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TERRITORIES OF GUAM, AMERICAN SAMOA, THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS, AND THE U.S. VIRGIN ISLANDS

HEARING

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

TO

RECEIVE TESTIMONY REGARDING THE STATE OF THE ECONOMIES AND FISCAL AFFAIRS IN THE TERRITORIES OF GUAM, AMERICAN SAMOA, THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS, AND THE UNITED STATES VIRGIN ISLANDS

MARCH 1, 2006

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TERRITORIES OF GUAM, AMERICAN SAMOA, THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS, AND THE U.S. VIRGIN ISLANDS

WEDNESDAY, MARCH 1, 2006

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 9:30 a.m., in room SD–366, Dirksen Senate Office Building, Hon. Pete V. Domenici, chairman, presiding.

OPENING STATEMENT OF HON. PETE V. DOMENICI, U.S. SENATOR FROM NEW MEXICO

The CHAIRMAN. The hearing will please come to order. Let's see, do we have everybody up here? We're going to get everybody up at once. I have to make sure that you understand this is not of my doings. I have a hearing, but the Senate runs the Senate, so I have to comply with their rules. We have a vote at 10 this morning and then we have the Prime Minister of Italy at 10:30. So we're going to go through this as quickly as we can and yet be deferential to you.

I'm going to start by first making sure we're all here. Governor Togiola Tulafono, American Samoa; Governor Camacho from Guam; Governor Turnbull from the Virgin Islands; Congressman Faleomavaega, not here yet? Congressman Christiansen from the Virgin Islands; Congressman Bordallo from Guam; Resident Representative Tenorio, Resident Representative of the United States from the Commonwealth of Northern Mariana Islands; and Mr. David Cohen, Assistant Secretary of the Interior for Insular Affairs.

I think we're going to have you up there close, too, if you will, sir. Do we have room for him at the table?

I know everybody wants to share a lot with us, and I know you have prepared statements, but this is for real today. Keep your oral statements short so the next person will have a chance to speak. So what I'd like very much to do is to just go in the manner that I started, just as I introduced you. No deference, I don't mean anything to Representatives or Governors, but let's start with American Samoa.

Please start, Governor Tulafono. You have 5 minutes, sir. Your statement will be made a part of the record. Thank you for coming.

[The prepared statement of Senator Talent follows:]

PREPARED STATEMENT OF HON. JAMES M. TALENT, U.S. SENATOR FROM MISSOURI

Mr. Chairman, I want to take this opportunity to welcome Governor Turnbull who will be testifying on the economic and fiscal challenges facing the Virgin Islands and other United States Territories.

I believe that the challenges outlined in Governor Turnbull's prepared statement and submissions are real and that there is sufficient evidence to show that the Government of the Virgin Islands has made significant fiscal progress over the course of the last seven years. All state budgets including my own, suffered in the aftermath of the 9/11 attacks on this country. It should come as no surprise that the national recession that followed 9/11 would also have an impact on the fragile economies of our insular areas.

However, geographic isolation from the rest of the United States is an additional hardship on the economy of these Territories, making it is difficult to attract or maintain businesses and investment in these areas without special tax incentives or programs.

I share the concerns of several of my colleagues on this Committee that we need to be careful when we legislate for our fellow citizens in the Territories. They do not have voting representation in this body. We need to listen to their concerns so that, in our efforts to help them, we don't make matters worse.

In that regard, this Committee needs to take an active role in helping our Territories achieve self-sufficiency by growing their private sector economies. We should also work closely with other Committees, including the Committee on Finance, to enact reasonable rules that promote economic development while precluding opportunities for tax abuse.

Mr. Chairman, I want to thank you for holding this hearing. I hope it will lead to action from this Committee that will prove helpful to our fellow citizens in our Territories.

Thank you very much.

STATEMENT OF HON. TOGIOLA T.A. TULAFONO, GOVERNOR OF AMERICAN SAMOA

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

The CHAIRMAN. You're welcome.

