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# COMPACT OF FREE ASSOCIATION

## An Assessment of the Amended Compacts and Related Agreements

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International Affairs and Trade





# COMPACT OF FREE ASSOCIATION

## An Assessment of the Amended Compacts and Related Agreements

Highlights of [GAO-03-890T](#), a testimony before the House Committee on International Relations, Subcommittee on Asia and the Pacific

### Why GAO Did This Study

In 1986, the United States entered into a Compact of Free Association with the Pacific Island nations of the Federated States of Micronesia, or FSM, and the Republic of the Marshall Islands, or RMI. The Compact provided about \$2.1 billion in U.S. funds, supplied by the Department of the Interior, over 17 years (1987-2003) to the FSM and the RMI. These funds were intended to advance economic development. In a past report, GAO found that this assistance did little to advance economic development in either country, and accountability over funding was limited. The Compact also established U.S. defense rights and obligations in the region and allowed for migration from both countries to the United States.

The three parties recently renegotiated expiring economic assistance provisions of the Compact in order to provide an additional 20 years of assistance (2004-2023). In addition, the negotiations addressed defense and immigration issues. The House International Relations and Resources Committees requested that GAO report on Compact negotiations.

This testimony discusses negotiated changes to the levels and structure of future assistance, including the potential cost to the U.S. government. Further, it reviews accountability, defense, and immigration changes brought about by the amended Compacts and related agreements.

[www.gao.gov/cgi-bin/getrpt?GAO-03-890T](http://www.gao.gov/cgi-bin/getrpt?GAO-03-890T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Susan S. Westin at (202) 512-4148 or [WestinS@gao.gov](mailto:WestinS@gao.gov).

### What GAO Found

The amended Compacts of Free Association between the United States and the FSM and the RMI to renew expiring U.S. assistance could potentially cost the U.S. government about \$6.6 billion in new authorizations from the Congress. Of this amount, \$3.5 billion would cover payments over a 20-year period (2004-2023), while \$3.1 billion represents payments for U.S. military access to Kwajalein Atoll in the RMI for the years 2024 through 2086. While the level of annual grant assistance to both countries would decrease each year, contributions to trust funds – meant to eventually replace grant funding – would increase annually by a comparable amount. Nevertheless, at an assumed annual 6 percent rate of return, earnings from the FSM trust fund would be unable to replace expiring grant assistance in 2024, while earnings from the RMI trust fund would encounter the same problem by 2040.

The amended Compacts strengthen reporting and monitoring measures that could improve accountability over assistance, if diligently implemented. These measures include the following: assistance grants would be targeted to priority areas such as health and education; annual reporting and consultation requirements would be expanded; and funds could be withheld for noncompliance with grant terms and conditions. The successful implementation of the many new accountability provisions will require appropriate resources and sustained commitment from the United States, the FSM, and the RMI.

Regarding defense, U.S. military access to Kwajalein Atoll in the RMI would be extended from 2016 through 2066, with an option to extend through 2086. Finally, Compact provisions addressing immigration have been strengthened. For example, FSM and RMI citizens entering the United States would need to carry a passport, and the U.S. Attorney General could, through regulations, specify the time and conditions of admission to the United States for these citizens.

**Estimated New U.S. Authorizations for the FSM and the RMI, Fiscal Years 2004-2086 (U.S. dollars in millions)**

	FSM	RMI	Total
<b>Fiscal years 2004-2023</b>	<b>\$2,296</b>	<b>\$1,204</b>	<b>\$3,500</b>
<b>Fiscal years 2024-2086</b>	Not applicable	<b>3,081</b>	<b>3,081</b>
<b><i>Fiscal years 2004-2086, total possible new U.S. authorizations for the FSM and the RMI</i></b>	<b>\$2,296</b>	<b>\$4,285</b>	<b>\$6,581</b>

Source: GAO estimate based on the amended Compacts.

Note: These figures are adjusted for inflation. In 2004 U.S. dollars, the total cost would be \$3.8 billion.

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to testify on the Compact of Free Association between the United States and the Pacific Island nations of the Federated States of Micronesia, or the FSM, and the Republic of the Marshall Islands, or the RMI.<sup>1</sup> In 1986, the United States entered into this compact with the two countries after almost 40 years of administering the islands under the United Nations Trust Territory of the Pacific Islands. The Compact has provided U.S. assistance to the FSM and the RMI in the form of direct funding as well as federal services and programs for almost 17 years. Further, the Compact establishes U.S. defense rights and obligations in the region and allows for migration from both countries to the United States. Provisions of the Compact that address economic assistance were scheduled to expire in 2001; however, they can remain and have remained in effect while the United States and each nation renegotiated the affected provisions.<sup>2</sup>

Today I will discuss our review of the amended Compacts and related agreements that the United States signed with the FSM and the RMI in April and May of 2003, respectively. (According to a Department of State official, while the original Compact was one document that applied to both the FSM and the RMI, the Compact that has been amended is now a separate Compact with each nation.) Specifically, I will discuss changes to levels and structure of future assistance, including the potential cost to the U.S. government. Further, I will comment on changes in accountability and other key issues addressed in the amended Compacts and related agreements. Our testimony is based on our reports on the Compact published over the past several years as well as our assessment of the amended Compacts that was requested by Chairman Leach and Ranking Minority Member Faleomavaega, Subcommittee on Asia and the Pacific, House Committee on International Relations; Ranking Minority Member Lantos, House Committee on International Relations; Ranking Minority Member Rahall, House Committee on Resources; and Congressman Bereuter.

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

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

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## Summary

The amended Compacts of Free Association with the FSM and the RMI to renew expiring assistance would require about \$3.5 billion in funding over the next 20 years with a total possible authorization through 2086 of \$6.6 billion from the U.S. Congress.<sup>3</sup> The amended Compacts would provide decreasing levels of annual assistance over a 20-year term (2004-2023) in order to encourage budgetary self-reliance. Simultaneously, the Compacts would require building up a trust fund (with contributions that would increase annually) for each country to generate annual earnings that would replace the grants that end in 2023. Per capita grant assistance would fall over the 20-year period, particularly for the RMI. At an assumed trust fund rate of return (6 percent), in 2024 the RMI trust fund would cover expiring grant assistance, while the FSM trust fund would be insufficient to replace grants. By the year 2040, however, RMI trust fund returns also would be unable to replace grant funding.

The amended Compacts include many strengthened reporting and monitoring measures that could improve accountability if diligently implemented. The amended Compacts and related agreements have addressed most of the recommendations that we have made in past reports regarding assistance accountability. For example, assistance would be provided through grants targeted to priority areas, such as health and education, and with specific terms and conditions attached. Annual reporting and consultation requirements would be expanded, and funds could be withheld for noncompliance with Compact terms and conditions. The successful implementation of the many new accountability provisions will require a sustained commitment and appropriate resources from the United States, the FSM, and the RMI.

