COMPACT OF FREE ASSOCIATION WITH THE REPUBLIC OF PALAU: ASSESSING THE 15–YEAR REVIEW

HEARING

BEFORE THE

SUBCOMMITTEE ON ASIA AND THE PACIFIC

OF THE

COMMITTEE ON FOREIGN AFFAIRS
HOUSE OF REPRESENTATIVES

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COMPACT OF FREE ASSOCIATION WITH THE REPUBLIC OF PALAU: ASSESSING THE 15–YEAR REVIEW

WEDNESDAY, NOVEMBER 30, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ASIA AND THE PACIFIC,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 11:43 a.m., in room 2226 Rayburn House Office Building, Hon. Donald A. Manzullo (chairman of the subcommittee) presiding.

Mr. MANZULLO. The subcommittee will come to order.

In 1994, the United States and the Republic of Palau established a Compact of Free Association ending 49 years of direct American administration of that country and other island nations under the auspices of the U.N.'s Trust Territory of the Pacific Islands.

Palau consists of eight main islands and more than 250 smaller islands, with a total population of approximately 20,000 people. The Compact with Palau was negotiated in the 1980s, at the height of the Cold War, with the goal of establishing democratic self-governance and economic self-sufficiency in Palau while preserving strategic control of the Western Pacific.

The original Compact of Free Association was completed in 1986 but did not enter into force for another 8 years. The Compact provided for several types of assistance, including direct economic assistance for 15 years to the Palau Government; establishment of a trust fund to provide Palau $15 million in annual payments from 2010 to 2044; infrastructure investments; and the provision of Federal services such as postal, weather, and aviation. The Government Accounting Office, which is represented here today, estimated that Palau received a total of $852 million between 1995 and 2009.

Under the Compact, citizens of Palau are granted uninhibited access to reside and work in the United States and its territories as "lawful non-immigrants," and eligibility to volunteer for service in the U.S. Armed Forces. It should be noted that a number of volunteers from Palau have paid the ultimate sacrifice in service of our nation, and our hearts and thoughts go out to their families.

Last year, the administration completed a 15-year review of the Compact, as required under the terms of the agreement, with a total cost of $215 million. The revised agreement does not change the fundamental provisions of the original Compact; however, it does gradually reduce the financial support provided by the U.S. and extends the life of the agreement to 2024.

More importantly, the revised agreement greatly improves the likelihood of the existing trust fund's ability to sustain payments through 2044 as originally planned. The revised agreement also requires visitors from Palau to have a machine-readable passport to enter the U.S., and it conditions future financial assistance on Palau's progress in achieving key economic reforms.

Just 2 weeks ago, the President announced a dramatic expansion of the U.S.-Australia defense relationship in part to counter China's rapid development of its military forces. Palau is indeed an important friend in the region. It is one of six Pacific Island nations to have diplomatic ties with Taiwan, rather than China. Palau also consistently supports the U.S. and Israel at the United Nations by voting with us over 90 percent of the time.

The relationship with Palau has evolved into a strong partnership with people who share American values. It is my hope that the witnesses today will provide acceptable offsets for the funding request that accompanies the revised Compact agreement.

With our national debt now over $15 trillion, increases in expenditures must be justified and offsets found to balance the costs. Funding to Palau is no different.

I thank the witnesses for appearing today. I now recognize Ranking Member Faleomavaega for his opening remarks.

[The prepared statement of Mr. Manzullo follows:]

One Hundred Twelfth Congress

Congress of the United States

Committee on Foreign Affairs
Subcommittee on Asia and the Pacific

November 30, 2011

Compact of Free Association with the Republic of Palau: Assessing the 15-year Review

Chairman Donald A. Manzullo
Opening Statement

In 1994, the United States and the Republic of Palau established a Compact of Free Association ending 49 years of direct American administration of that country and other island nations under the auspices of the United Nations' Trust Territory of the Pacific Islands. Palau consists of eight main islands and more than 250 smaller islands, with a total population of approximately 20,000 people. The Compact with Palau was negotiated in the 1980s at the height of the Cold War with the goal of establishing democratic self-governance and economic self-sufficiency in Palau while preserving strategic control of the Western Pacific.

The original Compact of Free Association was completed in 1986 but did not enter into force for another eight years. The Compact provided for several types of assistance, including direct economic assistance for 15 years to the Palau government, establishment of a trust fund to provide Palau $15 million in annual payments from 2010 to 2044, infrastructure investments, and the provision of federal services such as postal, weather, and aviation. The Government Accounting Office, which is represented here today, estimated that Palau received a total of $852 million between 1995 and 2009.

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eligibility to volunteer for service in the U.S. armed forces. It should be noted that a number of volunteers from Palau have paid the ultimate sacrifice in service of our nation, and our hearts and thoughts go out to their families.

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The relationship with Palau has evolved into a strong partnership with people who share American values. It is my hope that the witnesses today will provide acceptable offsets for the funding request that accompanies the revised Compact agreement. With our national debt now over $15 trillion, increases in expenditures must be justified and offsets found to balance the costs. Funding to Palau is no different. I thank the witnesses for appearing today.

Mr. FALEOMAVAEGA. Mr. Chairman, thank you for calling this hearing. I deeply appreciate again your leadership and your efforts in bringing this important issue before the members of our subcommittee.

Thank you for calling the hearing on the 15th Anniversary Review of the Compact of Free Association with the Republic of Palau.

Just as a matter of observation, Mr. Chairman, I have followed this matter with Palau as well as with the Federated States of Micronesia and with the Republic of the Marshall Islands, having served previously as a staff member on the Committee on International Affairs.

An interesting observation, Mr. Chairman, is that immediately after World War II, we would just simply grab these Micronesian islands and say, "It is ours," and we put a fancy term like "a strategic trust" of our country. We didn't even have to ask permission from the United Nations. We just went ahead and took them.

And in the process, becoming a strategic trust, we eventually then placed it before this trusteeship council, whereby we eventually worked up a very unique political relationship with these three Micronesian entities.

The Compact of Free Association negotiations actually started with the Carter administration and was then continued on by the Reagan administration, which granted the islands sovereignty but retained military authority for the United States and in Palau and gave us some base rights for some 50 years.

Programmatic and financial assistance were specified for 15 years. And bilateral reviews of Palau's needs at the 15, 30, and 40th earmarks were required to determine assistance for the succeeding periods. Freely associated state citizens were also given free access, not only to come to the United States but they could also join the military.

The extent of U.S. military authority in Palau raised questions there and at the United Nations. Palau has finally approved the Compact a few years after the Federated States of Micronesia and the Republic of the Marshall Islands gave approval of their own Compacts with our Government.

The U.N. Security Council in 1994 finally left the trusteeship terminated. And this is where we are now.

The Bush administration negotiated a revised Compact with the other two Micronesian entities: FSM and the RMI after their first 15-year periods were approved by Congress in the year 2003, increasing financial assistance to 83 percent in one case, and the other one by a 47 percent increase for both FSM as well as RMI or the Republic of the Marshall Islands.

In 2008, before the 15-year mark, the Bush administration began the review with Palau to ensure a seamless transition. However, there were a number of delays in the review on the U.S. side, but it finally produced an agreement that was signed 15 months ago by the President of Palau and an authorized representative of our Government.

The State Department says this agreement was sent to Congress in January of this year but the last I heard, it still had not been

received by the Speaker's office. So I don't know where this document is, Mr. Chairman, but we really need to follow up on this.

At the insistence of the current administration, the agreement would provide 62 percent less financial assistance than during the first period of free association and would phase out these decisions before the next review in Fiscal Year 2024. This will require cuts in Palau's budget, decrease in its revenues, and reduce GDP in the short term.

This is shortsighted in my opinion, Mr. Chairman, in light of the stakes involved. The record will show that the levels of assistance are arbitrary and, in my humble opinion, without justification.

The agreement would also amend the Compact for U.S. border security and revise seven agreement subsidiaries to the Compact in response to U.S. requests concerning civil aviation, Weather and Postal Service operations, as well as telecommunications. The stakes are primarily that Palau gives the U.S. military control over our military strategic interests in this part of the Pacific.

The Pentagon had stated for the record that this "security arrangement" is "very critical and irreplaceable" for "the United States in an increasingly contested region." Ever since we left Suvla Bay and Clark Air Force Base in Guam, the other Micronesian islands have now become very, very key and important parts of our strategic overall defense system in this part of the Pacific.

I just want to give my colleagues a little sense of where Palau is located, Mr. Chairman. I brought a little map here. This is Palau. I know it doesn't show it, but it is the same size as the State of Texas if we take the dimensions of the people, 20,000 population, but this is the capacity in terms of their EEZs or their zones that make them as the Republic of Palau.

This is why these islands are so important, Mr. Chairman, I don't know how else to say it but it is very, very critical that we not do the things that we are doing, especially in our current process of negotiating in good faith. I would hope that we are doing this in good faith with the leaders and the people of Palau.

I will come back to the map again when I finish my opening statement, Mr. Chairman. And I thank you for this.

Year after year, the State Department reports that Palau votes with the U.S. more than any other country, including on issues we are often isolated, such as Israel, Cuba, and even the Uyghurs. I am very, very curious to find out where we are with the Uyghurs given the effort the President of Palau made, despite all of the criticisms that they received on that.

In my opinion, Palauans have become very Americanized in half a century. Despite our relationship with this important ally, they are becoming discouraged at the time the review and the agreements have taken. A few of the people of Palau and their leaders are wondering whether Palau should become more independent and benefit from the desires of China and other countries that are not necessarily friendly, but are interested in this part of the world.

So yes, you mentioned earlier, Mr. Chairman, that we need to look at the offset that seems to be the crucial issue that we are going to be discussing here. The fact that this issue covers the jurisdictions of three committees, the Foreign Affairs Committee, the

House Resources Committee, the Armed Services Committee, my gosh, you cannot have a more complicated issue than this. If it was possible in the 1970s and '80s to work out an agreement, the fact of the matter is, it was the arguments made by the Department of Defense in the 1970s that made these Micronesian entities a very, very critical part of our strategic and overall importance to our defense system.

Mr. MANZULLO. You are at 7 minutes.

Mr. FALEOMAVAEGA. I am on 7 minutes already, Mr. Chairman? I will wait for my 5 minutes, then. Thank you for giving me a couple of more minutes.

I look forward to hearing from our witnesses this afternoon and hope that this hearing will produce some good results. Thank you, Mr. Chairman.

[The prepared statement of Mr. Faleomavaega follows:]

STATEMENT OF
THE HONORABLE ENI F.H. FALEOMAVAEGA
RANKING MEMBER

before the
SUBCOMMITTEE ON ASIA AND THE PACIFIC

"Compact of Free Association with Palau: Assessing the 15-year Review"

November 30, 2011

Mr. Chairman:

Thank you for calling this hearing on the 15th Anniversary Review of the Compact of Free Association with Palau. I have worked on Palau matters since I was on the staff of the Committee on Interior and Insular Affairs, and I closely observed the Review as Chairman of this Subcommittee.

World War II caused the United States to become involved with Palau and the other Micronesian islands controlled by Japan. We took the islands in some of the war's toughest battles, with one of the bloodiest in Palau. Later, we convinced the United Nations to let us govern the islands as the only strategic territory in its trusteeship system. This enabled us to deny access to any other nation.

The trusteeship required us to develop the islands economically and into self-government. So, to preserve military control, we extended domestic programs and financial assistance to develop a reliance on the United States, and in Palau and two other island groups of the territory, encouraged the status of free association as an alternative to independence.

Compacts of Free Association negotiated by the Reagan Administration granted the islands sovereignty but retained military authority for the United States and in Palau gave us base rights for 50 years. Programmatic and financial assistance were specified for 15 years and bilateral reviews of Palau's needs at the 15, 30, and 40-year marks were required to determine assistance for succeeding periods. Freely associated state citizens were also given free access to the U.S.

The extent of U.S. military authority in Palau raised questions there and in the U.N. but Palauans finally approved the Compact a few years after the other islands approved their compacts. The U.N. Security Council in 1994 finally let the trusteeship be terminated.

The Bush Administration negotiated revised compacts with the other islands after their first 15-year periods approved by Congress in 2003, increasing financial assistance 63% in one case and 47% in the other.

In 2008, before the 15-year mark, the Bush Administration began the review with Palau to ensure a seamless transition. However, there were a number of delays in the Review on the U.S. side, but it finally produced an Agreement signed 15 months ago by the president of Palau and the representative of the United States. The State Department says it was sent to the Congress in January but last I heard it still had not been received by the Speaker's Office.

At the insistence of the current Administration, the Agreement would provide 62% less financial assistance than during the first period of free association and would phase out this assistance before the next review in Fiscal Year 2024. This will require cuts in Palau's budget, increases in its revenue, and reduce GDP in the short-term. It is shortsighted in light of the stakes involved, and the record will show that the levels of assistance are arbitrary, but, I suppose, it reflects the reality of our budget.

The Agreement would also amend the Compact for U.S. border security, and revise seven agreements subsidiary to the Compact in response to U.S. requests concerning civil aviation, Weather and Postal Services operations, and telecommunications, etc.

The stakes are primarily that Palau gives the U.S. military control over a strategic expanse of the western Pacific the size of Texas almost as if the islands were U.S. territory. The Pentagon says that, "this security arrangement provides an unyielding foundation" that is "critical" and "irreplaceable" for "the United States in an increasingly contested region." It advises that, "Failure to follow through on our commitments to Palau, as reflected in" the Agreement "would jeopardize our defense posture" in a region that "will become increasingly important".

In addition, according to year-after-year State Department reports, Palau votes with the U.S. in the U.N. more than any other member -- including on issues in which we are often isolated, such as concerning Israel and Cuba.

Palauans became very Americanized during a half century of U.S. government, and continue to feel very close to the U.S. Many serve -- and sacrifice -- in our military. But they are becoming discouraged by the time that the Review and its Agreement have taken. A few wonder whether Palau should become more independent and benefit from the desires of China and Arab countries to have Palau change some of its policies.

I have not heard anyone in Congress question the Agreement. And committee leaders on both sides of the aisle and the Capitol have expressed support. But there is an impediment: the need for an offset for the cost that will reduce other spending and how to marry it with approval legislation. OMB Director Lew has identified possible offsets but all are within the jurisdiction of the Natural Resources Committee and the bipartisan leadership of that committee says that none can pass the committee. One, however, has been enacted on an annual basis through appropriations bills for the past few years. With three committees involved, the Administration needs to work out a solution with us.

The cost is relatively small. At this point, it is less than $184.5 million over 10 years and

less than $198.75 million through FY24 because of interim appropriations.

There are some enhancements to the Agreement that I would like to see made, although a couple could be made in the future if conditions actually warrant:

- A more immediate matter is that the cost of required audits of Compact grants, now paid for by the U.S., should be shared, as in the cases of the other two states.
- Also, certain FCC requirements may need to be waived as was done in the revised compacts with the other states to enable Palau to have a fiber optic Internet cable.
- If there is excessive inflation in the future, there should be an adjustment in grants. Congress added an adjustment to the revised compacts with the other states.
- Grants to the Postal Service to provide domestic rate service to all three states should be redirected to them if the Postal Service discontinues the service in the future.

With that, Mr. Chairman, I look forward to hearing our witnesses, and to the Subcommittee reporting legislation to approve the Review's Agreement.

Mr. MANZULLO. Without objection, Mr. Rohrabacher is welcome to join the subcommittee.

Mr. ROHRABACHER. Thank you very much. Thank you very much for allowing me to sit in on your hearing today. I am here.

I want to make sure that I express a deep-felt appreciation that I have for Palau. My father was a Marine during the second world war. And he landed in Palau many times. And the Marines paid a very heavy price for these islands. And you might say that they implanted the American spirit there. And we should never ever take that for granted, that sacrifice and the friendship that that sacrifice bought for our country.

It has been 15 years since we signed, last signed. And it is the last element of the Compact of Free Association. And I think that the free association has served us well.

And now that we are entering a time when we face an economic crisis in our country and a potential threat and a gathering storm with China entering the Pacific in a very, very dramatic way, it pays us to maintain that friendship and that relationship with Palau, both on economic terms in the long run, having such a relationship with the country there in the vast Pacific, which I see as a tremendous economic resource as well as the expansion of the Chinese military. If we have Palau on our side, we are a safer country. So those things taken for granted are taken into consideration.

I think that I appreciate this hearing and hope that we do justice by this relationship.

Mr. MANZULLO. Thank you.

Mr. Sablan?

Mr. SABLAN. Thank you very much, Mr. Chairman and Ranking Member Faleomavaega, for the opportunity to join you and other members of the subcommittee on Asia and the Pacific in assessing the 15-year review of the Compact of Free Association with the Republic of Palau.

The Compact of Free Association with Palau was originally negotiated by the Reagan administration because of the strategic importance of the western Pacific. The Compact gives the United States military control of an area as large as, as Congressman Faleomavaega said, the State of Texas. The Pentagon says that this security arrangement provides a foundation for the United States in an increasingly contested region, allowing critical access, influence, and a strategic position.

The relationship between the United States and the Republic of Palau will only grow in importance. Together with our partnership with the other freely associated states and in conjunction with the U.S. Territory of Guam and the Commonwealth of the Northern Mariana Islands, which I represent, we have built a network of strategic alignments here in the western Pacific. This gives the United States presence and position in an area of the world that is more and more a center of commerce and a source of economic resource.

The Compact the Reagan administration negotiated promised assistance to Palau for 50 years. It specified programs and grants for the first 15 years and required periodic bilateral review to assess the relationship and to determine future assistance. Talks initiated

under President George W. Bush produced an agreement which was finally sent to Congress this year that phases non-financial assistance during the current 15-year period. This period ends with Fiscal Year 2024 and reduces assistance to Palau by 62 percent.

This hearing comes at a critical time. Delays in approving the agreement negotiated by the Bush administration and the proposed cuts in assistance are causing some in Palau to question their relationship with the United States.

The Palauan people are a very patient people, but, as we all know, patience sometimes has its limits.

The present Government of Palau stands firm in wanting to maintain these strategic ties, but we in Congress need to be aware that other voices are asking whether Palau should be more independent and develop relationships with other powers in the region. This would be a very dangerous outcome.

As our Department of Defense has advised, failure to follow through on our commitments to Palau, as reflected in the agreement under consideration today, would jeopardize our defense posture.

The Natural Resources Committee Subcommittee on Fisheries, Wildlife, Oceans, and Insular Affairs, of which I am ranking member, shares jurisdiction with respect to the Compact with Palau.

In addition, the relationship with Palau is very close to my heart because the islands that I represent in Congress were once part of the United Nations trust territory of the Pacific islands, along with Palau. And, to this day, the Northern Marianas is home to many citizens of Palau. And, to this day, I am the only Micronesian Member of Congress, of which Palau is a part of.

So as someone who knows Palau and the western Pacific and understands the history and strategic importance of our region, I strongly urge the Subcommittee on Asia and the Pacific to approve the agreement now before us.

Again, thank you, Mr. Chairman, Mr. Faleomavaega, and other members of the committee, for the courtesy extended to me in allowing me to be part of today's hearing. I look forward to the testimony of the witnesses. Thank you.

Mr. MANZULLO. Thank you, Mr. Sablan.

Mr. Duncan?

Mr. DUNCAN. Thank you, Mr. Chairman.

Reading through some of the opening statements and whatnot, in listening to the gentleman's from California comments, it sparked something that I am interested in hearing about. And that is the fact that some of the detainees from Guantanamo Bay have been repatriated here. And I would love to hear how that is working out, how those gentlemen are adapting to the society. If somebody could just throw that in at some point in time during your testimony, it would be great. Thanks.

Mr. MANZULLO. Thank you.

Our witnesses are James Loi, who became Deputy Assistant Secretary for the Bureau of East Asia and Pacific Affairs at the U.S. Department of State on July 18, 2011. He is responsible for relations with Australia, New Zealand, and the Pacific islands.

Previously, Mr. Loi served as chief of staff and special assistant to Dr. Kurt Campbell, Assistant Secretary of State. He has also

served at the National Security Council as Director for Australia, New Zealand, and Pacific Island Affairs and as Director for East Asian Economic Affairs.

Prior to the NSC, he was a visiting fellow with the Freeman Chair in China Studies at the Center for Strategic and International Studies. From 1986 through 2005, he served in various capacities with the U.S. Navy in both enlisted and commissioned officer status and on active and reserve duty, attaining the rank of Commander.

