending. The territories have requested that these caps be increased or removed, and that the cost-share ratios be adjusted to 77/23 as a means to ease the strain on island 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, and could cost in excess of $1 billion per year, because any such measure would almost undoubtedly include Puerto Rico. Territorial delegates have introduced several bills on this subject.

Recommendation: The IGIA should reiterate with the Department of Health and Human Services the territories' plight regarding Medicaid funding.

n. Earned Income Tax Credit

The U.S. Virgin Islands and Guam are "mirror code" jurisdictions; their tax regulations are set to directly mirror the Federal tax code, with tax revenues going directly into the local treasuries. This benefit, however, also makes the local treasuries responsible for such benefit programs as the Earned Income Tax Credit (designed to offset the disproportionate cost of OASDI costs on low-income workers) and the Child Tax Credit. This liability has posed significant challenges for both territories; in some cases Guam has been unable to meet its EITC obligations.

The territories have proposed a structure whereby the costs of EITC payments would be passed on to the Federal Treasury, credited from OASDI payments that are made by local employers. The delegates to the House of Representatives from Guam and the U.S. Virgin Islands have introduced several pieces of legislation that would create this structure, citing a similar structure in place to assist Child Tax Credit payments. The Department of the Treasury has opposed this measure, citing tax policy concerns.

The Government of the U.S. Virgin Islands continues to seek a cost sharing arrangement with respect to the Earned Income Tax Credit Issue.

Recommendation: If avoidance of cost relating to EITC and similar tax programs is of high enough priority for a territory, it may, after signing an implementation agreement with the IRS, adopt a tax code modification.

o. Permanent Removal of Cap on Rum Excise Tax Cover-Over

The U.S. Virgin Islands (along with Puerto Rico) receive a significant share of the Federal excise tax on liquor produced in the territory. Their original share was $13.25 (out of $13.50) per proof gallon; legislation in the 1980s established a reduction provision to take effect in 2002, whereby the amount covered over would be lowered to $10.50 per proof gallon. Both territories objected to this provision, as the revenues from the rum tax are among the most stable available to them; these revenues back much of the municipal debt issued by these jurisdictions.

Since the reduction provision took effect, a series of temporary extensions of the $13.25 level have been applied by Congress, the latest expiring at the end of 2007. The U.S. Virgin Islands has requested that the reduction be permanently abandoned, and that the cap be removed. Legislation has been introduced that would effect these changes.

Recommendation: Congressional legislation is necessary to implement the request of the Virgins Islands. No further action is possible without an administration position.

p. Border Patrol Station in the U.S. Virgin Islands

At the 2008 IGIA Plenary Session, U.S. Virgin Islands Governor John deJongh submitted, in writing, a request for establishment of a fully staffed and equipped border patrol station in the U.S. Virgin Islands.

Recommendation: The IGIA should discuss this issue with the Department of Homeland Security.

q. Health Issues

A critical service that has been the focus of several Federal initiatives is the quality of health care services provided in the insular areas. In 2008, several conferences were held with respect to various aspects of health issues in the insular areas.

- Department of Health and Human Services spearheaded the 1st Pacific Summit on Diabetes on Saipan in the CNMI in September 2008.
- The Secretary of the Interior Dirk Kempthorne co-convened with the Secretary of Veteran's Affairs James B. Peake, Under Secretary of Defense for Personnel and Readiness David S.C. Chu and Assistant Secretary of Health Joxel Garcia, a Leader's Summit from September 28-29 of 2008 to focus on improving health care services in the insular areas. An important result of the Health Summit was the establishment of the *Interagency Coordinated Assets for Insular Health Response* (ICAIHR).
- The Secretary of Veteran's Affairs James B. Peake chaired a VA Task Force on Health Care and Benefits Services to Veterans in the Pacific insular areas and the United States Virgin Islands. The Task Force was convened and formally chartered in Honolulu on November 1, 2008.

The first meeting of the ICAIHR task force was held on February 3, 2009. The Members of the Task Force identified important points as follow:

Department of Defense ICAIHR recommendations

- The Department of Defense remains committed to helping move the comprehensive reassessment of the health needs of the insular areas. We would like to work closely with the VA, and HHS to craft a Statement of Work for a comprehensive update of the 1998 IOM Study with the additional requirement that the identification of the needs and issues facing insular area veterans, both active duty and reservists, be addressed.

- The Department of Defense recognizes the strategic importance of the insular areas and that effectively meeting the challenging health needs of the insular area population is particularly critical for the stability of the area.