The amended Compacts address other key issues. One key change to Compact defense provisions would occur – U.S. military access to Kwajalein Atoll in the RMI could be extended from 2016 to 2086. This extension would cost \$3.4 billion of the total possible authorization of \$6.6 billion. Amended Compact provisions addressing one additional key area – immigration – have been strengthened by adding new restrictions and

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<sup>3</sup>Although the amended Compacts have been signed by the U.S., FSM, and RMI governments, they have not been approved by the legislature of any country. Therefore, in our testimony we describe the amended Compacts' requirements and potential impact in a conditional manner in recognition that the Compacts have not yet been enacted. The total possible cost to renew expiring assistance in fiscal year 2004 U.S. dollars would be \$3.8 billion on the basis of the Congressional Budget Office forecasted inflation rate (see appendix).

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expressly applying the provisions of the Immigration and Nationality Act of 1952 (INA), as amended (P.L. 82-414), to Compact migrants. FSM and RMI citizens entering the United States would need to carry a passport, and regulations could be promulgated that would impose time limits and other conditions on a Compact migrant's admission to the United States.

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## Background

In 1986, the United States and the FSM and the RMI entered into the Compact of Free Association. This Compact represented a new phase of the unique and special relationship that has existed between the United States and these island areas since World War II. It also represented a continuation of U.S. rights and obligations first embodied in a U.N. trusteeship agreement that made the United States the Administering Authority of the Trust Territory of the Pacific Islands.<sup>4</sup> The Compact provided a framework for the United States to work toward achieving its three main goals: (1) to secure self-government for the FSM and the RMI, (2) to assist the FSM and the RMI in their efforts to advance economic development and self-sufficiency, and (3) to ensure certain national security rights for all of the parties. The first goal has been met. The FSM and the RMI are independent nations and are members of international organizations such as the United Nations.

The second goal of the Compact – advancing economic development and self-sufficiency for both countries – was to be accomplished primarily through U.S. direct financial payments (to be disbursed and monitored by the U.S. Department of the Interior) to the FSM and the RMI. For the 15-year period covering 1987 through 2001, funding was provided at levels that decreased every 5 years. For 2002 and 2003, while negotiations to renew expiring Compact provisions were ongoing, funding levels increased to equal an average of the funding provided during the previous 15 years. Thus, funds available to the two governments were “bumped-up”

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<sup>4</sup>From 1947 to 1986, the United States administered this region under a trusteeship agreement that obligated it to foster the development of political institutions and move the Trust Territory toward self-government and promote economic, social, and educational advancement. In addition, the agreement allowed the United States to establish military bases and station forces in the Trust Territory and close off areas for security reasons as part of its rights. In addition to the islands of the FSM and the RMI, the Trust Territory included Palau and the Northern Mariana Islands.

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during the last 2 years of assistance.<sup>5</sup> For 1987 through 2003, U.S. assistance to the FSM and the RMI to support economic development is estimated on the basis of Interior data, to be about \$2.1 billion.<sup>6</sup> We have found that many Compact-funded projects in the FSM and the RMI experienced problems because of poor planning and management, inadequate construction and maintenance, or misuse of funds. Further the U.S., FSM, and RMI governments provided little accountability over Compact expenditures and have not ensured that funds were spent effectively or efficiently.

Economic self-sufficiency has not been achieved. Although total U.S. assistance (Compact direct funding as well as U.S. programs and services) as a percentage of total government revenue has fallen in both countries (particularly in the FSM), the two nations remain highly dependent on U.S. funds. U.S. direct assistance has maintained standards of living that are higher than could be achieved in the absence of U.S. support. In addition, U.S. programs have been extended to the FSM and the RMI to provide a wide range of critical services, such as health care, education, telecommunications, and job training, but in most cases local conditions have impaired the programs' effectiveness.<sup>7</sup>

The third goal of the Compact – securing national security rights for all parties – has been achieved. At the time that the Compact was negotiated, the United States was concerned about the use of the islands of the FSM

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<sup>5</sup>The FSM received additional U.S. grant assistance of about \$17.5 million in fiscal year 2002 and about \$18 million in fiscal year 2003. The RMI received additional U.S. grant assistance of about \$3.1 million in fiscal year 2002 and \$3.3 million in fiscal year 2003 (excluding increased payments related to Kwajalein land use).

<sup>6</sup>The cost of prior assistance in fiscal year 2004 U.S. dollars was \$2.6 billion. This estimate does not include payments for Compact authorized federal services or U.S. military use of Kwajalein Atoll land, nor does it include investment development funds provided under section 111 of Public Law 99-239. Additionally, the Compact served as the vehicle to reach a full settlement of all compensation claims related to U.S. nuclear tests conducted on Marshallese atolls between 1946 and 1958. In a Compact-related agreement, the U.S. government agreed to provide \$150 million to create a trust fund. While the Compact and its related agreements represented the full settlement of all nuclear claims, it provided the RMI with the right to submit a petition of "changed circumstance" to the U.S. Congress requesting additional compensation. The RMI government submitted such a petition in September 2000, which the U.S. executive branch is still reviewing.

<sup>7</sup>For more information on U.S. programs and services provided to the FSM and the RMI, see U.S. General Accounting Office, *Foreign Assistance: Effectiveness and Accountability Problems Common in U.S. Programs to Assist Two Micronesian Nations*, [GAO-02-70](#) (Washington, D.C.: Jan. 22, 2002).

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and the RMI as “springboards for aggression” against the United States, as they had been used in World War II, and the Cold War incarnation of this threat – the Soviet Union. The Compact and its related agreements established several key defense rights for all three countries. The Compact obligates the United States to defend the FSM and the RMI against an attack or the threat of attack in the same way it would defend its own citizens. The Compact also provides the United States with the right of “strategic denial,” the ability to prevent access to the islands and their territorial waters by the military personnel of other countries or the use of the islands for military purposes. In addition, the Compact grants the United States a “defense veto” over actions by the FSM or the RMI governments that the United States determines are incompatible with its authority and responsibility for security and defense matters in these countries. Finally, through a Compact-related agreement, the United States secured continued access to military facilities on Kwajalein Atoll in the RMI through 2016.<sup>8</sup> In a previous report, we identified Kwajalein Atoll as the key U.S. defense interest in the two countries.<sup>9</sup> Of these rights, only the defense veto is due to expire in 2003 if not renegotiated.

