



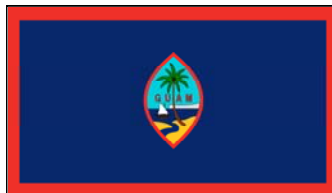
U N I T E D S T A T E S
DEPARTMENT OF THE INTERIOR
OFFICE OF INSULAR AFFAIRS

**A Private Sector Assessment for
Guam**

2006 Island Fellows

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I. Foreword

This report is designed to be helpful to Guam's policymakers who are looking for ways to make Guam more hospitable for private sector economic development. We don't pretend to have all of the answers; we're just trying to make a constructive contribution to the conversation. This report analyzes policy from the perspective of impact on the business climate. We realize that policymakers don't have the luxury of examining policy from that perspective alone, and that social and political factors also have to be taken into account. We believe that it would be presumptuous of us to try to evaluate local policies from a social or political perspective, and respect the prerogative of local leaders to perform that analysis.

We would like the readers of this report to keep a couple of important things in mind. First, this report is designed to focus on areas where the business climate might be improved. The report may therefore appear to present a more negative picture of the business climate in the territory than is warranted. While the U.S. territories are not perfect, their business climates are arguably much better than those in the many developing economies that routinely attract outside investment. All of the territories benefit from the protection of the U.S. flag and the U.S. legal system, duty-free access to the U.S. market, safety (including U.S. military protection), U.S. financial support, use of the U.S. dollar, an English-speaking workforce that is well trained by the standards of the developing world and infrastructure that is good by the standards of the developing world. Each of the territories has its own particular competitive advantages as well.

The reader should also keep in mind that this report is based upon conditions as we found them in the summer of 2006. It is always possible that subsequent events could have a significant impact on how one might analyze the business climate of the territory.

This report was created by two MBA students and reviewed and edited by the staff of the Office of Insular Affairs. We therefore consider the report to be a product of OIA. It is offered with the greatest humility out of the desire to be of service. We recognize that the future of Guam belongs to the people of Guam, and that the role of the Federal Government is to provide our best information and analysis to help island leaders make informed decisions about their future. We hope that this report will be put to good use, and will help the people of Guam to navigate their way to a strong, prosperous future.

David B. Cohen
Deputy Assistant Secretary of the Interior
Washington, D.C.
December 2006



II. Introduction

It is widely recognized that private sector development is crucial for driving long-run economic growth. Compared with other U.S. territories, Guam has done fairly well. With a well-developed financial system, relatively straightforward processes for establishing a business, and a tax code, legal system and property rights that mirror those of the U.S., Guam provides an environment that is able to generate and support private sector growth. In fact, the economy supported reasonably high levels of growth during the early 1990s, with business receipts growing at 6.8% per year from 1990-1996 and Gross Island Product (GIP) growing at 4.4% per year over the same period¹.

The recent challenges faced by Guam are driven largely by its size and external dependence, which make the island vulnerable to shocks affecting its tourism- and military-driven economy. Looking ahead, the upcoming military build-up poses a significant opportunity for Guam, but will also test the island's ability to support rapid growth in both the private sector and the military. In light of this opportunity, the challenge for the Government of Guam will be to ensure that it is well-poised to capitalize on this growth opportunity by creating an environment that allows the private sector to flourish.

As Island Fellows working for the Department of Interior's Office of Insular Affairs, we traveled to Guam to conduct a review of the island's business environment. Our purpose was to identify factors that may hinder the healthy development of the private sector during the military build-up. We spent over three weeks on Guam, meeting with government officials, business leaders, members of the military, and other relevant bodies. During these meetings we solicited information about specific aspects of the business climate including infrastructure, labor policies, tax policy, government transparency, the legal system, business licensing, the financial system and land ownership. We used the gathered information, along with comparative data, to analyze the opportunities and challenges businesses face when operating on Guam.

Based on our review, we see infrastructure, labor and taxation as three areas in which the government can have the most significant, positive impact on the development of the private sector. Within these areas, we believe that the economy of Guam could benefit most from:

- Ensuring that infrastructure can accommodate the pressure from the military build-up and the associated increase in tourism by privatizing water, solid waste management and the port;
- Adopting creative solutions to expand the labor force to meet the future needs of both the private sector and the military; and
- Re-examining the tax incentive program and lowering tax rates across the board to ensure healthy development of the private sector.

Our assessment of each of these areas is included in the pages that follow.

¹ Guam Statistical Yearbook, 2004



III. Infrastructure

The upcoming military build-up, and subsequent economic activity, has focused attention on the state of Guam's infrastructure. The governor and administrative officials are currently working with the military to make sure that power, water, ports and roads will be able to adequately meet future demands. In the past, Guam's publicly-owned assets have struggled with fiscal and management problems. Services had been substantially below U.S. standards, including issues with clean and safe drinking water, air and water pollution, and a problematic waste disposal system. These issues impact the private sector by affecting reliability and quality of service and increasing the costs of doing business. In a 2005 survey conducted by the Guam Chamber of Commerce², businesses cited public utilities as one of the key impediments to growth on the island. The current legislature and leadership recognize that changes must be made and is attempting to create programs that better serve end-users.

While the majority of Guam's infrastructure assets are still publicly owned and operated, telephone service and power generation have been recently privatized. The success of these changes and the burden on the government of funding utilities has resulted in a push towards privatization by both the private and public sector. The situation of Guam's public utilities lends itself to privatization for a variety of reasons, including the high cost of system-wide improvements, a limited labor pool, and a lack of continuity in top management. This section seeks to describe how present day infrastructure services affect the economy, what steps the government is taking to privatize infrastructure, and the potential benefits from continuing the privatization process.

A. Water

With only two sources of water – the Northern Guam Lens Aquifer, which supplies water to the northern and most densely populated section of the island, and the U.S. Navy-owned Fena Lake, which sells water to the Guam Waterworks Authority (GWA) to supply the southern portion of the island – issues of water control are potentially controversial. In the past, Guam Waterworks Authority has faced fiscal and operational difficulties in meeting the water and wastewater needs of its customers. In 2001, the Consolidated Commissions on Utilities (CCU) was appointed to oversee the GWA (and Guam Power Authority), and since then key improvements have been made, most notably in profitability, the installment of “radio-read” meters to better gauge water consumption, a reduction in the labor force, and an improved cost structure. As a result of these efforts, Guam received special notice in the 2006 Environmental Protection Agency Progress Report³ for significant improvements to the safety and quality of drinking water.

Although these changes show progress by the CCU, some work remains to be accomplished. Water-loss is still a challenge for the GWA. Currently, 40% of water treated is lost due to siphoning off of water by nonpaying users, infrastructure problems,

² Guam Chamber of Commerce survey

³ 2006 Progress Report, Region 9: Communities and Ecosystems, U.S. Environmental Protection Agency



or meter inaccuracies. According to the World Bank's scorecard for water utilities⁴, a water-loss rate of 40% is average for developing countries. The mean water-loss rate for developed countries is 16%. By understanding and addressing the sources of these losses, the GWA may be able to boost their fragile financial position and reduce costs to consumers.

Reducing system loss is particularly important because past financial problems have prevented the GWA from keeping water production and treatment facilities up-to-date, which results in sporadic water outages for some residents. These generally occur at peak hours and on weekends for residents on higher elevations or at the end of service lines. The GWA is continuing to work to address issues with inconsistent water pressure, slow response time to leak repairs, sporadic sewage overflows, and violations of the EPA's Clean Water and Safe Drinking Water Acts. To address these problems the GWA has developed a capital improvement plan and estimates that \$400 million will be necessary over the next five to ten years to modernize and maintain the system. For the consumer, this will likely result in 5-15% rate increases.

To best achieve its goals, the GWA is trying to raise the level of expertise of personnel operating and maintaining equipment. However, Guam's remote location makes it difficult to hire highly trained employees. In order to compensate for this scarcity, the GWA is implementing training programs for employees. Further development of technical training programs, GWA sponsored courses at local colleges, or employee incentive programs could potentially raise GWA employees' skill levels.

Steps the government is taking to privatize the GWA:

The GWA is currently inviting bids for a performance management contract for its wastewater system and is working to propose a law which will allow it to form a partnership with a private organization for the treatment and distribution of water. After careful consideration, the CCU has determined that a full concession public-private partnership (PPP) contract would be the best option for Guam. A full concession PPP may work well for Guam because it allows a private operator to take charge of capital investments, operations and maintenance, and carry subsequent risk, while Guamanians continue to own the assets of the GWA. As part of the agreement, the private operator (concessionaire) carries out all of the capital investment, operates services and is paid back through users' service fees. At the end of the contract period facilities are returned to public authorities. These types of concessions are commonly used in situations where there is a significant lack of public funding or where it is determined that the private sector will be able to provide a higher quality of financing and service.