- The Department of Defense recognizes the impact of redeployment of active duty forces within the area, particularly Guam, and is committed to working with the entire team to ensure that this redeployment does not aggravate current health care service delivery issues.

Department of Veteran's Affairs ICAIHR Recommendations

Veterans Affairs is committed to providing world-class health care, disability compensation and pensions to eligible veterans, a seamless transition from military life to the civilian workforce, and memorial benefits that include burial in cemeteries that are truly "national shrines."

- On November 1, 2008, the VA formally chartered a VA Task Force on Health Care and Benefits Services to Veterans in the Pacific insular areas and the United States Virgin Islands.
- The VA Task Force on Health Care and Benefits Services to veterans in Pacific insular areas and United States Virgin Islands reported recommendations for consideration by the Department in December 2008. The full report with findings and recommendations should be available early 2009. Preliminary findings and recommendations found in the report are:

  1. Insufficient veteran population and demographic data exists to adequately plan for the future.
  Recommendation: Initiate a Veteran Demographic Study and identify existing data repositories, particularly between VA, DOD, and DOI.

  2. Improve the understanding of veteran eligibility to benefits and access to VA's benefits staff.
  Recommendation: As appropriate, add VA Veterans Benefits Administration (VBA) staff; expand the use of VA kiosks, printed and electronic materials. Evaluate the need for staff education regarding the unique cultural needs for each island. Evaluate the capacity and services provided at the VBA Region Office in Manila, Honolulu, and VBA Regional Office, Pittsburgh to augment/support insular area needs.

  3. Access to VA health care services is limited for veterans in the Freely Associated States and currently does not fall under the purview of the VA Domestic program. Veteran Care is covered under the Foreign Medical Program.
  Recommendations: Increase collaboration with DOD, on their mercy mission to the Pacific to include veteran care (as allowable by existing authorities). Establish a mechanism for DOD to capture veterans that are treated on a mercy mission. VA will meet with DOD to discuss potential of VA participation in the mercy missions.

The Veterans Affairs Caribbean Basin Office reports:

- Initiated quarterly leadership visits to the community based outpatient clinics in the Virgin Islands.
- Shared clinical performance and administrative information with VA employees, establishing clear expectations with them
- Communicated directly with Veteran Service Officers, both during town hall meetings and through their representatives. This included meeting frequently with the local government representatives and their designated Veterans' Advocates.

Department of Health and Human Services ICAIHR Recommendations

The U.S. Department of Health and Human Services supports the health and well-being of the island jurisdictions and is engaged in the following ICAIHR related activities:

- Conducting an inventory of HHS grants to the insular areas to assess current HHS funding and programmatic support. HHS provided more than $80 million to the Outer Pacific in Fiscal Year 2007.

- Multiple HHS offices and agencies provide support to the insular areas, including: grants management technical assistance training; assisting the implementation of jurisdictional action plans from 2008 Pacific Summit on Diabetes; and collaborating with Pacific Island Health Officers Association and island health officials to address health care needs in outer Pacific islands.

- Revitalizing the intradepartmental working group on the insular areas to improve coordination of HHS support to the insular areas and examining the possibilities of commissioning an Institute of Medicine report on the current status of health and health care delivery in the insular areas.

U.S. Department of Health and Human Services' ***recommendations*** *for ICAIHR moving forward:*

- Primary care, prevention, and health education strategies need to be at the forefront of ICAIHR, in addition to addressing the issues related to the health care delivery system infrastructure.
- Insular health officials and leaders, as well as central (headquarters-based) and regional officers who have expertise in insular area health, need to be involved in all processes of ICAIHR.
- An observer status for freely associated states in IGIA for ICAIHR activities should be considered.

Financial Management

Financial management repeatedly has been 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.

In 2008, all single audits due (fiscal year 2007) were completed as agreed (both USVI and AS were under time approved extensions). Moreover, Guam steadily implemented improvements to its financial processes that have resulted in receiving an unqualified (“clean”) opinion from its independent auditors. (Palau and Pohnpei, FSM, have consistently received “clean” opinions on their financial statements for the past three years.)