Another aspect of the special relationship between the FSM and the RMI and the United States involves the unique immigration rights that the Compact grants. Through the original Compact, citizens of both nations are allowed to live and work in the United States as “nonimmigrants” and can stay for long periods of time, with few restrictions.<sup>10</sup> Further, the Compact exempted FSM and RMI citizens from meeting U.S. passport, visa, and labor certification requirements when entering the United States. In recognition of the potential adverse impacts that Hawaii and nearby U.S. commonwealths and territories could face as a result of an influx of FSM and RMI citizens, the Congress authorized Compact impact payments to address the financial impact of these nonimmigrants on Guam, Hawaii,

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<sup>8</sup>U.S. access to Kwajalein Atoll is established through the U.S.-RMI Military Use and Operating Rights Agreement (MUORA). Funding provided for U.S. military access to Kwajalein for the years 1987 to 2003 is estimated, on the basis of Interior data, to be \$64 million for development assistance and \$144 million for the RMI government to compensate landowners for U.S. use of their lands.

<sup>9</sup>See U.S. General Accounting Office, *Foreign Relations: Kwajalein Atoll Is the Key U.S. Defense Interest in Two Micronesian Nations*, GAO-02-119 (Washington, D.C.: Jan. 22, 2002).

<sup>10</sup>Typically, nonimmigrants include those individuals who are in the United States temporarily as visitors, students, or workers.

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and the Commonwealth of the Northern Mariana Islands (CNMI).<sup>11</sup> By 1998, more than 13,000 FSM and RMI citizens had made use of the Compact immigration provisions and were living in the three areas. The governments of the three locations have provided the U.S. government with annual Compact nonimmigrant impact estimates; for example, in 2000 the total estimated impact for the three areas was \$58.2 million. In that year, Guam received \$7.58 million in impact funding, while the other two areas received no funding.<sup>12</sup>

In the fall of 1999, the United States and the two Pacific Island nations began negotiating economic assistance and defense provisions of the Compact that were due to expire. Immigration issues were also addressed. According to the State Department, the aims of the amended Compacts are to (1) continue economic assistance to advance self-reliance, while improving accountability and effectiveness; (2) continue the defense relationship, including a 50-year lease extension (beyond 2016) of U.S. military access to Kwajalein Atoll in the RMI; (3) strengthen immigration provisions; and (4) provide assistance to lessen the impact of Micronesian migration on Hawaii, Guam, and the CNMI.

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## Amended Compacts Would Alter Assistance Levels and Structure

Under the amended Compacts with the FSM and the RMI, new congressional authorizations of approximately \$3.5 billion in funding would be required over the next 20 years, with a total possible authorization through 2026 of \$6.6 billion. Economic assistance would be provided to the two countries for 20 years – from 2004 through 2023 – with all subsequent funding directed to the RMI for continued U.S. access to military facilities in that country. Under the U.S. proposals, annual grant amounts to each country would be reduced each year in order to encourage budgetary self-reliance and transition the countries from receiving annual U.S. grant funding to receiving annual trust fund earnings. Annual grant assistance to the FSM would fall from a real value of \$76 million in fiscal year 2004 to a real value of \$55 million in fiscal year 2023. Annual grant assistance to the RMI would fall from a real value of \$35 million to a real value of \$24 million over the same period. This decrease in

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<sup>11</sup>Payments were also authorized for American Samoa, but impact compensation has not been sought.

<sup>12</sup>See U.S. General Accounting Office, *Foreign Relations: Migration From Micronesian Nations Has Had Significant Impact on Guam, Hawaii, and the Commonwealth of the Northern Mariana Islands*, [GAO-02-40](#) (Washington, D.C.: Oct. 5, 2001).



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grant funding, combined with FSM and RMI population growth, would also result in falling per capita grant assistance over the funding period – particularly for the RMI. If the trust funds established in the amended Compacts earn a 6 percent rate of return, the FSM trust fund would be insufficient to replace expiring annual grants. The RMI trust fund would replace grants in fiscal year 2024 but would become insufficient for this purpose by fiscal year 2040.

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### Amended Compacts Could Cost the U.S. Government \$6.6 Billion

Under the amended Compacts with the FSM and the RMI, new congressional authorizations of approximately \$6.6 billion could be required for U.S. payments from fiscal years 2004 to 2086, of which \$3.5 billion would be required for the first 20 years of the Compacts (see table 1). The share of new authorizations to the FSM would be about \$2.3 billion and would end after fiscal year 2023. The share of new authorizations to the RMI would be about \$1.2 billion for the first 20 years, with about \$300 million related to extending U.S. military access to Kwajalein Atoll through 2023. Further funding of \$3.1 billion for the remainder of the period corresponds to extended grants to Kwajalein and payments related to U.S. military use of land at Kwajalein Atoll.<sup>13</sup> The cost of this \$6.6 billion new authorization, expressed in fiscal year 2004 U.S. dollars, would be \$3.8 billion (see the appendix for a breakout of estimated new U.S. authorizations to the FSM and the RMI in fiscal year 2004 U.S. dollars).

This new authorized funding would be provided to each country in the form of

- annual grant funds targeted to priority areas (such as health, education, and infrastructure), audit assistance, and disaster assistance;
- contributions to a trust fund for each country such that trust fund earnings would become available to the FSM and the RMI in fiscal year 2024 to replace expiring annual grants;
- payments the U.S. government makes to the RMI government that the RMI transfers to Kwajalein landowners to compensate them for the U.S. use of their lands for defense sites; and

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<sup>13</sup>U.S. access to Kwajalein Atoll in the RMI has already been secured through 2016 through a Compact-related agreement. The U.S. proposal to the RMI extends this funding to 2066, with an additional 20-year optional lease at that point.

- an extension of federal services that have been provided under the original Compact but are due to expire in fiscal year 2003.

**Table 1: Estimated New U.S. Authorizations for the FSM and the RMI, Fiscal Years 2004-2086 (U.S. dollars in millions)**

	FSM	RMI	Total
<b>Fiscal years 2004-2023</b>			
Grants for priority areas	\$1,612	\$701 <sup>a</sup>	<b>\$2,313</b>
Trust fund contributions	517	276	<b>793</b>
Payments for U.S. military use of Kwajalein Atoll land <sup>b</sup>	Not applicable	191	<b>191</b>
Compact-authorized federal services <sup>c</sup>	167	37	<b>204</b>
New U.S. authorization for 2004-2023	\$2,296	\$1,204	<b>\$3,500</b>
<b>Fiscal years 2024-2086</b>			
Grants to Kwajalein	Not applicable	\$948 <sup>a</sup>	<b>\$948</b>
Payments for U.S. military use of Kwajalein Atoll land	Not applicable	2,133	<b>2,133</b>
Possible New U.S. authorization for 2024-2086	Not applicable	\$3,081	<b>\$3,081</b>
<b>Fiscal years 2004-2086, total new U.S. authorizations for the FSM and the RMI</b>	<b>\$2,296</b>	<b>\$4,285</b>	<b>\$6,581</b>

Source: GAO estimate based on the amended Compacts. Under the amended Compacts, U.S. payments are adjusted for inflation at two-thirds of the percentage change in the U.S. gross domestic product implicit price deflator.