Thomas Bussanich is the Director of the Budget and Grants, Management Division of the Department of Interior's Office of Insular Affairs. His responsibilities include management of the Compact of Free Association funding to Palau, the Federated States of Micronesia, and the Marshall Islands, and of capital improvement programs in the U.S. territories.

Mr. Bussanich has been involved with U.S.-affiliated Pacific islands since 1978 when he served as a Peace Corps volunteer in Micronesia. He is a graduate of the University of Colorado.

Brigadier General Richard Simcock currently serves in the Office of the Secretary of Defense, Asia and Pacific Security Affairs, as the Principal Director of South and Southeast Asia.

Prior to that, he served as the legislative assistant to the Commandant at the U.S. Marine Headquarters. In 2008, General Simcock served as the director of the Tactical Training and Exercise Control Group in Palms, California after relinquishing command of the 6th Marine Regiment.

In 2003, General Simcock graduated from the top-level school at the Naval War College in Newport, Rhode Island, after which he reported to the U.S. Marine Corps Headquarters as a Congressional Liaison Officer to the U.S. House of Representatives.

He first joined the Marines in 1983 and had a long and successful career filling a wide variety of positions on bases in California, Florida, Hawaii, Virginia, and Japan.

David Gootnick has been Director of International Affairs and Trade at the Government Accountability Office since 2001. His portfolio includes insular affairs, humanitarian aid, development assistance, economic assistance, and global health.

From 1994 through 2001, he served as Director of the Office of Medical Services at the U.S. Peace Corps. Prior to that, he was a practicing physician and director of the University Health Services at New York University.

We welcome our witnesses. The lights show 5-minutes for your testimony. When it turns yellow, you have 1 minute remaining. When it turns to red, then you supposedly should stop at that point, although I am not going to throw the gavel at you.

We will start with our first witness, Mr. Loi. Thank you for coming here.

Mr. LOI. Thank you, Chairman. I do have a——

Mr. MANZULLO. Please start. All the witnesses' testimonies, in written form, will be made part of the record. Eni, this includes your complete opening statement, which you didn't have a chance to read.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman.

Mr. MANZULLO. Proceed.

STATEMENT OF MR. JAMES L. LOI, DEPUTY ASSISTANT SECRETARY, BUREAU OF EAST ASIAN AND PACIFIC AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. LOI. Thank you, Mr. Chairman, Ranking Member Faleomavaega, and members of the subcommittee. Thank you for the opportunity to appear before you today to discuss the Pacific, sometimes the overshadowed second part of Asia-Pacific but, nonetheless, an integral part of the administration's enhanced focus on and engagement with the Asia-Pacific region.

The vast stretch of the Pacific and the island countries that reside within it are critical to our national security, with our close friends and allies like Palau forming a security arc that stretches from California to the Philippines, safeguarding our interests in the Pacific as well as critical sea lines of communication, through which much of our trade flows.

Of our many friends and partners in the region, we have perhaps none stronger than Palau, a country which paid a dear price in blood and treasure to liberate in 1944, a country to which we made a solemn promise to help transition from trusteeship to independence through our Compact of Free Association, and a country which provides us strong support, whether that be in regional fora, multilateral institutions through the many Palauan sons and daughters that joined the U.S. military at per capita rates higher than any U.S. state, or through its voluntary actions, such as the decision in 2009 to accept 6 Guantanamo detainees when few others would step up to the plate.

And perhaps let me just break here and respond to Congressman Duncan's question. Sir, from what I understand, a number of the Uyghurs have adjusted well to life in Palau with one or two perhaps still struggling to find permanent employment. I think it is safe to say that most, if not all, of them, though, are interested in permanently relocated to a third country.

And I know my colleague Ambassador Fried at the State Department is working that. I also know that there is a representative from the Palauan Government in Washington this week who will be meeting with Ambassador Fried to talk about next steps on the detainees. But beyond that, I don't have much additional information.

With respect to foreign policy goals, I think we have two critical ones with respect to Palau: Firstly, continuity in reinforcement of our full authority and responsibility for the security and defense of Palau; and, secondly, ensuring that we continue to earn and enjoy Palau's strong support in regional and multilateral fora.

On the first, my colleague General Simcock will speak in detail, but suffice it to say that Palau does enjoy, as the ranking member Faleomavaega said, a strategic position in the western Pacific as part of the so-called Second Island Chain.

Our Compact of Free Association provides the United States the critical right of strategic denial foreclosing access to Palau by military forces and personnel of any nation except the United States. In light of the evolving security climate in the Asia-Pacific, the relatively modest annual cost associated with the proposed legislation approving the results of the 15-year Compact review are worth this rate of strategic denial alone.

With respect to the second goal, Palau is amongst our strongest supporters in regional and multilateral fora. In the former, Palau has been an ardent advocate for enhanced U.S. participation and engagement in the Pacific Islands Forum and a positive partner as we were to ascend the South Pacific Tuna Treaty, an agreement that provides access for the U.S. tuna fleet to the rich waters of the South Pacific and which supports thousands of tuna industry jobs here in the U.S. and American Samoa.

At the United Nations, Palau's voting confidence with the United States is about 90 percent. This compares to 67 percent for the United Kingdom, 66 percent for Canada, 49 percent for Japan and South Korea. So it is markedly higher.

Despite enticements from others interested in enhancing their engagement in the region, China, Russia, the Arab League nations, Palau has not only supported us 100 percent on Israel and consistently on human rights in Cuba-related votes but has been at the forefront of actively helping us garner the support of others.

My colleague from the Department of the Interior will discuss in greater detail the specifics of the Compact and the legislation the administration has submitted, but let me just state that over two decades ago, the framers of the Compact undertook a promise to help this young nation through financial and other assistance to achieve self-governance and a sustainable economic development path. They were wise in recognizing that any plan would require review and its necessary adjustments.

The 15-year review finds us at a point where the goal of self-governance is firmly in place but the goal of sustainable economic development, while progressing well, remains a work in progress and requires additional financial support.

The tiered nature of the support agreed to in this 15-year review is designed to ease Palau off dependence on U.S. direct economic assistance and toward that sustainable reliance and economic development.

Importantly, the resulting agreement will require the Palauan Government to undertake economic and fiscal reforms. And should the United States believe that progress toward such reform is adequate, we will be able to withhold assistance.

In closing, members of the subcommittee, since that bloody battle in Peleliu in 1944, the United States has embarked on a long road of partnership with the people of Palau, from liberation to trusteeship and, finally, to independence.

The United States and the American people are admired around the world for our sense of duty, commitment to the well-being of others, and integrity in upholding our word. With Palau, one can see all three of these threads woven into the fabric of our bilateral relationship.

It was a sense of duty that led thousands of Marines to pay the ultimate price in freeing Palau from colonialism and occupation. It was a commitment to Palau's future that led us to help Palau transition from trusteeship to independence. And it is our integrity that has driven us and must drive us to uphold our commitment.

The implementation of the results of the Compact review will help ensure that our hard-fought investments in this young country achieve their intended returns. Importantly, as the generation for

which the second world war was a defining experience passes and other emerging powers seek to increase their influence in the region, passage of this legislation will send a reassuring signal to others that the United States is and will be engaged and remains a faithful friend and ally through both good and challenging times.

Thank you. I look forward to answering your questions.

[The prepared statement of Mr. Loi follows:]

Testimony of James Loi
Deputy Assistant Secretary of State
Bureau of East Asian and Pacific Affairs
U.S. Department of State

Before the
House Foreign Affairs Committee
Subcommittee on Asia and the Pacific

November 30, 2011

Compact of Free Association with the Republic of Palau:
Assessing the 15-year Review

Chairman Manzullo, Ranking Member Faleomavaega, and Members of the Subcommittee, I am here today to testify on the importance of our bilateral relationship with Palau as well as to discuss the Compact with Palau and proposed legislation approving the results of the mandated 15-year Compact Review. History has proven that this small Pacific island nation remains indispensable to our national security and other core interests in the Pacific. Current and future challenges convince us we must remain steadfast to a thriving relationship that delivers much more than it costs.

Our Compact with Palau took effect in 1994. It does not have a termination date and requires a review on the 15-year, 30-year, and 40-year anniversaries. Our two governments worked closely over 20 months of discussions and negotiations to conclude the recent15-year review, which resulted in an Agreement my predecessor, Ambassador Frankie Reed, signed with President Toribiong in September of 2010. The legislation now proposed is to implement the Agreement. The Agreement and proposed legislation are the outcome of the review and the manifestation of the shared commitments between our two governments.

The proposed Compact Review legislation would amend Title I of Public Law 99-658 regarding the Compact of Free Association between the Government of the United States of America and the Government of Palau. In formal language, this bill would approve the results of the 15-year review of the Compact, including the Agreement between our two governments following the Compact of Free Association Section 432 Review. It appropriates funds for the purposes of the

amended PL 99-658 for fiscal years ending on or before September 30, 2024, to carry out the Agreement resulting from the review.

The Agreement does not change the 1994 Compact, except in so far as it will require Palauans coming to the United States under the Compact to have machine readable passports (instead of allowing them to come to the U.S. without passports). It will require them to decrease the amount of money the Compact allows Palau to take out of its Compact Trust Fund through FY 2023. In addition, Palau will be required to make meaningful economic reforms and, if the U.S. determines that insufficient progress has been made on economic reform, the U.S. may delay assistance payments until it deems sufficient progress has been made. The Agreement does other things that are not changes to the Compact but supplement it and result from a review of how the Compact worked over its first 15 years. In particular, the Agreement is intended to strengthen the Trust Fund so it will perform as the Compact framers intended. It is also designed to result in Palau adjusting to the level of assistance it will receive through withdrawals from the Trust Fund, once the payments under the Agreement end in FY 2023.

The Agreement is specifically designed to get Palau to adjust to the amount of money ($15 million a year) the Compact allows it to withdraw from the Trust Fund through FY 2044. The Agreement does this in three ways. First, the Agreement provides a glide path for Palau to move from reliance on the over $18 million it has been receiving (through a combination of direct assistance and Trust Fund withdrawals), to a $15 million level. Second, the Agreement provides for U.S. contributions to the Trust Fund from FY 2013 through FY 2023 and decreases the amount Palau may withdraw from the Trust Fund during this period, to allow the Trust Fund to grow so that it will be sufficient to meet the purpose of providing $15 million a year to Palau through FY 2044 and thus not give rise to request for further additional U.S. contributions in direct assistance or further U.S. contributions to the Trust Fund after FY 2023. Third, the agreement commits Palau to economic reforms.

TRANSITION TO INDEPENDENCE

Palau has been and continues to be a strong partner with the United States. It sits on the westernmost point of an arc from California to the Philippines and anchors a security zone that safeguards U.S. interests in the Pacific. Our relationship was born after terrible battles in World War II, notably at Pelelieu in Palau, and has been built over the decades since 1945.

Shortly after the end of World War II, the United Nations assigned the United States administering authority over the Trust Territory of the Pacific Islands, which included Palau and island districts of Micronesia that we had liberated from Japanese occupation. Palau adopted its own constitution in 1981, and the governments of the United States and Palau concluded a Compact of Free Association that entered into force on October 1, 1994. The Compact fulfills our two government's collective commitment to Palau's self-governance in accordance with the freely expressed wishes of the Palauan people. The Compact also provides for an important element of our Pacific strategy for defense of the U.S. homeland and allows us to carry out important foreign policy objectives.

PALAU REMAINS A FRIEND AND RELIABLE PARTNER

The United States paid dearly in blood in World War II to free Palau. More than 3,000 American soldiers lost their lives and more than 10,000 were wounded in the Battle of Peleliu, one of the bloodiest battles of World War II. Mr. Chairman, the battle for Palau is a story that every American should understand and that generations before us have acknowledged as creating a sacred trust to remember and honor.

Rising from the ashes of the war, with the strong and steady bipartisan support of the American people, Palau rebuilt its infrastructure and modeled its government upon the principles of democracy, human rights, and fundamental freedoms. President Toribiong recently signed an Executive Order designating the last Monday of May Memorial Day in Palau, an official holiday. On this day, the people of Palau honor those who paid the ultimate sacrifice to defend the freedom and democratic principles we all enjoy today. Palau remains a strong reliable partner and continues to share our values.

The United States can count on Palau to vote with us on controversial issues in multilateral fora. On a number of important resolutions in the General Assembly over the past year, Palau stood by us and provided critical votes. Palau has voted with the United States on controversial resolutions related to Israel 100 percent of the time and on human rights issues 93 percent of the time. Palau's overall voting coincidence with us is about 90 percent, compared to United Kingdom at 67 percent, Canada at 66 percent, Australia at 63 percent, New Zealand, Japan and South Korea at 49 percent. Additionally, Palau has voted repeatedly with the United States on the U.S. embargo on Cuba. In 2009 Israel and Palau were the only two countries that voted with the United States on the Cuba embargo.

Although Palau is a steadfast and committed friend of the United States, China, the Arab states, and Russia are actively courting Palau and the other Pacific island nations. These countries seek to build influence in the region. The United States must maintain and strengthen its relationship with Palau by maintaining our strong friendship and upholding our commitments as set forth in the Compact.

The results of the 15-year Compact Review as reflected in the proposed legislation nurture our unique relationship. By supporting the Compact Trust Fund, the United States contributes to Palau's development and secures our security interests. Our contribution represents a vital link between our two countries. Implementation of the results of the Compact review will send a reassuring signal to Palau and others in the Pacific region and beyond that the United States follows through on its commitments, in good times and in difficult times. These are indeed difficult times for us. However, it is essential to our long-term national interests to make sure that the United States remains true to its identity as a Pacific power. Meeting vital interests more than six decades ago, the United States invested blood and treasure. Today, it remains in our strategic, political and economic interests to nurture Palau's young democracy, support its development and increase its self-sufficiency.

THE UNITED STATES' POSITION AS A PACIFIC POWER

Mr. Chairman, our identity as a "Pacific power" was, in many ways, forged on the beaches of the Pacific during World War II.

The importance of our special relationship with Palau is most clearly manifested in the U.S. defense posture in the Asia–Pacific region, which forms a north-south arc from Japan and South Korea to Australia. Maintaining U.S. primacy in the Pacific depends on our strong relationship with the Freely Associated States of Palau, the Marshall Islands and the Federated States of Micronesia, which along with Hawaii, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa comprise an invaluable east-west strategic security zone that spans almost the entire width of the Pacific Ocean.

Additionally, critical security developments in the region require the United States' sustained presence and engagement, particularly given the range of U.S. strategic interests and equities in the Western Pacific. Essential elements of our presence include the Reagan Ballistic Missile Defense Test Site on U.S. Army Kwajalein Atoll and disaster relief operations throughout the region. This posture will become increasingly important as regional powers become active and seek to

supplant U.S. military leadership and economic interests in the region. Following through on our commitments to Palau, as reflected in the proposed legislation, buttresses our defense posture in the Western Pacific.

Palau does not maintain its own military forces, but under the terms of our Compacts, their citizens are eligible to serve in the U.S. Armed Forces. And they do. Palauan citizens volunteer in the U.S. military at a rate higher than in any individual U.S. state. Approximately 200 Palauan men and women serve in our military today, out of a population of about 14,000. Palau is indeed a strong partner. We are grateful for their sacrifices and dedication to promoting peace and fighting terrorism. Palau has deployed soldiers for U.S. coalition missions and participated in U.S.-led combat operations in the world's most difficult and dangerous places, including Afghanistan and Iraq, where several Palauans have lost their lives in combat.

President Toribiong's niece and Minister Jackson Ngiraingas' son both serve in the U.S. Navy. The son of Minoru Ueki, Palau's Ambassador to Japan, serves in our army. Palau Paramount Chief Reklai has a daughter and son in the Army. Palau's Ambassador to the United States Hersey Kyota has two adult children serving in the Armed Forces. He has several nephews serving in the Army and Marine Corps. Similarly, many other Palauan sons and daughters of other government officials and of ordinary Palauan citizens served honorably in U.S. military units over the past decades and most recently in Afghanistan and Iraq.

The Compact and our continued commitment to Palau, as manifested in the proposed legislation, reinforce an important element of our Pacific strategy for defense of the U.S. homeland. As you will hear from my colleague from the Department of Defense, the U.S.-Palau Compact includes provisions that put Palau off limits to the military forces of any nation, except the United States. The United States enjoys access to Palauan waters, lands, airspace, and its Exclusive Economic Zones (EEZ), a vital asset for our defense and security needs. Our relationship with Palau allows the United States to guard its long-term defense interests in the region.

CONTINUED COMMITMENT BEYOND DEFENSE INTERESTS

The importance of our strong relationship with Palau extends beyond defense considerations. Palau works closely with the U.S. to detect and combat international crime and terror. In 2009, Palau resettled six ethnic Uighur detainees from Guantanamo at a time when few other countries were willing to step up.

Palau was the first island partner to sign the U.S. Coast Guard ship rider and ship-boarding agreements that bolster law enforcement in the vast Pacific region.

Our people-to-people ties continue to grow. Since 1966, more than 4,200 Peace Corps Volunteers taught English, offered life skills education, and supported economic development, education, capacity building, and marine and terrestrial resource conservation in Palau and in the two other Freely Associated States. Today approximately 55 Peace Corps volunteers serve in Micronesia and Palau.

THE IMPORTANT POSITION OF PALAU

Mr. Chairman, the President, Secretary Clinton, and others in this Administration deeply appreciate the historic World War II legacy of the Pacific and the strategic role it plays, particularly in keeping the Pacific Islands allied with the United States. Today, we find ourselves in a tumultuous global political environment that calls for wisdom and long-term strategic vision. Our investment in Palau will help to ensure that Palau will be able to achieve budgetary self-sufficiency over time and continue to stand with us as a staunch, dependable, and democratic ally.

Palau's stable government is modeled on our own. Palau shares our vision on important international goals for human rights and democracy. The maturity of the democratic process in the relatively young state of Palau is a testament to the strong values of the people of the Pacific and reinforces the value of the Compact as a vehicle for their transition to greater self-sufficiency.

Palau was the first insular area, including the U.S. territories, to get a unqualified audit opinion on the government's financial statements. Palau puts a great deal of care into maintaining a pristine environment, especially by addressing critical areas of energy, water, sewer, and transportation. They understand the importance of continuing efforts to operate within a balanced budget.

Under the Agreement, Palau will do its part financially. The Agreement sets up a fund for the routine and periodic maintenance of major capital improvement projects financed by the United States. The Agreement requires Palau to contribute $150,000 to the maintenance fund on a quarterly basis for fourteen years through FY 2024. Under the Agreement, Palau will also contribute, not by financial outlays, but by making hard economic adjustments. Palau is committed to reforms such as improvements in fiscal management, including the elimination

and prevention of operating deficits; reductions in the national operating budget; reductions in the number of government employees; reductions in the amount of the national operating budget dedicated to government salaries; and a reduction of government subsidization of utilities, and meaningful tax reform.

Palau is a steadfast friend to the United States. We must remain true to our commitment to the people of Palau. The bottom line is that Palau is an irreplaceable and loyal partner, who shares our interests in preserving regional and international security. Failing to affirm the results of the 15-year review of the Compact with Palau is not in our national interest. We appreciate the interest and leadership of this Committee in considering this legislation promptly and hope both the Senate and the House will pass it this session.

Mr. Chairman, although the Department of the Interior is responsible for implementing and funding the Compact programs, I would like to say a few words about the assistance package resulting from the 15-year review. The direct economic assistance provisions of the Compact expired on September 30, 2009. The outcome of the 15-year review resulted in an assistance agreement that, adjusted for amounts already provided, would provide $201 million to Palau over the next 13 years and enable Palau to transition to reliance on a $15 million a year withdrawal from its trust fund, instead of the $13 million in direct assistance and $5 million from its trust fund that it has come to rely on. The assistance package is designed to ease Palau off of U.S. direct economic assistance as it continues to grow and reform its economy. As a result of the Compact review, Palau will have continued eligibility for a wide range of Federal programs and services from agencies such as the U.S. Postal Service, federal weather services, the Federal Aviation Administration, the Department of Agriculture, and Health and Human Services.

If the bilateral Agreement between our two countries is not implemented, the trust fund would be unable to provide a steady outlay of $15 million a year, from now until 2044, which was the intended purpose of the Compact negotiators in the 1980s. For the smooth continuation of our bilateral relationship as well as the continued economic development and advance of self sufficiency, it is crucial that we provide Palau the assistance agreed to in the Compact review.

