

**STATEMENT OF THE HONORABLE GERALD M. ZACKIOS,
MINISTER OF FOREIGN AFFAIRS,
REPUBLIC OF THE MARSHALL ISLANDS
BEFORE THE
HOUSE OF REPRESENTATIVES COMMITTEE ON NATURAL
RESOURCES, SUBCOMMITTEE ON INSULAR AFFAIRS
REGARDING IMPLEMENTATION OF THE COMPACT OF FREE
ASSOCIATION, AS AMENDED**

July 24, 2007

Madame Chairwoman, Distinguished Members, Ladies and Gentlemen:

Thank you for the opportunity to appear before you today. His Excellency President Kessai H. Note sends his warm personal regards and thanks the Subcommittee for convening this hearing so that we may present our views on implementation of the Compact, as amended.

I testified before this honorable Committee on July 10, 2003, to encourage Congressional support and approval of the Compact of Free Association, as amended. In November, 2003, the U.S. Congress approved the Compact, as amended, and it was signed into law the following month. In January, 2004, the Marshall Islands Nitijela approved the Compact, as amended, which came into effect on May 1, 2004, coinciding with the 25th anniversary of our Constitution.

The Government of the Republic of the Marshall Islands (RMI) has also appreciated the opportunity to work closely with your Staff Director Tony Babauta and Subcommittee Counsel Brian Modeste these past several months. Their hard work is appreciated by our Government.

Over three years have now passed since the amended Compact became law, and it is appropriate that we consider the progress and problems we have experienced to date. I would like to take this opportunity to thank the GAO for their reports on implementation of the Compact, as amended. These reports provide important insight into the early implementation of the amended Compact, and while we have some disagreement with some of the GAO recommendations, by and large their input and counsel is very much appreciated by our Government.

Compact Sector Grants

Overall, we have made a great deal of progress with respect to implementing the Compact, as amended. The procedures we developed regarding the Joint Economic Management and Financial Accountability Committee (JEMFAC) have worked well through a process of requiring consensus between our two governments on the allocation

and division of Compact annual sector grant funding.

During the past three years, the RMI Government has invested heavily in the Education, Health, and Public Infrastructure sectors in terms of allocating available annual grant funding—in fact, the Public Infrastructure grant allocations have been mostly for improving education and health facilities. The Health and Education sectors are identified within the body of the Compact as priority sectors. The RMI Government intends to remain fully committed and focused on improving our education and health outcomes.

Our Government has also done much to improve the groundwork for more robust private sector development with enactment of further changes to our land registration laws, enactment of a secured transactions law, and other reforms to create an environment conducive to the private sector growth. I must, however, mention one aspect of the amended Compact which is not consistent with our mutual desire to promote private sector development. I am referring to the Postal Services Agreement under the new Federal Programs and Services Agreement, which imposes international rates on mail sent to the RMI and makes other unfavorable changes to the previous Postal Services Agreement. The current Postal Services Agreement has been bitterly opposed by our Chamber of Commerce, has substantially increased the cost of doing business in the RMI, and serves as a disincentive for RMI-U.S. commerce. I would therefore, ask for the Subcommittee's support in encouraging the USPS to engage our Government in restoring these lost benefits and amending the current Postal Services Agreement.

We believe that implementation of the accountability provisions in the amended Compact in respect to annual sector grant funding has to date, been largely a success for the RMI. We must, however, continue to improve on our performance and see positive and measurable results that will encourage greater ownership of the new system within our government, and to the Marshallese people who are the real beneficiaries of better accountability and good governance.

I mention “ownership” because that is the most crucial component to a successful implementation of the new annual grant procedures and new Fiscal Procedures Agreement (FPA). Contrary to the statements by people who have opposed the Compact, as amended, many of these procedures were already part of the domestic law of the RMI. We already had a Financial Management Act and Procurement Act which, in many respects, mirror provisions of the new FPA. The problem was that these laws were largely ignored in the past.

As we have endeavored to usher in an era of greater accountability, we are cognizant that such efforts must start from the top. As we move forward and enforce our own laws, we are aware that problems with local capacity remain, and must be resolved if we are to institutionalize the changes we are undertaking.

The RMI has also moved forward over the past three years with taking measures to implement the Compact, as amended, and adopting a system of performance based budgeting within the government. We started this program with the core sectors of Health and Education. We are now moving to a performance based budget system within other

sectors of the government that are not funded from the Compact.