Note: Numbers may not sum due to rounding.

<sup>a</sup>The 1986 U.S.-RMI Military Use and Operating Rights Agreement (MUORA) grants the United States access to certain portions of Kwajalein Atoll and provides \$24.7 million of funding for development and impact on Kwajalein from 2004 to 2016. Approximately \$112 million of the new proposed U.S. grant assistance of \$701 million is for increasing this funding to Kwajalein from 2004 to 2016 and for continuation of the increased level of funding through 2066 and possibly to 2086 if the agreement is extended.

<sup>b</sup>As part of the 1986 MUORA, the RMI government has also allocated \$162 million of U.S. funding from 2004 to 2016 under this agreement to landowners via a traditional distribution system to compensate them for the U.S. use of their lands for defense sites. The U.S. proposal increases these payments from 2004 to 2016 and continues the increased level of payments through 2066 and possibly to 2086 if the agreement is extended.

<sup>c</sup>Federal services authorized in the Compact include weather, aviation, and postal services. Services associated with the Federal Emergency Management Agency have been excluded. An estimate of assistance from the U.S. Agency for International Development's Office of Disaster Assistance has not been included.

In addition to the new authorized funding, the U.S. government has further expenditures related to the FSM and the RMI. These include (1) the cost of

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U.S. program assistance, estimated at around \$1 billion<sup>14</sup> to the two countries for the next 20 years; (2) payments previously authorized of about \$187 million for U.S. military access to Kwajalein Atoll in the RMI through 2016; and (3) oversight and administration by the Department of the Interior, estimated at a cost of around \$42 million over the 20-year period. Combining these three sources of U.S. funding (\$1.2 billion) with new authorizations (\$6.6 billion), the total U.S. cost for all Compact-related payments related to the FSM and the RMI would amount to about \$7.8 billion, including estimated inflation.

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### Amended Compacts Would Reduce U.S. Grant Support Annually

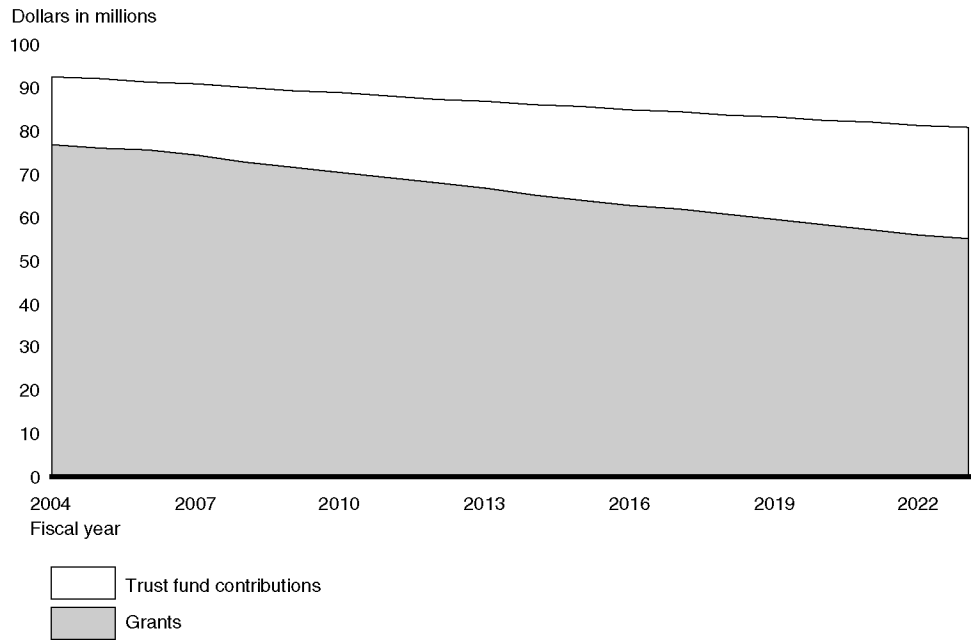
Under the U.S. proposals, annual grant amounts to each country would be reduced each year in order to encourage budgetary self-reliance and transition the countries from receiving annual U.S. grant funding to receiving annual trust fund earnings. Thus, the amended Compacts increase annual U.S. contributions to the trust funds each year by the grant reduction amount (see figs. 1 and 2). Annual grant assistance to the FSM would fall from a real value of \$76 million in fiscal year 2004 to a real value of \$55 million in fiscal year 2023.<sup>15</sup> Annual grant assistance to the RMI would fall from a real value of \$35 million to a real value of \$24 million over the same period.

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<sup>14</sup>In addition to Compact authorized federal services, numerous U.S. federal agencies extend specific programs offered in the United States, such as Pell grants and Head Start, to the FSM and the RMI in areas such as education and health. The level of this program assistance has varied over time as certain programs have been eliminated and other programs have been introduced. Currently, the U.S. Congress is reviewing a number of education programs to the FSM and the RMI, and the level of continued program assistance is uncertain.

<sup>15</sup>Although new authorization figures are provided in current dollars so that total costs to the U.S. government can be identified, this display of economic assistance is provided in fiscal year 2004 constant dollars for comparative purposes to show the impact of changes in government funding on the economy and population.