If the Agreement is not implemented, Palau will not have had time to adjust to the reduction from $18 million to $15 million in combined direct assistance and trust fund withdrawals on which it has been relying, and will not have embarked on the reforms called for in the September 2010 agreement. There will be a shock to

the Palauan economy from the $3 million reduction in assistance (between direct assistance and trust fund withdrawals), and serious damage to our bilateral relationship in a key region of the world.

Mr. Chairman, in closing I would like to emphasize that Palau, a small island country far away in the Pacific, was our protectorate and is now our ally. The people of Palau are woven into the American fabric, serving with distinction and honor in our military and living and working beside us in the United States. Thanks to its geography, Palau is a unique outpost in our security arc in the Pacific. It is a place America liberated with its blood and that now helps us protect the western flank of our homeland. As the economic center of gravity continues to shift to the Asia Pacific, the vital importance to U.S. interests of a stable, increasingly prosperous and democratic Palau continues to grow.

I hope that my testimony today, coupled with that of my colleagues from the Department of the Interior and the Department of Defense, gives you a more robust and complete picture of the key role played by the Compact in not only cementing our partnership with Palau, but also in serving the interests of the United States.

I look forward to working with you and other Members of Congress to secure and advance U.S. interests in Palau by passing the legislation implementing the results of the Compact review.

Thank you again for giving me the opportunity to testify before you today and to clarify the importance of this legislation. I look forward to answering your questions.

Mr. MANZULLO. Thank you.
Mr. Bussanich?
Mr. BUSSANICH. Thank you, Mr. Chairman.

STATEMENT OF MR. THOMAS BUSSANICH, DIRECTOR OF BUDGET, OFFICE OF INSULAR AFFAIRS, U.S. DEPARTMENT OF THE INTERIOR

Mr. BUSSANICH. Chairman Manzullo and members of the subcommittee, thank you. I am pleased to be here today to discuss the agreement between the United States and Palau following the Compact of Free Association section 432 review. My statement today will focus on financial assistance for Palau.

The Compact of Free Association has proven to be a very successful framework for United States-Palau relations. The goals of the first 15 years of the Compact have been met: The trusteeship was terminated; Palau's self-government was restored; a stable democratic state was established; third countries were denied military influence in the region; and the United States financial assistance provided a base for economic growth.

The United States, through the Department of the Interior, has provided $600 million in assistance to Palau, including $149 million for a road system, in the capitalization of the Compact trust fund.

The Compact trust fund was an important feature of U.S. assistance. Capitalized at $70 million, the objective was to produce $15 million annually as revenue for Palau's Government operations from 2010 through 2044.

Palau has made economic gains under the Compact of Free Association. Its growth, in real terms, has averaged just over 2 percent per year. Palau's governmental services are meeting the needs of its community. And the country has taken control of its destiny and is moving in the right direction.

As the United States and Palau began the section 432 review, both countries agreed that prospects for economic growth relied on four key factors: The viability of the trust fund to return $15 million a year; the implementation of fiscal reform; increased foreign investment and private sector growth; and, the continuation of some United States assistance and domestic programs.

For the United States, the viability of the Compact trust fund was of paramount concern. As the 15-year review began, Palau's trust fund, which had earned roughly 9 percent annually since its inception, had suffered significant losses. As GAO reported in 2008, it was uncertain that the trust fund could meet its goal of providing $15 million annually through 2044.

The condition of the trust fund, fiscal and economic reforms, and private sector growth became the focus of the bilateral review. The agreement that arose from the 15-year review will address these concerns, maintain stability, and promote economic growth.

The agreement extends United States assistance, in declining annual amounts, through Fiscal Year 2024. The total of direct financial assistance to Palau under the agreement is over $200 million. The declining amount of assistance is intended to provide an incentive for Palau to develop other sources of revenue and serves notice

that the Palau has agreed to make systemic adjustments to its government.

The agreement contains five categories of financial assistance: First, direct economic assistance for education, health, public safety, and justice in amounts starting at $13 million, declining to $2 million, the last payment, in 2023. The timing of payments is conditioned on Palau's making certain fiscal reforms.

Second, infrastructure projects are provided in the amount of $40 million spread over 6 years.

Third, the agreement creates an infrastructure maintenance fund using annual grants of $2 million to protect crucial United States investments in Palau that significantly contribute to economic development. Palau will contribute matching funds of $150,000 annually to this fund.

Fourth, a fiscal consolidation fund of $10 million to help Palau reduce its debt. The United States creditors must receive first priority.

Fifth, the trust fund. The agreement aims to bolster the viability of the trust fund to yield payments of up to $15 million annually through 2044. The United States will contribute $3 million from 2013 through 2022 and contribute $250,000 in 2023.

Palau will delay withdrawals from the fund, drawing only $5 million annually through 2013, and gradually increasing withdrawals to $13 million in 2023. From 2024 through 2044, Palau is expected to withdraw up to $15 million annually, as originally scheduled.

Withdrawals from the trust fund may only be used for education, health, and administration of justice and public safety.

The United States and Palau will work cooperatively on economic, financial, and management reforms. Palau will be judged on the elimination of operating deficits, reductions in its annual budgets, reducing the number of government employees, implementing meaningful tax reform, and reducing subsidies to public utilities. If the United States has determined that Palau has not made significant progress on reforms, the United States may delay payment of economic assistance.

The Palau Compact legislative proposal does have PAYGO costs. These costs are included in the President's budget along with a number of legislative proposals with PAYGO savings. The offset proposals include: Net receipt sharing, termination of payments for reclaiming abandoned coal mines, and production incentives, fees on non-producing Federal oil and gas leases.

The administration looks forward to continuing our partnership with Palau. The Department of the Interior is proud of the positive advancements our assistance to Palau has provided over the last 15 years and looks forward to the progress that we anticipate will be made over the next 15 years.

Thank you.

[The prepared statement of Mr. Bussanich follows:]

STATEMENT
OF
MR. THOMAS BUSSANICH, DIRECTOR OF BUDGET, OFFICE OF INSULAR AFFAIRS
DEPARTMENT OF THE INTERIOR

BEFORE THE
HOUSE COMMITTEE ON FOREIGN AFFAIRS
SUBCOMMITTEE ON ASIA AND THE PACIFIC

REGARDING
THE AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE REPUBLIC OF PALAU FOLLOWING THE COMPACT OF FREE ASSOCIATION SECTION 432 REVIEW

NOVEMBER 30, 2011

Chairman Manzullo, and members of the Subcommittee on Asia and the Pacific, I am pleased to be here today to discuss the agreement between the Government of the United States and the Government of the Republic of Palau following the Compact of Free Association section 432 review. My colleagues from the Departments of State and Defense will discuss the importance of the United States - Palau relationship as it relates to national security and our policies in the Pacific. My statement today will focus on the financial assistance components of the new agreement with Palau for which the Department of the Interior will be responsible.

THE UNITED STATES – PALAU RELATIONSHIP

The Department of the Interior and the Government of Palau have been partners since 1951, when the Navy transferred to the Department of the Interior the administration of the United Nations Trust Territory of the Pacific Islands. Since the end of World War II, Palau has emerged from its status as a war-ravaged protectorate to become a sovereign nation and member of the world community. Consistent with the provisions of the 1994 Compact of Free Association, Palau has exercised its sovereignty in accordance with the principles of democracy and in a firm alliance with the United States.

The Compact of Free Association has proven to be a very successful framework for United States – Palau relations. The goals of the first fifteen years of the Compact have been met: the trusteeship was terminated; Palau's self-government was restored; a stable democratic state was established; third countries were denied military influence in the region of Palau; and with United States financial assistance, a base for economic growth has been provided.

The financial terms and conditions of the original Compact have been fully implemented by the United States and Palau. The United States, through the Department of the Interior, has provided over $600 million of assistance including $149 million used to construct the 53-mile road system on the island of Babeldoab and $38.7 million for health care and education block grants. Most of the funding, $400 million, was expended on activities defined under Title Two of the Compact, which included general government operations, energy production, communications, capital improvements, health and education programs and establishment of the Compact Trust Fund.

The Compact Trust Fund was an important feature of U.S. assistance. Capitalized with $70 million during the first three years of the agreement in the 1990s, the objective of the trust fund was to produce an average annual amount of $15 million as revenue for Palau government operations for the thirty-five year period fiscal year 2010 through fiscal year 2044. The fund also generated $5 million in annual operational revenue for Palau since the fourth year of the agreement, totaling $60 million for the years 1998 through 2009.

Palau has made strong economic gains under the Compact of Free Association. Its growth, in real terms, has averaged just over 2 percent per year. Palau's governmental services are meeting the needs of its community. Palau has taken control of its destiny and is moving in the right direction.

COMPACT REVIEW

As both the United States and Palau began the required Compact section 432 review several years ago, each side took pride in the growth evident in Palau. However, the review, which examined the terms of the Compact and its related agreements and the overall nature of the bilateral relationship, also focused attention on several important issues. The United States and Palau agreed that prospects for continued economic growth relied on four key factors: 1) the viability of the Compact trust fund and its ability to return $15 million a year; 2) the implementation of fiscal reforms to close the gap between Palau's revenues and expenditures by shrinking its public sector and raising revenue; 3) the promotion of increased foreign investment and private sector growth, and, 4) the continuation of certain United States assistance, including access to United States Federal domestic programs and services.

From the perspective of the United States, the viability of the Compact Trust Fund was of paramount concern. The economies of Pacific islands are always fragile; their size, distance from markets and relative lack of resources make growth a perennial problem. Although Palau has some relative advantages in contrast to other Pacific island countries, the Compact Trust Fund was established with the intention of providing a relatively secure revenue base for Palau's government through fiscal year 2044. As the 15-year review began, Palau's trust fund, which had earned roughly 9 percent annually since its inception, had suffered significant losses. As GAO reported in 2008, it was uncertain that the trust fund could pay $15 million annually to the Government of Palau through fiscal year 2044.

COMPACT AGREEMENT

The condition of the Compact Trust Fund, the need for fiscal and economic reforms, and the goal of strengthening conditions for private sector growth became the focus of the bilateral review. The *Agreement Between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review* (Agreement) that arose from the 15-year review, will address these concerns, maintain stability, promote economic growth and increase the progress already made under the Compact of Free Association.

The Agreement extends United States assistance, in declining annual amounts, through fiscal year 2024. The total of direct financial assistance to Palau under the Agreement is $229 million, although $26.2 million of that amount has already been appropriated for direct economic assistance by congressional action in fiscal year 2010 and in fiscal year 2011. An additional $1,760,000 in direct economic assistance has been provided to Palau in fiscal year 2012 under the current continuing resolution.

Under the Agreement, in 2011 the United States was to provide Palau $28 million, of which $13 million is the aforementioned direct assistance. The amount will decline every year thereafter. The declining amount of assistance is intended to provide an incentive for Palau to develop other sources of local revenue and serves notice that the Palauan government has agreed that it will need to make systemic adjustments to its government in order to live within those same resources.

The Agreement contains five categories of financial assistance to Palau.

Direct economic assistance. The Agreement provides for direct assistance for education, health, administration of justice and public safety, in amounts starting at $13 million in 2011, declining to $2 million, the last payment, in 2023. The timing of direct assistance payments is conditioned on Palau's making certain fiscal reform efforts. If the United States government determines that Palau has not made progress in implementing meaningful reforms, direct assistance payments may be delayed until the United States Government determines that Palau has made sufficient progress on the reforms.

Infrastructure projects. Under the Agreement, the United States is to provide grants to Palau for mutually agreed infrastructure projects—$8 million in 2011 through 2013, $6 million in 2014, and $5 million in both 2015 and 2016. The Agreement does not name any projects.

Infrastructure maintenance fund. Under the Agreement, a trust fund will be established to be used for maintenance of capital projects previously financed by the United States, including the existing Compact Road. From 2011 through 2024, the United States government will contribute $2 million annually and the Palau government

will contribute $600,000 annually to the fund. This will protect crucial United States investments in Palau that significantly contribute to economic development.

Fiscal consolidation fund. The United States will provide grants of $5 million each in 2011 and 2012 to help the Palau government reduce its debt. United States creditors must receive priority, and the government of Palau must report quarterly on the use of the grants until they are expended. This fund will also simplify needed economic adjustments to Palau's fiscal policies.

Trust fund. The Agreement increases the size of Palau's trust fund directly and indirectly to bolster the likelihood that the trust fund will yield payments of up to $15 million annually through 2044. First, the United States will contribute $3 million annually from 2013 through 2022 and contribute $250,000 in 2023. Second, the government of Palau will delay withdrawals from the fund, drawing $5 million annually through 2013 and gradually increasing its withdrawal ceiling from $5.25 million in 2014 to $13 million in 2023. From 2024 through 2044, Palau is expected to withdraw up to $15 million annually, as originally scheduled. Under the Agreement, withdrawals from the trust fund may only be used for education, health, administration of justice and public safety.

CONTINUING COOPERATION

The United States and Palau will work cooperatively on economic reform. The Agreement requires the two governments to establish an advisory group to recommend economic, financial and management reforms. Palau is committed to adopting and implementing reforms. Palau will be judged on its progress in such reforms as the elimination of operating deficits, reduction in its annual budgets, reducing the number of government employees, implementing meaningful tax reform and reducing subsidies to public utilities.

Palau's progress in implementing reforms will be addressed at annual bilateral economic consultations. If the government of the United States determines that Palau has not made significant progress on reforms, the United States may delay payment of economic assistance under the Agreement.

The Agreement also continues to provide other United States services and grant programs, including those of the United States Postal Service, the National Weather Service, and the Federal Aviation Administration. The Postal Service moves mail between the United States and Palau, and offers other related services. Palau maintains its own postal service for internal mail delivery. The National Weather Service reimburses Palau for the cost of operating its weather station in Palau, which performs upper air observations twice daily, as requested, for the purpose of Palau's airport operations and the tracking of cyclones that may affect other United States territories, such as Guam. The Federal Aviation Administration provides aviation services to Palau, including en-route air traffic control from the mainland United States, flight inspection of airport navigation aids, and technical assistance and training.

The proposed legislation will also allow the continuance of other Federal program services currently available to Palau under separate authorizing legislation, including programs of the Departments of Education and Health and Human Services. The general authorization for Palau to receive such services was created by the Compact, but individual program eligibility has been created by specific laws that include Palau as an eligible recipient.

The Palau Compact legislative proposal does have PAYGO costs. These costs are included in the President's Budget along with a number of legislative proposals with PAYGO savings. Some proposals that fall under this Committee's jurisdiction include:

- Net Receipt Sharing, which takes into account the costs of managing Federal oil and gas leases before revenues are shared with the States;
- Terminate payments for reclaiming abandoned coal mines to states that are already certified as having cleaned up all of their priority sites; and
- Production incentive fees on non-producing Federal oil and gas leases.

Each example by itself could provide more than enough savings to offset the costs of the Palau Compact. These proposals are also viable; Net Receipt Sharing, for example, has been enacted for four years through annual appropriations language.

The Administration looks forward to continuing our partnership with Palau. The Department of the Interior is proud of the positive advancements our assistance to Palau has provided over the last fifteen years and looks forward to the progress that we anticipate will be made over the next fifteen years.

Mr. MANZULLO. Thank you.
General Simcock?

STATEMENT OF BRIGADIER GENERAL RICHARD L. SIMCOCK, II, PRINCIPAL DIRECTOR, SOUTH AND SOUTHEAST ASIA, OFFICE OF THE DEPUTY UNDER SECRETARY OF DEFENSE, U.S. DEPARTMENT OF DEFENSE

General SIMCOCK. Chairman Manzullo, Congressman Faleomavaega, other members of the subcommittee, thank you for the opportunity to talk with you today.

It is obvious from the comments I have heard already that there is an in-depth knowledge about Palau today. I think with a lot of stories, it is difficult to start a book in a middle chapter. And there is a history of Palau from a security perspective that I would like to talk about just a little bit today, if I may.

Sir, I also brought a map with me using technology you can see on that one. If I could ask you to think about today. Let's say today is 30 November 1940. And I am talking to Members of Congress about Palau. I feel pretty confident that none of the members would know where Palau is. I wouldn't have the benefit of having two Pacific island nation representatives here.

So, even if I brought a map and pointed it to it, most of the members would say, "General, so what?" I would basically be told, "Thank you for your interest in national defense. We here on Capitol Hill have more pressing issues. In 1940 fiscal considerations at that time are more important. Please go back to the Pentagon and do what you do."

Now, gentlemen, if I can roll the clock forward to 7 December 1941 and the attack, the empire Japan on Pearl Harbor. All of a sudden, we started paying attention to the Pacific region. And we watched Japan occupy large areas within the Pacific region. Islands that we had never heard of were all of a sudden were on headlines throughout papers throughout this country.

Now I ask you to roll the clock forward one more time to September 1944, when the United States paid the price of 10,000 casualties, U.S. Marines and sailors, to liberate Peleliu, modern-day Palau, from the empire of Japan. Everyone knew where Peleliu was at that time.

The strategy that the empire Japan had at that time was to cripple our fleet and to set up a defense-in-depth for the purpose of securing resources, resources that Japan did not have and could not get through peaceful means. So they took by force. The empire of Japan misread the United States in our will to fight through that defense-in-depth and liberate those islands and actually defeat the aggression of Japan.

Now, Mark Twain said that history doesn't repeat, but it certainly rhymes. I ask you now to roll the clock forward to 30 November this year and why is Palau important.

The map behind me depicts two island chains. The first island chain is the island chain closest to mainland Asia. Second island chain is the one moving eastward, further out in the Pacific. Palau is part of that second island chain.

Today China is securing resources around the globe. And I know you members are very familiar with that. But the physical charac-

teristics of the Pacific Ocean have not changed. It will be used by China the same way that the Japanese used it 60 years ago, as a way to bring resources back to the homeland. And China is very concerned about that.

The map behind me was not produced at the Pentagon. That is not my map. That map was produced in China by an organization I can loosely affiliate to a think tank.

What the Chinese are concerned about when they look at the map, are those island chains and a defense-in-depth, if you will, in reverse because they look at those lines are ways of stopping them from getting the resources around the world that they are purchasing today back to mainland China. And they are very, very concerned about that.

So when I talk to the defense attache from China, he talks to me about Cold War strategies and strategies of containment that our country is trying to do to their country. And it is an issue that he brings up with me on a daily basis when I see him.

So I would say to you that when you look at Palau and the strategic importance from a security aspect, I think you can use the strategy of 60 years ago. And it is very applicable today in what one of the countries in the region is trying to accomplish.

And the last thing I would just say, sir—and that is to Congressman Rohrabacher and your father—when we liberated Palau, as I said, it was 10,000 Marines and sailors. Jim Loi and I were there about 4 or 5 months ago. And you talk about, sir, a homecoming. And it wasn't because it was Rich Simcock. It was because a U.S. Marine was coming to Palau. And you want to talk about being treated like royalty, very similar to what the chairman talked about with the Ambassador from South Korea.

I have never had to be on the receiving end of being liberated from occupation, but the South Koreans understand it. And I am here to tell you, sir, that the Palauans understand it. And they pay off that type of response to our nation. Approximately 500 Palauans serve in the military today. That is how they say thank you. So there is tremendous strategic importance to Palau.

Gentlemen, I look forward to your questions. Thank you.

[The prepared statement of General Simcock follows:]

Testimony
of

Brigadier General Richard Simcock
Principal Deputy for South & Southeast Asia
Office of the Secretary of Defense

Before the
House Committee on Foreign Affairs
Subcommittee on Asia and the Pacific
November 30, 2011

"Department of Defense's Support of the Palau Compact Agreement Review"

Introduction

Members of the Committee, thank you for the opportunity to appear before you to discuss the importance of the Palau Compact Agreement. Since its enactment in 1994, the Compact has served as an important foundation for our security strategy in the Asia-Pacific region, providing the United States with critical access, influence, and strategic denial of access to other regional militaries. Our Compact with Palau, coupled with our compacts with the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI), has enabled DoD to maintain critical access and influence in the Asia-Pacific region. Passage of S. 343, a bill to amend Title I of PL 99-658 regarding the Compact of Free Association between the United States and Palau, is vital to allowing the Department to continue to benefit from the security arrangement afforded by the Compact. Today, I would like to take the opportunity to discuss the importance of Palau and the Compact to preserving U.S. national security interests in the Asia-Pacific region.