Consequently, we are gradually seeing how performance based budgeting can be an important management tool within the government; to better plan out government's activities; and to measure the results of those activities over time. This is why ownership is so important. We need to understand and implement these processes not because someone is telling us to do so, but because we understand their benefits and choose to do so. This is the difference between going through the motions of a procedure simply because it is required, and adopting a system because you know and understand that it will lead to better performance and better results.

This is also why it is necessary for the Department of Interior to show restraint and understanding as our government moves forward on implementation of annual sector grant assistance. While the RMI realizes that we have internal capacity issues and constraints, DOI must similarly realize that micromanagement and imposing additional burdensome requirements will more likely result in resentment, and not progress.

The reporting obligations of the new Compact are the key to monitoring this progress. Our capacity is growing to meet these many requirements and the most critical among these is the annual report to the President of the United States on the progress of the Compact implementation. I think it is true to say that both sides recognize that the present timing for the preparation of this report is unrealistic and I would suggest that this is an area in need of review if we are to best reflect the Compact's progress.

We also see the need for the foreseeable future to coordinate Compact activities within the Government through a viable framework that focuses only on matters related to the Compact. In this respect, I am pleased to announce that our Cabinet has recently approved the formal creation of an Office of Compact Implementation that will oversee all aspects of Compact implementation on behalf of the RMI.

Full Inflation Adjustment

While I do not wish to dwell on the past, I would like to raise again a couple of issues I mentioned in my Statement of July 10, 2003, with respect to outstanding matters in the Compact as amended, that needed to be addressed.

The first issue that I mentioned in my statement before this Committee in 2003 was the need for a full inflation adjustment. At that time, I stated:

“First, a full inflation adjustment for Compact funds so that the grant assistance and compensation provided by the Compact does not lose real value and fully supports the Compact's mutual commitments. We do not know why a partial adjustment is mandated unless the United States has the intention of deflating the grant assistance and compensation, and thus our budget and economy. I would like to draw you and your staff's attention to one chart in our Issue Paper that is particularly interesting. The chart shows the amount of funds we are losing to inflation as well as to the grant assistance decrement. While we can achieve more revenue generation and cut budget costs to fill

this increasing gap, we cannot do it with such a rapid decline in the funding. A full inflation adjustment would reduce this gap and make fiscal stability more manageable.”

The issue of full inflation continues to be problematic for the RMI in terms of the Government maintaining fiscal stability as annual grant assistance declines over the years as was predicted by the RMI four years ago. The GAO also dedicated an entire report to dealing with the long term effect of declining grant assistance under the amended Compact. In the RMI’s comments to the GAO Report in November, 2006, we noted:

“One of the major challenges regarding social and economic stability remains the size of the annual decrement of the Compact Title Two Section 211 sector grant funding (\$500,000) and the only partial inflation adjustment. The resulting significant annual decline in the nominal and real value of this funding will place pressure on providing adequate social services and fiscal stability as well as impact private sector performance. This is despite the changes the RMI is making in focusing amended Compact funding mainly on health, education and infrastructure development and maintenance.”

Recently, this situation has been further exacerbated by rapidly rising costs of imported fuel, which is causing major problems with the provision of public utilities and inter-island services for our widespread communities and creating an overall inflationary effect that is putting a damper on our economic growth.

Although annual decrements of \$500,000 are a major improvement over the original Compact with decreases of \$4 million every four years, these decrements over time may result in the same problems that plagued the RMI under the original Compact that cannot be overcome through reducing essential government services or changing the tax structure. Full inflation adjustment to amounts provided under Article II of the amended Compact remains an important issue, and one if not addressed in the short term, will cause significant fiscal problems in the long term.

Supplemental Education Grants

The second issue that I raised in my testimony of July 10, 2003, concerned the elimination of eligibility for many federal education programs that the RMI had received during the term of the original Compact.

This issue was addressed through provision of a supplemental education grant (SEG) of \$6.1 million annually, to be adjusted for inflation which was to allow the RMI Government to design and implement education programs to replace those lost through the termination of certain federal programs. These funds were to be made available to the RMI within 60 days after the date of appropriation.

Unfortunately, these appropriations have taken place well into the fiscal year, and delays in the RMI receiving the funds have been in excess of six months as opposed to 60 days as required by law. In addition, rather than adjusting the \$6.1 million for inflation, the RMI has seen this amount decrease over the years as it has been subject to across the board budget cuts. For example, over the past two fiscal years there has been a \$712,000

shortfall between the planned SEG amounts, and the actual amounts appropriated. There is now a real danger of creating a *de facto* ceiling for the SEG that is below the authorized amount, and does not include inflation.