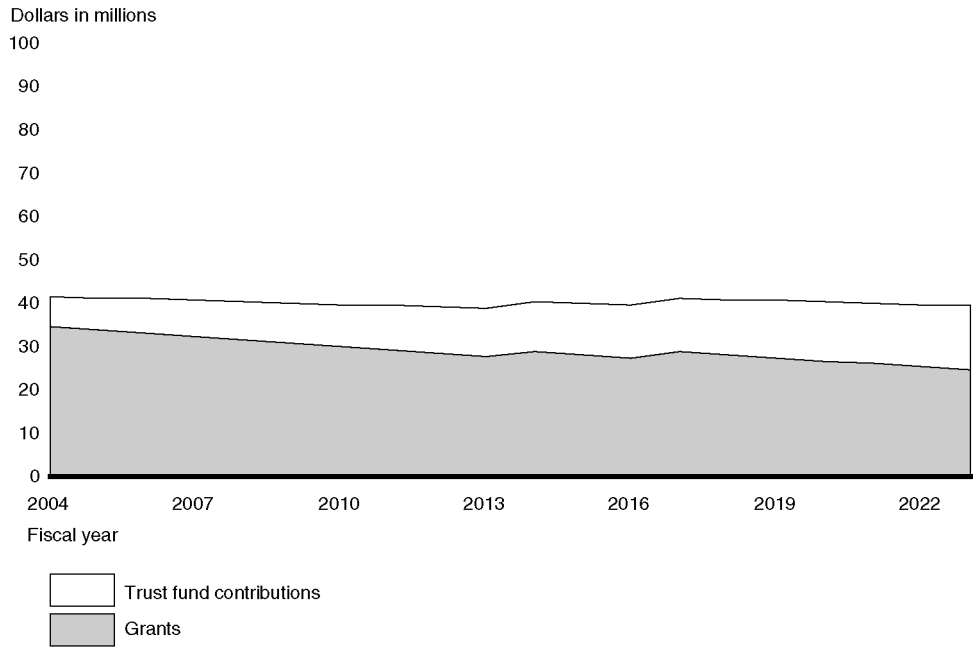
**Figure 1: Estimated New U.S. Authorizations for Economic Assistance to the FSM by Type of Funding, Fiscal Years 2004-2023 (fiscal year 2004 U.S. dollars, in millions)**



Source: GAO analysis of amended Compacts.

Note: This analysis excludes program assistance.

**Figure 2: Estimated New U.S. Authorizations for Economic Assistance to the RMI by Type of Funding, Fiscal Years 2004-2023 (fiscal year 2004 U.S. dollars, in millions)**



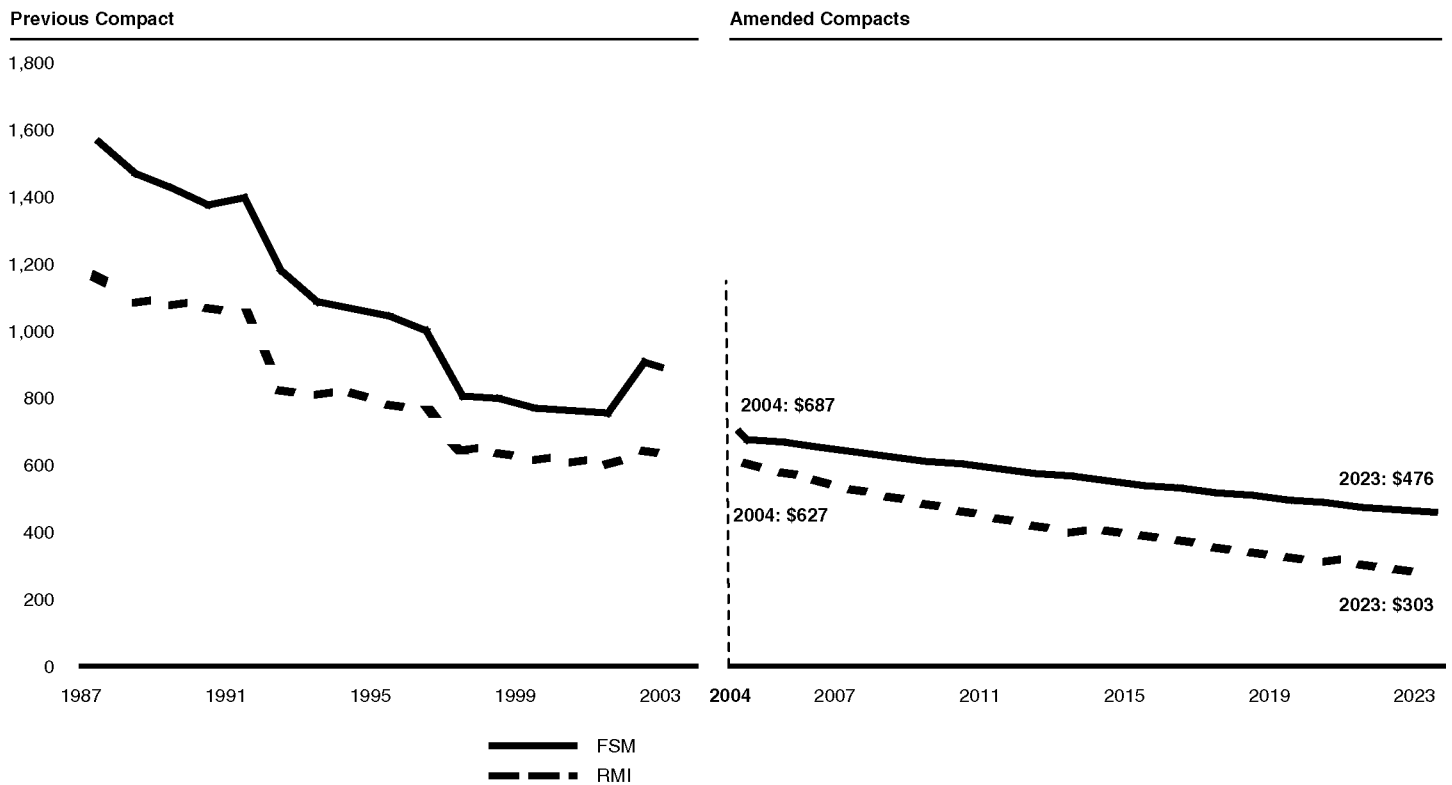
Source: GAO analysis of amended Compacts.

Note: This analysis excludes program assistance and payments for U.S. military use of Kwajalein Atoll land.

This decrease in grant funding, combined with FSM and RMI population growth, would also result in falling per capita grant assistance over the funding period – particularly for the RMI (see fig. 3).<sup>16</sup> Using U.S. Census population growth rate projections for the two countries, the real value of grants per capita to the FSM would begin at an estimated \$687 in fiscal year 2004 and would further decrease over the course of the compact to \$476 in fiscal year 2023. The real value of grants per capita to the RMI would begin at an estimated \$627 in fiscal year 2004 and would further decrease to an estimated \$303 in fiscal year 2023. The reduction in real per capita funding over the next 20 years is a continuation of the decreasing amount of available grant funds (in real terms) that the FSM and the RMI had during the 17 years of prior Compact assistance.

<sup>16</sup>The migration impact of the amended Compacts is difficult to determine, but if migration slows as a result of the amended Compacts or other economic and demographic influences, then our per capita estimates would be overstated.

**Figure 3: Estimated FSM and RMI per Capita Grant Assistance for Fiscal Years 1987-2023 (fiscal year 2004 U.S. dollars)**



Source: GAO analysis of amended Compacts.