Palau's Contributions to American and Global Security

Let me begin by discussing Palau in the context of the regional security environment in the Western Pacific. The Pacific Islands region is sparsely populated, physically isolated, and geographically widespread. However, Palau lies at a pivotal crossroad in the Pacific, an area near critical sea lines of communication and rich fishing grounds. It is also located directly in the so-called "Second Island Chain" from Mainland Asia, close to all of the major East and Southeast Asian powers. With our strategic interests and equities expanding and

shifting more toward the Asia-Pacific region, having Palau as a strong partner in the Pacific is increasingly important to maintaining military, as well as political and diplomatic, leadership in this quickly evolving strategic environment.

We must take note of critical security developments in the Pacific that require the Department's sustained presence and engagement. Broadly speaking, countries such as China, Russia, and the Arab states are actively courting Pacific Island States, challenging the security status quo in the region, and increasing their economic, diplomatic, and military engagement with the island States. These critical security developments require sustained U.S. presence and engagement in the region. Our relationship with Palau under the Compact would be reinforced with passage of this legislation and would ensure the United States the extraordinary advantage to deny other militaries access to Palau. For these reasons, it is imperative that the U.S. Government sustain this advantage.

Since the Compact of Free Association between the Government of the United States of America and the Government of Palau went into effect in 1994, the United States has taken full responsibility for the security and defense of Palau. This unique security arrangement has created a steadfast and reliable partner that helps the United States advance its national security goals in the region.

Palau in the Regional Security Context

I would also like to highlight the extraordinary service of Palauans in the U.S. Armed Forces and contributions to U.S. security. Under the provisions of the Compact, Palauans are able to serve in the U.S. Armed Forces. In fact, Palauans serve in the U.S. Armed Forces in impressive numbers. Sadly, five Palauans have made the ultimate sacrifice, and numerous others wounded, fighting on the battlefield in Afghanistan and Iraq since 9/11. Their sacrifice in the defense of the U.S. homeland and U.S. and Coalition security interests should not go unnoticed. Furthermore, in 2009, Palau stepped up to offer resettlement to six Uighur detainees from Guantanamo Bay at a time when other countries were hesitant to take these individuals.

Most notably, our commitment to the Compact with Palau allows the Department to leverage Palau's strategic geopolitical position to sustain U.S. security interests in the region. The United States exercises full authority over and responsibility for the security and defense of Palau, an arrangement similar to those that we have with the Federated States of Micronesia and the Republic of the Marshall Islands. With this authority and responsibility, the United States is entitled to military

access to the lands, water, and airspace of Palau and retains the right to deny such access to the military forces of other nations. Our current security arrangement affords us expansive access, which will be an increasingly important asset in the defense and security interests of the United States in the Asia-Pacific region in coming years. The Department recognizes the strategic value of the Compact, and we hope to continue to utilize it to serve our national security interests.

U.S.-Palau Defense Relations

We have growing national security interests and equities in the Western Pacific, a region that is traditionally overlooked and undervalued. Together with the two other Compact States, the Federated States of Micronesia and the Republic of the Marshall Islands, Palau forms part of an important security zone under exclusive U.S. control that spans the entire width of the Pacific when we include Hawaii and the U.S. territories, Guam and the Commonwealth of the Northern Mariana Islands. Palau's location makes it an important part of the U.S. strategic presence in the Asia-Pacific. The Palau Compact affords us strategic positioning in a country with a unique geopolitical position in the Asia-Pacific. The region's lack of political and security infrastructure has given rise to a trend of growing transnational crime, which underscores the importance of continued DoD engagement in the Western Pacific. With this in mind, the Department seeks to develop creative ways to remain strategically engaged in the region. Recognizing that Palau has no military and only limited law enforcement capabilities and resources, the Department's engagement with Palau primarily focuses on helping them develop maritime security and humanitarian assistance capabilities.

First, maritime security has been one of the most fruitful areas of cooperation between our two nations. DoD sends mobile training teams to Palau to help train local security personnel in maritime security-related matters. Palau's EEZ is part of the Pacific's richest fishing grounds and has traditionally faced serious problems with foreign exploitation of the fishery resources. Large numbers far-ranging fishing vessels from other pacific nations threaten encroachment. Japan, China, Taiwan, and the United States participate in a highly competitive multi-million dollar tuna industry. The Department is currently reviewing ways to use existing DoD assets and cooperative mechanisms to enhance maritime domain awareness in the region.

To combat illegal fishing, the U.S. Coast Guard has entered into a shiprider agreement with Palau, which enables Palauan security officials to embark on transiting U.S. Coast Guard vessels to conduct maritime patrol of its enormous,

under patrolled Exclusive Economic Zone (EEZ). This kind of shiprider agreement allows the U.S. Coast Guard to play a more active role in developing partner law enforcement capacity of the island States. In addition, we are cooperating with Japan, Australia, Palau, the Marshall Islands, and Micronesia to bring to fruition the Sasakawa Peace Foundation's $10 million initiative to support maritime surveillance in all three Compact States.

Second, the Department's humanitarian programs have been very well-received in island communities. These programs primarily focus on the removal of explosive remnants of war from the World War II era, humanitarian projects, and prisoner of war/missing in action operations. DoD's 12-person Civic Action Team maintains a rotational presence in Palau, conducting small- to medium-scale humanitarian and civic action projects in the health, education, and infrastructure areas. Especially notable are the large-scale, multinational, pre-planned humanitarian missions, the U.S. Air Force's Pacific Angel and U.S. Navy's Pacific Partnership, which include medical and engineering projects in remote regions that are conducted in close coordination with local communities. In the summer of 2010, more than 1,900 Palauans were treated, 14 community service projects were completed, and more than 1,000 man hours spent across the three states of Koror, Peleliu and Angaur when USS BLUE RIDGE (LCC-19) stopped in Palau as part of Pacific Partnership 2010. Also, the longest running humanitarian campaign in the world, Operation Christmas Drop, which provides air-dropped supplies to the people of the remote Micronesian islands each December, celebrated its 58th anniversary in December 2010 and continues annually to assist the remote islands of Palau. These humanitarian missions are evidence that the Department's engagement in Palau extends well beyond traditional security parameters.

Conclusion

In conclusion, U.S. power projection in the Asia-Pacific region will continue to be essential to our national security interests. The U.S.-Palau Compact is a strategic asset for U.S. presence in the Western Pacific, an increasingly important region. Loss of the defense rights and exclusive access granted to the United States under the Compact would adversely affect U.S. national security. Our relationship with Palau is unique and reliable. Passage of the proposed legislation approving the results of the 15- year Compact Review would ensure this important security agreement continues and would reassure Palau of our sustained commitment to Palau and its people and of our shared interest in regional and global security. I urge you to support the continued security agreement the United States has

developed with Palau over the years and ask for your support of the proposed legislation.

Mr. MANZULLO. Thank you, General.

Mr. Gootnick?

Mr. GOOTNICK. Thank you, Mr. Chairman.

STATEMENT OF MR. DAVID B. GOOTNICK, DIRECTOR, INTERNATIONAL AFFAIRS AND TRADE, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. GOOTNICK. It is a remarkable parable that Brigadier General Simcock has put forward. I am going to return to some of the much more mundane aspects of the economic provisions under the Compact. And thank you for asking GAO to participate in this hearing.

As has been stated, the 1994 Compact provided 15 years of economic assistance; established the trust fund; built the Compact road; provided for postal, weather, and aviation; and, importantly, established the basis for discretionary U.S. Federal programs, including Head Start, Community Health Centers, Pell grants, airport improvements, Special Education, and numerous others.

Taken together, Compact and U.S. program assistance is valued at more than $850 million, of which U.S. program assistance was nearly a third.

My statement, which I will briefly summarize, describes first the economic provisions of the agreement; second, the impact of the agreement on Palau's trust fund; and, third projected Palau Government revenues under the agreement.

First, as Mr. Bussanich has well-covered and well-stated, the agreement would provide $215 million in assistance, with a steady annual decrement from roughly $28 million in 2011 to $2 million in 2024. If you have the graphic in the GAO testimony statement, the cover page or page 11 has a nice display and shows you that annual decrement.

It shows that $107 million, roughly half of this assistance, would support government operations and that the agreement also provides $40 million for infrastructure projects, $28 million in the maintenance fund, $10 million to debt relief, and adds $30 million to the trust fund. And, importantly, the agreement extends postal, weather, and aviation, and the authority to continue discretionary Federal programs.

The agreement puts certain conditions on the $215 million package. For example, economic assistance is directed to specific sectors, such as health, education, and public safety. Also, an advisory group would be appointed and tasked to make recommendations for fiscal and management reforms. And the U.S. may delay funding conditioned on the progress of reforms.

For the infrastructure funds, a project must have a land title and a certified scope of work to get funding and the maintenance funds primarily for U.S.-financed projects, in particular the Compact road and the international airport.

Debt relief prioritizes U.S. creditors, requires U.S. concurrence on debts to be paid.

Second, regarding the trust fund, the proposed U.S. contributions and the $89 million delay in scheduled withdrawals would markedly improve the fund's prospects. In 2009, we reported that the trust fund would require an annual return above 10 percent to yield its proposed schedule through 2044. However, under the

agreement, as of the end of Fiscal Year '11, the trust fund would need only 5.5 percent return to yield its new scheduled withdrawals. And this is well below the 7.4 percent it has earned to date.

Lastly, Mr. Chairman, to offset the steady decline in budget support through 2024, estimates prepared for the Government of Palau project a growing reliance on trust fund withdrawals and domestic revenue as well as steady access to U.S. Federal programs. Specifically, the estimates project a steep rise in domestic revenue from roughly 40 to nearly 60 percent of total government revenues by 2024.

And the estimates project that discretionary Federal programs will grow at roughly the rate of inflation. And they are projected at half of all U.S. assistance over the next 15 years.

As you know, Mr. Chairman, unlike other components of this agreement, these programs, U.S. Federal programs, depend on annual appropriations.

In summary, the economic provisions of the agreement extend and gradually reduce Compact assistance through 2024, establish new conditions for the use of U.S. funds, and reset the trust fund to significantly improve its long-term prospects. Palau has employed projections of its long-term fiscal condition that rely on increased domestic revenue and the continuation of U.S. Federal programs.

This completes my remarks. I am happy to answer any questions.

[The prepared statement of Mr. Gootnick follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Asia and the Pacific, Committee on Foreign Affairs, House of Representatives

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COMPACT OF FREE ASSOCIATION

Proposed U.S. Assistance to Palau for Fiscal Years 2011-2024

Statement of David Gootnick, Director
International Affairs and Trade

U.S. Government Accountability Office
GAO 90 YEARS 1921-2011
ACCOUNTABILITY * INTEGRITY * RELIABILITY

GAO-12-249T

GAO
Accountability * Integrity * Reliability

Highlights

Highlights of GAO-12-249T, a report to a testimony before the Subcommittee on Asia and the Pacific, Committee on Foreign Affairs, House of Representatives

November 30, 2011

COMPACT OF FREE ASSOCIATION

Proposed U.S. Assistance to Palau for Fiscal Years 2011-2024

Why GAO Did This Study

The Compact of Free Association between the United States and the Republic of Palau, which entered into force in 1994, provided for several types of assistance aimed at promoting Palau's self-sufficiency and economic advancement, included were 15 years of direct assistance to the Palau government; contributions to a trust fund meant to provide Palau $15 million each year in fiscal years 2010 through 2044; construction of a road system, known as the Compact Road; and federal services such as postal, weather, and aviation. U.S. agencies also provided discretionary federal programs related to health, education, and infrastructure. In 2008, GAO projected that total assistance in fiscal years 1994 though 2009 would exceed $852 million.

In September 2010, the United States and Palau signed an agreement (the Agreement) that would, among other things, provide for additional assistance to Palau beginning in fiscal year 2011 and modify its trust fund. A bill, now pending, was introduced in the Senate on February 14, 2011, to approve the Agreement and appropriate funds to implement it.

In this testimony, GAO updates a June 2011 testimony on (1) the Agreement's provisions for economic assistance to Palau, (2) its impact on the trust fund's likelihood of sustaining scheduled payments through fiscal year 2044, and (3) the projected role of U.S. assistance in Palau government revenues. GAO reviewed the Agreement; examined Palau's recent single audit reports and budget projections; and assessed trust fund balances and disbursement plans.

View GAO-12-249T. For more information contact David Gootnick at (202) 512-3149 or gootnickd@gao.gov.

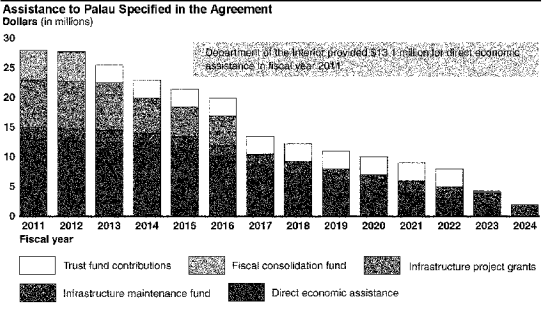
What GAO Found

The Agreement would provide steadily decreasing assistance, totaling approximately $215 million, for fiscal years 2011 through 2024. The proposed assistance includes the following:

- direct economic assistance ($107.5 million) for Palau government operations
- infrastructure project grants ($40 million) to build mutually agreed projects
- infrastructure maintenance fund ($28 million) for maintaining the Compact Road, Palau's primary airport, and certain other major U.S.-funded projects
- fiscal consolidation fund ($10 million) to assist Palau in debt reduction
- trust fund contributions ($30.25 million) in addition to the $70 million contributed under the compact

The legislation implementing the Agreement was not approved by Congress in fiscal year 2011.

Assistance to Palau Specified in the Agreement



Source: GAO analysis of the Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review.

Notes: All dollar amounts are in nominal dollars (i.e., unadjusted for inflation). Funds were not provided in fiscal year 2011 for infrastructure projects, the infrastructure maintenance fund, or the fiscal consolidation fund.

Under the Agreement, the United States would contribute to the trust fund in fiscal years 2013 through 2023, and Palau would reduce its withdrawals by $89 million in fiscal years 2010 through 2023. GAO projects that the fund would have an 86 percent likelihood of sustaining payments through fiscal year 2044 with these changes, versus 24 percent without these changes.

Estimates prepared for the Palau government project declining reliance on U.S. assistance under the Agreement—from 28 percent of government revenue in fiscal year 2011 to 2 percent in fiscal year 2024—and growing reliance on trust fund withdrawals and domestic revenues. The estimates show trust fund withdrawals rising from 5 percent to 24 percent and domestic revenues rising from 40 to 59 percent, of total government revenue. According to the estimates, U.S. assistance in fiscal years 2011 through 2024 would total $427 million, with discretionary federal programs accounting for about half of that amount.

United States Government Accountability Office

Chairman Manzullo, Ranking Member Faleomavaega, and Members of the Subcommittee:

I am pleased to be here today to discuss the September 2010 agreement between the U.S. and Palau governments.[1]

The Compact of Free Association between the United States and the Republic of Palau, which entered into force in 1994,[2] provided for several types of assistance aimed at promoting Palau's economic advancement and eventual self-sufficiency.[3] In addition to establishing Palauan sovereignty and U.S.-Palau security and defense arrangements, the compact provided economic assistance to Palau.[4] This assistance comprised, among other things, direct economic assistance for 15 years to the Palau government; the establishment of a trust fund intended to provide Palau $15 million annually from 2010 through 2044; investments in infrastructure, including a major road; and the provision of federal services, such as postal, weather, and aviation. The compact also established a basis for U.S. agencies to provide discretionary federal programs related to health, education, and infrastructure. In June 2008, we projected that U.S. assistance to Palau from 1995 through 2009 would exceed $852 million, with assistance under the compact accounting for about 68 percent and assistance through discretionary programs accounting for about 31 percent.[5] We also reported in 2008 that the likelihood of the Palau trust fund's being able to sustain the planned payments through 2044 was uncertain.

[1] *The Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review* (Sept. 3, 2010).

[2] *The Compact of Free Association between the Government of the United States of America and the Government of the Republic of Palau* (Oct. 1, 1994).

[3] See *Proclamation 6726, Placing into Full Force and Effect the Compact of Free Association with the Republic of Palau*, 59 Fed. Reg. 49777 (Sept. 27, 1994). Congress approved the Compact of Free Association in Public Law 99-658 on November 14, 1986, and Public Law 101-219 on December 12, 1989. The grant funds specified by the compact are backed by the full faith and credit of the U.S. government.

[4] Unless otherwise noted, all years cited are fiscal years (Oct. 1-Sept. 30). In addition, all dollar amounts in this report are in nominal dollars (i.e., unadjusted for inflation).

[5] GAO, *Compact of Free Association: Palau's Use of and Accountability for U.S. Assistance and Prospects for Economic Self Sufficiency*, GAO-08-732 (Washington, D.C.: June 10, 2008).

The September 2010 agreement between the U.S. and Palau governments (the Agreement) followed a formal review of the compact's terms required 15 years after the compact entered into force.[6] Provisions of the Agreement would, among other things, extend economic assistance to Palau beyond the original 15 years and modify trust fund arrangements. A bill now pending before the U.S. Senate would approve the Agreement and appropriate funds to implement it.[7] The Senate Committee on Energy and National Resources held a hearing to review the pending bill on June 16, 2011; as of November 17, Congress had not voted on this bill.

In June 2011, we testified before the Senate, describing (1) the extension of economic assistance to Palau as outlined in the Agreement, (2) the impact that this assistance would have on the Palau trust fund's sustainability, and (3) the projected role of U.S. assistance in Palau government revenues.[8] For our June statement, we reviewed the Agreement, assessed trust fund balances and disbursement plans under various assumptions and investment returns, and examined single audit reports and budget estimates prepared for the Palau government.

My statement today updates our June 2011 statement, in particular, our analysis of the impact of the economic assistance outlined in the Agreement on the sustainability of Palau's trust fund. We determined that these data were sufficiently reliable for the purposes of our review. We conducted this update in November 2011 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our

[6]Section 432 of the compact provides for the U.S. and Palau governments to formally review the terms of the compact and its related agreements and to consider the overall nature and development of their relationship, on the 15th, 30th, and 40th anniversaries of the compact's effective date. The governments are to consider the operating requirements of the government of Palau and its progress in meeting the development objectives set forth in section 231(a) of the compact. The terms of the compact shall remain in force until otherwise amended or terminated pursuant to title four of the compact.

[7]The pending bill, Senate Bill 343, amends Title I of Public Law 99-658; approves the results of the 15-year review of the compact, including the Agreement; and appropriates funds for the purposes of the amended Public Law 99-658 for fiscal years ending on or before September 30, 2024, to carry out the agreements resulting from the review.

[8]GAO, *Compact of Free Association: Proposed U.S. Assistance to Palau and Its Likely Impact*, GAO-11-659T (Washington, D.C.: June 16, 2011).

stated objectives and to discuss any limitations in our work. We believe that the information and data obtained, and the analysis we conducted, provide a reasonable basis for any findings and conclusions.

Background

Palau consists of 8 main islands and more than 250 smaller islands, with a total land area of roughly 190 square miles, located approximately 500 miles southeast of the Philippines. About 20,000 people live in Palau, concentrated largely in one urban center around the city of Koror, and more than one-quarter of the population is non-Palauan.[9] Palau's economy is heavily dependent on its tourism sector and on foreign aid from the United States, Japan, and Taiwan.[10] Similar to many small island economies, Palau's public sector spending represents a significant percentage of its gross domestic product (GDP).[11]

U.S. relations with Palau began when American forces liberated the islands near the end of World War II. In 1947, the United Nations assigned the United States administering authority over the Trust Territory of the Pacific Islands, which included what are now the Federated States of Micronesia, the Republic of the Marshall Islands, the Commonwealth of the Northern Mariana Islands, and Palau. Palau adopted its own constitution in 1981. The U.S. and Palau governments concluded a Compact of Free Association in 1986; the compact entered into force on October 1, 1994. The Department of the Interior's (Interior) Office of Insular Affairs (OIA) has primary responsibility for monitoring and coordinating all U.S. assistance to Palau, and the Department of State (State) is responsible for government-to-government relations.

[9]Palau's private sector relies heavily on foreign workers, mostly from the Philippines. We reported in 2008 that since 1994, foreign workers, as registered with Palau's Social Security Office, had grown to account for half of Palau's total labor force. Because many of these foreign workers send wage income back to their home nations, in 2005 the annual net outflow of remittances from Palau equaled an estimated 5.5 percent of its gross domestic product (GDP).

[10]The International Monetary Fund (IMF) projected that in 2010, Palau's GDP was an estimated $218 million and reported that Palau's GDP per capita was about $10,500. Business and tourist arrivals were projected to be 78,000 in 2010. See IMF, *Republic of Palau Staff Report for the Article IV Consultation* (Apr. 12, 2010).