Mr. TULAFONO. I would also like to record our gratitude for your leadership in the territorial issues and for allowing this opportunity for us to meet with you today.

Talofa and greetings to you, Mr. Chairman, and to your honorable members of the Senate Committee on Energy and Natural Resources. I am very honored and pleased with this opportunity to testify to the committee on economic and fiscal conditions in American Samoa.

American Samoa's economic condition has never been more precarious. Historically we have had some growth, but it's been in low wage industries and our unemployment rate has been high. Our most serious problem is the level of per capita income, which is only one-fifth the U.S. average and is falling. The family poverty rates in American Samoa were 58.2 percent compared with the U.S. rate of 8.7 in the year 2000.

We're threatened with sudden and severe economic dislocation. Our largest industry, tuna canning, could be forced to reduce operations or close in the very near future. The canneries represent approximately 90 percent of American Samoa's private sector and account for one-third of the total jobs in the territory. Directly and indirectly the canneries account for more than one-half of the total jobs in the territory. The immediate threat to this industry is in the impending loss of Federal tax exemptions, as you're well aware, under section 936, more competitive locations in other parts of the world and threats to the duty-free access to the U.S. market afforded to our Samoan canneries.

I want to point out that OIA has provided valuable technical assistance in advancing our development. Most recently OIA funded a project to review the current U.S. tax structure and propose substitute or alternative incentives which may replace current section 936 tax incentive for the territory. We've shared the findings of that effort with our Congressman and, of course, we're very supportive of all the efforts put into obtaining any extension of the present tax credit program. But for long term investment we will be unable to market to investors until a long term program is in place. We could use this valuable time to design and establish a permanent solution to the need for investment incentives in the insular areas. We're not afraid to fend for ourselves if we could be put on equal footing with foreign countries who are receiving the benefit of favorable trade agreements and treatment. That way there's a way the insular areas can forge favorable development that will assist their own economic development without asking the U.S. Government for cash assistance.

In the 1990's American Samoa made a marked improvement in capital construction and maintenance programs. These improvements were accomplished with Federal assistance in our operations and maintenance, as well as help we received from the Federal Government to recover from natural disasters. The American Samoa Government continues to experience a positive cash-flow and continues to meet its current liabilities. Our financial health is stable for now. Our financial management systems have helped the American Samoa Government to abide by the spirit of our fiscal reform plan and have resulted in increased accountability and transparency.

American Samoa will be current with its—is now current with its single audit compliance in the early part of this year. For the first time since 1991 we've conquered and completed this most formidable task. We continue to work hard on these fiscal and financial management reforms.

I also would like to point out our dedication to increasing local revenue. In the last 10 years local revenues have increased by 59 percent to an estimated $65 million in fiscal year 2006.

In conclusion, American Samoa has always been grateful for the assistance it's received from the Federal Government. Of course, as a part of the American family, we've been unstinting in our support for America at home and abroad, at peace and at war. While we have made progress in our development, we still have very serious concerns about the adequacy of our public facilities and services, especially in health care, education, and our economic well-being. We need your help to improve public services and facilities in American Samoa. We need your help in preventing and mitigating future economic shocks in the cannery industry by establishing a permanent tax credit program at the earliest possible time. It's difficult to imagine the ramifications of a 50 percent rate of unemployment, especially with no unemployment compensation and very limited opportunity for migration. We need to find a solution to this issue very soon. This is a potential catastrophe that we cannot say after the fact we did not see it coming.

Again, thank you for the opportunity to testify before your committee.

[The prepared statement of Governor Tulafono follows:]

Prepared Statement of Togiola T.A. Tulafono, Governor of American Samoa

INTRODUCTION

Talofa and greetings Senator Domenici and honorable members of the Senate Committee on Energy and Natural Resources. I am very honored and pleased with this opportunity to submit written testimony to the Committee on economic and fiscal conditions in American Samoa.