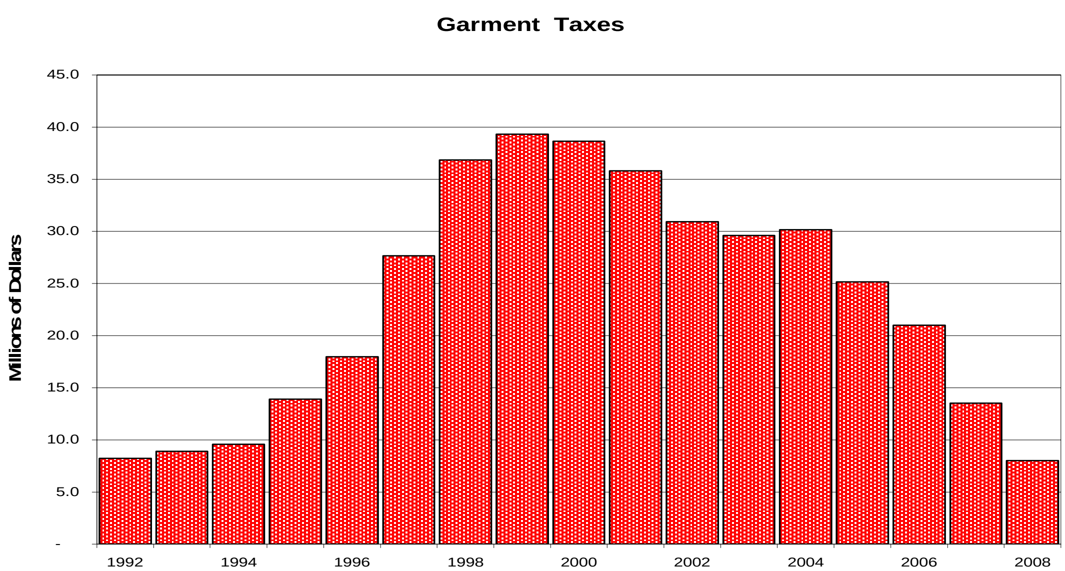
Recommendation: The Department of Education, the Department of Agriculture, the Department of Health and Human Services, the Department of the Interior, and other major program agencies should continue consultations as appropriate, and make every effort to improve financial management in the territories.

5. EXTRAORDINARY CIRCUMSTANCES

a. Report on CNMI Economy by OIA Economist

The bad news for the CNMI is that its economy has been on a slippery and declining slope for several years and is still sliding. All major indicators in the CNMI point to declines in both business and government activities. The good news is that the bottom is in sight.

CNMI's economy is going through a protracted and painful contraction that has affected every segment of business, government and community. From the mid-1990s to the mid-2000s the CNMI economy was dominated by garment manufacturing, tourism and government. All did well, but especially strong were garment exports and tourism. In 1996, CNMI tourist traffic peaked at 736,117. Garment factories were growing and bringing more temporary alien workers from Asia. Garment makers did not reach their peak until 2000 when there were 34 or factories licensed on Saipan that shipped over $1 billion worth of garments to the mainland United States (a record high level) and paid over $39 million in direct taxes to the CNMI government's general fund.



As of 2008, there were 5-7 factories (licenses) and their contribution to CNMI tax collections was projected to be around $8 million in fiscal year 2008. As recently as 2005, garment factories paid $26 million in direct CNMI taxes. In fiscal year 2009, garment makers are projected to pay practically zero taxes because they may have shut down.

A Slow and Painful Demise of a Once Surging and Controversial Industry. Garment factories have been leaving Saipan because they can no longer compete with mass producers of garments in places such as China and Mexico. Since January 2005, WTO country quotas and import duties on garments have favored developing countries. This allows them to earn the foreign exchange to buy more high-value goods from advanced economies.

Saipan garment-makers cannot compete with mass producers even if they pay less than the U.S. minimum wage. The Congress raised the minimum wage rates in both the CNMI and American Samoa in the summer of 2007. Soon thereafter, the leaders of these territories were in Washington explaining why their territories cannot pay higher wages. The territories have difficulty paying higher wages because they have to compete with countries with much lower wage costs, some of which are large economies with surplus labor. Meanwhile, CNMI garment factories declined from thirty-four to between five and seven in 2008, and they are likely to be down to zero soon.