Arguments for a full-concession public private partnership:

- It may be difficult for Guam to fund capital requirements needed to improve facilities. The Government of Guam (GovGuam) is already faced with a substantial deficit, which would otherwise shift the burden onto ratepayers for funding capital

⁴ Kingdom, Bill and Nicole Tynan, "A Scorecard for Water Utilities in Developing Countries", World Bank Online Discussions, <http://rru.worldbank.org/Discussions/Topics/Topic9.aspx>



improvements. If some degree of outsourcing was used, the GWA could create a partnership which requires a private operator to finance system upgrades. The GWA has stated that they feel an experienced private operator would be better able to finance and manage system-wide improvements while at the same time keeping water rates affordable.

- A public-private partnership would allow the transformation from public to private to be handled with the care and social sensitivity it deserves. For the privatization process to be successful, deeply-held principles among the Chamorro people regarding water rights may need to be preserved.
- The people of Guam would continue to own the rights to Guam's water and all of the GWA's facility assets.
- The CCU already successfully oversees a private partnership in its management of Guam Power Authority.

B. Solid waste management

Waste management is a difficult issue for the islands throughout Micronesia. Several islands face major pollution hazards, overflowing dumps, and lack proper garbage collection programs. These problems stem from the fact that islands are generally small with limited areas for landfills and shipping garbage is rarely a practical solution. Guam is no stranger to the challenges of solid waste disposal. Guam's municipal dump, the Ordot dump, is a 50-year old unlined, uncontrolled dump that has been over-capacity for 20 years. Proper landfill operation procedures at the site, including the placement of daily cover material and proper waste compaction, have not been conducted. Trash pickup services have struggled to keep up as well. With the continual breakdown of trash pickup vehicles, some residents complained of having had to wait up to four weeks for their trash to be removed.

Some of the longstanding issues with the landfill include:

- polluted surface waters from leachate, which runs into the Longfit River below the dump and eventually into the ocean at Pago Bay; this pollution led to a Federal Consent Decree⁵ requiring the Government of Guam to close the dump
- an accumulation of carbon monoxide due to repeated fires, which has affected air quality and forced temporary evacuations of nearby homes from toxic fumes
- odor, noise, and animal problems
- illegal dumping of trash in the woods or along beaches because of inadequacies in garbage pickup.

These issues are particularly problematic for Guam because of its reliance on its natural resources for tourism, trade, food, and water. Changes may need to be made if the islands are to protect their ecologically fragile land and marine areas.

Steps the government is taking to privatize solid waste disposal:

⁵ U.S. District Court of Guam, 2004



For many years locals and government officials have called for the privatization of the Ordot Dump. Popular opinion holds that the private sector would have the financial backing and technical expertise to safely close the Ordot Dump and construct a new facility. However, lately there has been little momentum behind the actual pursuit of privatization bids. Although we realize that this is a difficult task, it is an option that the Government of Guam could pursue, as it may be necessary to ensure the longevity of Guam's natural resources:

- Private operations are typically more focused on efficiency and profit-making. Currently, monthly garbage disposal charges are \$8 for residential areas. However, collection has been erratic, with only 30% of fees being collected. GovGuam faces the dilemma that consumers are unwilling to pay more for collection services but improvements cannot be made without rate increases. Ideally, a private agency would have a collection rate that more appropriately matches service charges to costs and could use these revenues to finance improvements to the landfill.
- Privatization has had success in the Pacific Islands. Pohnpei State in the Federated State of Micronesia found itself in a similar situation to Guam, facing severe waste management challenges. Some citizens of Pohnpei realized that waste disposal could be conducted more efficiently as a private entity and founded Pohnpei Waste Management Services. Since then, Pohnpei has seen major improvements in solid waste disposal and is adapting its model to meet the needs of other FSM islands.
- Before Ordot can be closed, a new landfill must be opened. Unfortunately, GovGuam has not yet been able to support financially the establishment of a new municipal solid waste management facility. The private sector would most likely be able to provide the technical and financial capabilities to construct a safe landfill which would effectively meet Guam's future needs.
- By consolidating the waste needs of multiple Pacific Islands, the private sector could create financially viable disposal programs for recyclable materials in ways that individual jurisdictions could not. Collaboration on the disposal of materials such as aluminum cans, toxic wastes and large machinery would enable the islands to enjoy economies of scale to make these programs cost effective. If coordinated and planned out properly, these materials could be shipped off-island for recycling in countries where the waste industry is better developed.
- Private sector influence could lead to the development of legislation which supports reusable materials or the minimization of waste. In Kiribati, for example, the government has recently introduced new legislation to impose tariffs on the importation of containers for soft drinks and used lead acid batteries. The revenue raised is intended to financially maintain recycling systems while at the same time lowering demand for plastic packaging.

C. Port

Guam's port serves as the primary seaport in Micronesia, and the Guam Port Authority operates the largest U.S. deepwater port in the Western Pacific region. The Port Authority, an autonomous agency of the Government of Guam, has handled Guam's port operations for more than 30 years. Guam's extreme reliance on imports (95% of goods



consumed on Guam are imported) makes the state of the port critical to Guam's economy. The opinion of Guam's legislature is that private sector participation in port operations will lessen the financial burden on the government and support investment in a way that GovGuam has been unable to do. In 2003, the Guam legislature enacted Public Law 27-60 requiring the commercial port to enter into a public-private partnership for terminal operations and maintenance of the port.

Steps the government is taking to privatize the port:

In April of 2005, the Port Authority of Guam issued a Request for Proposals for the privatization of its cargo terminal operations and equipment maintenance. By the end of 2005, the port had reviewed and ranked their top three submitted proposals. However, during the negotiations process a lawsuit was filed against the Port Authority by one of the offerors and since then all negotiations have ceased. Officials are hopeful that once the lawsuit is settled, negotiations will continue.

Arguments in favor of a public private partnership for port operations:

- Privatization will likely lead to the upgrade and/or replacement of cargo handling equipment. Guam's port is currently operating with two gantry cranes, one 20 years old and the other 27 years old, while awaiting approval for a loan for a third crane. The industry standard for a crane's life is generally 20 years, but good maintenance can extend this time to 30 years. Operating with only two cranes leaves Guam in a precarious situation. Any subsequent problems with either of these cranes could substantially affect cargo discharge or the availability of cargo. This situation also eliminates any buffer in the event of typhoons and puts more emphasis on the scheduling of barges. As a stipulation in their notice for privatization bids, Guam can require certain capital allotments for modernization and improvements of port equipment.
- A partnership could help increase seaport efficiency through an improved management and financial plan. Traditional economic benefits from port privatization, including reduced labor costs and the elimination of institutional barriers, could improve the efficiency of Guam's port and reduce port tariff charges. For an island whose livelihood depends on imports, reducing tariffs could substantially stimulate economic growth and improve living standards, as well as reducing the cost of doing business. The Guam Port Authority has done its best to maximize the efficiency of its operations. Currently, Guam's port is averaging 20 total container moves per hour. In the offer which is currently in court, the offeror only guaranteed 22 moves per hour so the increase from privatization was fairly small. Analyzing and comparing port productivity is difficult because of the variance in factors from location to location. Comparisons between ports are complicated by factors such as equipment availability, yard layout, berth space, vessel loading plans and weather. However, even slight increases in efficiency could have major economic consequences over time, and improvements may entice businesses to use Guam as a major stop on shipping routes.



D. Roads

Weather and environmental factors make road maintenance difficult for the island of Guam. Typhoons are commonly responsible for damaging bridges and pavement surfaces. Roads on Guam are primarily paved out of a coral and oil mixture. When the roads become wet, the oil from the pavement mixture floats to the surface, making the roads slippery and dangerous. For this reason, the speed limit throughout the island is 35mph. Roads are not graded according to U.S. standards, and during the rainy season (from about August until March) water can pool unevenly on road surfaces. Pooling of rainwater sometimes leads to flooding in the southern portion of Guam, which does not have sewer drainage built beneath the road surfaces. Guam's drivers also have to deal with frequent potholes, which can easily blow out tires (many travel guides specifically warn visitors driving on the island to beware of the frequency and size of these potholes). To combat these problems the governor launched the Island Wide Village Street Restoration Program in April of 2006 to improve primary and secondary roads and repair pot holes across the island.

Steps the government is taking to privatize road maintenance:

At this time there has been little discussion of privatizing Guam's roads. Although Guam's roads face many of the same problems as its other infrastructure sectors, the privatization of roads would be a difficult process. Generally, tolling is the primary revenue source for private companies; however, Guam does not have any tolls and its small size and limited roads does not lend itself well towards these types of charges. Perhaps fines from traffic violations or parking tickets could be matched to road improvements to provide a broader revenue source for Guam's road system.

E. Power

The Guam Power Authority (GPA) is a good example of a public-private partnership on Guam. In the early 1990's, the GPA was overwhelmed by a fast growing load demand that had a negative impact on its ability to maintain power plant units. The GPA entered into contracts for the privatization of management, construction, operations, and maintenance of its plants. Since then, the GPA has managed power distribution while the independent power producers have overseen power generation.