[11]According to the IMF, in 2010, Palau's public sector spending was projected at approximately 42 percent of its GDP.

Key provisions of the compact and its subsidiary agreements address the sovereignty of Palau, types and amounts of U.S. assistance, security and defense authorities, and periodic reviews of compact terms. Table 1 summarizes key provisions of the Palau compact and related subsidiary agreements.

Table 1: Key Provisions of Palau Compact of Free Association and Subsidiary Agreements

Compact section	Description of key provisions
Title one: Government Relations	*Sovereignty* Established Palau as a self-governing nation with the capacity to conduct its own foreign affairs. *Immigration privileges* Provided Palauan citizens with certain immigration privileges, such as the rights to work and live in the United States indefinitely and to enter the United States without a visa or passport. This privilege remains in effect as long as the compact agreement is not amended by mutual agreement or mutually or unilaterally terminated.
Title two: Economic Relations	*Compact direct assistance* Established 15-year term of budgetary support for Palau, beginning on compact's effective date. This support included direct assistance for current account operations and maintenance and for specific needs such as energy production, capital improvement projects, health, and education. *Trust fund* Required the United States to contribute to a trust fund for Palau. *Compact Road* Required the United States to construct a road system (the Compact Road).[a] *Compact federal services* Required the United States to make available certain federal services and related programs to Palau, such as postal, weather, and aviation. The compact subsidiary agreement implementing such services was in force until October 1, 2009.[b] *Accountability for compact funds* Required Palau to report on its use of compact funds and required the U.S. government, in consultation with Palau, to implement procedures for periodic audits of all grants and other assistance.

Compact section	Description of key provisions
Title three: Security and Defense Relations	*U.S. authority for security and defense matters* Established that the United States has full authority and responsibility for security and defense matters in or relating to Palau, would take action to meet the danger of an attack on Palau, and may conduct activities on land, water, and airspace as necessary. *Strategic denial* Foreclosed Palau to the military of any nation except the United States, unless they are invited by the United States and under the control of the U. S. armed forces. *U.S. defense sites and operating rights* Established that the United States may establish land and sea defense sites in Palau and has certain military operating rights. The subsidiary agreement implementing this provision provides the United States exclusive use of certain land adjoining the airport and certain submerged land in Malakal Harbor and remains in effect through 2044. *Service in the armed forces* Established eligibility of Palau citizens to serve in the U.S. armed forces. The provisions on U.S. authority for security and defense matters, U.S. defense sites and operating rights, and service in the armed forces remain in effect unless the compact is terminated by mutual agreement or, if the compact is unilaterally terminated, until October 1, 2044, and thereafter as mutually agreed. The strategic denial provision remains in effect through 2044 and thereafter until terminated or otherwise amended by mutual consent.
Title four: General Provisions	Established general provisions regarding approval and effective date of the compact, conference and dispute resolution procedures, and compact termination procedures. Required reviews of its terms on the 15th, 30th, and 40th anniversaries of the compact's entry into force—that is, in 2009, 2024, and 2034, respectively.

Source: GAO analysis of the Compact of Free Association between the Government of the United States and the Government of the Republic of Palau.

Notes:

The compact's subsidiary agreements relate to specific titles of the compact and, in many cases, contain implementing details of compact provisions.

Years are fiscal (Oct. 1-Sept. 30).

[a]The compact called for the United States to build the Compact Road according to mutually agreed specifications before October 1, 2000. The road was completed and turned over to Palau on October 1, 2007. See GAO-08-732, appendix V, for more information.

[b]Federal Programs and Services Agreement Concluded Pursuant to Article II of Title Two and Section 232 of the Compact of Free Association, which took effect in 1995, established the legal status of programs and related services, federal agencies, U.S. contractors, and personnel of U.S. agencies implementing both compact federal services and discretionary federal programs in Palau. Under this agreement, the United States Postal Service (USPS) conveys mail between the United States and Palau and offers other services such as Priority Mail®, Collect on Delivery, and USPS Domestic Money Orders. Palau maintains its own postal service for internal mail delivery. Under this agreement, the National Weather Service reimburses Palau for the cost of operating its weather station in Palau, which performs upper air observations twice daily and as requested for the purpose of Palau's airport operations and the tracking of cyclones that may impact other U.S. territories such as Guam; and the Federal Aviation Administration provides aviation services to Palau, including en-route air traffic control from the mainland United States, flight inspection of airport navigation aids, and technical assistance and training.

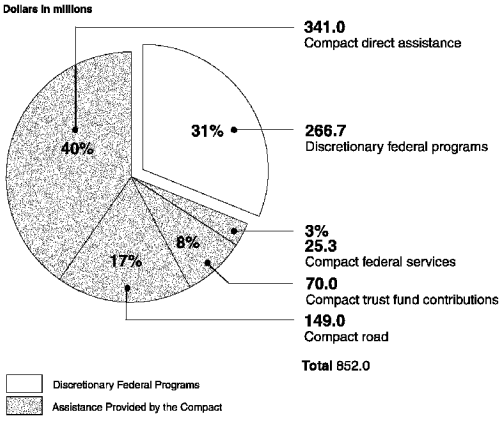
In addition to the U.S. assistance provided under the compact, U.S. agencies—the Department of Education, the Department of Health and Human Services (HHS), and Interior, among others—provide discretionary federal programs in Palau as authorized by U.S. legislation[12] and with appropriations from Congress. (See app. II for a complete listing of these programs in Palau.)

In our 2008 report, we projected that U.S. assistance to Palau from 1995 through 2009 would exceed $852 million. Of this total, economic assistance under the compact accounts for a projected 68 percent and discretionary federal programs account for a projected 31 percent (see fig. 1).[13]

[12]The compact's federal programs and services agreement, establishing the legislative framework for the provision of discretionary federal programs in Palau, was in force until October 1, 2009. These services continued under program authority in 2010 and 2011.

[13]GAO-08-732.

Figure 1: U.S. Assistance to Palau in 1995-2009 as Projected in 2008



Source: GAO analysis.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

Percentages may not sum to 100 because of rounding.

Amounts shown for compact direct assistance, compact trust fund contributions, and the Compact Road are based on Interior's Office of Insular Affairs' actual and estimated payments to Palau for 1995-2009, as reported in Interior's budget justification to Congress for 2009.

Amount shown for compact federal services is based on GAO estimates of past expenditures by the National Weather Service, U.S. Postal Service, and Federal Aviation Administration.

Amount shown for estimated discretionary federal programs is the sum of (1) U.S. agency program expenditures as reported in single audits for 1995-2006 for the Palau national government and for 1997-2006 for the Palau Community Action Agency and the Palau Community College, (2) GAO estimates of U.S. agency program expenditures for 2007-2009, and (3) GAO estimates of DOD Civic Action Team costs for 1995-2009. Estimated and projected federal program expenditures do not include the value of U.S. loans to Palau. For more information, see GAO-08-732.

Agreement Would Extend U.S. Assistance for 15 Years, with Annual Decreases

The September 2010 Agreement between the U.S. and Palau governments would extend assistance to Palau to 2024 but steadily reduce the annual amount provided. The Agreement would also extend the authority and framework for U.S. agencies to continue compact federal services and discretionary federal programs.[14]

Assistance to Palau Would Decline through 2024

Key provisions of the Agreement would include, among others, extending direct economic assistance to Palau, providing infrastructure project grants and contributions to an infrastructure maintenance fund, establishing a fiscal consolidation fund, and making changes to the trust fund. U.S. assistance to Palau under the Agreement would total approximately $215 million from 2011 through 2024.[15] The pending legislation would authorize and appropriate funds to Interior for this assistance.[16]

The legislation implementing the Agreement was not approved by Congress during 2011. Department of the Interior provided $13.1 million for direct economic assistance in 2011; however, funds were not provided for infrastructure projects, the infrastructure maintenance fund, or the fiscal consolidation fund.

[14]Other provisions in the Agreement would define reporting and auditing requirements and passport requirements. The Agreement would require that, by 2018, Palau resolve all deficiencies identified in annual single audit reports, which are required by the Compact's fiscal procedures agreement, such that no single audit report recommendations or deficiencies dating from before 2016 remain. In addition, the Agreement alters the entry procedures for citizens of Palau visiting the United States, requiring them to present a valid machine-readable passport to travel to the United States.

[15]The compact provided for direct assistance to Palau only through 2009. For 2010 and 2011, Interior provided $13.1 million for direct assistance to Palau each year. For 2012, Interior's Budget Justification proposed $29.25 million in direct assistance, while the Agreement provides for $27.75 million.

[16]Senate bill 343, 112th Cong. The pending implementing legislation would also extend the authority, and authorize appropriations, for the provision of compact federal services in Palau. However, the proposed legislation does not appropriate funds for compact federal services.

- *Direct economic assistance ($107.5 million).* Under the Agreement, the U.S. government would provide direct economic assistance—budgetary support for Palau government operations and specific needs such as administration of justice and public safety, health, and education—amounting to $13 million in 2011 and declining to $2 million by 2023. The Agreement also calls for the U.S. and Palau governments to establish a five-member Advisory Group to provide annual recommendations and timelines for economic, financial, and management reforms. The Advisory Group must report on Palau's progress in implementing these or other reforms, prior to annual U.S.-Palau economic consultations.[17] These consultations are to review Palau's progress in achieving reforms[18] such as improvements in fiscal management, reducing the public sector workforce and salaries, reducing government subsidization of utilities, and tax reform. If the U.S. government determines that Palau has not made significant progress in implementing meaningful reforms, direct assistance payments may be delayed until the U.S. government determines that Palau has made sufficient progress.

- *Infrastructure projects ($40 million).* Under the Agreement, the U.S. government would provide U.S. infrastructure project grants to Palau for mutually agreed infrastructure projects—$8 million in 2011 through 2013, $6 million in 2014, and $5 million in both 2015 and 2016. The Agreement requires Palau to provide a detailed project budget and certified scope of work for any projects receiving these funds.

- *Infrastructure maintenance fund ($28 million).* Under the Agreement, the U.S. government would make contributions to a fund to be used for maintenance of U.S.-financed major capital improvement projects,

[17]The Agreement requires that Palau undertake economic, legislative, financial, and management reforms giving due consideration to those identified by the IMF; the Asian Development Bank; and other creditable institutions, organizations, or professional firms.

[18]The compact requires that the United States and Palau consult annually regarding Palau's economic activities and progress in the previous year, as described in a report that Palau must submit each year. Our 2008 report noted that Palau had met reporting conditions associated with direct assistance but that, contrary to compact requirements, the bilateral economic consultations had not occurred on an annual basis; and had been informal and resulted in no written records. See GAO-08-732.

including the Compact Road and Airai International Airport.[19] From 2011 through 2024, the U.S. government would contribute $2 million annually, and the Palau government would contribute $600,000 annually to the fund.[20]

- *Fiscal consolidation fund ($10 million).* Under the Agreement, the U.S. government would provide grants of $5 million each in 2011 and 2012, respectively, to help the Palau government reduce its debts. Unless agreed to in writing by the U.S. government, these grants cannot be used to pay any entity owned or controlled by a member of the government or his or her family, or any entity from which a member of the government derives income. U.S. creditors must receive priority, and the government of Palau must report quarterly on the use of the grants until they are expended.

- *Trust fund ($30.25 million).* Under the Agreement, the U.S. government would contribute $30.25 million to the fund from 2013 through 2023. The government of Palau will reduce its previously scheduled withdrawals from the fund by $89 million.[21] From 2024 through 2044, Palau can withdraw up to $15 million annually, as originally scheduled. Moneys from the trust fund account cannot be spent on state block grants, operations of the office of the President of Palau, the Olibiil Era Kelulau (Palau National Congress), or the Palau Judiciary. Palau must use $15 million of the combined total of the trust fund disbursements and direct economic assistance exclusively for education, health, and the administration of justice and public safety.

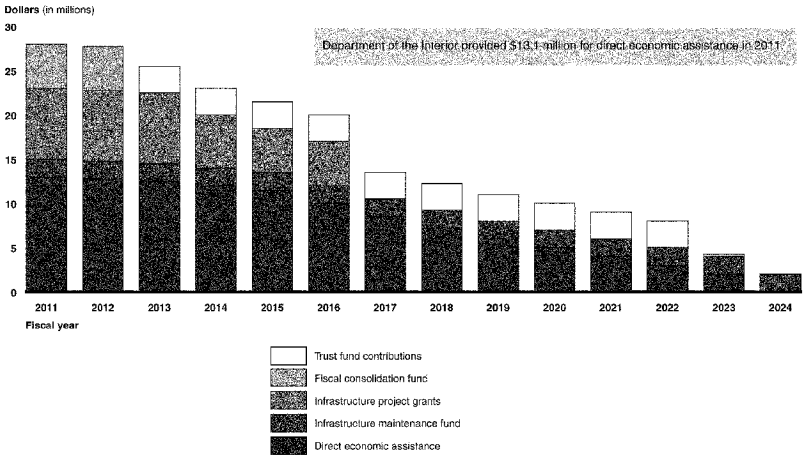
[19]In 2008, we reported that Palau and U.S. officials had expressed concerns about Palau's ability to maintain the Compact Road in a condition that would allow for the desired economic development. We also reported that Palau made initial efforts to maintain the road, but at levels that would cause the road to deteriorate over time and would not provide the economic development benefits envisioned for the people of Palau. See GAO-08-732.

[20]Under the compact, Palau owes the United States a total of $3 million. Under the Agreement, Palau would deposit $3 million in the infrastructure maintenance fund but not expend it. Any future income derived from the $3 million must be used exclusively for the maintenance of the Compact Road.

[21]Under the Agreement, Palau would withdraw $5 million annually through 2013 and gradually increase its maximum withdrawal from $5.25 million in 2014 to $13 million in 2023.

Annual U.S. assistance to Palau under the Agreement would decline from roughly $28 million in 2011 to $2 million in 2024. Figure 2 details the timeline and composition of assistance outlined in the Agreement.

Figure 2: U.S. Assistance to Palau for 2011-2024, as Outlined in the Agreement



Source: GAO analysis of the Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

Compact federal services and discretionary federal programs are not included in this analysis.

Funds were not provided in 2011 for infrastructure projects, the infrastructure maintenance fund, or the fiscal consolidation fund.

Agreement Would Continue Compact Federal Services and Extend Framework for Discretionary Federal Programs

The Agreement would extend the authority for the provision of compact federal services and discretionary programs in Palau.

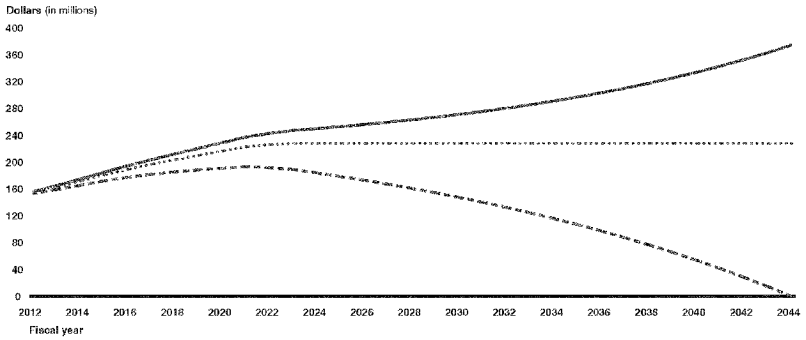
- *Federal services.* The Agreement would amend the compact's subsidiary agreements regarding federal services. The proposed legislation implementing the Agreement would authorize annual appropriations for weather and aviation services. The proposed legislation would have also authorized appropriations of $1.5 million to Interior for 2011 through 2024, to subsidize postal services to Palau, the Republic of the Marshall Islands, and the Federated States of Micronesia.
- *Federal discretionary programs.* The Agreement would extend the framework for U.S. agencies to provide discretionary federal programs to Palau, with implementation of the programs contingent on annual appropriations to those agencies. The proposed legislation would extend the eligibility of the people, government, and institutions of Palau for certain discretionary programs, including special education and Pell grants.

Agreement's Provisions Would Significantly Improve Prospects for Palau Trust Fund

The addition of $30.25 million in U.S. contributions and the delay of $89 million in Palau withdrawals through 2023, as provided by the Agreement, would improve the fund's prospects for sustaining scheduled payments through 2044. At the end of 2011, the fund had a balance of approximately $147 million. The trust fund would need a 5.5 percent annual return to yield the proposed withdrawals from 2011 through 2044 under the Agreement. This rate is well below the 7.4 percent return that the fund earned from its inception to September 30, 2011.[22] Figure 3 shows projected trust fund balances in 2012 through 2044 under the Agreement, with varying rates of return.

[22]All rates of return on the trust fund are net of fees and commissions unless otherwise noted.

Figure 3: Projected Palau Trust Fund Balance under the Agreement, with Varying Rates of Return, 2012-2044



Source: GAO analysis.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

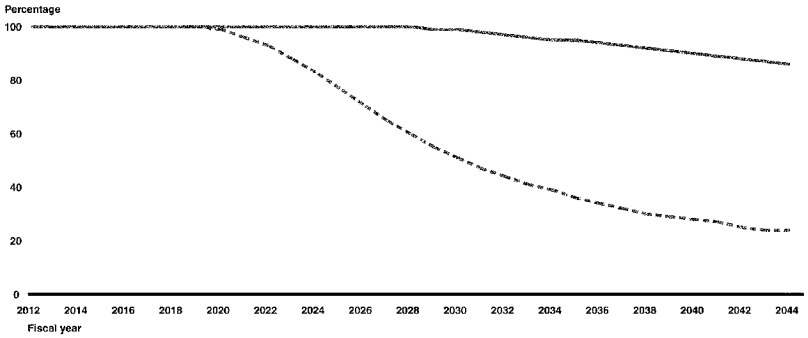
The analysis shown is based on the fund's balance as of September 30, 2011, and assumes that the Agreement's provisions related to the trust fund—including additional U.S. contributions and reduced Palau withdrawals through 2023—are approved.

The additional contributions and reduced withdrawals scheduled in the Agreement would also make the trust fund a more reliable source of revenue under conditions of market volatility. With these changes, the trust fund would have an approximately 86 percent probability of sustaining payments through 2044. In comparison, the fund had a 24

percent probability, at the end of 2010, of sustaining the $15 million annual withdrawals scheduled under the compact through 2044.[23]

Figure 4 compares the probability that the trust fund will sustain the proposed withdrawals under the terms outlined in the Agreement with the probability that the trust fund will sustain the withdrawals scheduled under the compact.

Figure 4: Probability That Palau Trust Fund Will Sustain Scheduled Withdrawals under Two Scenarios



Source: GAO analysis.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

[23]The probability of the fund's sustaining $15 million annual payments through 2044 under the original compact terms has diminished since 2008, when we determined that the probability was 46 percent. See GAO-08-732.

This figure depicts results from 10,000 trial runs. For each run, the returns of each asset class are randomly drawn from a distribution based on the historical returns. The account balances and the withdrawal amount from the trust fund are then calculated based on the returns and the withdrawal schedule. The probability of the trust fund's being able to disburse the scheduled amount is then generated from a distribution of 10,000 disbursements each year.

The figure's upper line shows the probability that the trust fund will sustain scheduled withdrawals under the Agreement's provisions of (1) annual U.S. contributions of $3 million from 2013 through 2022 and $250,000 in 2023 and (2) annual Palau withdrawals of $5 million in 2011, gradually increasing to $13 million in 2023, and $15 million from 2024 through 2044. The figure's lower line shows the probability that the trust fund will sustain scheduled payments under the compact's provision of $15 million annual withdrawals through 2044.

Estimates Prepared for Palau Project Declining Reliance on U.S. Assistance under the Agreement

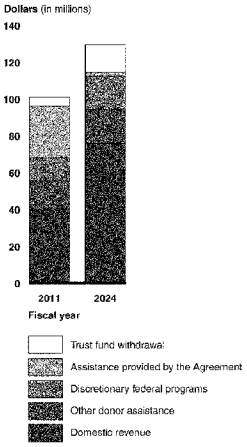
Estimates prepared for the government of Palau project that Palau's reliance on U.S. assistance provided under the Agreement will decline, while its reliance on trust fund withdrawals and domestic revenue will increase.[24] These estimates show U.S. assistance, as provided under the Agreement, declining from 28 percent of government revenue in 2011 to less than 2 percent of government revenue in 2024. The estimates also show Palau's trust fund withdrawals growing from 5 percent of government revenue in 2011 to 12 percent in 2024. In addition, the estimates indicate that Palau's domestic revenue will rise from 40 percent of all government revenue in 2011 to 59 percent in 2024.[25] Finally, the estimates prepared for Palau project a relatively steady reliance on U.S. discretionary federal programs, ranging from 12 percent of all government revenue in 2011 to 14 percent in 2024. The estimates assume that discretionary federal programs will grow at the rate of inflation; however, discretionary programs are subject to annual appropriations and may not increase over time.