These problems arise as a result of the fact that SEG funding is an annual discretionary appropriation under the U.S. Compact of Free Association Amendments Act 2003. This has caused tremendous problems for our Ministry of Education in developing and implementing crucial education programs supplementing the Education sector grant in the Compact. In addition, the lower amount will impact education sector performance by limiting the scope and depth of sector operational, development and reform activities.

This issue is of such great importance to the RMI that on March 8, 2006, President Note wrote a letter to Secretary Spelling asking that the SEG be made available as a permanent appropriation in the same manner as other Compact assistance.

I would now ask the Administration and Congress once again to make provision that the SEG be made available to the RMI as a permanent appropriation and adjusted for inflation in the same manner as other financial assistance under the Compact. This will be crucial for the success of efforts to improve the educational outcomes for the Marshallese people.

Trust Fund

The Compact of Free Association, as amended, also includes provision for a Trust Fund which will build up until 2023, at which time income from the Trust Fund will be made available to the RMI to coincide with the end of annual grant assistance.

As we noted in our comments to the last GAO Report, we agree with their findings questioning the adequacy of the Trust Fund in 2023 to fulfill its purpose. What became clear in the U.S. agency comments to the GAO Report is that there are differences of opinion as to the purposes of the Compact Trust Fund.

References are made to the negotiations history of the Trust Fund Agreement (TFA), and in particular to Article 3 of the TFA which states that the Fund is to provide an annual source of revenue after 2023.

This provision and others were hotly debated during the negotiations, but Article 3 cannot be viewed as a stand-alone provision. Rather, the TFA must be read as a whole, and when one does that, it is clear that the goal established in the Agreement is to provide for a smooth transition between the end of annual economic assistance, and income from the Trust Fund. The TFA also provides that starting in FY 2024, the RMI may receive an amount equal to the annual grant assistance in 2023 plus full inflation. The Agreement does not say “up to” that amount or any other amount, and the negotiating history will show that the reason the word “may” appears rather than “shall” is that the disbursement of the funds would be based on RMI compliance with whatever rules are in place at that time governing their use. Since this reference is the only reference in the TFA to amounts

available starting in FY 2024, and thereafter, we believe that this is the benchmark that we should be striving to achieve in the future.

We point this out not for the reason of engaging in another protracted debate on the purpose of the Trust Fund, but to point out that the Fund should have goals other than simply saying that it will produce revenues starting in FY 2024. Our discussion should center around what can be done between now and then to maximize Trust Fund income and to make it viable in the future.

There are many ways in which future viability of the Trust Fund can be achieved. Over the past year, the TFC has considered the possibility of securitizing future U.S. contributions to the Trust Fund. This could permit investment of larger amounts in the early years allowing the corpus and income producing potential of the Fund to substantially increase over current projections. The RMI Government looks forward to receiving a report on the advisability and risk of securitizing future U.S. contributions, but urges that this be done as quickly as possible since this is a time sensitive concept. If feasible, we would strongly support securitization of future Trust Fund contributions.

A second way to improve the long-term viability of the Fund would be to extend the term of annual grant assistance for at least another two years before distributing income from the Trust Fund. This would be consistent with the intent of both governments when the Trust Fund was originally negotiated, and it was anticipated that the Fund would be invested for a full 20 years before it would be expected to produce annual income. This did not happen due to the delay in approving and implementing the Compact, and the wording of Section 216(b) of the amended Compact.

Another way to improve the Trust Fund's viability would be to attract additional subsequent contributors to the Fund. The RMI is most pleased that it was able to bring Taiwan in as a subsequent contributor to the Fund, and looks forward to participation by other Subsequent Contributors. In this respect, we would encourage the U.S. Government to actively seek additional contributions from other sources as the RMI has done over the past three years.

Finally, we were anticipating that a technical amendment would be included in H R 2705, the Compacts of Free Association Amendments Act of 2007, which would allow the RMI and U.S. Governments to make certain technical amendments to the Trust Fund Agreement regarding the Fund custodian and sub-custodian in order to facilitate investments by the Investment Advisor, Goldman Sachs, and to streamline the cumbersome process noted by the GAO in their report. It is our understanding that the Administration had submitted such an amendment, but it does not seem to have been included in the current version of HR 2705.

The good news about problems concerning the future adequacy and viability of the Trust Fund is that there is time to take measures to address these concerns. The RMI believes, however, that these measures need to be taken as quickly as possible. Already there is concern among the Marshallese people that the Trust Fund will not be a viable and sustainable source of revenue in the future. This belief was further supported by the

findings of the GAO in their Report. As time passes, this will lead to increased migration as people will lack confidence in the future of their nation.