Steps the government is taking to privatize power distribution:

Although the public-private union has been successful at the GPA, in the future, Guam may consider privatizing power distribution as well. There are multiple reasons why this may be the best alternative for the island. First of all, the Department of Defense is Guam Power Authority's number one customer, using 16% of the island's energy and accounting for 20% of GPA's sales receipts. In the past, GPA's distribution has suffered from inconsistent outputs, delayed repairs after typhoons, a lack of funds to move distribution points and lines underground, theft, and a fee system that does not accurately reflect costs. While these problems can be addressed without privatization, it is important for GPA to determine whether or not these issues can be handled more effectively by a private contractor. The worst outcome would be for the military to decide to produce its own power, and cause GPA to lose its most valuable customer, because of concerns about the reliability of the distribution network.



F. Privatization looking forward

Guam has already had some major successes with privatization. On January 25, 2005 Guam Telephone Authority (GTA) was sold to TeleGuam Holdings, LLC, making it the first full privatization of a government-owned utility on Guam. Since then there have been major improvements in overall telephone quality and service. However, GovGuam has been unable to reach agreement on the privatization of other utilities. In order to do so, the government may want to consider on the following issues:

- Ensuring that the privatization process is transparent to the public. It is important for Guamanians to not feel that privatization is an attempt by the government to take advantage of locals. A lack of open and accurate communication in the past has led to public outcries against privatization. To give one example, Concerned Citizens Against Guam Waterworks Authority Privatization has campaigned that turning water private will put at stake the Chamorro people's right to water and self-determination. Many Chamorros fear that privatization will undermine equal access to water. The lack of communication between GovGuam and the public created hostilities based on a lack of accurate information. By including the public on the bidding process through public forums, town hall meetings, and publications, local stakeholders will be able to make decisions that they feel best serve their community.
- Releasing details of privatization contracts. In order to meet the needs of rate payers, utility governing boards may want to include employees and the public in the privatization decision-making process. By sharing details of the bids, the public can see that decisions are being made based on what is best for the public in the long term and not private interests. This will help avoid any potential negative backlash and a loss of productivity at a time when major improvements have been made and new leadership is emerging.
- Leveraging successful aspects of the Guam Telephone Authority privatization as a model for future privatization efforts. Consumers are reported to be extremely satisfied with the improvements to telephone service and customer care that emerged after the privatization process. Although there was a great deal of apprehension about privatizing telephone service initially, the results have been extremely positive. This would serve as a good framework for further privatization efforts.



IV. Labor

One of the most important challenges for Guam to address going forward is the impending need for labor. As a small, geographically remote island, it is understandably more difficult to maintain a flexible labor force. There is a limit to the available labor pool to draw from, and it is more costly to develop specialized skills on-island (because of the small scale involved). The upcoming military build-up will magnify this challenge; it is estimated that Guam's economy will need another 20,000-30,000 workers (representing a 33-50% increase in the labor force), but it is not clear where these workers will come from. While the bulk of the jobs created will be in the construction industry (the number of additional construction workers needed is estimated at 15,000-20,000), local interest in working in the construction trades is relatively low, with only a handful of workers completing apprenticeship/training programs annually.

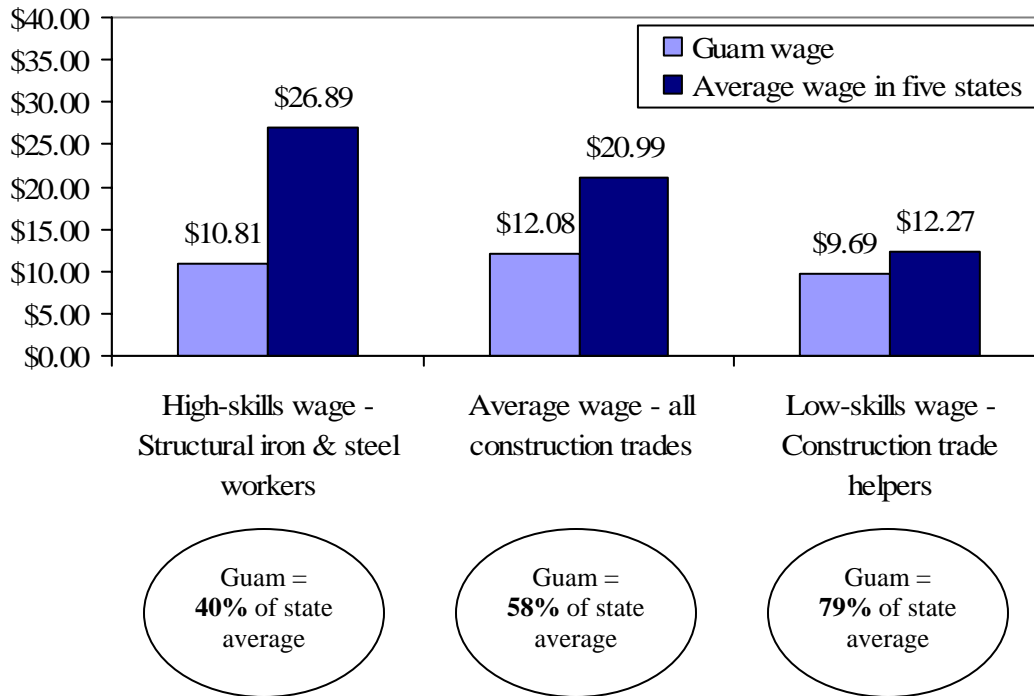
In this section we will discuss some of the factors shaping the labor market as well as potential solutions for the Government of Guam to consider in order to meet the labor force needs of both the military and the private sector.

A. Factors shaping the labor market

There are a number of factors shaping the labor market, an analysis of which (with a particular emphasis on the construction industry) could help determine potential alternatives for the government to explore.

- Wages in the construction industry are low:* Construction wages on Guam are on average only 58% of what they are in the U.S. states (for the purposes of this comparison, five states were chosen based on their relative proximity to Guam and/or the relatively large number of Guamanians residing there: California, Hawaii, Nevada, Oregon and Washington). As Exhibit 1 shows, the differential is even greater for higher-skilled jobs, such as structural iron and steel work, where Guam wages are only 40% of what they are in the five comparison states (see Appendix 1 for data on all construction trade wages). Another indication that the skill premium is low is that construction workers on Guam on average earn only 2.3 times the minimum wage, as compared with 3.1 times the minimum wage across the five states analyzed. As a result of this wage gap, it is not surprising that many Guamanians leave the island to seek higher paying jobs elsewhere. The Guam Airport Authority estimated that 17,000 more passengers departed than arrived on Guam between 1998 and 2003, suggesting a net annual out-migration of approximately 2% of the population.



Exhibit 1: Construction wages on Guam compared to five states⁶

One of the factors contributing to low construction wages on Guam is the presence of H-2B⁷ workers. This increases the labor supply on the island and drives down wages. In addition, foreign workers (largely from the Philippines) are generally willing to work for lower wages than Guamanians. Since employers are able to charge a fee (typically \$360/month) in order to provide for food and housing, they can lower the effective wage paid to foreign workers by spending less than the fee charged on these services.

- *Locals may not be interested in the construction trades:* Some Guamanians view the construction trade as extremely cyclical and not viable as a long term career. The Guam Community College reports that enrollment in its construction apprenticeship and training programs is very low, with most of its students pursuing programs in electronics, business, computers, and automotive trades.
- *The number of foreign workers that can currently be brought in is limited:* The national cap for H-2B visas is 66,000. Unless this regulation is modified, Guam

⁶ Bureau of Labor Statistics, May 2005 State Occupational Employment and Wage Estimates, <http://www.bls.gov/oes/current/oesrcst.htm>

⁷ The H-2B visa program is used for temporary non-agricultural workers employed for service or labor if unemployed persons capable of performing the service cannot be found within the country.



will not likely be able to meet its demand for 20,000-30,000 additional workers simply by only bringing in foreigners.

- *The use of foreign workers for military construction projects is prohibited:* Current restrictions prohibit nonimmigrant aliens from performing work under a contract for: (1) a military construction project on Guam, or (2) base operations support on Guam⁸. Given that much of the new construction will be on-base, this will intensify demand for U.S. workers.
- *Students graduating from the public school system may be under-prepared for the labor force:* The troubles facing Guam's public school system appear to have impacted the quality of education received by its graduates. Managers report that some of the individuals entering the labor force do not have adequate reading and writing skills, which makes it much harder to train and prepare them for higher-skilled jobs.
- *GovGuam employs a relatively large share of the available labor pool:* The Government of Guam hires 24% of the labor force, a relatively large share when compared with the U.S. states, as shown in Exhibit 2. In addition, government jobs on Guam pay relatively well, with average hourly earnings of \$16.85, as compared with \$10.99 for the private sector (while this is admittedly a crude comparison, it suggests that the government may be paying a premium over the private sector)⁹. This indicates that public sector employment may be the preferred option for Guamanians, which shrinks the labor pool, especially the skilled labor pool, available to the private sector.