Figure 5 shows the types and amounts of Palau's estimated revenues for 2011 and 2024.

[24]The government of Palau provided fiscal projections through 2024 to the Senate Committee on Energy and Natural Resources in January 2011. The estimates were prepared by an independent economist retained by the government of Palau.

[25]In March 2011, the IMF reported that Palau government revenues as a percentage of GDP are below average for island nations in the Pacific. The report cited opportunities for increased tax revenues by eliminating the gross revenue tax, replacing it with a corporate income tax, introducing a Value Added Tax, and increasing the level of taxation on high earners. The IMF also noted that Palau could reform its civil service to decrease wage expenditures. IMF, "Staff Visit to Republic of Palau—Concluding Statement of the IMF Mission" (Mar. 8, 2011).

Figure 5: Estimated Palau Government Revenues for 2011 and 2024



Source: GAO analysis and estimates prepared for the Government of Palau.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

The years shown were chosen to illustrate the trend in Palau's revenues from 2011, when the terms proposed by the Agreement would begin, through 2024, when assistance provided by the Agreement would expire.

Federal services were not included in the estimates prepared for Palau.

"Trust fund withdrawal" includes the maximum withdrawal for 2011 and 2024 as specified in the Agreement.

"Assistance provided by the Agreement" includes all funding specified in the Agreement.

"Discretionary federal programs" includes estimates prepared for the government of Palau for program funding and grants from U.S. agencies in 2011 and 2024.

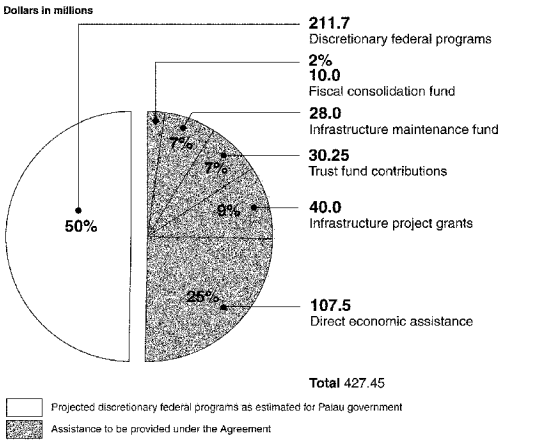
"Other donor assistance" includes estimates for assistance from other foreign donors for 2011 and 2024.

"Domestic revenue" includes estimates of taxes and fees to be collected by the Palau government in 2011 and 2024.

Estimates Prepared for Palau Project Discretionary Program Funding as Half of U.S. Assistance

The estimates prepared for the government of Palau project that U.S. assistance to Palau from 2011 through 2024, including discretionary federal programs, will total approximately $427 million. The estimates further project that discretionary programs will account for nearly half of U.S. assistance through 2024, with assistance amounts specified in the Agreement accounting for the other half. (See fig. 6.) In contrast, in 2008, we estimated discretionary program funding accounted for less than one-third of total U.S. assistance to Palau from 1995 through 2009.

Figure 6: U.S. Assistance to Palau in 2011-2024 as Estimated for Palau and as Provided under the Agreement



Source: GAO analysis of the Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review, estimates prepared for the Government of Palau.

Notes:

Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

The analysis depicted is based on the estimates prepared for the government of Palau and on the Agreement's provisions. This analysis does not include federal services, which are not addressed in the estimate prepared for Palau and generally are not specified in the Agreement.

"Discretionary federal programs" includes all funds appropriated to federal agencies for assistance to Palau. The discretionary federal program estimates prepared for the government of Palau include annual adjustments for inflation, but not for population growth, from 2009 through 2024. Although the Agreement does not specify funding for discretionary federal programs, it extends authority for U.S. agencies to provide them in Palau subject to annual appropriations.

Chairman Manzullo, Ranking Member Faleomavaega, and Members of the Subcommittee, this completes my prepared statement. I would be happy to respond to any questions you may have at this time.

GAO Contact and Staff Acknowledgments

For further information about this statement, please contact David Gootnick at (202) 512-3149 or gootnickd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement.

Emil Friberg (Assistant Director), Ming Chen, Brian Hackney, Reid Lowe, and Grace Lui made key contributions to this statement. Robert Alarapon, Benjamin Bolitzer, Joyce Evans, Mattias Fenton, Farahnaaz Khakoo, Sarah McGrath, Jeremy Sebest, Cynthia Taylor, and Anu Mittal provided technical assistance.

Appendix I: U.S. Assistance to Palau Provided Under the Compact and Outlined in the Agreement

Table 2 shows the assistance provided to Palau under the compact from 1995 through 2009. Table 3 shows the proposed assistance to Palau for 2011 through 2024, as outlined in the Agreement.

Table 2: Compact Assistance Provided to Palau in 1995-2009

Dollars in millions

Types of assistance	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Total
Direct assistance	$126.5	$23.5	$22.4	$21.2	$13.6	$13.6	$13.8	$13.9	$14.1	$14.1	$12.7	$12.8	$12.9	$13.0	$13.1	**$341.1**
Infrastructure	53.0	0	96.0	0	0	0	0	0	0	0	0	0	0	0	0	**149.0**
Trust fund contributions	66.0	0	4.0	0	0	0	0	0	0	0	0	0	0	0	0	**70.0**
Total	**$245.5**	**$23.5**	**$122.4**	**$21.2**	**$13.6**	**$13.6**	**$13.8**	**$13.9**	**$14.1**	**$14.1**	**$12.7**	**$12.8**	**$12.9**	**$13.0**	**$13.1**	**$560.1**

Source: GAO analysis of the Interior OIA Budget Justifications and Performance Information fiscal year 2012.

Note: Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

Table 3: Proposed Assistance to Palau as Outlined in the Agreement

Dollars in millions

Types of assistance	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total
Trust fund contributions	$0	$0	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00	$3.00	$0.25	$0	$30.25
Infrastructure maintenance fund	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	28.00
Infrastructure project grants	8.00	8.00	8.00	6.00	5.00	5.00	0	0	0	0	0	0	0	0	40.00
Fiscal consolidation fund	5.00	5.00	0	0	0	0	0	0	0	0	0	0	0	0	10.00
Direct economic assistance	13.00	12.75	12.50	12.00	11.50	10.00	8.50	7.25	6.00	5.00	4.00	3.00	2.00	0	107.50
Total	$28.00	$27.75	$25.50	$23.00	$21.50	$20.00	$13.50	$12.25	$11.00	$10.00	$9.00	$8.00	$4.25	$2.00	$215.75

Source: GAO analysis of the Agreement between the U.S. government and the government of the Republic of Palau following the Compact of Free Association Section 432 review.

Note: Years are fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

Appendix II: U.S. Discretionary Program Funds Expended in 2009

Table 4 lists discretionary U.S. federal program funds expended by the Palau national government, the Palau Community College, and the Palau Community Action Agency, as reported in the organizations' single audit reports for 2009.

Table 4: U.S. Federal Program Expenditure in Palau as Reported in 2009 Single Audit Reports

U.S. agency	Federal program	2009 expenditure
Agriculture	Cooperative Forestry Assistance	$155,422
Agriculture	Community Facilities Loans and Grants	124,745
Agriculture	Unknown	1,604
Commerce	Special Oceanic and Atmospheric Projects	306,485
Commerce	Unallied Management Projects	1
Education	Pell Grant	2,250,348
Education	Freely Associated States-Education Grant Program	1,309,324
Education	Special Education-Grants to States	859,119
Education	Upward Bound Program	315,164
Education	Talent Search	204,406
Education	Upward Bound Math and Science	198,998
Education	Gaining Early Awareness and Readiness for Undergraduate Programs	198,205
Education	Student Support Services Program	189,771
Education	Special Education-Grants to States	122,755
Education	Federal Work-Study	109,923
Education	Academic Competitiveness Grant	78,346
Education	Supplemental Educational Opportunity Grant	52,600
Education	Byrd Honors Scholarships	46,500
Education	Adult Education-State Grant Program	29,038
HHS	Head Start	1,670,508
HHS	CDC and Prevention-Investigations & Technical Assistance	976,068
HHS	Consolidated Health Centers	564,525
HHS	Substance Abuse and Mental Health Services-Projects of Regional and National Significance	431,171
HHS	National Bioterrorism Hospital Preparedness Program	387,003
HHS	Public Health Emergency Preparedness	343,717
HHS	Epidemiologic Research Studies of AIDS and HIV Infection in Selected Population Groups	260,367
HHS	Material and Child Health Federal Consolidated Programs	201,257
HHS	Family Planning-Services	171,235
HHS	Maternal and Child Health Services Block Grant to the States	149,718

U.S. agency	Federal program	2009 expenditure
HHS	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	116,313
HHS	Immunization Grants	113,372
HHS	Block Grants for Prevention and Treatment of Substance Abuse	111,340
HHS	Universal Newborn Hearing Screening	95,591
HHS	DEH-PHCI	72,266
HHS	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	67,785
HHS	Basic/Core Area Health and Education Center	62,506
HHS	Block Grants for Community Mental Health Services	58,245
HHS	Consolidated Knowledge Development and Application (KD&A) Program	55,430
HHS	Preventive Health Services - STD Control Grants	48,079
HHS	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation and Surveillance Systems	44,845
HHS	HIV Care Grants	38,249
HHS	ARRA-Grants to Health Center Programs	20,990
HHS	HIV/Aids Surveillance	19,372
HHS	Preventive Health and Health Services Block Grant	17,375
HHS	Drug Free Communities Support Program Grants	12,759
HHS	Civil Rights and Privacy Rule Compliance Activities	12,620
Interior	Social, Economic and Political Development of the Territories	628,346
Interior	Historical Preservation-Grants in Aid	254,436
Justice	Juvenile Justice and Delinquency Prevention-Allocation to States	1
Labor	ARRA WIA Dislocated Workers Program	128,027
Labor	WIA Dislocated Workers Program	118,574
Labor	ARRA WIA Youth Activities	81,112
Labor	WIA Adult Program	63,241
Labor	WIA Youth Activities	62,637
Labor	ARRA WIA Adult Program	49,162
Transportation	Airport Improvement Program	$4,309,960
Total		**$18,370,956**

Source: GAO analysis of Republic of Palau National Government Independent Auditor's Reports on Internal Control and on Compliance Year Ended September 30, 2009; Palau Community College Comprehensive Annual Financial Report Fiscal Year Ended September 30, 2009; and Palau Community Action Agency Report on the Audit of Financial Statements In Accordance with OMB Circular A-133 Year Ended September 30, 2009.

Notes:

Year is fiscal (Oct. 1-Sept. 30), and dollar amounts are in nominal dollars (i.e., unadjusted for inflation).

HHS = Department of Health and Human Services.

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Mr. MANZULLO. Thank you so much.

Mr. Faleomavaega, you are recognized for 5 minutes.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman.

I want to thank the members of the panel for their most eloquent statements. I would like to pose some questions that hopefully will give us a little better understanding of the situation that we currently face concerning Palau.

Correct me if I am wrong on this because it seems that the basis that we dealt with these island entities immediately following the second world war, given the fact that there was no question about the importance of these islands when we entered in the war against Japan, when they invaded us in 1941.

I do want to thank General Simcock for his testimony because it appears to me that we have three agencies involved. We have the Interior Department, the State Department and the Defense Department, all involved in some way or another not only with the administration but also have political ties with the Republic of Palau.

And let me ask General Simcock, would it be fair to say our number one priority and the very reason why we have this relationship with the island entities is because of our strategic and military interest in this part of the world. Could that be considered the number one reason why we are there?

Put it another way. Is Palau important as part of our overall strategic importance in this part of the Pacific? Because here is another problem I am faced with, General. There is no way you can talk about Palau without discussing the Federated States of Micronesia, without discussing the Republic of the Marshall Islands, why we conducted 67 nuclear test bombs that we dropped in those island entities and the fact that Guam is now about a $40 billion military presence there in terms of its importance strategically when we look at Asia, if that is where the potential danger is posed and, of course, the Northern Mariana Islands. My good friend Mr. Sablan represents that important island group.

General Simcock, is it fair for me to say that this is the very reason why we are there in the first place, because Palau is a very important part of our overall strategic military interest in this part of the Pacific? We are the size of Texas, even though 20,000 people there are scattered all over the place.

General SIMCOCK. Congressman Faleomavaega, you are absolutely right. The quick answer to your question, yes. I would just expand on one more point. And I would just say that it always starts with security. Everything builds from security. If you don't have security, all of the other interests, be they economic, diplomatic, whichever you want to talk about, sir, they go away. But you are absolutely right. But today the scope is narrow on Palau, but Asia-Pacific region is very, very vast.

Mr. FALEOMAVAEGA. I want to also note as a matter of interest—and correct me, General, if I am wrong on this—I read the summary reports that we currently have 700 military installations in and outside the United States. When I asked how many military bases does China have outside of China, the response I got was zero. Is that correct? We currently have well over 700 military installations in and outside the United States currently right now?

General SIMCOCK. Sir, I don't know the exact figure.

Mr. FALEOMAVAEGA. Can you provide that for the record?

General SIMCOCK. Yes, sir.

Mr. FALEOMAVAEGA. It is a very interesting situation. We currently have a $700 billion budget to defend our country for 1 year, provide enough resources for our Navy, Army, Air Force for 1 year's time schedule?

Would it be correct also for me to say that if there is any agency that should be part of the overall providing the necessary resources that we deal with, Palau should also be with the Department of Defense?

Here is a problem that I am faced with. The State Department does the negotiations. Defense Department says it is very critical to our needs for national survival. Yet, the results of the negotiations totally does not match in terms of the importance of Palau.

And, yet, the essence of what we are giving Palau, a 62 percent decrease in funding. It just blows my mind. And, yet, in negotiations, renegotiations of the two contacts with the Republic of the Marshall Islands and the Federated States of Micronesia, the increases are 47 percent for one and 63 percent for the other. And we are decreasing Palau's needs by 62 percent.

Maybe Mr. Loi can help us with this. Can you give us a sense of why the discrepancy or is this a discrepancy on my part? Please correct me on that.

Mr. LOI. Congressman, I am not—I don't know the specifics of the discrepancy. I mean, all I can say is this agreement was reached between two sovereign countries, negotiators agreeing on the specifics. You know, I was not in this position when the review agreement was——

Mr. FALEOMAVAEGA. Mr. Secretary, I fully understand that and I don't want to blame you for this. Could you provide for the record why we had this problem?

Here is another problem I would like to add on to my——

Mr. MANZULLO. You are at 6 minutes now. We can come back.

Mr. FALEOMAVAEGA. Okay. I will wait for the second round. I am sorry. Thank you, Mr. Chairman.

Mr. MANZULLO. Do you have questions, Mr. Duncan?

Mr. DUNCAN. According to Wikianswers, there are 761 U.S. military bases around the world, 156 countries.

Anyway, recently I was in the Philippines. And we were talking with Filipinos about China's extension of their territorial waters and the Spratly Islands actively staking claim to some areas that historically were areas claimed by the Philippines. And so we see this growing extension of China into these waters. So, General, I know that the U.S. Coast Guard plays a role in patrolling the waters in and around Palau.

Given this growing assertion, assertiveness of China within the Pacific theatre and really around the world when you get right down to it with them gobbling up control of resources, are we planning on increasing U.S. naval presence in and around the waters around Palau? I mean, what is our plan there to combat this?

General SIMCOCK. Sir, thank you for the question. Again the quick answer is yes. I mean, our national leadership has stated the vital interest within this region to the United States. As such, we

are taking appropriate plans and actions to use our military to support U.S. interests in that region.

In fact, the chairman mentioned in his statement we have concluded agreements with Australia to have rotational forces go through Australia. It is an increase, if you will, of forces in the region of southeast Asia conducting a rotational presence, training within that area.

So, sir, yes, the quick answer is we are taking actions to increase military presence and commitment to the region.

Mr. DUNCAN. Getting back to the U.S. military presence around the world, I am fine with that. Protect American national interests, wherever they may be. A lot of the countries have asked the United States to station military personnel there. So I personally don't have a problem with any of that.

For my second question, given the difficulties in implementing the 2006 base realignment agreement with Japan to relocate the U.S. Marine Air Base from Okinawa to Guam, is Palau being considered as a potential location for that or any other resources, to your knowledge?

General SIMCOCK. To my knowledge, sir, not in the way that you posed the question that it would be directly tied to Guam or any other area. The answer would more accurately I think be that we are looking at all possibilities to increase engagement and to have ways to facilitate the commitment and presence within the region.

Mr. DUNCAN. I have no further questions.

Mr. MANZULLO. Mr. Sablan?

Mr. SABLAN. Thank you very much, Mr. Chairman.

I also would like to say thank you to the witnesses for, you know your testimonies and providing insight into the issue before us. I would like to think that sometimes, you know, like any business, for example, banks, they spend a fortune trying to bring in new customers. And then once they capture the customer, they charge a $5 monthly fee and lose that customer after they spent a fortune. It looks like this is something that we are headed here to.

I have not heard anyone put any less importance to the relationship between the United States and Palau. It has been critical for what I hear.

I also understand that the only impediment to approval of this agreement that any Member of Congress, from what I understand, has had the need for an offset of the relatively minor cost, now less than $184 million over 10 years because of appropriations to date.

The administration has suggested offset proposals that the bipartisan leaders of the House and Senate Natural Resources Committees say it will not pass their committees. While one offset has shown to have support in Congress, the others, and this one included, seem to be standing at a stalemate.

Either Mr. Loi or Mr. Bussanich, will the administration propose an offset that is more viable legislatively?

Mr. BUSSANICH. Well, sir, I have to say that the offsets that have been proposed by the administration, the three that I mentioned have been vetted through the Department of the Interior and the Office of Management and Budget and are included in the overall budget of the President.

So at this time, this is the recommendation of the administration to look at, particularly, these three elements, which are the abandoned mine land payments, the fee on non-producing leases, and the net revenue receipt sharing on minerals.

But the position of Congress, as you have just related to me, is something that we will make aware, pass back up the chain as we discuss this. Certainly this is the proposal that is on the table at this point from the administration's point of view.

Mr. SABLAN. So there is a possibility of a more viable, much acceptable offsets?

Mr. BUSSANICH. Well, all I can say, sir, is that the administration is firm in its support of this agreement and the continuation of the relationship with Palau.

Mr. SABLAN. Thank you.

General Simcock, thank you very much for your testimony. Thank you for your service to our country through the Marines. That also liberated the Northern Marinas Saipan particularly.

I appreciate your insight, sir, into the national defense perspective and why this agreement is important for the United States. You mentioned in your testimony Palau forms a part of that security zone under the exclusive U.S. control. That expands the second sort of like border or boundary. That includes the Northern Marianas and Guam.

So can you give me a better understanding of the role Palau plays in the security of the Asia-Pacific in relation to the other islands, such as the Northern Marianas, that chain?

General SIMCOCK. Yes, sir. I think when you are trying to single out Palau, Palau is important, absolutely, but it plays a part of the overall regional perspective. And I would say to you that other locations are also important, but the map that I showed you, sir, again, that was not my map. That is another country's map and the way that they are looking at from their perspective U.S. presence in the region.

And I think that their position is we have a strong position within the Pacific. And it is a strong position militarily we need to maintain.

Mr. SABLAN. So in their perspective, Palau is part of that chain that goes up to Guam and Northern Marinas, all the way up to Okinawa or Iwo Jima, for example?

General SIMCOCK. Yes, sir.

Mr. SABLAN. All right. So are you planning on increasing the U.S. naval engagements in the waters of Palau?

General SIMCOCK. Sir, we don't have plans to do that.

Mr. SABLAN. So how does this impact the defense strategy in relation to the rest of the islands?

General SIMCOCK. An example, sir, part of our training Pacific partnership, we have ship visits to Palau. We have small detachments of military personnel that provide engineering support on Palau. The relationships and the engagement that we conduct on Palau maintains that relationship so that we don't lose the position of strength that we enjoy in the Pacific today.