CNMI Economic and Financial Contraction Indicators:

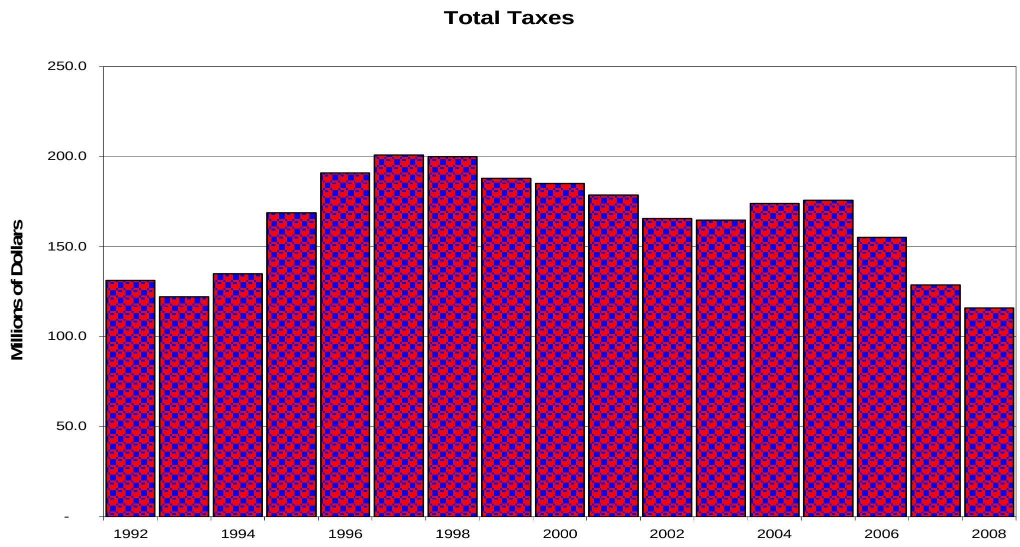
	1997	2007	% Change
Tourist Arrivals	726,690	389,345	-46.4
Garment Sales ($M)	800.0	454.0	-43.3
GBR Taxes	74.6	50.0	-33.0
Income Taxes	46.6	35.5	-23.8
Excise Taxes	29.2	17.9	-38.7
Garment Taxes	27.7	13.5	-51.3
Total Taxes	200.9	128.8	-35.9
Total Local Revenues	242.6	160.5	-33.8
Total General Fund	248.0	168.2	-32.2
Wages & Salaries	114.2	88.4	-22.6
GBR Total	2,500.0	1,170.0	-53.2

Note: GBR stands for Gross Business Receipts (business sales)

An Untimely Big Blow to Tourism. The other part of the new economic regime, also in effect since 2005, in the CMNI is the much smaller tourism industry. In June 2005, Japan Airlines (JAL) announced suddenly that it would pull out of CNMI in October. Before the pullout, JAL carried 40 percent of Japanese tourists and 29 percent of all tourists to CNMI. JAL's pullout caused the instantaneous loss of roughly 150,000 Japanese tourists and no other carrier took the routes, despite CNMI efforts on every front. The CNMI governor and then Deputy Assistant Secretary of the Interior traveled to Tokyo and otherwise made their views known that JAL was making an unwise business decision, but JAL left Saipan with no further explanation. The best guess is that JAL needed more money per passenger mile to justify continued service, and that short, economy routes such as Tokyo-Saipan did not yield the higher revenue that JAL was seeking in the midst of a major financial and corporate restructuring.

Recall that CNMI received 736,117 tourists in 1996. In 2007, the count was down to 389,345 tourists. The implications of the drop are straightforward for hotel occupancy rates, hotel room rates, hotel worker wages and salaries and hotel taxes that go to the CNMI treasury. Economic and financial ripple effects (the so-called multiplier effects) work the same way in booms as they do during busts.

For the CNMI government this means declining taxes year after year. In 1997, the CNMI general fund collected $200.9 million in taxes. In 2007, it collected $128.8 million.



Apart from cutbacks in personnel, furloughs and other austerity measures, the CNMI government has not contributed to the public retirement fund for two years and it owes nearly $200 million in contributions. CUC, Saipan's utility company which the government owns and operates, only held a two-week fuel supply according to an April 2008 issue of a local newspaper. To compensate, the CUC raised its non-residential rates. Rolling blackouts then occurred once or twice a day and lasted from one to three hours at a time. Unreliable power supply has become a nuisance for many. Major hotels utilize their own generators, as do other big businesses.

In 2008, the United States economy entered its recession. CNMI has been in one for several years. Again, the good news for the CNMI is that the bottom may be in sight. The CNMI economy will most likely hit rock bottom in 2009 when all the garment factories have left. The question is what will be the composition of the post-garment CNMI economy? Regardless of what economy emerges from this transition, Saipan has to get back in the business of being a pristine island destination.

Economic & Financial Revitalization. The CNMI is in the midst of a difficult transition from economic growth and financial stability to a dwindling economy and severe public finance stresses. There is talk of skilled persons leaving the islands for better prospects in other places. There are justified worries about both the present and the future, especially for young Americans who live there and have dreams of better days and times. There are legitimate concerns about the deteriorating standards of living in the CNMI.