Exhibit 2: Government's share of the labor force¹⁰

Country/ territory	Population	Labor force	Government workers	Government workers (% of population)	Government workers (% of labor force)
U.S.A.	298,444,215	149,605,000	18,657,010	6.3%	12.5%
Guam	160,000	62,050	15,150	9.5%	24.4%

B. Implications of the labor shortage

These factors imply that if there is no change in current policy, Guam may need to rely largely on labor from the states in order to meet its needs. This has several implications:

1. In order to attract workers to Guam wages will be bid up to higher than what they currently are in the states (where there are existing labor shortages already in the

⁸ Department of Defense, Defense Acquisition Regulations System website
http://www.acq.osd.mil/dpaptest/dars/dfars/html/current/222_73.htm#222.7302

⁹ Department of Labor, Government of Guam, March 2006 Current Employment Report

¹⁰ U.S. Census Bureau, 2000 Insular Area Census Profiles (updated with more recent data where available)



construction industry). Based on the analysis above, this implies that construction wages on Guam could double.

2. From the point of view of the private sector, a significant increase in construction wages could have a negative impact on private sector growth, as the increased cost of labor would make new projects (such as the construction of a new hotel) much less attractive; the growth in the military sector may make the non-military sector of the economy less competitive and less profitable. This would hamper private sector development, reduce the diversification of the economy, and make Guam even more heavily dependent on the presence of the military.
3. In addition, with U.S. workers being more attractive than foreign workers, there is the danger that a two-tiered wage system may emerge (particularly if additional foreign workers are brought in but restrictions prohibiting foreign laborers from working on base are not modified). The possibility that U.S. workers could earn substantially more than foreign workers for essentially the same work, could potentially lead to social problems.
4. Finally, it is likely that the higher paying, supervisory-level jobs will go to non-Guamanians, as they may be more likely to have the right skill set. This could mean that the local population may not benefit from the growth to the fullest extent possible.

C. Alternatives to address the labor shortage

In order to address this situation, there are a number of actions that the government might consider pursuing to both develop the local labor force and address future labor shortages.

I. Strengthen the local skill-base:

- **Generate increased interest in construction trades:** While construction wages have been relatively low in the past and the industry has been seen as cyclical, both of these factors are likely to change. As discussed above, wages could rise substantially, and the military build-up is likely to be accompanied by ten or more years of substantial construction work. The Government of Guam might want to conduct a public relations campaign for the construction trade, by showcasing it as an attractive career option for young people entering the labor force. This can be done by advertising the benefits of a career in construction in the media (with a specific focus on high school-age students looking to enter the labor force) and working with training providers to attract more people towards programs in construction.
- **Enhance apprenticeship and training programs, particularly at the high school level:** The Guam Community College provides apprenticeship and training programs for construction jobs, and the Guam Contractors Association is planning on offering apprenticeship programs as well. Both providers could increase their training capacity and the numbers of programs offered, and also enhance their



- presence at the high school level in order to make it easy for graduating students to learn about different occupations and more easily enter into apprenticeship programs. These actions would be timed to coincide with the beginning of the build-up. In addition, they could work closely with industry leaders to proactively forecast demand for labor, obtain funding for programs and marketing efforts, and develop content.
- **Develop and retain highly skilled local talent:** In addition to developing construction skills in the local population, the government could benefit from developing and retaining workers with managerial and other highly paid skills. While Guam may not have the ability to provide a broad range of training on-island, programs could be developed to allow Guamanians to develop skills off-island, while simultaneously encouraging them to return to Guam, including:
 - Scholarship/loan programs with incentives to return to Guam. Promising students could be offered scholarships that fund their education off-island. These scholarships would be tied to a commitment from the student that s/he will return and work on Guam for a certain period of time, with the stipulation that if the student does not return to Guam, the scholarship converts into a loan. Additionally, family members of the student could be required to guarantee the loan to increase the likelihood of repayment. The private sector can be involved in this program by having individual companies fund scholarships for the development of skills relevant to their industries. A similar program has been started recently by the Saipan Higher Education Financial Assistance Board, which provides various types of funding for higher education to local students, and can be used as a model for Guam. Saipan's program is funded primarily through local license fees from poker and pachinko machines¹¹.
 - Increased training opportunities for professionals. Professionals (employed in both the private and public sectors) could be provided with opportunities for ongoing training. Programs could be developed with universities in the states that offer short, focused trainings in particular areas (for example, executive programs for civil servants at a school of public policy, management training programs for mid-level managers at a business school). Again, the private sector can be leveraged to provide support for these programs.
 - **Address possible improvements to the public education system:** While this is a longer-term goal, it is never too early to start considering ways to improve. We believe that the following actions could be considered to further improve the level of performance in the system:
 - Stabilizing school system leadership: This would allow longer term policies to be enacted and take effect.
 - Ensuring adequate and stable funding for the school system: The growth of the economy will alleviate this problem to some extent (given that the

¹¹ <http://www.saipanshefa.com/>



primary source of funding is currently 83.2% of withholding taxes from the previous month), but a more stable source of funds could protect the school system during cyclical downturns in the economy.

Exhibit 3: Comparison of school system performance¹²

	Guam	U.S. Average
Total student enrollment	30,985	n/a
2004-2005 expenditures	\$133,576,651	n/a
Percent of expenditure spent on salaries & benefits	86.8%	81.9%
Graduation rate	94%	71%
Spending per pupil	\$4,405	\$8,468
Average teacher salary	\$34,326	\$46,597
Student to teacher ratio	16.7	15.9
SAT10 scores ¹¹ (average across grade levels)	31.75	50

- Addressing social promotion: At first sight, Guam's 94% graduation rate may indicate a highly successful school system. However, the low average SAT10 score¹³ raises questions about how much students have learned by the time they graduate. Social promotion, the practice of promoting a student to the next grade despite poor grades, has been pointed out as one of the causes of this discrepancy.
- Conducting a detailed review of Department of Education staffing. From the above data we can see that the majority of DOE spending goes towards salaries and benefits; in fact, a higher percentage of Guam's budget goes towards salaries than the national average, even though Guam is spending more on salaries, but spends substantially less per teacher. One might guess that the overall number of teachers is the reason for Guam's high salary expenditure, but the higher than average student to teacher ratio means that there are fewer teachers per pupil in the Guam public school system. This suggests that there may be more non-teaching staff members than necessary. The government may want to consider redirecting funding away from administrative and office positions.
- **Streamline government employment:** The discussion above suggests that the Government of Guam pays higher wages on average than the private sector and hires more employees than may be necessary. This makes private sector jobs less attractive and further limits the amount of labor available to the private sector. Gradually trimming down the government workforce would not only make government agencies more efficient, but also increase the size of the labor pool

¹² National Center for Education Statistics, Institute of Education Sciences, U.S. Department of Education

¹³ The SAT10 or Stanford Achievement Test Series, Tenth Edition (SAT 10), produced by Harcourt Assessment is a series of nationally-normed achievement tests which has been used by administrators and teachers for more than 80 years.



available to the private sector. Hopefully, this would encourage more talent to pursue private sector employment and possibly increase entrepreneurship as well.

II. Increase supply of labor on the island:

- **Creatively recruit Guamanians living in the states/elsewhere.** The U.S. Census Bureau estimates that there are roughly 93,000 Chamorros and part-Chamorros living elsewhere in the states. This suggests that the number of people of Guamanian descent living off-island is sizable. We understand that the government already has efforts underway to compile a database of these individuals. This is an attractive group to target, as they would integrate better into the local economy. Specific strategies for targeting this group could include:
 - Sending marketing messages to make them aware of specific upcoming opportunities on Guam.
 - Creating an integrated website which includes job search resources as well as general information about Guam. This website could include an online job bank with relevant, up-to-date job postings, resources for anyone considering moving to Guam (for example, information on the real estate market and the school system), links to the websites of relevant government agencies and private sector companies, and links to the websites of local newspapers and magazines. While Guam's Department of Labor does already have an online job bank, this could be integrated into a portal that provides more comprehensive information.

- **Address regulations governing foreign workers.** While the Government of Guam has little control in this area, it can continue to work closely with the Department of Defense and the State Department to make its case for the following:
 - *Modifying visa regulations:* Due to the H2-B cap, there is a limit to the number of foreign workers that Guam can bring in. Modifications to the current visa regulations, for example creating a Guam-only temporary work visa for the duration of the military construction, could allow Guam to increase its labor supply. If an expanded Guam-only visa program were approved, one of the most effective ways to manage the distribution of the visas would be to auction them off. This would ensure that visa recipients were employed by those projects with the greatest need, and it would also increase the transparency of the process. In conjunction with these developments, GovGuam could also develop effective rules and regulations for the guest worker program to minimize abuses of the system and to ensure that workers return home when their visas expire.
 - *Changing on-base worker requirements:* If Guam is able to bring in additional foreign workers it may also want to press for modifications to the regulations that prevent foreign workers from working on the military bases. Allowing foreign workers to work in non-sensitive areas would



increase the supply of workers able to work on the bases, and prevent major disparities in wage rates between foreign and U.S. workers. Additionally, Department of Defense regulations state that an exception to the prohibition on foreign workers may be made under certain conditions¹⁴. GovGuam may want to work closely with the Department of Defense to ensure that Guam will be allowed an exception based on similar conditions.

