Interagency Group on Insular Areas
2007 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. Customs and border regulations differ from territory to territory. Two territories were just recently brought under the U.S. minimum wage, and that wage rate is still not fully applied. 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.

[1] Guam, American Samoa, and the U.S. Virgin Islands all have elected non-voting delegates. There is legislation in Congress right now (part of an omnibus bill) that would grant the CNMI a non-voting delegate, but the legislation has not yet been passed. These delegates, along with the delegate from the

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

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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 Congress. These delegates also now 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.

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 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**

Several developments with profound implications for the fiscal, economic, and policy climate in the territories unfolded throughout 2006. Plans to move 8000 Marines presently stationed on Okinawa (as well as other units that support the Marine mission) to Guam are advancing; the announced timetable has construction of supporting infrastructure beginning in early 2010. This will increase the population of the island by almost 25%, which require a major and rapid development of the civilian and military infrastructure base in the territory.

In addition to the developments on Guam, two major legislative initiatives advanced in 2007, with profound implications for the economies of the affected territories. The first, stipulating incremental increases in the minimum wage rates in American Samoa and the CNMI, was passed by Congress and signed into law by the President. The first increases went into effect over the summer. The second major increase is scheduled for early 2007.

The second major legislative change involves immigration and border control policy. Legislation was introduced in 2007 that would extend Federal immigration control over the CNMI, under provisions included in the original covenant. In its final form, the legislation creates a region-wide visa waiver program (encompassing Guam and the CNMI); the countries to be included in the program will be determined through regulatory action.

In addition, work has continued on a range of other policy areas that have been raised by the islands over the last five years. Long-term efforts in support of infrastructure finance, and a wide range of additional individual issues have continued. Much of the background work performed on these issues has proved very useful for the efforts centered on this year’s developments.

a. **Guam Military Build-Up**

i. **Background**

The planned redeployment of 8000 Marines and other U.S. forces from Okinawa and other bases to Guam collectively represents the largest shift of forces in the Pacific Region since the end of the Vietnam war. The estimated investment, just for DOD mission-related infrastructure, will be in excess of $10 billion; construction is slated to begin as early as the beginning of calendar year 2010, with the major force movements beginning in 2012. The financing is a unique combination of direct investments and financing instruments, provided by both the United States and the Government of Japan.

This planned shift will likely herald a period of rapid growth of Guam's economy, and will also likely have significant ripple effects on the regional economy. However, the scale and pace of the buildup presents a variety of issues that will need to be addressed to ensure that the necessary resources can be brought to bear to allow the Department of Defense mission to proceed successfully, while ensuring that the potential benefits to Guam and its regional neighbors are realized and that the rapid influx of investment and population does not have unforeseen negative impacts on the territory.

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

- A massive increase in local construction activity, both directly and indirectly tied to DOD projects.
- Significant fluctuations in the local housing and land markets.
- Significant impacts on the cost of materials and consumer goods.
- Significant impacts on the cost and supply of labor.
- Significant additional demands on water, power, and solid waste infrastructure that already have outstanding performance and technical issues.
- Significant additional demands on transportation infrastructure, both from the additional population and from significantly increased traffic at the port.

At the 2007 annual meeting of the Interagency Group on Insular Areas, Major General David Bice, USMC (ret.), Executive Director of the Joint Guam Program Office, presented an outline of the planned buildup. At the request of the Government of Guam, with the full concurrence of the Joint Guam Program Office, a new IGIA working group was established. The first full meeting of the group was on August 2, 2007, at the Department of the Interior; a second full meeting was held in November. The group plans to hold a third meeting concurrent with the 2008 annual meeting of the IGIA.

The working group, under the joint leadership of the Department of Defense, Department of the Interior, and Government of Guam, has several general areas of responsibility, including maintaining lines of communication during the development of regulatory, policy, and budgetary decisions in support of the buildup, identifying equities of the various potential Federal and local players, defining potential requirements for staffing and other resources that will be caused by the increased program and oversight activity resulting from the buildup, working to coordinate efforts between the various Federal equities, and assisting in the overall planning process.

The working group is further divided areas of interest into five subgroups, focusing on environmental, infrastructure, socioeconomic, labor/workforce, and health and human services issues that will be created by the expected rapid changes on Guam. Other cross-cutting issues, such as transportation infrastructure and workforce healthcare, have also emerged over the course of the groups' discussions. Some initial efforts are already under way, particularly on the environmental impact front; the Departments of Labor, Defense, and Interior are also working to beef up the training capacity on Guam and throughout the region.