Both Governments have a strong interest in seeing to it that the Trust Fund is successful, and fulfills its purpose.

Kwajalein

No discussion of implementation of the Compact, as amended, by the RMI would be complete without referring to the situation with respect to Kwajalein, the MUORA, and land use issues.

The Compact, as amended, also amends the Military Use and Operating Rights Agreement (MUORA) and Status of Forces Agreement (SOFA) between our two governments. The economic provisions of these changes are reflected in Sections 211(b) and 212 of the Compact, as amended.

Section 211(b)(2) provides for the continuation of what had previously been referred to as “impact funding” under Section 213 of the original Compact, but unlike the original Compact, is now partially adjusted for inflation. This payment is to be made as long as the MUORA is in effect. Despite a great deal of acrimony between the Government and the Kwajalein leadership, these funds are currently being utilized for their intended purposes on a somewhat limited basis. I have attached a letter to this statement dated June 29, 2007, that I sent to the Kwajalein leadership on behalf of President Note expressing our concern about the fact that these funds were not being put to use for the improvement of the Ebeye community.

Section 212 entitled “Kwajalein Impact and Use” provides the sum of \$15 million annually, adjusted for inflation, from FY 2004 to FY 2013. Starting in FY 2014, this amount is increased to \$18 million annually, or the \$15 million plus inflation adjustment, whichever is greater for the term of the MUORA.

The amended MUORA provides for U.S. use of Kwajalein until at least 2023, and possibly until 2086.

The RMI Government views the U.S. base at Kwajalein as a national asset and of great importance to our development and economy. This was the view we brought to the Compact negotiations and we were pleased that the U.S. also saw the Compact negotiations as an opportunity to provide for the use of Kwajalein on a long term basis.

Unfortunately, many of the Kwajalein landowners have not seen the use of Kwajalein from the same perspective. The amended MUORA requires that the RMI Government enter into a new or amended Land Use Agreement to amend or replace the existing Land Use Agreement of 1982, which expires in 2016.

This problem was known when Congress approved the Compact, as amended, and provision was made that the difference between what the Kwajalein landowners were

receiving under the LUA of 1982, and what they would receive under a revised LUA pursuant to the amended MUORA would be put in an escrow account until a revised LUA was concluded, or for a term of 5 years. If at the end of 5 years from the date of enactment of the Compact legislation, (November, 2008), there is no revised LUA, the funds are to be paid back to the U.S. Treasury or as otherwise agreed between the two governments. Presently, the balance in the escrow account is approximately \$16 million.

Although the RMI has offered to meet with the Kwajalein leadership and landowners on many occasions, and has proffered a draft Amended LUA to conform with the Amended MUORA, the Kwajalein leadership has refused to meet with the government to discuss a way forward on this issue.

Instead, the Government has been falsely accused of excluding the Kwajalein landowners from the Compact negotiations. Unlike the original Compact negotiations, the Kwajalein landowners were specifically included during the amended Compact negotiations, and met jointly with the RMI and U.S. negotiating teams on several occasions. We know that the record reflects this fact.

There is nothing new to this pattern and it serves to demonstrate that Kwajalein matters must be kept on a government to government basis. The Kwajalein leadership/landowners will continue to attempt to deal directly with the U.S. Government to achieve their goals. We can only hope that the U.S. government supports and does not undermine our efforts in this regard.

The problem with implementing provisions of the amended Compact as they relate to Kwajalein continues to be a very divisive internal political issue within the RMI, and I don't believe that it is appropriate to air those internal problems here. Our Government wants to move forward on Kwajalein as we know that it is our national interest to do so. In this respect, we will continue to press forward in working toward a new or amended LUA.

Section 177 and Nuclear Issues

Amendments were not made to the Section 177 Agreement during negotiations for the amended Compact since the RMI was told by the U.S. Compact Negotiator that those issues would be addressed by Congress pursuant to the Changed Circumstances Petition our Government submitted in September, 2000.

I was most pleased to be able to represent the RMI Government during a joint House Resources and House International Relations Committee hearing regarding these issues on May 25, 2005, and I welcomed former Chairman Pombo's statement at the conclusion of the hearing that he believed that the RMI had demonstrated that changed circumstances exist.

We look forward to continuing to work with the Subcommittee on these difficult issues, and would appreciate the Subcommittee's support for our efforts in the Senate to move matters forward.

Thank you for the opportunity today to express our views on implementation of the Compact of Free Association, as amended.