¹⁴ The prohibition does not apply if: (1) There is no acceptable offer in response to the solicitation of a project; (2) The Secretary concerned makes a determination that the prohibition is a significant deterrent to obtaining offers on the project; or (3) Another solicitation is issued for the project.

http://www.acq.osd.mil/dpaptest/dars/dfars/html/current/222_73.htm#222.7302



V. Taxation

Our analysis of taxation-related issues on Guam included a review of the tax incentive program, the structure of the gross receipts tax, and the efficiency of tax collection activities.

A. Tax incentives

Guam has a long history with investment incentives. Investment incentives were first authorized in 1965, and are issued to companies in the form of Qualifying Certificates (QCs) which provide the recipients with abatements and rebates on a variety of taxes (income tax, property tax and the gross receipts tax (GRT)). A large number of industries is eligible for the QC program, including agriculture, aquaculture, commercial fishing, export trading, hotels/motels, insurance, mari-culture, manufacturing, residential real estate and tourism. The goals of the QC program are similarly broad. QCs are issued to any company that “promotes the general economic development of the territory” by creating employment, replacing imports, reducing prices, creating affordable housing or other vitally needed facilities, or establishing Guam as a financial center¹⁵. The maximum term for QCs is 20 years, and it is not uncommon for companies to receive benefits for the full term. It is also possible for companies to receive extensions once their QCs expire, if they undertake significant additional investment (for example, renovations to a hotel). A 2001 audit report of the QC program points out that three beneficiaries of the program have already received benefits for more than 30 years. In addition, the QC program imposes a hefty set of restrictions on the recipient,¹⁶ but compliance with these restrictions has been reported to be weak.

Costs of tax incentive programs

While the goal of investment incentive programs everywhere has understandably been to stimulate investment and promote economic development, academic research indicates that they are generally not cost effective; studies conducted by the Foreign Investment Advisory Service and the International Monetary Fund indicate that in general, generous incentive programs do not lead to higher levels of investment and growth. Surveys of investors indicate that tax incentives do not affect most location decisions of most foreign direct investment (FDI). Investors typically care more about the overall environment and are likely to rate other factors more highly, such as a stable political environment, a reasonable tax code and the availability of infrastructure and labor. While there are some

¹⁵ QC regulations, Guam Economic Development and Commerce Authority website

¹⁶ Restrictions include: providing monthly reports including financial data; establishing a profit sharing/pension plan and health and life insurance programs; having at least 75% of employees be U.S. citizens/permanent residents; maintaining operational control of the business/development; obtaining consent before transferring a substantial portion of their assets or if there is a change in ownership; and giving preference to local businesses for the procurement of goods and services.



success stories (such as Singapore), there are many other countries that have experimented significantly with tax incentives but have not enjoyed equally positive results (for example, Bangladesh, El Salvador, Jamaica, Mexico, Pakistan, the Philippines and Turkey)¹⁷. An interesting data point from Guam's own history is that there was a five year moratorium on the issuance of QCs between 1990 and 1995, one of the highest growth periods on Guam's recent history.

Not only do investment incentive programs tend to be ineffective, but they also bring with them a number of costs:

- **Tax incentives create distortions in the economy.** By favoring certain activities over others, tax incentives inherently create distortions in the economy and divert resources away from potentially more productive uses. Taxpayers not intended to receive benefits will plan activities so as to qualify for the incentive. In addition, they create an unequal playing field in industries where some companies are receiving incentives and others are not.
- **They often accrue to investment that would have occurred anyway.** Studies indicate that many investors choose a location first and then negotiate with the local government for incentives (the incentives themselves do not play a role in the location decision). In addition, administering authorities often end up issuing incentives to all new investment as opposed to only those investments that would not have otherwise taken place (either because it is difficult to distinguish between the two or for political reasons).
- **They lead to a race to the bottom.** A frequently made argument is that countries (particularly small ones) have to offer incentives in order to compete effectively to attract investment. However, any competitive incentive advantage tends to be competed away fairly quickly, and simply results in a smaller tax base for the economy without any added competitive advantage.
- **It is hard to stop giving out incentives once a program has been started.** It is often politically difficult for a government to end an incentive program. Once even limited incentives are allowed, the door is opened for others involved in non-targeted industries to lobby to be included. In Guam's case, as mentioned above, three companies received exemptions for over thirty years and several companies have recently received extensions.
- **They make the tax system more complicated.** Incentive programs are typically accompanied by a number of restrictions on the activities of the recipient. These restrictions make investment procedures more complex, which increases the burden on the administering/monitoring authority and encourages evasion on the part of the investor.
- **They lead to unnecessary revenue losses for the government.** For the reasons discussed above, tax incentives lead to revenue losses for the government that are not commensurate with the additional economic activity generated. Guam's

¹⁷ Joel Bergsman, "Advice on Taxation and Tax Incentives for Foreign Direct Investment", May 1999, IFC website
 Jacques Morisset, "Tax Incentives," Viewpoint, January 2003, Note number 25x



Department of Revenue and Taxation estimates that companies enjoyed an annual average of \$6.5 million in tax credits through the QC program between 1995 and 2003.

Alternatives to existing program

Based on this evidence, it appears that tax incentive programs are typically not cost effective and hard to target and administer effectively; they also tend to lead to unnecessary losses of revenue for the government. Therefore, one could argue that Guam's economy would be better off without an incentive program.

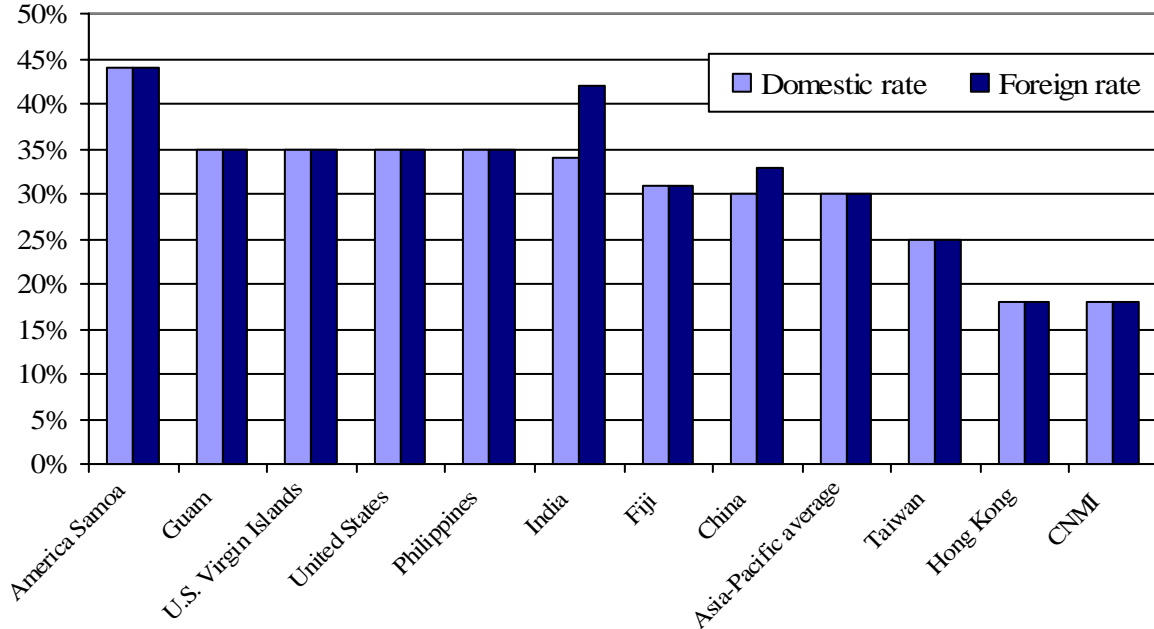
Discontinuing benefits to established industries could be considered. The hotel and tourism industry, a major recipient of QCs in the past, is worth closer examination. It is estimated that between 1995 and 2003, the hotel industry alone enjoyed over \$18 million in tax credits. It has been suggested that relative to other tourist destinations, Guam's tourism industry is still in its infancy, and thus it should continue to be protected. This argument may have had some validity in earlier years when few tourists had heard of Guam and the tourism infrastructure was completely undeveloped. But with an average of over a million tourists visiting Guam annually over the last 10 years, it may be more difficult to sustain this argument today. In fact, a study of small island tourist economies indicates that Guam's tourism industry is relatively well-developed in terms of tourist penetration and maturity. Guam ranks eighth out of 36 economies in terms of tourist penetration (this measure is based on visitor spending, visitor density and room density)¹⁸. Additional information on these rankings is available in Appendix 1. The Board of Directors of GEDCA (then GEDA) imposed a moratorium on the issuance of QCs to hotels between December 1989 and September 1997, presumably for these very reasons. Hotels became recipients of QCs once more in 1997 in response to the deteriorating economic environment, though there is some question as to whether this was an economically sound decision.