Note: This analysis includes only Compact funds available to governments. Therefore, the analysis excludes investment development funds provided under section 111 of Public Law 99-239, trust fund contributions, federal programs and services, audit assistance, and MUORA-related lease payments that the RMI government transfers to Kwajalein landowners. U.S. Census population historical and projected population growth rates are used in conjunction with the most recent country Census data. U.S. Census projections are subject to revision.

The decline in annual grant assistance could impact FSM and RMI government budget and service provision, employment prospects, migration, and the overall gross domestic product (GDP) outlook, though the effect is likely to differ between the two countries. For example, the FSM is likely to experience fiscal pressures in 2004, when the value of Compact grant assistance drops in real terms by 8 percent relative to the 2001 level (a reduction equal to 3 percent of GDP).<sup>17</sup> For the RMI, however,

<sup>17</sup>The level of grant assistance in 2001 was converted into fiscal year 2004 dollars for comparison purposes.

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the proposed level of Compact grant assistance in 2004 would actually be 8 percent higher in real terms than the 2001 level (an increase equal to 3 percent of GDP). According to the RMI, this increase would likely be allocated largely to the infrastructure investment budget and would provide a substantial stimulus to the economy in the first years of the new Compact.

Challenges to achieving economic self-sustainability in the long run remain significant for both countries. First, education and health indicators show the need to improve basic services in these areas, as the nations face challenges with regard to literacy rates, high birth rates, and access to safe water. Second, private sector employment is largely made up of services and distribution activities that support the public sector such that employment prospects are uncertain, given declining U.S. assistance. Third, private sector growth, which would rely on expanded exports and a growing tourism industry, is limited by constraining factors common to small island economies, such as limited domestic markets, a narrow resource base, and a lack of infrastructure.<sup>18</sup> Fourth, socioeconomic activities, infrastructure, and population may be vulnerable to the impacts of climate change because the two countries could experience coastal inundation, more frequent droughts and floods, and increases in tropical cyclone intensities that could damage transport infrastructure.<sup>19</sup>

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## Trust Funds May Be Insufficient to Replace Expiring Grants

Given the challenges for achieving economic self-sustainability, the amended Compacts were designed to build trust funds that, beginning in fiscal year 2024, yield annual earnings to replace grant assistance that ends in 2023. Both the FSM and the RMI are required to provide an initial contribution to their respective trust funds of \$30 million. In designing the trust funds, the State Department assumed that the trust fund would earn

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<sup>18</sup>Potential sources of private sector growth include export earnings from three sectors: commercial agriculture, fisheries, and tourism.

<sup>19</sup>The Intergovernmental Panel on Climate Change predicts that rising sea levels over the next 50 years will result in land loss for areas in the RMI and the FSM that will disrupt virtually all economic and social sectors. The sea level rises could trigger significant migration because resettlement within national boundaries, or abandonment of some atolls altogether, may be the only viable option, with substantial costs for resettlement. For example, in the RMI the average elevation on Majuro is 2.2 meters. In Kwajalein Atoll, Ebeye's average elevation is 2.2 meters, and the maximum elevation is 2.5 meters.

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a 6 percent rate of return.<sup>20</sup> The amended Compacts do not address whether trust fund earnings should be sufficient to cover expiring federal services, but they do create a structure that sets aside earnings above 6 percent, should they occur, that could act as a buffer against years with low or negative trust fund returns. Importantly, whether the estimated value of the proposed trust funds would be sufficient to replace grants or create a buffer account would depend on the rate of return that is realized (see table 2).<sup>21</sup>

- If the trust funds earn a 6 percent rate of return, then the FSM trust fund would yield a return of \$57 million in fiscal year 2023, an amount insufficient to replace expiring grants by an estimated value of \$27 million. The RMI trust fund would yield a return of \$33 million in fiscal year 2023, an estimated \$5 million above the amount required to replace grants in fiscal year 2024. Nevertheless, the RMI trust fund would become insufficient for replacing grant funding by fiscal year 2040.
- If the trust funds are comprised of both stocks (60 percent of the portfolio) and long-term government bonds (40 percent of the portfolio) such that the forecasted average return is around 7.9 percent, then both trust funds would yield returns sufficient to replace expiring grants and to create a buffer account. However, while the RMI trust fund should continue to grow in perpetuity, the FSM trust fund would eventually deplete the buffer account and fail to replace grant funding by fiscal year 2048.

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<sup>20</sup>The State Department chose a 6 percent return in order to reflect a conservative investment strategy. This rate of return can be compared with the current average forecasted return for long-term U.S. government bonds of 5.8 percent by the Congressional Budget Office.

<sup>21</sup>This analysis does not take into account volatile or negative returns. The sufficiency of either the FSM or the RMI trust fund to replace grants has not been tested under conditions of market volatility.



**Table 2: Estimated Performance for the FSM and the RMI Trust Funds under Alternative Rates of Return (U.S. dollars in millions)**

	Fund earns State Dept. assumed return (6%)		Fund earns return from 60% stocks and 40% long-term government bonds (7.9%)	
	FSM	RMI	FSM	RMI
Projected value of trust fund at the end of FY 2023	\$1,013	\$575	\$1,255	\$717
Projected value of FY 2023 trust fund return	57	33	92	53
Surplus of FY 2023 trust fund return over FY 2024 required grant funding	-27	5	8	25
Year when trust fund return is unable to replace grant funding	FY 2024	FY 2040	FY 2048	<sup>a</sup>

Source: GAO estimate based on amended Compacts adjusted for expected inflation.

Note: The historic average real rate of return from the U.S. stock market has been 7 percent. Assuming a trust fund based on 60 percent stocks, which at a forecasted inflation rate of 2.2 percent would earn a 9.2 percent return, and 40 percent long-term U.S. government bonds, which would earn the forecasted nominal rate of return of 5.8 percent, a nominal rate of return of 7.9 percent could be achieved for the trust fund. The estimated value of the trust funds includes monies accrued in the buffer accounts and reflect the initial contribution made by the FSM and the RMI to their respective trust funds.

<sup>a</sup>The RMI trust fund under this scenario continues to grow in perpetuity. However, this analysis assumes a steady real rate of return and does not account for volatility in returns.

## Amended Compacts Have Strengthened Accountability Over U.S. Assistance

I will now discuss provisions in the amended Compacts designed to provide improved accountability over, and effectiveness of, U.S. assistance. This is an area where we have offered several recommendations in past years, as we have found accountability over past assistance to be lacking. As I discuss key proposed accountability measures, I will note where appropriate whether our previous recommendations have been addressed. In sum, most of our recommendations regarding future Compact assistance have been addressed with the introduction of strengthened accountability measures in the signed amended Compacts and related agreements. I must emphasize, however, that the extent to which these provisions will ultimately provide increased accountability over, and effectiveness of, future U.S. assistance will depend upon how diligently the provisions are implemented and monitored by all governments.