THE STATE OF AMERICAN SAMOA'S ECONOMY:

Samoan History and Society

The islands of eastern Samoa became part of the U.S. in 1900 and 1904. American Samoa, located in the Central South Pacific, is the only United States territory south of the equator. A central premise of ceding eastern Samoa to the U.S. was to preserve the rights and property of the islands' inhabitants. American Samoa's constitution makes it government policy to protect persons of Samoan ancestry from the alienation of their lands, the destruction of the Samoan way of life and language, and to encourage business enterprise among persons of Samoan ancestry. We, in turn, ceded authority over our lands to the U.S. and pledged to it our allegiance. The depth of our commitment is evident today, in the high numbers and contributions our people to the U.S. military and their service in the present wars.

Modern Economic Development

American Samoa has had a relatively high population growth rate, averaging 2.8 percent annually between 1980 and 2000. The employment growth rate was also relatively high over this period. However, most of the gains were in quite low wage employment sectors. American Samoa's rate of unemployment has been estimated at close to 10 percent over the past two decades. Unfortunately, annual unemployment estimates are not available for American Samoa. U.S. Census data, however, showed an unemployment rate of 5.2 percent in the 2000 U.S. Census for American Samoa. The reason for this low number was that subsistence workers without paid employment were not included in the labor force in 2000 U.S. Census data. Some of these workers, a large number according to local surveys, may have been looking and available for work. Some of the unemployed may have wanted work but were discouraged from looking for jobs. If subsistence workers were included in the labor force as unemployed, American Samoa's rate of unemployment could range as high as 16 percent. (Unemployment data sources: U.S. Census of Population, American Samoa, 2000 and the American Samoa Government Department of Commerce.)

American Samoa's most serious economic problem, however, is low per capita personal income. Data suggests that per capita income in American Samoa is only one-fifth that of the United States. It also suggests that American Samoa is losing economic ground with respect to the U.S. Between 1979 and 1999, per capita income in American Samoa (not adjusted for inflation) increased an average of 4.3 percent per year. With inflation rates averaging about 3 percent per year during the period, money income in American Samoa has increased only 1.3 percent annually over the 20-year period. Furthermore, family poverty rates in American Samoa were 58.2 percent compared with a U.S. rate of 8.7 percent in 2000. (Income and poverty data sources: U.S. Census of Population for American Samoa, 2000 and various years and U.S. Census of Population for the U.S., 2000.)

In many respects, this income disparity reflects fundamental differences in the economies of major industrialized countries and insular areas. Economic development is an exceedingly difficult task for nations throughout the Pacific Basin and as well as for remote, insular economies throughout the world. This difficulty is due in part to the economic barriers related to distance to markets and sources of supply, considerations of scale, lack of raw materials, and capital and labor force deficiencies. These are barriers that are vastly lower or nonexistent in major industrialized countries

It is important to understand the structure of American Samoa's economy. Roughly 92 percent of American Samoa's entire economy is based directly or indirectly on canned fish exports and federal expenditures. This basic inflow of funds is that which the remainder of the territory's economy depends.

American Samoa is not only in a state of long term economic stagnation, low growth rates, high unemployment and excessively low per capita income. It is now threatened with sudden and severe economic dislocation. Its largest industry, tuna canning, could face reduced operations or closures in the near future. The canneries represent about 90 percent of American Samoa's private sector and about one-third of the total jobs in the territory. The threat to this industry is in the impending loss of federal tax exemptions, more competitive locations in other parts of the world, and other forces adversely affecting the industry in American Samoa.