In order to encourage the development of new industries on Guam, a more attractive alternative may be to lower corporate taxes across the board, as opposed to providing incentives to select industries. As indicated above, investors do care about the *overall* tax environment that a location offers. Based on the data in Exhibit 4 below, U.S. tax rates (which Guam mirrors) are relatively high compared to tax rates in other parts of the world. In addition, tax rates around the world are falling.

Lowering the corporate tax rate would have the effect of stimulating additional investment without creating harmful distortions in the economy, increasing the complexity of the economy, or increasing the need for oversight. This increased investment could expand the tax base sufficiently to offset the lower tax rates.

¹⁸ Jerome McElroy, "Small Island Tourist Economies Across the Life Cycle," Asia-Pacific Viewpoint, Vol. 47, No. 1, April 2006



Exhibit 4: Effective corporate tax rate comparison¹⁹

See Appendix 3 for further details on this exhibit.

Ireland provides an interesting example of this point. Ireland experimented significantly with investment incentives in the 1970s and early 1980s but continued to suffer from a host of macroeconomic problems, including persistently low GDP growth (real GDP grew by at an annual average of 2.1% from 1982-1984), rising unemployment rates and widening fiscal deficits. In the 1980s and 1990s Ireland underwent two phases of reform, which included significant reductions in both public expenditures and tax rates. The lowered tax rates increased Ireland's attractiveness for foreign direct investment, and growth increased significantly (real GDP grew by at an annual average of 7.4% from 1992-1999). The reduction in tax rates is believed to be a key aspect of the overall reform package which helped stimulate investment and growth in Ireland²⁰. Ireland's corporate income tax rate currently stands at 12.5%, the lowest in the European Union²¹.

There are a number of ways in which Guam can achieve a lower tax rate:

- The easiest option would be for Guam to reduce the gross receipts tax (GRT). The exhibit below provides a hypothetical example demonstrating the impact of a 1% reduction in the GRT on the effective tax rate paid by corporations. While this may be the most feasible option to implement (as the GRT is relatively easy

¹⁹ KPMG Corporate Tax Survey, 2006

²⁰ Hauptmeier, Sebastian, Martin Heipertz and Ludgar Schuknecht, "Expenditure Reform in Industrialized Countries: A Case Study Approach," European Central Bank, Working Paper Series, No. 634/May 2006 <http://www.ecb.int/pub/pdf/scpwps/ecbwp634.pdf>

²¹ KPMG Corporate Tax Survey, 2006



to change) it will have a limited effect, as corporations will still need to pay the full corporate income tax.

Exhibit 5: Effect of a change in the GRT

	GRT = 4%			GRT = 3%		
	Company 1	Company 2	Company 3	Company 1	Company 2	Company 3
Pre-tax profit margin	10%	20%	40%	10%	20%	40%
Sales	100	100	100	100	100	100
Pre-tax profits	10	20	40	10	20	40
GRT	4	4	4	3	3	3
Income tax (35%)	2.1	5.6	12.6	2.45	5.95	12.95
Post-tax profits	3.9	10.4	23.4	4.55	11.05	24.05
Tax as % of pre-tax profits	61%	48%	42%	55%	45%	40%

- A second option would be for Guam to nominally maintain U.S. corporate income tax rates, but refund a fixed percentage of taxes paid to all tax payers. This is similar to what is done in the Commonwealth of the Northern Mariana Islands. While this would lower the effective corporate tax rate paid, it could increase the burden on the Department of Taxation, and make the system less transparent and more confusing for investors, particularly outsiders who are unfamiliar with the system.
- The third option would be for Guam to de-link from the U.S. tax code and establish a low, flat corporate income tax rate (of say, 10-15%). This could provide a significant boost to the private sector and make Guam a choice destination for foreign investors. While there is some risk involved with this option (as some investors may see the separation from the U.S. tax code as a negative signal), it is likely that the benefits of a low tax rate and a significantly simplified tax system (especially when compared to the complexity of the U.S. tax code) will outweigh these risks.

Of the three options discussed above, it appears that the third could provide the greatest stimulus to foreign investment.

B. Gross receipts tax (GRT)

Analysis of the GRT

Guam currently has a GRT of 4%. Companies can claim exemption on the taxes paid by their suppliers (which makes the GRT somewhat like a value added tax in practice), but this is complicated by the fact that certain industry groups (such as wholesalers) do not pay any GRT at all. The argument behind the exemption to wholesalers was to prevent the same goods from being taxed multiple times, and to prevent off-island distributors from gaining an advantage over local distributors who do have to pay the GRT.



As discussed above, selective exemptions can lead to distortions in economic activity, favor strong interest groups at the expense of weaker ones that do not have the ability to lobby for exemptions, and reduce the transparency of the taxation system, which can have a negative impact on investment.

Potential alternatives to the GRT

An alternative for Guam may be to switch over to a true value added tax (VAT) system. A VAT would potentially work better than the current system because it does not rely on selective exemptions, and therefore does not create as many potential distortions. In addition, it prevents taxes from cascading (that is, when the same good is taxed multiple times), because it only taxes each party on the value that is added to the good or the service. An additional consequence is that high volume, low margin businesses are penalized to a much lesser extent under the VAT than under the GRT, because they are only taxed on the value-added, and not on their overall sales.

The VAT is also likely to be preferable to a sales tax (which we understand the government considered transitioning to a few years ago). Compared to the sales tax, the VAT does not unduly tax consumer-oriented activities. In addition, research indicates that the VAT is a relatively efficient revenue-generating instrument; that it can serve as a catalyst for improving the tax system; and that it tends to improve compliance because companies have an incentive to register with the taxation authority in order to obtain a refund²².

Finally, switching over to a VAT would be relatively straightforward (as compared with switching over to a sales tax) because the mechanisms required to administer the VAT are fairly similar to what is already in place for the GRT. This would make the transition easier for both taxpayers and the tax collecting authority.

C. Tax collection and enforcement

Challenges facing tax collection and enforcement

The Department of Revenue and Taxation performs vital services for Guam's economy – it provides the Government of Guam with the funds to supply basic infrastructure and social services to the people of Guam, and it regulates the functioning of the private sector.

Currently, the Department of Revenue and Taxation appears to be facing some challenges in the areas of collection and enforcement. The department is still processing tax returns for the year 2003; it currently has around \$140 million in outstanding receivables that it is struggling to collect; and it does not appear to have the capacity to deal with any new problems that arise without putting current activities on hold. Further, anecdotal

²² Grandcolas, Christophe, "VAT in the Pacific Islands" Asia-Pacific Tax Bulletin, January/February 2004



evidence from the business community suggests that the application and enforcement of taxation rules is perceived to be somewhat arbitrary.

The problems facing the department appear to be a function of several issues:

- Limited automation, weak management information systems, and inadequate training for the staff on IT-related issues.
- A significantly reduced budget in recent years, which is leaving the department scrambling to do the same amount of work as before with fewer people (the current headcount is at 162, which has dropped from a high of roughly 300 some years ago).
- Limited political attention on the problems facing the department, with other priorities such as education and healthcare demanding the attention of policymakers.

Poor collection and enforcement result in lost revenues for the government, which in turn impacts the quality of services provided by the government. The slow refund process means that individuals and companies tend to withhold as little tax as possible. This exacerbates the collections problem. In addition, the delay in receiving tax refunds increases the cost of doing business, and is likely to encourage evasion. The unpredictability of the tax system also creates disincentives for doing business and encourages evasion. Finally, if companies are spending time figuring out how to “game” the tax system, this is time spent away from more productive activities.

Potential actions to address these challenges

While addressing these problems can be quite complex, improving the efficiency and effectiveness of the tax system has the potential to help rectify problems throughout the government by providing a larger and more stable source of revenue for government programs.

One recommendation that has been made in the past is to increase the staff of the department. The Tax Conversion and Reform Commission estimated in 2003 that the staff needed to be increased to 217 personnel (from 130 at that time) in order to address the issues outlined above. Three years later, however, the personnel count stands at 162, and the amount of tax owed to the government remains large (roughly \$140 million today, versus \$149 million in 2003).

Increasing the budget and headcount of the department, however, are not necessarily the only solutions. With effective processes, sound MIS systems and an appropriately-trained staff, the current size of the department would likely be adequate. A look at three of the smallest U.S. states and other territories indicates that on a per capita basis, Guam’s budget is fairly ample. Of course, we recognize that there are differences in the scope of activities covered by each department and the level of technology available to each jurisdiction. Nevertheless, this should give the department a benchmark to work from as it works to increase the sophistication of its systems.