Mr. SABLAN. All right. Mr. Gootnick, I just want, Sir, to take this moment to thank you for the many things you do for us in the

Northern Marianas and other parts of Micronesia. Thank you very much.

I yield for now, Mr. Chairman.

Mr. MANZULLO. Thank you.

Mr. Kelly?

Mr. KELLY. Thank you, Chairman.

And to all of the panel, thank you for being here. General, I was particularly interested in your comments. I can remember years ago listening to a tape of General MacArthur's address to a joint session of Congress in April 1951. And I had asked Mr. Fong to get me some of that information.

Let me just read back to you because you referenced people who don't study history. In that address, General MacArthur, when he talked about the island chain and talked about our Westernmost defense, said,

> "A vast moat to protect us as long as we hold it . . . [a] protective shield for all of the Americas and all of the free lands of the Pacific Ocean area, a chain of islands extending in an arc from the Aleutians to the Marianas held by us and our free allies, from this island chain, we can . . . prevent any hostile movement into the Pacific."

And not to belabor this, but there is an old saying that an ounce of prevention is worth a pound of cure. We seem to always—when a war threat is over, we down-throttle. Then, all of a sudden, we have to traject way up again.

If you can, if you can articulate because I think it is so critical that people understand, when I look at that, that chain of islands, the strategic importance to us as a nation and to our allies in the Pacific as we look into the future, the People's Republic of China and Arab states in Palau. So if we were to vacate that, if we were no longer to have our strong presence there, if we were to go away from what General MacArthur told us based on history, loss of life, wealth, and everything that we have invested in that area, long range, strategically from a defense standpoint, this is critical for us to maintain that presence, is it not?

General SIMCOCK. Congressman Kelly, you put me in a difficult position when you start comparing me to General MacArthur, probably one of the——[Laughter.]

Mr. KELLY. Well, it is history.

General SIMCOCK [continuing]. Finest military minds that our nation has produced, sir.

Can I put it in these terms?

Mr. KELLY. Absolutely.

General SIMCOCK. Sir, I am in violent agreement with you. Everything that you just said is absolutely true. I am a product of the all-volunteer force. And one of the reasons the all-volunteer force was developed was so we wouldn't have to go through the cycle, sir, that you talk about, the deep downturns in defense, because postwar draw-downs and then just as the clock moved along be put into a position where we had to build back up again.

So the all-volunteer force has done, arguably, a very good job of maintaining a very capable and credible military worldwide. If you narrow it down, sir, to the region that we are talking about, the

argument is still the same. And, as I said to Congressman Sablan, we are in a good position now. And it is not a position that we want to relegate to anyone else. That's about as best as I can put it, sir.

Mr. KELLY. And I appreciate that. I listened to that tape several times over and over and over again. And I keep thinking to myself as I go back. We just don't remember. Our memory falls short of what has happened to us before. And it kind of ensures the fact that we can lose it again in the future because of our refusal to believe what has happened in the past. And we keep backburnering these things.

And I know the dollars are critical. I understand that. But my greatest fear is that we continue to believe that these threats don't exist. That is the part that bothers me.

I really believe that we have lulled ourselves into believing that we are truly safe and we don't need to keep up a stronger front. But that western border extends far beyond California and the Western states. It goes way out beyond Hawaii, beyond the Aleutians. And that is where that island chain is so critical for us in defense as it goes forward.

And I do know the People's Republic of China has great plans. Being a person who has been to Korea many times in the southern part of the peninsula, I again understand you are talking about the people from Palau when you stepped there. The Koreans are so thankful for our commitment in freeing them in 1949 and 1950. So I'm with you on it.

So thank you so much for your service. And all members of the panel, thank you so much for being here today. Thank you. Thank you, Mr. Chairman.

Mr. MANZULLO. Mr. Kelly, Mr. Loi has retired as a Commander in the Navy. He might feel slighted if you don't ask him that same question. [Laughter.]

Mr. KELLY. I don't want to slight anybody that has performed a service for our country, but I just thought with the General sitting here today. And I am going to try to find that CD because if anybody has listened to General MacArthur's treatise on that and what he saw coming in the future—and his warning was, his fear was, that we would forget what we had just been through because time has a way of insulating us from the pain. And that is the problem that I see happening right now. We have to really be aware of how much pain that caused then and it can cause again if we don't keep our guard up. So thank you.

And if I offended anybody who served before, I certainly did not mean to do that.

Mr. MANZULLO. I just wondered if Commander Loi wants to weigh in on it.

Mr. KELLY. Would you, Commander?

Mr. LOI. Congressman, I think the only thing I would add is, like the General, I violently agree with you. And I think I am happy to say that I think the administration understands that. If you read the Secretary's speech, Secretary Clinton's speech, that she gave in Hawaii a couple of weeks ago in the piece that she published in Foreign Policy talking about the pivot as we draw down from Afghanistan and Iraq, that the question that faces us is, do

we do what we have done in the past after tragic campaigns and withdraw home and kind of tend to our domestic issues, which obviously are important, or do we pivot? Do we pivot to the region that is going to shape the history of this century beyond, and that is the Asia-Pacific?

And so what we are very focused on—and it is not just the State Department. It is also other agencies at the table. It is, how do we pivot? How do we make sure that we don't do what we have done in the past and that we build up our presence, our engagements in the Asia-Pacific? And that is what we are trying to do? And that is why, you know, this agreement is important.

Mr. KELLY. And I appreciate that. And I think it is so important. I think that one of the things that I have learned is that sometimes our allies start to wonder about where we are, when we are with them really strong for a while, and then we disappear. Geopolitically, we face a great deal of loss there.

I know in Korea, the southern part of the peninsula, it was great geopolitical consequences. And the course was very critical for us to get established for the people of Korea, southern Korea, to understand that we are still on board with them and how important they are to us in a geopolitical and from a defense strategy. So thank you again.

Mr. MANZULLO. Thank you, Mr. Kelly.

The problem here is not the fact that Congress does not understand the strategic——

Mr. FALEOMAVAEGA. Will the chairman yield? I just wanted to compliment Mr. Kelly for his keen insights and observation about this issue because I have been here 23 years now as a member of this committee and I have been saying the Pacific has been totally neglected by Washington for all of these years. And saying this with all sincerity, we keep saying it is very, very important. But we just don't match it with actually giving the proper resources that we need to do this with.

But I want to compliment you, sir, for your observation——

Mr. LOI. Thank you.

Mr. FALEOMAVAEGA [continuing]. On what is happening here in the Pacific. And I thank the chairman for this.

Mr. MANZULLO. Okay. The problem is money. That is the problem with this entire city in these budgetary times.

My question is technical, Mr. Bussanich. The offsets that you have listed on page 5 come out of the Interior budget. Is that correct?

Mr. BUSSANICH. That is correct, sir.

Mr. MANZULLO. Is it necessary for the offsets to come out of the Interior budget or can they come out of other budgets?

Mr. BUSSANICH. Well, sir, this issue has certainly been considered by the administration. And I think by the virtue of history and the relationship that the Interior Department has had with all the Pacific islands and the fact that it has been essentially the lead agency in the Micronesian region, including for Guam and the Northern Marianas. It has been the lead agency since the '50s, that that funding relationship is and remains appropriate.

Mr. MANZULLO. But, there are three committees of jurisdiction. There is State, which is well-known for wasting a lot of money; and

Defense, which has a lot of issues as well. The Interior budget is a lot smaller—isn't that correct?—than the other two?

Mr. BUSSANICH. Yes, sir.

Mr. MANZULLO. Maybe, Mr. Gootnick, you can help us on the technicalities of this. I mean, we really want to get this thing done. As I said, Congress is in agreement that Palau is extraordinarily important and the resources have to be there, but the issue is from—Mr. Gootnick, can you help us? Do you understand my question?

Mr. GOOTNICK. Mr. Chairman, I have always had a persnickety relationship with cutting-edge technology.

Mr. MANZULLO. But you are a physician, so you should be able to figure that out.

Mr. GOOTNICK. I can't speak directly to the offsets. It is my general understanding that the offset requirement really relates to a current rule of budgeting and the Congress.

Mr. MANZULLO. Okay.

Mr. GOOTNICK. And so there would be flexibility to obtain the offsets wherever you rationally find them.

Mr. MANZULLO. So is it your understanding that if Congress wanted to, it could try to find the offsets in areas besides Interior?

Mr. GOOTNICK. Well, it would be good to get concurrence from my colleagues at the table, but that is my understanding.

Mr. MANZULLO. Well, it could be a legal issue and none of us has the exact answer at this point. It is something that we can explore unless anybody is comfortable in trying to answer that.

The other question is the—I tell you what. Eni, why don't you go ahead and I will just yield my time to you.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman.

I once read somewhere in the Bible, it says that if I were to talk between—well, anyway, it talks about Moses, you know, freeing the Israelites from the bondage from Pharaoh and it takes only 2 weeks to walk from Egypt to go to the Promised Land, where Israel is now located. But, in essence, it took the Israelites 40 years to finally get to the Promised Land.

I want to ask Secretary Loi because I am a little fuzzy about this. The administration claims that you sent the agreement to Congress in January of this year. However, we contacted the Speaker's office, and they never received the document.

Please, this is not putting you on the spot, Mr. Secretary Loi but can you follow up on this and find out exactly where this agreement is between the White House and also here at the Speaker's office? Where is the agreement? Now, this was in January. This is almost 12 months.

Mr. LOI. Sir, I mean, I can update you.

Mr. FALEOMAVAEGA. Can you?

Mr. LOI. Well, the Speaker's office has acknowledged receipt. In fact, they acknowledged receipt in January and told us that it had been sent to the committee in February. We confirmed that again yesterday. So I don't know——

Mr. FALEOMAVAEGA. Okay.

Mr. LOI [continuing]. Where the report is coming from, but at least what we are being told by the Speaker's office is that they did acknowledge receipt.

Mr. FALEOMAVAEGA. Okay. I have a couple of laundry list items I would like for you, Secretary Loi, if you could follow up on this, I really would appreciate it. Again, you are not at all at fault for what has happened because you just came on board a couple of months ago so I fully understand your predicament.

The cost of conducting audits, for which this continues with the renegotiating of the two Compacts with the Marshall Islands and also with the Federated States of Micronesia, you rejected this to continue with Palau. That is one issue.

The other issue is also dealing with the FCC requirements dealing with fiber optics, with which Palau really would like to work, for which was granted also to the Marshall Islands and the Federated States of Micronesia. And this again was rejected for Palau's needs. And then also the question of the postal service, the rates for domestic means of Palau. And this again is somewhat of a fuzzy situation YAD. This issue was done also by some way reconciling in the way that FSM and RMI also be given the same benefit in the uses of the postal service.

And there is also the question of the excessive inflation if there is, tell me the time when something happens, that this kicks in and somehow we can work this thing out. Here again this is another issue that, as I understand, was not part of the agreement negotiations.

Going back to General Simcock's observation, it is one of these ironies that the State Department is the primary negotiator with this agreement, also talking about the funding in all of this. And, yet, when it comes to the actual funding, it goes to the Interior Department for the administration.

Do we have other activities like this that go on that State Department could bless the negotiations; yet, the funding comes out of Interior and the reason why we can't find an offset because the Interior budget obviously is much, much less than the State Department?

And I would like to ask Mr. Bussanich, where does the Interior Department stand on this?

Mr. BUSSANICH. Well, sir, actually, we were full partners in the negotiation. We were at the table on every occasion. In fact, it was I who was at the table on every occasion. For any of the discussions that took place with Palau, I was authorized to participate and was a full partner.

And certainly the discussions going back to the negotiations and the liaising with the Office of Management and Budget and other budget officials was done through the Department and done through my office. So we are fully apprised. This is not a State Department deal that was done in the darkness without the Interior part of it, participating in it fully.

I can, if you would like, answer I think some of the questions or at least provide a little information regarding a couple of the things you just raised——

Mr. FALEOMAVAEGA. Sure.

Mr. BUSSANICH [continuing]. Particularly the question of audits, the postal service, and inflation. Under the original—I would like to point out that the Compacts between the financial provisions of——

Mr. FALEOMAVAEGA. You know, I am sorry, Mr. Bussanich, but my time is running. So could you submit that for the record?

Mr. BUSSANICH. Absolutely, sir.

Mr. FALEOMAVAEGA. I would really like the response from the Interior Department concerning this issue.

Mr. BUSSANICH. Very much.

Mr. FALEOMAVAEGA. I also would like to have the GAO, Dr. Gootnick, your observation as to the GAO study that was conducted, was this before or after the negotiations took place? I am just curious where the GAO comes into play on this.

Mr. GOOTNICK. The presentation I have offered you today is based on our current analysis of the agreement, the September 2010 agreement. Previously we had done work at the request of Congress on the Compact of Free Association in the run-up to the 15-year review and reported out in 2008.

Mr. FALEOMAVAEGA. Okay. You mentioned something about the trust fund that seems to have some problems and also seems to be one of the key issues in the negotiations. Can you elaborate on this again with the trust fund?

Mr. GOOTNICK. Right. Well, we initially did an analysis of the status of the trust fund for our 2008 report and have updated that now three times. So what we are able to do is take the trust fund balance, the historic rate of return for the portfolio that is held by the fund, and run a variety of statistical simulations which help us understand essentially the health of the trust fund and are able to determine the rate or return it will require in order to achieve its projected——

Mr. FALEOMAVAEGA. Let me just say, Mr. Chairman, at this point in the negotiation, what we are doing, in my humble opinion, the leaders of Palau are not very happy with the way negotiations are being conducted. And the fact that there seems to be such a fuzziness going on between the administration and the Congress, there's interest in trying to approve funding as part of the negotiations.

General Simcock, many of my relatives are in the Marine Corps and are very proud of being part of the Marine Corps. But I think I need to weigh in, Mr. Chairman, as I represent the Army. I believe it is the most senior of all of the military agencies represented here.

At any rate, General Simcock, we can talk about us currently having 11 nuclear super carriers, 21 altogether with carriers that we have. China only has one. In my opinion, the Chinese are not stupid, but they do have, what, close to 100 nuclear submarines floating all over the place.

As a very knowledgeable and strategic person, General Simcock, if you had a choice, would you rather have an aircraft carrier or a nuclear submarine running around the Pacific?

Mr. MANZULLO. You don't have to answer that question.

Mr. FALEOMAVAEGA. Okay. You don't have to answer the question. I know my time is up. I just want to say one thing.

Mr. MANZULLO. Especially with the Navy present at the table.

Mr. FALEOMAVAEGA. I just want to say this. We spent almost $1 trillion when we went against Saddam Hussein. We are spending over $120 billion a year on the war in Afghanistan. And I cannot in trying to explain to the leaders of Palau the $184 million, what-

ever it is for the 10-year period, that my Government cannot come up with a solution to this very simple solution of giving what is proper and what is reasonable in our relationship that is important, if we really consider Palau just as important as Guam or the Northern Marianas or even the State of Hawaii, when it comes to our strategic and military policies.

In my opinion, Mr. Chairman, the way things are going on now and as a—I am still learning how to speak English, Mr. Chairman. What do you call that? A hypothetical.

What if the Chinese want to come and set up a marine submarine base in Palau? Wouldn't that be a good thing for studying how less important these islands are or maybe——

Mr. MANZULLO. On that question, I am going to have to——

Mr. FALEOMAVAEGA [continuing]. Or even have Fiji come in, ask China to come and set up a submarine base. Wouldn't that be an important part of our national posture looking at how important these islands are to simply say they are not important as part of our national forum.

So, with that, Mr. Chairman, I know my time is way, way over.

Mr. MANZULLO. It is over.

Mr. FALEOMAVAEGA. I thank you for your patience. And I want to thank the gentlemen from——

Mr. MANZULLO. But this is your area of the world.

Mr. FALEOMAVAEGA. Well, thank you, Mr. Chairman.

Mr. MANZULLO. Mr. Sablan?

Mr. SABLAN. Thank you very much, Mr. Chairman.

This morning I was talking to my staff about the question I posed earlier. And they inserted the word "relatively minor cost," not less than $184 million.

I agree with nickel and diming Palau, not just have we done that to one of our best allies and a very important partner in the Pacific. We can't seem to find a way to live up to that commitment we made in that agreement reached between our Government and the Government of Palau.

And, again, I said earlier that the people of Palau are a very patient people. And I know them because I grew up with them. I was 11 years old when I first went to Palau. They are a very patient people, but patience has its limits. And we have I think invested a large sum of money in trying to capture Palau in the sense of and we are going to charge them that $5 bank fee, and they are going to walk away unless we get to do something.

We need to find our offsets because we can sit here and talk and talk until we turn blue, but I don't think this is going to go anywhere unless we find viable offsets that is acceptable to Congress. And somebody needs to do that because we all agree that this is important. And it is enough to nickel and dime them through the fine work of some of us here in this table.

I mean, I am not blaming anyone. You are doing your job. And then we turn around and talk among ourselves that we can't find the nickel that we need that we agreed 62 percent. Only Palau can give that kind of bargain, only the good people of Palau. And now we can't even live up to that commitment. Now, we should be ashamed of ourselves.

I am not ashamed, but, you know, we should try and work hard and find a way to do this, Mr. Bussanich. I know Interior has the smallest pot. I agree with you. Maybe Mr. Loi and the General. I am not saying that we do, but we need to sit down at the table again and find something that is acceptable so that the committee of jurisdiction, Natural Resources, will move forward with this because I know the objection is already offset. And please, you know, this is in our interest, not in Palau's interest. We are talking about the interest of the United States.

And I thank everyone for being here today. I appreciate the time and the testimony. Chairman Manzullo and Ranking Member Faleomavaega, thank you, sir, for including me in today's hearing. I am very grateful. Thank you very much.

Mr. MANZULLO. I appreciate that.

Mr. Bussanich, I have a job or a request for you. We are going to mark this up next year, and I am going to put in the markup that the money comes from three departments: State, Defense, and Interior. If you consider yourself to be the point person to work with our committee on this, or somebody else in Interior, we want to get this thing done.

It is too critical. It is too important. It is too strategic for us to have all this work done and then come down to these offsets which come out of a department that really doesn't have that much to work with the first place. I can appreciate the fact that you had to get creative to come up with these three offsets.

Could you be willing to work with Mr. Su on the subcommittee and with the other two departments to see if they are willing to—I mean, I am going to try to put it into organic legislation that they have to take Palau into consideration.

Mr. BUSSANICH. Well, certainly, sir, I will do that. And I know that my colleagues here understand what you are saying. And we will work through the administration to find the most appropriate offsets for this.

Mr. MANZULLO. Okay. Well, thank you for a very enlightened hearing. Eni, you are correct. We don't spend enough time talking about what is going on in the Pacific.

Mr. FALEOMAVAEGA. No. They are just a bunch of dinky islands. They are not that important to our overall strategic——

Mr. MANZULLO. No. Come on. I have corn in my district, and you have tuna. You know?

Mr. FALEOMAVAEGA. I do want to thank you, Mr. Chairman, for your initiative. And I really look forward in working with you. Probably the best way that we can find the offsets is to have commitments from all three agencies in how best to resolve this.

I don't consider this problem so complicated from Palau. It is just that——

Mr. MANZULLO. I am sure we will get some feedback.

Mr. FALEOMAVAEGA [continuing]. Why do we make it so complicated? This is what is really puzzling to me. I really look forward in working with you, Mr. Chairman, on this legislation.

Mr. MANZULLO. Okay.

Mr. FALEOMAVAEGA. If I may, Mr. Chairman, I would like to submit for the record, unanimous consent, a Washington Post article dated November 29, 2011. There is an article written by Mr. Wal-

ter Pincus. It is entitled "Gauging the Asia-Pacific Region's Defense Levels." Very, very important.

Mr. MANZULLO. You want to make it for the record?

Mr. FALEOMAVAEGA. Yes, for the record.

Mr. MANZULLO. For the record——

Mr. FALEOMAVAEGA. Like I said, the President has made a pivot and I don't know if it is because he plays basketball. I suppose you pivot a lot from Afghanistan and Iraq. And now we are going to pivot to the Asia-Pacific region as if the Asia-Pacific region is not important. So I am trying to see if there is another very, very good——

Mr. MANZULLO. Well, we will probably have a hearing, bring PAYCOM in. That whole area is to the extension of——

Mr. FALEOMAVAEGA. Yes.

Mr. MANZULLO. China is extending its borders way beyond.

Mr. FALEOMAVAEGA. Yes.

Mr. MANZULLO. Going into the interior of other countries I think is quite interesting. And it obviously saw part of this.