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The following summary describes key accountability measures included in the amended Compacts and related agreements:

- The amended Compacts would require that grants be targeted to priority areas such as health, education, the environment, and public infrastructure.<sup>22</sup> In both countries, 5 percent of the amount dedicated to infrastructure, combined with a matching amount from the island governments, would be placed in an infrastructure maintenance fund. We recommended in a September 2000 report that the U.S. government should negotiate provisions that would provide future Compact funding through grants targeted to priority areas and that funding should be set aside for infrastructure maintenance.<sup>23</sup>
- Compact-related agreements with both countries (the so-called “fiscal procedures agreements”) would establish a joint economic management committee for the FSM and the RMI that would meet at least once annually. The duties of the committees would include (1) reviewing planning documents and evaluating island government progress to foster economic advancement and budgetary self-reliance; (2) consulting with program and service providers and other bilateral and multilateral partners to coordinate or monitor the use of development assistance; (3) reviewing audits; (4) reviewing performance outcomes in relation to the previous year’s grant funding level, terms, and conditions; and (5) reviewing and approving grant allocations (which would be binding) and performance objectives for the upcoming year. In our previously cited 2000 report, we recommended that the U.S. government negotiate an expanded agenda for future annual consultations. Further, the fiscal procedures agreements would give the United States control over the annual review process: The United States would appoint three government members to each committee, including the chairman, while the FSM or the RMI would appoint two government members.
- Grant conditions normally applicable to U.S. state and local governments would apply to each grant. General terms and conditions for the grants would include conformance to plans, strategies, budgets, project

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<sup>22</sup>Public infrastructure projects would be focused in the areas of education, health, and safety. Progress reports for each project would be required, and funding would be provided on a reimbursable basis. For the RMI, not less than 30 percent or more than 50 percent of the annual grant assistance would be available for public infrastructure projects.

<sup>23</sup>See U.S. General Accounting Office, *Foreign Assistance: U.S. Funds to Two Micronesian Nations Had Little Impact on Economic Development*, [GAO/NSIAD-00-216](#) (Washington, D.C.: Sept. 22, 2000) for a review of the first 12 years of direct Compact assistance.

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specifications, architectural and engineering specifications, and performance standards. Other special conditions or restrictions could be attached to grants as necessary. Specific post-award requirements address financial administration by establishing, for example, (1) improved financial reporting, accounting records, internal controls, and budget controls; (2) appropriate use of real property and equipment; and (3) competitive and well-documented procurement. In our 2000 report, we recommended that future assistance be provided with grants that had specific requirements.

- The United States could withhold payments if either country fails to comply with grant terms and conditions. The withholding amount would be proportional to the breach of the term or condition. In addition, funds could be withheld if the FSM or RMI governments do not cooperate in U.S. investigations regarding whether Compact funds have been used for purposes other than those set forth in the amended Compacts. In our 2000 report, we recommended that withholding of funds be allowed.
- The fiscal procedures agreements would require numerous reporting requirements for the two countries. For example, each country must prepare strategic planning documents that are updated regularly, annual budgets that propose sector expenditures and performance measures, annual reports to the U.S. President regarding the use of assistance, quarterly and annual financial reports, and quarterly grant performance reports. In our 2000 report, we recommended that expanded reporting requirements be negotiated.
- The amended Compacts' trust fund management agreements would grant the U.S. government control over trust fund management: The United States would appoint three members, including the chairman, to a committee to administer the trust funds, while the FSM or the RMI would appoint two members. After the initial 20 years, the trust fund committee would remain the same, unless otherwise agreed by the original parties. We have reported that well-designed trust funds can provide a sustainable source of assistance and reduce long-term aid dependence.<sup>24</sup>

The fiscal procedures agreements would require the joint economic management committees to consult with program providers in order to coordinate future U.S. assistance. However, we have seen no evidence

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<sup>24</sup>See U.S. General Accounting Office, *Foreign Assistance: Lessons Learned From Donors' Experiences in the Pacific Region*, GAO-01-808 (Washington, D.C.: Aug. 17, 2001).

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demonstrating that an overall assessment of the appropriateness, effectiveness, and oversight of U.S. programs, as we recommended, has been conducted.<sup>25</sup>

The successful implementation of the many new accountability provisions will require a sustained commitment by the three governments to fulfill their new roles and responsibility. Appropriate resources from the United States, the FSM, and the RMI represent one form of this commitment. While the amended Compacts do not address staffing issues, officials from Interior's Office of Insular Affairs have informed us that their office intends to post six staff in a new Honolulu office. According to an Interior official, these staff will consist of a health grant specialist, an education grant specialist, an accountant, an economist, an auditor, and an office assistant. Interior can also contract with the Army Corps of Engineers for engineering assistance when necessary. Honolulu-based staff may spend about half of their time in the FSM and the RMI. Further, an Interior official noted that his office has brought one new staff on board in Washington, D.C., and intends to post one person to work in the RMI (one staff is already resident in the FSM). We have not conducted an assessment of Interior's staffing plan and rationale and cannot comment on the adequacy of the plan or whether it represents sufficient resources in the right location.

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## Amended Compacts Address Other Key Areas

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### U.S. Military Access to Kwajalein Atoll Could Be Extended Until 2086

The most significant defense-related change in the amended Compacts is the extension of U.S. military access to Kwajalein Atoll in the RMI. While the U.S. government had already secured access to Kwajalein until 2016 through the 1986 MUORA, the newly revised MUORA would grant the United States access until 2066, with an option to extend for an additional 20 years to 2086. According to a Department of Defense (DOD) official, recent DOD assessments have envisioned that access to Kwajalein would be needed well beyond 2016. He stated that DOD has not undertaken any further review of the topic, and none is currently planned. This official

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<sup>25</sup>This recommendation was included in [GAO-02-70](#).

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also stated that, given the high priority accorded to missile defense programs and to enhancing space operations and capabilities by the current administration, and the inability to project the likely improvement in key technologies beyond 2023, the need to extend the MUORA beyond 2016 is persuasive. He also emphasized that the U.S. government has flexibility in that it can end its use of Kwajalein Atoll any time after 2023 by giving advance notice of 7 years and making a termination payment.