Exhibit 6: Comparison of budget for Department of Taxation²³

State / Territory	Population	Dept of Taxation budget (\$m)	Dept of Taxation, headcount	Budget/ Capita (\$)	Headcount/ Capita (x1000)
American Samoa	57,794	1.1	48	19.0	0.83
CNMI	80,000	1.8	68	22.5	0.85
Guam	160,000	9.0	162	56.3	1.01
Wyoming	509,294	8.1	129	15.9	0.25
Vermont	623,050	13.6	195	21.9	0.31
North Dakota	636,677	21.5	133	33.8	0.21

Many of these steps are already being planned and implemented, and the Government could continue to sustain this effort by continuing to automate tax returns and internal processes, hiring additional IT professionals as needed to support these systems, hiring temporary staff if necessary to catch up on the backlog of returns waiting to be processed, and ensuring that staff have access to training and resources to enable them to be effective.

²³ State Department of Taxation websites, interviews



VI. Transparency

The formal rules affecting the transparency of legal, political, and economic systems on Guam is comparable to that of the U.S. states. Within each sector we investigated – tax and revenue, labor, education, and public works - we found there were well-documented regulations guiding the decision making process. However, we did find some instances where decisions seemed to be made outside the boundaries of established rules. The primary area that we believe could benefit most from increased transparency is the procurement of government contracts, and it is here that the implementation of the existing laws, rules and regulations can have the greatest impact on outside perceptions.

Clear systems that indicate where money is being spent, for what and by whom, could increase accountability within the system. This is especially important in the procurement of government contracts, where there can be the appearance of susceptibility to political influence. Guam currently operates under the Model Procurement Code approved by the American Bar Association, with modifications and adjustments to suit Guam's organizational and local needs. Regulations controlling procurement and management of supplies or services are governed by the Office of the Governor's Procurement Policy Office (commonly referred to as the Policy Office). The Policy Office consists of three officers appointed by the Governor, the Director of Public Works and the Director of Administration. The role of the Policy Office is not to award or administer any particular contract, but instead to consider and decide matters of policy. Actual procurement is overseen by the Chief Procurement Officer of the General Services Agency, for the procurement of supplies and services, and the Director of Public Works for procurement of construction projects.

Guam's procurement code heavily favors local procurement. The aim of such laws is to promote local businesses wherever possible, though not at the risk of overspending the Treasury's money. When supplies are not available on island, U.S. suppliers are favored over international contractors. The General Services Agency is required to acquire supplies from the United States when the cost is less by ten percent than that from other contractors.

Guam's procurement regulations aim to make the procurement process fair, accessible to all, and available to the public. In order to make the bidding process impartial, publications of bids and requests for proposals are required to be made well in advance of need for delivery so as not to give certain bidders an unfair advantage. There are also specific regulations in place to prevent contracts being made based on kickbacks, contingent fees or family interests and strict remedies for any employee who breaches the code's standards for ethical behavior. If any member of the public believes that procurement data was withheld, then he/she has the right to file a complaint and Guam's Supreme Court will determine whether or not the government improperly withheld any data from the public.

In spite of regulations in place to combat the perception of favoritism towards certain businesses, there continue to be recorded instances of unfairly-managed bids or



government contracts²⁴. According to industry experts, about half the problems identified during audits of Government of Guam agencies are related to procurement violations²⁵. To avoid such situations, Guam could consider taking some or all of the following options:

- i. Requiring the public justification of bids that are accepted that are not the lowest cost.
- ii. Benchmarking the costs for the procured items or services against regional or international standards to help ensure Guam is paying a reasonable price.
- iii. Publicly announcing bid winners and amount of bid, and briefing non-winning bidders on how they could improve their bids in the future.
- iv. Designing and implementing a procedure that allows business to submit objections about the bidding procedures which will be investigated by a bureau separate from the procuring bureau.

Issues relating to transparency tend to be pervasive throughout governments everywhere. However, because Guam is such a small island, these issues and inconsistencies are more visible and have a much more immediate impact. Developing options to ensure enforcement of existing policies also has the potential to moderate many of the problems identified in the preceding sections.

²⁴ A rather well known and publicized example of this behavior occurred after Typhoon Paka hit Guam in 1997. The Disaster Recovery Antitrust Division carried out an investigation into public corruption concerning the more than \$70 million in federal funds made available to Guam by FEMA for disaster relief. The investigation led to multiple convictions, with former Director of Guam's Parks and Recreation Sonny Shelton, receiving a record-breaking ten-year sentence for organizing a bid-rigging, bribery, and money-laundering scheme from FEMA-funded contracts. Department of Justice, Antitrust Division, <http://www.usdoj.gov/atr/disaster.htm#guam>

²⁵ Limtiaco, Stephen, "Auditor not ready to hear appeals," Guam Pacific Daily News, December 30, 2005.



VII. Legal system

The legal framework of Guam appears to support business transactions reasonably effectively. Guam operates under the provisions of the Uniform Commercial Code (UCC) – a code adopted and adapted from the UCC of California. The judicial system includes a territorial supreme court and a U.S. district court. Laws are primarily the same as in the U.S. states and any problems that the legal sector faces appear to be a function of the size and scale of the economy (for example, until recently Guam did not have a full-time district court judge to deal with bankruptcy issues, which delayed decision-making).

In order to make the legal system even more user-friendly for businesses, Guam's court system may consider options in could pursue to increase the efficiency of its operations. Currently, Guam's judicial branch is trying to mirror the time standards (from date of filing to judgment) of the U.S. states. Inefficiencies that extend the number of days a case takes to be determined can substantially increase legal fees as well as opportunity costs for businesses. Assurances that decisions will be handed down in a timely fashion could reaffirm Guam's status as a good place to do business where disputes can be resolved in a fair and expeditious manner.

To better understand the source of case delays, Guam's judicial system might benefit from examining the flow of cases through the judicial system. Compiling data and statistics regarding the performance of the courts may enable the system to recognize what steps in the process delay the overall turnaround time. Another tool for expediting the legal process could be the enhanced use of videoconferencing. The remote location of Guam often requires expensive transportation costs and time delays that videoconferencing could mitigate.

In addition to the aforementioned cost-cutting mechanisms, Guam may also consider looking into existing federal programs which provide funding for efficiency tools, such as additional computers and electronic case filing systems. The Superior Court of Guam is currently operating under a \$175,000 grant²⁶ from the National Criminal History Improvement Program to implement digital recording technology in Guam's courtrooms. The grant is also intended to help continue converting manual criminal records to electronic format and help to put Guam in full compliance with the National Protection Order File.

²⁶ U.S. Department of Justice, Bureau of Justice Statistics, Justice Records Improvement Program, <http://www.ojp.usdoj.gov/bjs/nchip2.htm>



VIII. Business Practices

Obtaining a business license and setting up a business on Guam appears to be a well-regulated and straightforward process. The Licensing Office states that licenses can be issued in a week's time, and businesses consulted for this assessment did not report any significant delays or difficulties with this process.

In addition, outside (either U.S.-based or foreign) investors do not face significant obstacles in establishing their businesses on Guam. They need to complete an additional document called a Certificate of Authority, a fairly straightforward form that does not need to go to the Governor's office or other external agencies for approval, as is often the case in other territories.

The data suggest that foreign businesses owners can establish their entities on Guam with relative ease. Of the 2,926 businesses registered on Guam as of 2002, 25% are owned by non-U.S. citizens (and generate 28% of total business revenues)²⁷ The recent sale of several hotels between foreign companies also suggests that it is relatively straightforward for foreign investors to exit their investments on Guam as well.

Finally, the Guam Foreign Investment Equity Act of 2002 ensures that foreign, non-resident investors enjoy the same tax rates as they would in any of the 50 U.S. states. Until this act took effect, foreigners investing in Guam were not able to take advantage of specific tax treaties between the U.S. and their home countries, and were thus subject to a 30% withholding rate on dividends, interest and other forms of income. The passage of this act substantially reduced the tax rate for investors from tax treaty countries²⁸.

²⁷ U.S. Census Bureau, 2002 Economic Census of Island Areas

²⁸ Currently, over 60 countries have tax treaties with the U.S.

<http://www.irs.gov/businesses/international/article/0,,id=96739,00.html>



IX. Financial Infrastructure

The island's financial infrastructure is sound and adequately finances investment and entrepreneurship. All of the banks doing business on Guam are FDIC insured, and there is a healthy amount of competition in the sector. There are ten commercial banks active on Guam: one national bank, three state banks, two Guam-chartered commercial banks, one Guam-chartered savings and loan association and three foreign banks, with combined assets of over \$2.7 billion. In addition, there are fifteen finance companies licensed on Guam²⁹.

Banking procedures are similar to what they are in the states as well; interest rates on deposits and loans are similar to what they are in the states, property can be used to secure transactions, and credit information on borrowers is readily available.