Revitalizing broken economies is not an easy task, but the CNMI has no choice in this matter if it wants to be a viable and self-sustaining economy and allow future generations to call this place home and work and live here. A big plus for the CNMI is its three inhabited islands, each of which will play a uniquely useful role in revitalization. The other potential asset for the CNMI moving forward is its string of volcanic islands to the north which may yet provide an important geothermal alternative to fossil fuels. Proper management of the recently established Marianas Marine Trench Monument may also contribute to renewed prosperity.

b. Report on Economic Impact of Guam Military-Buildup by OIA Economist

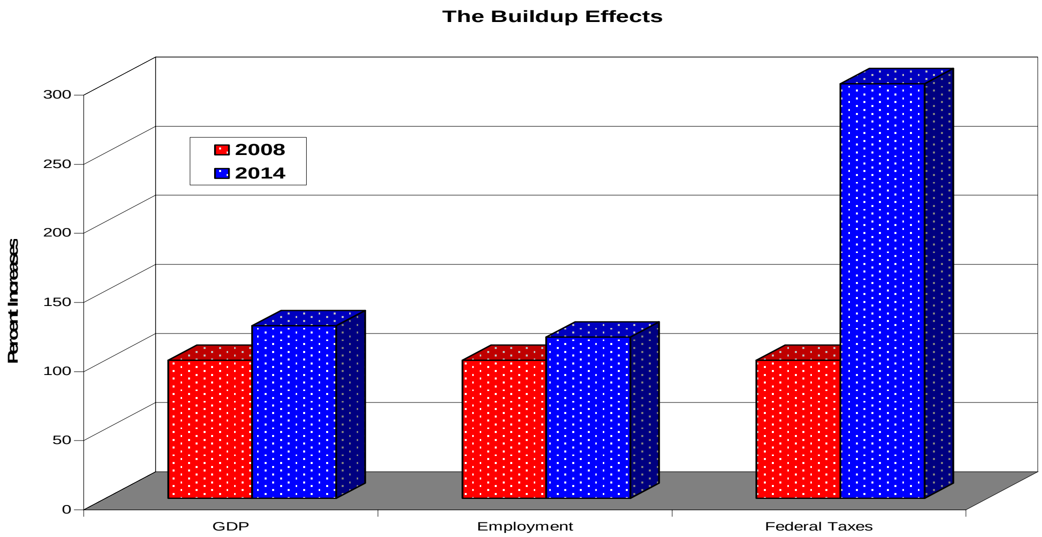
The planned redeployment of 8,000 Marines and 9,000 dependents from Okinawa, Japan to Guam together with other U.S. forces collectively represents the largest shift of forces in the Pacific region since the end of the Vietnam War. The anticipated buildup will increase the population of the island by almost 25%, which requires a major and rapid development of civilian and military infrastructure in the territory. The build-up will take at least six years to implement.

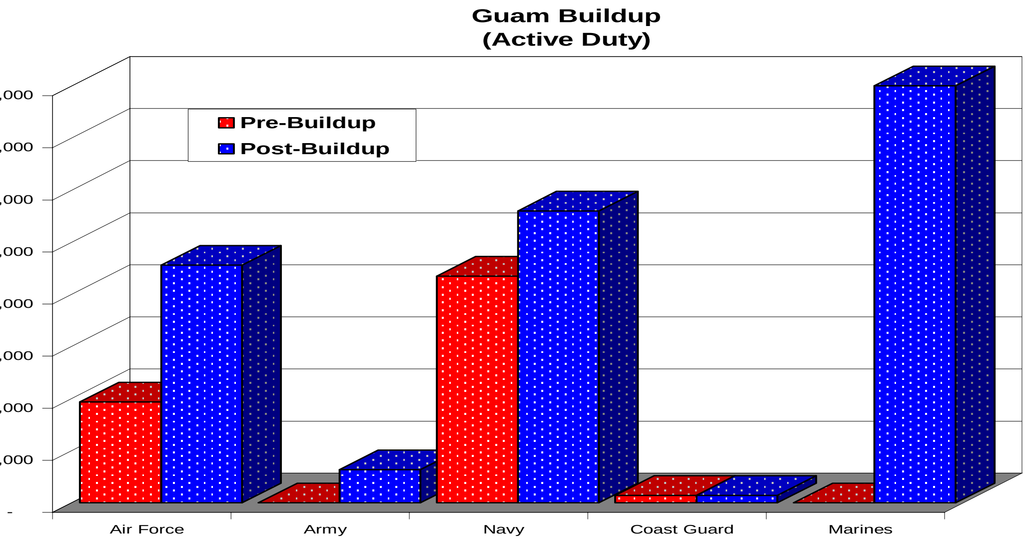
Most discussions on Guam have centered on the challenges the build-up presents for the citizens of Guam and the Government of Guam. Very little has been said about its economic and financial benefits. This report aims to outline the benefits and challenges of the buildup. It is imperative that the economic and financial benefits of the proposed build-up be presented clearly and objectively for all concerned.