We have estimated that the total cost of this extension would be \$3.4 billion (to cover years 2017 through 2086).<sup>26</sup> The majority of this funding (\$2.3 billion) would be provided by the RMI government to Kwajalein Atoll landowners, while the remainder (\$1.1 billion) would be used for development and impact on Kwajalein Atoll. According to a State Department official, there are approximately 80 landowners. Four landowners receive one-third of the annual payment, which is based on acreage owned. This landowner funding (along with all other Kwajalein-related funds) through 2023 would not be provided by DOD but would instead continue as an Interior appropriation. Departmental responsibility for authorization and appropriation for Kwajalein-related funding beyond 2023 has not been determined according to the State Department. The Kwajalein Atoll landowners have not yet agreed to sign an amended land-use agreement with the RMI government to extend U.S. access to Kwajalein beyond 2016 at the funding levels established in the amended Compact.

A few expiring provisions would be extended indefinitely in the amended Compacts. The “defense veto” – the ability of the United States to veto actions by the FSM or the RMI governments that the United States determines are incompatible with U.S. authority and responsibility for security and defense matters in the two countries – has been extended. In addition, the ability of FSM and RMI citizens to volunteer to serve in the U.S. military would be extended. According to a DOD official, this is a beneficial provision since it, for example, gives the United States access to persons with specialized knowledge and understanding of Pacific cultures while also providing career opportunities for FSM and RMI citizens.<sup>27</sup>

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<sup>26</sup>Our figure of \$3.4 billion is adjusted for inflation.

<sup>27</sup>In the amended Compacts, DOD’s civic action teams have been eliminated. Both countries would now have access to humanitarian assistance programs that would emphasize health, education, and infrastructure projects that DOD would carry out.

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## Amended Compacts Would Strengthen Immigration Provisions

While the original Compact's immigration provisions are not expiring, the State Department targeted them as requiring changes. The amended Compacts would strengthen the immigration provisions of the Compact by adding new restrictions and expressly applying the provisions of the INA to Compact nonimmigrants.<sup>28</sup> There are several new immigration provisions in the amended Compacts that differ from those contained in the original Compact (see table 3).

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<sup>28</sup>As noted in the Background section, FSM and RMI citizens who enter the United States are legally classified as "nonimmigrants" – that is, individuals who are in the United States temporarily as visitors, students, or workers.

**Table 3: Key Immigration Issues: A Comparison of the Original and Amended Compacts**

Issue	Original Compact	Amended Compacts
Passports	Compact nonimmigrants do not need a passport to be admitted to the United States.	Compact nonimmigrants would need a valid passport in order to be admitted into the United States.
Entry into the United States for naturalized FSM and RMI citizens	Naturalized FSM and RMI citizens are eligible to apply for admission to the United States 5 years after they are naturalized, so long as they were a resident of the FSM or the RMI during that time.	Naturalized citizens would only be admissible if they are immediate relatives of a citizen of the FSM or the RMI or if they were naturalized before April 30, 2003. <sup>a</sup>
Entry into the United States for the purpose of adoption	A child who came to the United States for the purpose of adoption is not expressly prohibited from seeking admission into the United States under the Compact. However, the United States government has maintained that such children are not admissible under the Compact, but, rather, that they had to seek admission under general immigration requirements for adopted children.	A child who is coming to the United States for the purpose of adoption would not be admissible under the amended Compacts. Instead, these children would have to apply for admission to the United States under the general immigration requirements for adopted children. This provision would apply to any child who applied for admission to the United States on or after March 1, 2003.
Conditions on admission to the United States and its territories or possessions for Compact nonimmigrants	The United States has the authority to establish limitations, either in statutes or regulations, on a Compact nonimmigrant's right to establish habitual residence in a territory or possession of the United States. <sup>b</sup>	The Attorney General would have the authority to issue regulations that specify the time and conditions of a Compact nonimmigrant's admission into the United States. <sup>c</sup>

Source: GAO legal analysis of the original and amended Compacts.

Note: In addition, any of the authorities in the amended Compacts that the United States may exercise could also be exercised by the governments of the U.S. territories or possessions where the INA does not apply (i.e., the CNMI and American Samoa), so long as the exercise of such authority is lawful under the laws of that territory or possession.

<sup>a</sup>Such naturalized citizens would also have to meet additional requirements, including residency requirements, unless they are an immediate relative of a citizen of the FSM or the RMI who is serving in the U.S. military.

<sup>b</sup>The United States promulgated regulations in September 2000 regarding the rights and limitations of habitual residents in the territories and possessions of the United States. These regulations applied to Compact nonimmigrants in Guam, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands. They did not apply to Compact nonimmigrants residing in the 50 states, the District of Columbia, American Samoa, or the CNMI.

<sup>c</sup>The INA would now expressly apply to any Compact migrant who seeks admission or is admitted to the United States. As such, in addition to the Attorney General's authority to promulgate regulations, any grounds of inadmissibility or deportability under the INA would now apply to Compact migrants except where the amended Compacts specify otherwise. Some modifications, however, were made to the INA provision, section 237(a)(5), allowing for deportation on the basis of an alien becoming a public charge.

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In addition, the implementing legislation for the amended Compacts would provide \$15 million annually for U.S. locations that experience costs associated with Compact nonimmigrants. This amount would not be adjusted for inflation, would be in effect for fiscal years 2004 through 2023, and would total \$300 million. Allocation of these funds between locations such as Hawaii, Guam, and the CNMI would be based on the number of nonimmigrants in each location.

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

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## Contacts and Acknowledgments

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



# Appendix: Estimated New U.S. Authorizations to the FSM and the RMI in Fiscal Year 2004 U.S. Dollars

The estimated value of new congressional authorizations to the FSM and the RMI would be approximately \$3.8 billion from fiscal years 2004 to 2086 measured in fiscal year 2004 dollars (see table 4).

**Table 4: Estimated New U.S. Authorizations for the FSM and the RMI, Fiscal Years 2004-2086 (Fiscal Year 2004 U.S. Dollars in Millions)**

	FSM	RMI	Total
<b>Fiscal years 2004-2023</b>			
Grants for priority areas	\$1,323	\$572	<b>\$1,895</b>
Trust fund contributions	411	218	<b>628</b>
Payments for U.S. military use of Kwajalein Atoll land	Not applicable	144	<b>144</b>
Compact-authorized federal services	135	30	<b>165</b>
New U.S. authorization for 2004-2023	\$1,868	\$963	<b>\$2,832</b>
<b>Fiscal years 2024-2086</b>			
Grants to Kwajalein	Not applicable	\$306	<b>\$306</b>
Payments for U.S. military use of Kwajalein Atoll land	Not applicable	688	<b>688</b>
New U.S. authorization for 2024-2086	Not applicable	\$993	<b>\$993</b>
<b>Fiscal years 2004-2086, total new U.S. authorizations for the FSM and the RMI</b>	<b>\$1,868</b>	<b>\$1,956</b>	<b>\$3,825</b>

Source: GAO estimate based on the amended Compacts.

Note: Numbers may not sum due to rounding.

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