Mr. FALEOMAVAEGA. Yes.

Mr. MANZULLO. General, thank you for coming up with this very fascinating diagram that demonstrates exactly what Congressman Kelly was talking about. I want to thank all four of you witnesses for bringing in material, your testimony. I am going to leave the record open for 10 days if anybody else wants to submit any additional testimony or additional remarks.

Eni, did you still want the General to give you the information on the bases?

Mr. FALEOMAVAEGA. I just want to share with the General——

Mr. MANZULLO. Well, first of all, did you still want the information?

Mr. FALEOMAVAEGA. Please, by all means.

Mr. MANZULLO. Okay.

Mr. FALEOMAVAEGA. Yes.

Mr. MANZULLO. All right.

Mr. FALEOMAVAEGA. I just want to share with the General that years ago I was privileged to go with the late Senator Chafee from Rhode Island. We went to Solomon Islands. And the Congress was appropriated $5 million to build a brand new parliamentary building for the Government of the Solomon Islands. As you know, General, this is where Guadalcanal was when Senator Chafee was a 19-year-old Marine. Let me tell you, Mr. Chairman, it was a very spiritual experience for me. And the irony of it all was when we asked who built the parliamentary building for the Solomon Islands, it was the Japanese, very ironic of the whole thing that we fought the Japanese in World War II and that when the bids went out, it was a Japanese company that built the parliamentary building for the Government of Solomon Islands.

Guadalcanal, we can go on and on. I cannot say enough about the valor and the courage of our Marines for what they have done for our country. For that, General Simcock, you have my utmost respect for all that you do and all of our men and women in uniform. Thank you for your services to our country.

Mr. MANZULLO. Thank you very much. This subcommittee is adjourned.

[Whereupon, at 1:14 p.m., the subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

SUBCOMMITTEE HEARING NOTICE
COMMITTEE ON FOREIGN AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C.

Subcommittee on Asia and the Pacific
Donald A. Manzullo (R-IL), Chairman

November 23, 2011

You are respectfully requested to attend an OPEN hearing of the Committee on Foreign Affairs, Subcommittee on Asia and the Pacific, to be held in **Room 2226 of the Rayburn House Office Building (and available live, via the WEBCAST link on the Committee website at http://www.hcfa.house.gov):**

DATE: Wednesday, November 30, 2011

TIME: 11:30 a.m.

SUBJECT: Compact of Free Association with the Republic of Palau: Assessing the 15-year Review

WITNESSES: Mr. James L. Loi
Deputy Assistant Secretary
Bureau of East Asian and Pacific Affairs
U.S. Department of State

Mr. Thomas Bussanich
Director of Budget
Office of Insular Affairs
U.S. Department of the Interior

Brigadier General Richard L. Simcock, II
Principal Director, South and Southeast Asia
Office of the Deputy Under Secretary of Defense
U.S. Department of Defense

Mr. David B. Gootnick
Director, International Affairs and Trade
U.S. Government Accountability Office

By Direction of the Chairman

The Committee on Foreign Affairs seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202/225-5021 at least four business days in advance of the event, whenever practicable. Questions with regard to special accommodations in general (including availability of Committee materials in alternative formats and assistive listening devices) may be directed to the Committee.

COMMITTEE ON FOREIGN AFFAIRS

MINUTES OF SUBCOMMITTEE ON *Asia and the Pacific* HEARING

Day *Wednesday* **Date** *November 30* **Room** *2226 Rayburn*

Starting Time *11:43 a.m.* **Ending Time** *1:14 p.m.*

Recesses [*0*] (____to ____) (____to ____) (____to ____) (____to ____) (____to ____) (____to ____)

Presiding Member(s)

Chairman Donald Manzullo

Check all of the following that apply:

Open Session [✓]
Executive (closed) Session [ ]
Televised [ ]

Electronically Recorded (taped) [✓]
Stenographic Record [✓]

TITLE OF HEARING:

"Compact of Free Association with the Republic of Palau: Assessing the 15-year Review"

SUBCOMMITTEE MEMBERS PRESENT:

Donald Manzullo, Eni Faleomavaega, Steve Chabot, Jeff Duncan, Brad Sherman, Mike Kelly

NON-SUBCOMMITTEE MEMBERS PRESENT: *(Mark with an * if they are not members of full committee.)*

Gregorio Kilili Camacho Sablan*, Dana Rohrabacher

HEARING WITNESSES: Same as meeting notice attached? Yes [✓] **No** [ ]
(If "no", please list below and include title, agency, department, or organization.)

STATEMENTS FOR THE RECORD: *(List any statements submitted for the record.)*

1. ***Chairman Manzullo - Opening statement***
2. ***Ranking Member Faleomavaega - Opening statement***
   - ***Washington Post article***
3. ***Dan Burton - Statement for the Record***
4. ***Deputy Assistant Secretary Loi - Response to Mr. Faleomavaega's question***
5. ***Mr. Thomas Bussanich - Response to Mr. Faleomavaega's question***
6. ***Brigadier General Simcock - Pacific island map***

TIME SCHEDULED TO RECONVENE _____
or
TIME ADJOURNED *1:14 p.m.*

Subcommittee Staff Director

Statement of
the Hon. Dan Burton
Subcommittee on Asia and the Pacific Hearing on
the 15th Anniversary Review of the Compact of Free Association with Palau

I would like to thank you for calling this important and timely hearing, Mr. Chairman. The Asia-Pacific region will be the most strategically important area for the United States to be engaged in the 21st century. The rise of China and the ongoing actions of Russia signal to the United States that we must pay close attention to this part of the world if we are to continue to strengthen democracy throughout the world. Our Compact with Palau is absolutely necessary to this engagement. At a time when fiscal responsibility is the first priority of Republican's in Congress, we must be careful not to sacrifice long term security for political expediency.

Very few Americans have thought much about the territory islands of Palau. But Palauans identify closely with the United States, many serving in our U.S. armed forces, willing to make the ultimate sacrifice. Palau has also been a strong and consistent ally with us at the United Nations. The State Department reports show that no member of the U.N. votes with the U.S. more than Palau, including on resolutions concerning Cuba and Israel when we are often isolated. This broad support may wane if we delay further the review of this important agreement.

The American taxpayer will ask us, "Why are we spending money on Palau?" And to that we should answer firmly with the security point. As stated in Department of Defense Documents, "This security arrangement ... in an increasingly contested region" -- clearly referring to China -- "allows the United States to maintain critical access, influence, and strategic position" and "Failure to follow through on our commitments to Palau, as reflected in" the Agreement "would jeopardize our defense posture." If the DOD feels that Palau is "irreplaceable," we should provide our support 100%. China wants to replace the U.S. military authority over a vast expanse of the western Pacific that this agreement provides for. We cannot let this happen.

I hope for swift congressional approval of the Agreement. No Member of Congress has questioned it, and committee leaders in both houses have expressed support. I hope that this hearing will prompt all concerned to work out the approval legislation for the sake of our national interest and the future of our security.

ARTICLE SUBMITTED FOR THE RECORD BY THE HONORABLE ENI F.H. FALEOMAVAEGA, A REPRESENTATIVE IN CONGRESS FROM AMERICAN SAMOA

The Washington Post

How much defense is enough in the Asia-Pacific region?

By Walter Pincus, Published: November 28, 2011

We need more transparency about the post-Iraq, post-Afghanistan Defense Department that can accept budget cuts over the next 10 years of $460 billion. And if the sequester of an additional $600 billion or more takes place beginning in fiscal 2013, would it "hollow out the force" and create "risks" because of threats we won't be able to deter?

More sensible than much of the rhetoric was Defense Secretary Leon Panetta's Nov. 14 plea attached to a letter to Sen. John McCain (R-Ariz.) for flexibility rather than across-the-board reductions, which are part of the sequestration law.

For now, let's focus on the so-called pivot to the Asia-Pacific area. For the past two months the area has been the center of attention for President Obama, Panetta and Secretary of State Hillary Rodham Clinton.

While the congressional deficit-reduction "supercommittee" was still working in October, Panetta, who was in Japan, said, "We will continue to not only maintain, but to strengthen our presence in this part of the world."

On Nov. 22, with the possibility of sequestration looming, Ben Rhodes, White House deputy national security adviser for strategic communications, told a news conference, "As we look at areas to cut, which will be the case going forward, we're going to make sure that we protect the capabilities that we need to maintain our presence in the Asia-Pacific."

The Nov. 16 announcement of new six-month rotations of 250 U.S. Marines to Australian bases for joint training in 2012 — growing eventually to 2,500 Marines — highlighted the beginnings of the so-called pivot.

But it isn't as if U.S. attention to the Iraq and Afghan wars had drained all forces away from the Pacific, where the United States has been for years as part of defense treaty obligations. As Air Force Maj. Gen. Michael Keltz, the Pacific region's director of strategic planning and policy, told reporters Nov. 16, "Quietly, in the background, we in the Pacific have been continuing to reinforce our relationships and our alliances. . . . We've numerically taken some things away, we've been quietly but very effectively increasing the capabilities that we have in the Pacific."

For example, Keltz said, three of six F-22 stealth fighter squadrons outside the continental United States are stationed in the Pacific — a National Guard squadron in Hawaii and two in Alaska that rotate to Guam and Japan. In addition, only two C-17 large transport squadrons have

been deployed outside the United States,in Alaska and Hawaii. The first Global Hawk, long-distance drone surveillance aircraft deployments were out of Guam.

Keltz also pointed out that F-22s have "leading-edge technology" that provide an "unprecedented amount of situational awareness."

Singapore has built a facility, ChangiPier, which has been offered for U.S. Navy deployments and repair. Keltz said discussions with the Singapore government are continuing.

New base facilities are being built in Japan and Okinawa, and a major transfer of 8,000 Marines from Japan is scheduled for Guam, but the costs — more than $20 billion — has held things up. Some 31 U.S. Navy nuclear attack submarines are based in the Pacific, along with eight strategic nuclear subs. Three of the latter are normally on patrol.

Then there is the Seventh Fleet which advertises the USS George Washington on its Web site as "the world's only forward-deployed aircraft carrier" based in Yokosuka, Japan. There are also two U.S. Navy guided-missile cruisers and seven guided missile destroyers. Also forward-deployed at Sasebo, Japan, is the largest of all amphibious warfare ships; the Essex, which resembles a small aircraft carrier. It carries some 33 aircraft and 1,800 Marines with their own landing craft.

Then there are facilities in Australia and South Korea that pre-date Sept. 11, 2001..

For more than 50 years, the United States has had a substantial military presence in the Pacific, so why in an era of tightened budgets is there this new emphasis? The most obvious answer is China.

A close reading of the Defense Department's most recent report to Congress on the Chinese military, released last August, shows why Beijing is sensitive to U.S. Pacific forces and America's growing security alliances in the area.

"Since China's emergence as a global economic actor, it has relied nearly exclusively on the United States as guarantor of a safe and unrestricted maritime domain," the report states. Almost 90 percent of China's trade goes via ship, and the report notes that even with its recent gains in naval power, China "would face great difficulty" if threats arose to its shipping through the South China Sea and Strait of Malacca, where much of its imported fuel must pass.

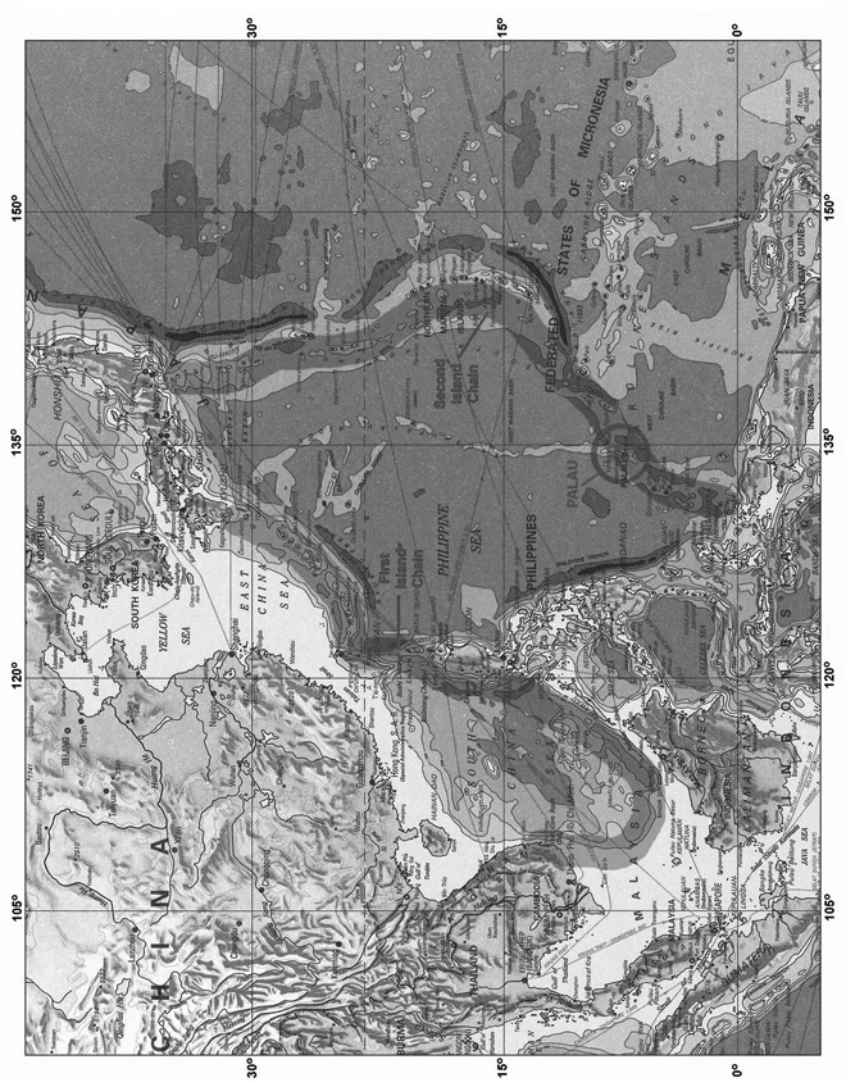
Chinese Rear Adm. Yin Zhuo has noted China's participation in the anti-piracy patrols in the Gulf of Aden has "shown the Navy's equipment is not particularly suited to blue water operations," the report said.

Against that background, why the emphasis on the U.S. Pacific buildup? Repeatedly, American officials have said versions of what Clinton said in a Nov. 18 interview with ABC News.

Speaking of the Marines going into Australia, she said, "We act in a way that promotes our interests and our values. . . . At the top of the list is rapid response to disasters. The United States is a generous nation."

But you can't deter natural disasters with aircraft carriers, drones or special forces.

MAP SUBMITTED FOR THE RECORD BY BRIGADIER GENERAL RICHARD L. SIMCOCK, II, PRINCIPAL DIRECTOR, SOUTH AND SOUTHEAST ASIA, OFFICE OF THE DEPUTY UNDER SECRETARY OF DEFENSE, U.S. DEPARTMENT OF DEFENSE



November 30, 2011
James Loi

Question for the Record:

Mr. Faleomavaega: The State Department does the negotiations; Defense Department says it's very critical to our needs and national survival. Yet the results of the negotiations, it totally doesn't match in terms of the importance of Palau, and yet the essence of what we're giving Palau, 62 percent decrease of the funding that we're giving. It just blows my mind. And yet in negotiations, renegotiations of the two compacts with the Republic of the Marshall Islands and the Federated States of Micronesia, the increases are 47 percent for one and 63 percent for the other, and we're decreasing Palau's needs by 62 percent. Can you give us a little sense of why the discrepancy and why we have this problem?

Mr. Loi: The results of the 15-year review of the U.S.-Palau Compact of Free Association very much reflect the importance of Palau and of our bilateral relationship. The Administration's position was developed and approved by all relevant agencies, and the assistance package was carefully negotiated between the two countries. The Agreement was signed by Palau's President Toribiong personally, and when approved by Congress, its implementation will result in Palau's Compact Trust Fund being able to perform as intended by the framers of the Compact. It will contribute $30.25 million more into the Trust Fund and

provide $94.50 million more in direct assistance, $40 million in new infrastructure, $28 million for infrastructure maintenance, and $10 million in debt reduction. A recent Government Accountability Report confirms that Palau will have access to federal programs that are estimated to have a value of $211.7 million dollars over the second 15-year period of the Compact. Moreover, during the first 15-year period, these programs are estimated to have had a value of $292 million.

It is unclear in what way the package reflects a decrease of 62 percent for Palau as your question suggests. Palau has been receiving a combination of direct U.S. assistance and withdrawals from the U.S. funded trust fund totaling $18.25 million per year. Over the second 15 years of the Compact, from 2009 onwards, Palau should receive from the same sources amounts starting at $18.25 million a year and decreasing in the last years to $15 million per year, according to a negotiated schedule.

I would like to note that Palau's compact intentionally differs substantially from those concluded with the FSM and RMI. The Government of Palau negotiated a unique agreement that was designed to have many additional benefits that the FSM and RMI compacts did not have, e.g., a trust fund and a large infrastructure project (the Compact road, at $150 million). Reflecting these

additional benefits, which were designed to continue to 2044, Palau's Compact does not include a requirement to renegotiate expiring assistance provisions, while the FSM and RMI compacts do. Whereas the other two Freely Associated States would have received no direct assistance after 2004, the U.S.-Palau compact provided for $15 million a year from 2009 through 2044. And furthermore, the 15-year review agreement would result in Palau receiving more than the agreed $15 million dollar level annually.

I believe the assistance provided under the 15-year Compact review and reflected in the pending legislation demonstrates our commitment to and support of Palau. I hope we can work together to pass the legislation as quickly as possible so that Palau may realize the benefits agreed to under the Compact review, including the assistance package.

Response for the Record
Subcommittee on Asia and the Pacific
"Compact of Free Association with the Republic of Palau: Assessing the 15-year Review"
November 30, 2011
Submitted by Mr. Thomas Bussanich in response to Ranking Member Faleomavaega

In the course of the House Foreign Affairs Committee hearing on the review of the Palau Compact of Free Association on November 30, 2011, Congressmen Faleomavaega raised questions concerning the audit, postal service and inflation provisions of the new agreement between Palau and the United States and how the provisions may differ from those in revised Compact agreements with the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI).

Although the FSM and RMI have very similar agreements with the U.S., Palau's Compact agreements have differed from those in significant respects. For example, the Palau trust fund and circumferential island road are features not duplicated in the first FSM and RMI funding agreements. FSM and RMI received disaster assistance protection under FEMA programs, Palau did not. Those differences reflect the interests of those countries and their negotiating teams, and reflect as well that the agreements were not negotiated simultaneously. FSM and RMI's Compacts entered into force in 1986 and were renegotiated in prior to 2003. Palau's Compact went into effect in 1994. The current agreement with Palau now under discussion differs significantly from those in effect for FSM and RMI, but suits the needs of Palau and the interests of the United States.

U.S. negotiators were given a limited ceiling for financial assistance for all three countries. Within that ceiling, the negotiators had latitude to work with each freely associated state (FAS) to construct assistance programs to meet each country's needs. The current agreement with Palau is the product of this process and represents good faith decisions of both governments.

With regard to audits, the FSM and RMI are each reimbursed half the cost of the annual audits, up to $500,000 annually. Although Palau is required to perform annual financial audits, the agreement does not earmark funds for audit expenses. Palau is instead expected to use U.S.-provided Compact economic assistance funds or other resources for this purpose. Palau may also use a portion of other Federal grants it receives to fund the annual audit, a well-established practice U.S. state and local governments use to meet Federal audit requirements.

Palau and the other FAS countries enjoy equitable services from the United States Postal Service (USPS) under their respective agreements, services that are subsidized by reimbursement payments made by the Department of the Interior (DOI) to the USPS. In the course of the Administration's preparation for the Palau fifteen year review, the existing annual subsidy of $2 million was found to be insufficient in meeting USPS costs. An additional $1.5 million was allocated to DOI for transfer to USPS. This necessary internal financing action has been mistakenly interpreted by some in Palau as a diminution of the funding that might have been available for use by their government.

Palau's new agreement is not partially adjusted for annual inflation, as are agreements with the FSM and RMI. This is consistent with U.S. goal of promoting economic and fiscal reform in Palau. Automatic program increases based on U.S. inflation rates are viewed as a disincentive to reform. The U.S. made a deliberate decision to limit its assistance to Palau to the fixed fifteen-year ceiling and would not agree to the indeterminate amount of additional assistance created by annual inflations increases.

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