Fisheries

In the last two decades, American Samoa's cannery industry has expanded substantially under declining production and rising foreign imports in the U.S. It has been able to do this because of wage levels well below those of the U.S. mainland and low fish resource costs. American Samoa is permitted conditional duty free access to the U.S. It is also exempt from prohibitions on landing the catches of foreign vessels in the U.S. Further, the tuna cannery industry in American Samoa, which presently employs about 4600 workers, has enjoyed generous corporate income tax benefits over the years. Nevertheless, forces in the world economy and in the tuna canning industry itself are eroding American Samoa's position in the industry. Trends in world trade, specifically reductions in tariffs, are lessening the advantage of American Samoa's duty free access to the U.S. market. The NAFTA agreement will remove the U.S. tariff on canned tuna in 2007. American Samoa's minimum wage, while well below the U.S. average, is well above competing areas of the world, including Mexico, a signatory to NAFTA and the ANDEAN treaty. (The Andean Trade Preference Act exempts canned tuna from the duty free goods entering the U.S. However, it does give the President the authority to grant duty-free entry of pouch packed tuna into the U.S.) A bill has been approved by the U.S. Congress to extend the IRS 936 provision for one year to allow time to develop a new incentive proposal. It expired at the end of 2005. Also, trade discussions are going on to remove some trade restriction on imports from Thailand, including those on canned tuna. This action would not be taken until late next year, but if passed, would make the outlook for the two canneries looks very bleak.

Diversified Industries

American Samoa has had some success over the years in attracting diversified manufacturing. Today a key target industry for development is technology based. (e-Commerce), which depends upon skilled workers and well-developed Internet-based communication systems. There are also pending proposals that present various diversification strategies for the Territory that will utilize local natural and human resources, such as a local fish processing facility, a fishermen and farmer's co-op, and numerous niche markets within the Tourism industry.

The Visitor Industry

This is another key target area for development. American Samoa's visitor industry has suffered a long and erratic period of decline. However, the industry has experienced some recovery in recent years. In fact in 2000 with 50,671 visitors it had recovered approximately to 1985 and 1990 levels. Between 1990-2000, there were large changes in the mix of visitors. There were declines in tourist, business and employment visitors, but there were offsetting gains in visitors visiting friends and relatives. Furthermore, this precipitous decline started much earlier. It started in the 1970's, when the number of tourists visiting American Samoa was over 42,000, about 7 times the number of tourists visiting the territory in 2000. An industry that has incurred dramatic losses in the past several decades, the tourism is making a slow but gradual recovery. Today, the prospects for developing EcoTourism as a niche market looks very promising, and the 2005-2009 EcoTourism Development Plan currently undergoing the process of seeking the approval and support of the local government. The plan includes a proposal to establish a semi-private Visitor's Bureau.

Government

American Samoa faces another source of serious economic decline and that is in falling real federal expenditures. For example, our DOI allocation for operations has remained at $23 million since 1977. This means that in real or purchasing power terms that amount has been seriously eroded over the last twenty nine years. Government is a large part of American Samoa's economy. It provides a net injection of federal funds that represents about one-third to one-half of American Samoa's economic base. In other words in economic terms federal expenditures are as important as the canneries to American Samoa's economy. This means that the trend of declining real federal expenditures could be an added drag on the American Samoa's longer term economic future.

Government has another role, however. Both the American Samoa Government and the Federal Government have important roles in the territory's economic development. Local government is responsible for accommodating development with highly trained people, Government facilities and services and a reasonable investment climate. The federal Government can be instrumental in strengthening the economies of U.S. insular areas. The Office of Insular Affairs has had an important role in several recent initiatives including the American Samoa Economic Advisory Commission (ASEAC); the President's Interagency Group on Insular Affairs; and a new trade initiative to bring investors into the territory in spring 2006 that is being supported by the U.S. Department of Interior, the American Samoa Government Department of Commerce, and the Governor's Office.

OIA has also provided valuable technical assistance in improving our fiscal systems. Most recently OIA funded a project to review the current U.S. tax structure and propose substitute or alternative incentive measures that will match or exceed the current Section 936 tax incentive for the Territory. We have delivered the findings of that effort to our Congressman and to this Committee. Naturally, we would be grateful for any extension of the present tax credit. We could use this valuable time to design and establish a permanent solution to the need for investment incentives in the Insular Areas.