Initial surveys have already been completed on the port, training needs, resource requirements to support the environmental impact study, housing, and other enforcement requirements. A full accounting of infrastructure needs in particular has been sought, though it is not clear how many of the projects currently under consideration would require actual up-front financing and which could use alternative methods of financing, and (due in no small part to the scale of some of the projects) prioritization of outside-the-fence needs remains a challenge. Added uncertainty comes from the fact that, while on an individual basis resources have been made available or promised (such as support resources for the EIS work), there has been no commitment to date to support action items that would require up-front financing.

Recommendation: The participating agencies should continue their efforts to quantify (to the extent possible) potential policy and program requirements necessary to ensure the success of the DOD transfer and that the impacts "outside the fence" do not exacerbate or create chronic problems, which would in the long term impede the DOD mission. This work should focus most particularly quantifying increased program demands, on resources required to support increased program demands, and on identifying capital projects that would require up-front

financing to ensure completion in the time frame required. This information will be critical for the policy determinations to be made in the course of the normal budget processes.

b. **Visa and Immigration policy**

i. **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.

These questions have taken on a new urgency in the face of the planned Guam military buildup. There are significant concerns about the ability of contractors working on Guam projects to meet their labor needs with local or mainland labor; as a result, other options may be necessary. However, the security implications of the increased DOD footprint on Guam must now also be weighed when considering exemptions to standard visa policy in the region.

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.

ii. **Immigration Control in the CNMI**

Two of the Insular Areas (Guam and the U.S. Virgin Islands) currently fall under modified versions of Federal visa and immigration control. Legislation currently pending in the U.S. Congress would extend this control over the CNMI, under a provision established in the CNMI's covenant with the U.S. Because of its independent immigration status, the CNMI has long used its ability to bring in non-resident labor to support its now-dying garment manufacturing industry.

That industry – and the non-resident workers in it - has been a long-standing source of concern for policymakers. Serious abuses were discovered in the 1990s, and a range of policy remedies was applied, including the creation of a Federal Labor Ombudsman's office, still supported by the Office of Insular Affairs.

Although significant progress was made, in late 2006 the Administration began examining options for implementing the "Murkowski Bill" – legislation originally introduced in 2001 that would have extended Federal immigration control over the CNMI. A drafting service was delivered at the request of the Senate Energy committee in 2007, and though the original draft has been significantly modified, the legislation is nearing passage by both houses of Congress.

The implementation of this legislation will still present challenges to Federal policymakers and local stakeholders. There are outstanding questions as to the status of the non-resident workers in the territory, many of whom have lived and worked in the CNMI for five or ten years. The legislation also creates a provision for a visa waiver program similar to the original Guam visa waiver program (and, due to recent amendments, is extended to include Guam); the exact countries eligible for the program would be established by regulation at a later date. The CNMI has also raised significant concerns about potential impacts on its economy, which was dependent on the non-resident workers for labor in factories, and tourists from non-visa-waiver countries.

Recommendation: The agencies involved in the consultations on this issue should continue their discussions, particularly if the legislation currently in Congress passes and faces implementation; representatives of the Departments of Interior, Labor, Justice, Treasury, and Homeland Security have been

involved in these consultations, and all have equities in the final structure of the regulations.

c. 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 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 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.

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.

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.

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.

The whole debate on infrastructure in the territories, however, has taken on a new urgency in light of the pending buildup on Guam. The situation on Guam has implications not only for the welfare of the population but the forward basing strategy currently under implementation by the Department of Defense.

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.

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), as these agencies already expend considerable resources in both technical assistance and capital improvement funds on energy and energy-infrastructure-related projects.

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.

d. **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.

2007 saw the fourth Conference on Business Opportunities in the islands; this event was the first Conference to be held in one of the territories (Guam). This is the seventh major event managed by the Department of the Interior in this program; in addition to four Conferences, there have been three trade missions organized by the Office of Insular Affairs.

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. During his 2007 trip to the Pacific territories and Freely Associated States, Secretary of the Interior Kempthorne discussed these issues with several of the territorial leaders he met with, and the Department of the Interior is continuing to explore options in this area.

The private sector economic development initiative continues to evolve. The 2008 Island Fellows Program will focus on the rollout of 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 the last Conference, where participants indicated an interest in long-term networking tools such as these.