²⁹ Year 2004, Twenty Second Annual Report of the Banking Commissioner of Guam



X. Land

There do not appear to be any significant issues with land that impact the development of the private sector.

Roughly 30% of the total land area in Guam is held by the Federal Government, with the Government of Guam holding approximately 25% and the remaining 45% being privately owned³⁰. While there is an ongoing movement to seek compensation for lands taken during the Second World War, we do not expect this to have a significant effect on private sector growth.

Property rights on Guam are well-developed, private land ownership is not restricted on the basis of nationality or residency, and to the best of our knowledge there are no obstacles to using land as collateral to secure credit transactions.

³⁰ <http://www.doi.gov/oia/Islandpages/gumain.htm>



XI. Conclusions

The most significant issues we feel that the Government of Guam faces are in the areas of infrastructure, labor and taxation. The Government has many options we feel it could consider, all of which would help improve the local business climate, including:

- Privatizing key components of infrastructure;
- Adopting creative solutions to address future labor shortages; and
- Reforming taxes by eliminating incentives and lowering tax rates across the board.

While the challenges faced are significant, with timely action and careful management they can be successfully addressed. We believe that Guam can offer an attractive environment for private sector activity and we are optimistic about the island's future growth prospects.



XII. Appendices

A. Appendix 1: Construction wage comparison³¹

Construction industry occupations	Mean hourly wage		Guam as % of average
	Guam	Average across CA, HI, NV, OR, WA	
Structural Iron & Steel Workers	\$10.81	\$26.89	40%
Reinforcing Iron & Rebar Workers	\$11.35	\$25.96	44%
Carpet Installers	\$8.71	\$19.61	44%
Operating Engineers/Equipment Operators	\$11.99	\$23.97	50%
Plasterers and Stucco Masons	\$10.61	\$19.68	54%
Electricians	\$13.72	\$25.04	55%
Construction Laborers	\$8.89	\$16.19	55%
Sheet Metal Workers	\$12.95	\$23.35	55%
Brickmasons and Blockmasons	\$12.87	\$23.11	56%
Carpenters	\$12.65	\$21.36	59%
Plumbers, Pipefitters, and Steamfitters	\$14.02	\$23.13	61%
Cement Masons and Concrete Finishers	\$12.22	\$19.82	62%
Helpers—Electricians	\$8.75	\$13.94	63%
Helpers—Carpenters	\$7.96	\$12.37	64%
Helpers--Pipelayers, Plumbers, Pipefitters, Steamfitters	\$8.67	\$13.35	65%
First-Line Supervisors/Managers	\$19.54	\$29.82	66%
Painters, Construction and Maintenance	\$11.87	\$17.51	68%
Helpers, Construction Trades, All Other	\$9.69	\$12.27	79%
All Construction and Extraction Occupations	\$12.08	\$20.99	58%
Minimum wage	\$5.15	\$6.76	
Average construction wage / Minimum wage	2.3x	3.1x	

³¹ Bureau of Labor Statistics, May 2005 State Occupational Employment and Wage Estimates, <http://www.bls.gov/oes/current/oesrcst.htm>



B. Appendix 2: Tourism Penetration Index (TPI)³²

Table 2. Tourism penetration index and destination rankings, 2001

Island	Spend/pop (US\$)	Density ^a /1000	Rooms/km ²	Impact indices ^b			TPI score ^c
				Spending	Density	Rooms	
<i>Most developed</i>							
UK Virgin Islands	16 048	413	33.8	0.929	1.000	0.450	0.793
St. Maarten	13 694	219	74.8	0.792	0.529	1.000	0.774
Aruba	12 714	235	40.3	0.735	0.568	0.538	0.614
Cayman Islands	16 250	258	20.9	0.940	0.624	0.277	0.614
Turks/Caicos	17 278	193	5.1	1.000	0.466	0.066	0.511
Bermuda	5484	84	64.7	0.316	0.201	0.865	0.461
Malta	1466	79	63.6	0.084	0.189	0.850	0.374
Guam	12 918	61	16.6	0.747	0.146	0.220	0.371
US Virgin Islands	9803	104	14.5	0.567	0.250	0.192	0.336
Average	11 739	183	37.1	0.678	0.441	0.495	0.539
<i>Intermediate</i>							
Anguilla	5083	106	11.8	0.293	0.254	0.155	0.234
Mariana Islands	7507	58	9.5	0.434	0.138	0.125	0.232
Bonaire	6250	120	3.2	0.361	0.289	0.040	0.230
Antigua	4060	85	7.2	0.234	0.204	0.094	0.177
Maldives	1064	35	28.3	0.060	0.083	0.377	0.173
Barbados	2498	57	15.8	0.143	0.136	0.209	0.163
Cook Islands	1810	108	3.3	0.103	0.260	0.042	0.135
Bahrain	977	57	12.3	0.055	0.136	0.162	0.118
St. Kitts	1590	64	6.5	0.091	0.153	0.085	0.107
St. Lucia	1753	53	7.3	0.100	0.126	0.095	0.107
Curacao	1721	38	5.9	0.098	0.090	0.076	0.088
Seychelles	1413	47	5.4	0.080	0.112	0.070	0.087
Martinique	590	41	6.4	0.033	0.097	0.083	0.071
Grenada	708	32	5.1	0.040	0.075	0.066	0.060
Montserrat	1125	36	2.4	0.064	0.085	0.029	0.059
Polynesia	1551	27	0.9	0.088	0.063	0.009	0.053
St. Vincent	690	22	5.2	0.039	0.051	0.067	0.052
Guadeloupe	858	20	4.7	0.048	0.046	0.060	0.051
Dominica	662	40	1.2	0.037	0.095	0.013	0.048
Average	2205	55	7.5	0.126	0.131	0.098	0.118
<i>Least developed</i>							
Reunion	332	25	1.1	0.018	0.058	0.012	0.029
Tonga	67	13	0.9	0.002	0.029	0.009	0.013
Samoa	218	10	0.3	0.011	0.022	0.001	0.011
Tuvalu	118	2	2.3	0.005	0.002	0.028	0.009
Marshall Islands	59	1	1.7	0.002	0.000	0.020	0.007
Cape Verde	96	5	0.6	0.004	0.010	0.005	0.006
Kiribati	34	1	0.2	0.001	0.000	0.000	0.001
Comoros	25	1	0.2	0.000	0.000	0.000	0.000
Average	118	7	0.9	0.005	0.015	0.009	0.010

Source: *Compendium of Tourism Statistics*, 2003 Edition (WTO, 2003); *The World Factbook* (CIA, 2001).

Notes: ^a Calculated as: (tourists × stay) ÷ (population × 365) × 1000.

^b Calculated as: (indicator value – minimum) ÷ (maximum – minimum).

^c Unweighted average of the three impact indices.

TPI, tourism penetration index; spend, spending; pop, population.

³² Jerome McElroy, “Small Island Tourist Economies Across the Life Cycle,” *Asia-Pacific Viewpoint*, Vol. 47, No. 1, April 2006



C. Appendix 3: Effective corporate tax rate comparison³³

Country/ territory	Domestic Rate	Foreign Rate	Notes
Guam	35%	35%	Tax rates mirror the U.S. and 35% is the highest rate in a progressive tax structure. Businesses are subject to a 4% tax on gross receipts.
CNMI	18%	18%	Businesses are rebated 50-90% of U.S. corporate income mirrored tax on a sliding scale. Businesses are subject to a 5% tax on gross receipts.
America Samoa	44%	44%	44% is the highest rate in a progressive tax structure (rate on > \$650K is 44%; \$75-650K is 34%; \$50-75K is 25%; <\$50K is 15%).
U.S. Virgin Islands	35%	35%	Tax rates mirror the U.S. and 35% is the highest rate in a progressive tax structure. Businesses are subject to a 4% tax on gross receipts.
United States	35%	35%	35% is the highest rate in a progressive tax structure.
China	30%	33%	State tax is 30%, local tax 3%.
Fiji	31%	31%	Rate reduced from 32% in 2004.
Hong Kong	18%	18%	The 17.5% rate applies to Hong Kong sourced profits that are derived from a business carried on in Hong Kong. Offshore profits, capital gains, dividends and most bank deposit interest income are exempt from tax.
India	34%	42%	The effective tax rate for domestic companies is 33.66% (30%, plus surcharge of 10% of the tax, plus education cess of 2% on tax and surcharge). Foreign companies are taxed at 41.82% (40%, plus a surcharge of 2.5% of the tax, plus education cess of 2% on the tax and its surcharge).
Philippines	35%	35%	After a four year start-up phase, domestic corporations and resident foreign corporations are subject to a 2% minimum corporate income tax (MCIT) based on gross income if the MCIT is greater than the corporate income tax determined by applying the 35% corporate income tax rate to the net income.
Taiwan	25%	25%	Maximum rate in tax structure, on income over \$TW 100,000.
Asia-Pacific average	30%	30%	N/A

³³ KPMG Corporate Tax Survey, 2006