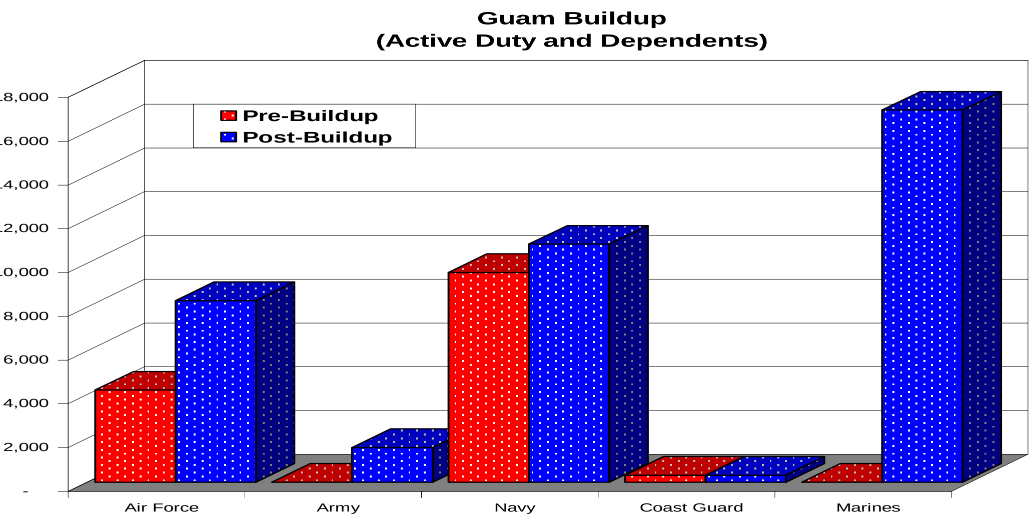
At best, the U.S.-affiliated Pacific economies, even those with large Federal grants, struggle to keep afloat. Their public finances are as strong as their shares of Federal grants. The build-up has the potential to make Guam a much more prosperous economy with a solid tax base.

The military build-up on Guam will also provide an important opportunity for American business and for the development and training of United States-eligible labor, including that present in the nearby CNMI and the freely associated states.

The following graph illustrates the benefits of the build-up in GDP, employment and taxes which will far outweigh the costs.


The Buildup Effects
Percent Increases
300
250
200
150
100
50
0
2008
2014
GDP
Employment
Federal Taxes


Guam Buildup
(Active Duty)
8,000
7,000
6,000
5,000
4,000
3,000
2,000
1,000
-
Pre-Buildup
Post-Buildup
Air Force
Army
Navy
Coast Guard
Marines


Guam Buildup
(Active Duty and Dependents)
18,000
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
-
Pre-Buildup
Post-Buildup
Air Force
Army
Navy
Coast Guard
Marines

6. Next Steps with respect to the IGIA for 2009

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. Through the Executive Order, the Secretary of the Interior or the Secretary's designee convenes the IGIA, presides at its meetings and directs its work in providing advice on the establishment or implementation of policies concerning American Samoa, Guam, the U.S. Virgin Islands (USVI) and the Commonwealth of the Northern Mariana Islands (CNMI). The Executive order was intended to improve the internal Executive branch management of insular issues. The Secretary's Office of Insular Affairs (OIA) coordinates, organizes and staffs the IGIA meetings.

The Acting Deputy Assistant Secretary has directed his staff from the Office of Insular Affairs to call meetings with the various federal agencies to follow up on specific issues as raised by the Governors and Delegates. The Acting DAS has proposed that at least one meeting take place with each agency before the next IGIA plenary session.

Despite the fact that the IGIA only provides a framework, without specific mandate or authority, OIA is committed to continued networking with the various Federal agencies on issues of relevance to the U.S. insular areas. This will be especially important as transition continues in 2009 to the administration of President Obama.

END OF REPORT

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