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. **Impact of Minimum Wage Increases in the Territories**

Under their original negotiated arrangement with the U.S., both the CNMI and American Samoa controlled their own minimum wage. In American Samoa's case, the wages were set by a wage board whose processes actually fell under the Fair Labor Standards Act; the CNMI operated completely independently.

In 2007, legislation was passed that extended Federal minimum wage levels to the CNMI and American Samoa, over a ten-year phase-in period. Territorial representatives immediately raised concerns; the CNMI had already experienced a range of external shocks, and was concerned that the sharp increase would stifle any remaining economic activity. In American Samoa's case, there were serious concerns that the change would force out the one major source of private sector revenue in the territory.

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.

In 2007, Secretary Kempthorne encouraged the Department of Labor to expedite an economic study provided for in the legislation to explore the expected impact of the wage increases; his concern stemmed in part from conversations he had with leaders in the CNMI and American Samoa during his 2007 visit. The report's findings, prepared with input from the Department of the Interior were limited due to a lack of certain critical data points, and the need for further examinations continues. The Department of the Interior will be placing a special emphasis on developing baseline economic data throughout the Insular Areas over the course of 2008.

Recommendation: Appropriate officials from the Department of Labor and 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 monitored and appropriate policy measures are taken to mitigate or prevent additional traumas to the economies of the CNMI and American Samoa.

iv. **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.

v. **Trade Policy/Trade Agreements**

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. Some of the territories, particularly American Samoa and (to a lesser extent) the CNMI, are most vulnerable to these effects, as they are dependent on one or two manufacturing industries that are very sensitive to changes in the world trade environment.

The CNMI has also requested a modification of General Note 3(a) of the Harmonized Tariff Regulations; this regulation governs the "value-added" proportional requirement for products manufactured in the CNMI (specifically, garments). The CNMI's garment industry has been collapsing since a new free trade agreement with China took effect; it became far more economical for companies to produce goods in China than the CNMI. The CNMI saw modifying the value-added ratio as a way to preserve the remaining factories in the territory.

USTR has offered to allow the territories to comment on pending agreements; in addition, the Administration extensively considered the Headnote 3(a) modification, though the relevant legislation passed before a determination could be reached.

Recommendation: USTR, the Department of Interior, the Department of Commerce, and other relevant agencies should continue to consult on these issues as they arise.

e. **Tax and Entitlement Program Issues**

i. **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. This is significantly lower than the mainland standard, where 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, and could cost in excess of $1 billion per year, as any such measure would almost undoubtedly include Puerto Rico.

Due to limited capacity in the healthcare facilities in the Insular Areas, healthcare costs eat up a significant portion of local government spending, due in no small part to the fact that the relatively low incomes in these territories leave a disproportionate number of residents eligible for Medicaid. Once the cap is reached, local governments are responsible for meeting the demand, which is made worse by the need for expensive off-island referrals for treatment. 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*. An administration position would be required to advance this initiative any further.*

ii. **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 to both territories; Guam has in some cases 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 Congressional delegates 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.

Recommendation: No further action is possible without an Administration position on this legislation.

iii. **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 lower 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, but the bills have not moved.

Recommendation: No further action is possible without an administration position on the legislation.

iv. **Virgin Islands Income Tax Issues**

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.

Following reports that some taxpayers had abused the program, Congress passed the American Jobs Creation Act of 2004. 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. Subsequently, the Treasury also issued regulations removing the statute of limitations on tax audits for Virgin Islands taxpayers; this move has prompted a request from the Virgin Islands Government that the treatment of these audits be kept in line with mainland standards.

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.

f. **Health**

i. **Introduction**

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.

ii. **Health Data**

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.

A major contributing factor to this issue is the fact that the territories are not included in many of the major health surveys and reporting mechanisms created for tracking health and disease indicators in the fifty states. Identifying funding streams to address these data shortfalls will be the next challenge that the Department of Health and Human Services and the Department of the Interior will face in this effort.

Recommendation: The Department of the Interior and the Department of Health and Human Services should continue their efforts to ensure that baseline health monitoring data is collected and maintained in all of the territories.

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.

g. **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, and subsequently both she and the Governor have requested that steps be taken to reduce the need for what they refer to as the "Federalization" of local management functions.

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 through the Virgin Islands Training Initiative, which have been aimed at improving the technical skills of the local financial staff in the territories (as well as the Freely Associated States). Performance on single audits continues to improve throughout the territories, and the Department of the Interior and its partners will continue these efforts.

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.

h. **Other Issues/Items Raised**

i. **Decisions on Formula Allocations**

Several representatives have repeatedly raised concerns about the formulas used to allocate funding from large, nationwide programs managed by USDA, DOT, and other agencies; there have been concerns that the territories lose out on formula allocations designed for communities and circumstances found in the mainland. Territories have raised this concern on an individual basis; American Samoa raised it in the context of a rural telemedicine support program; Guam has raised it more generally but mostly in the context of USDA Rural Development programs; the CNMI has focused on USDA's infrastructure programs.

Consultations among the member agencies have been extensive and productive. In many cases, the agencies have limited regulatory latitude to modify formulas established by legislation, but in some cases alternatives have been found; in the case of the American Samoa telemedicine request, although the remedy was not the exact solution American Samoa sought, the Federal Communications Commission (which manages the program in question) developed a regulatory alternative for American Samoa (and the other territories). In other cases, full solutions have not been possible, but the consultations have provided useful background information and lines of communication on priority issues and projects that have proven quite useful, particularly with regard to work being performed to support the buildup of forces on Guam.

Recommendation: The Department of the Interior, Department of Agriculture, and other relevant agencies should continue their consultations on this question as concerns arise.

ii. **Individual Funding and Other Questions**

Periodically, issues have been raised at IGIA meetings that are not specifically policy questions, and refer more to more specific needs in one or more of the territories. A frequent example is a need for additional Veterans' Affairs facilities; in more recent years, the Virgin Islands requested a full border control complement; American Samoa requested a full catalogue of Federal laws and regulations applicable in the territory; and Guam has requested regulatory action on FEMA decisions. While these, again, are not specifically policy concerns, these are nonetheless useful inputs to the work of the IGIA member agencies, as they serve to highlight needs that exist throughout the territories, some of which may be the result of previous policy decisions.

The IGIA members have also enjoyed some success at addressing these specific needs. The Veterans Affairs department in particular has been aggressive at addressing needs identified in the territories; in other cases, the Department of the Interior granted technical assistance funding to address needs or issues raised through the IGIA meetings. In other cases, though, agencies did not have the funding or regulatory flexibility to grant the requests submitted by the territories.

Recommendation: As appropriate under existing guidelines and procedures, IGIA member agencies should give requests made by the territorial representatives due consideration and report back their ability to address those requests.

3. **Federal Policy Towards the Territories and the Future Role of the IGIA**

Several territorial representatives have proposed that the Federal participants in the IGIA work to develop an overall Federal policy towards the territories, reflecting their unique status and position in the United States; they argued that this would help clarify many of the policy questions that have arisen, such as those regarding tax, entitlement, and other issues. At present, there is no overall policy, and agencies address the challenges relevant to the territories on an ad hoc basis; the IGIA provides a network, but no specific mandate or authority.

It bears noting that the territories already enjoy some significant exemptions from standard Federal policies, particularly those that reference taxation, border control, and other areas. Dedicated funding streams were established. Special incentives were created in the past to try to stimulate economic development.

Ironically, it was the unintended outcomes of these incentives that are at the root of some of the most pressing current concerns, such as the CNMI's extreme dependence on its declining garment industry. Significant investments were made in infrastructure and other areas without building the capacity necessary to maintain the investments and account for expenditures; the Department of the Interior and other agencies have been engaged in extensive efforts to remedy the capacity issues, but the long-term effects, such as failing infrastructure, must still be dealt with.

There are various arguments for a more focused and comprehensive Federal approach to America's insular territories. First and foremost is the strategic value of their locations near developing economies, communications hubs, or global hot spots, and that their value is diminished if the fiscal, economic, and social health of these areas are deficient. Second, for many visitors to the United States, the territories are the only stop they will ever make. America's status as a global leader requires that demonstrable and visible efforts be made to demonstrate that status, particularly in regions where other centers of power are challenging that status. Finally, citizens of the islands disproportionately bear the burden of service to the United States; on a per capita basis, far more residents of all four territories both serve in the Armed Forces and have given their lives in that service.

Recommendation: The members of the IGIA should endeavor to include relevant branch chiefs from the Office of Management and Budget and other White House offices in their deliberations, and discuss whether the development of a more comprehensive policy towards the U.S. territories is feasible.