Other federal agencies offer critical economic development support assistance.

Secondary Economic Industries

The foregoing review of fisheries, tourism and Government represents an analysis of those sectors of the American Samoa economy that drive the rest of the economy. In other words, it is the local purchases and payrolls of these primary sectors that provide the market for other secondary industries. As classified by the U.S. Census, it is a large sector accounting for most of the private business establishments (excluding canneries) and employing about 7,000 people in American Samoa in 2004.

Infrastructure

American Samoa has made marked improvement in its capital construction and maintenance programs in the decade of the 1990's. Some of the improvement was prompted by federal assistance in operation and maintenance, as well as assistance received from the federal Government for natural disasters. Some is attributable to improved agency management and capital improvements program planning. In fact American Samoa's infrastructure and services, while not up to industrialized nation standards, are the envy of many areas of the Pacific Basin. For example, American Samoa has one of the largest and best developed industrial parks in the Pacific. Also, the American Samoa Power Authority (ASPA) provides power, water and sewer systems to the local population, which is among the most reliable in the Pacific.

Total employment reported for American Samoa at year-end 2005 was 17,303. Government accounted for 6100 (35 percent) of total employment, canneries at 4500 (26 percent) and the remaining 6700 (39 percent) was in other areas of the private sector excluding the canneries.

American Samoa's Gross Domestic Product advanced at an annual rate of rate of 3.2 percent increasing from $450.3 million in 1999 to $510.1 million in 2003. and it is expected to continue increasing in the future. While the GDP growth looks favorable, personal income is the real measure, and, as indicated it is only a fraction (one-fifth) the U.S. average. However, despite the predominance of low wage jobs in American Samoa, its per capita income level is well above other Pacific island states and nations excluding other U.S. territories like Guam and the Commonwealth of the Northern Marianas (CNMI).

The real challenge is the rising cost of living in 2005, when inflation reached a record high of 9 percent. By early 2006, it is anticipated that inflation will reach double digits if the price of oil continues to increase. In addition, hurricane recovery financial assistance received from FEMA, coupled with the increase in minimum wage for majority of the workforce, has increased local demand for goods and services adding to already strong inflationary pressures.

Capital Improvement Projects

- The level of funds made available by the Department of the Interior (DOI) is formulated on a performance point system and American Samoa received $9,731,000 for fiscal year 2005.
- The awards have been declining over the past few years but are projected to rise for FY2007, FY2008 and FY2009 to $10,000,000 a year.
- This year (Program Year 2005) saw a number of projects completed for a total expenditure of $10,619,090 in six categories.
- Funds came from awards received in several previous fiscal years with expenditures on health (about 1.5 million dollars) and education (about 1.6 million dollars) being the top program areas.

- For next year (FY20051PY2006), total C1P expenditures set at 9.7 million dollars). Funds being ear-marked for health (1.7 million):
  - Education (2.8 million),
  - Utilities (2.6 million),
  - International sea/air ports (.5 million),
  - Public works (.7 million),
  - Public safety (.5 million),
  - Parks/recreation (.07 million),
  - Other public building projects (.3 million) and
  - Operational and maintenance set-aside (.5 million)

I also would like to point out our dedication to increasing local revenues. In the last ten years, local revenues have increased by 59 percent to an estimated $65 million in FY 2006.

In conclusion, American Samoa has always been grateful for the assistance it has received from the Federal Government. Of course, as a part of the American family, we have been unstinting in our support for America at home and abroad, at peace and at war.

While we have made progress in our development, we still have very serious concerns about the adequacy of our public facilities and services, especially in health care, education and our economic well being.

You are, of course, aware of the effects on our entire country of an increasingly integrated global economy. This trend might well eviscerate American Samoa's economy by causing drastically reduced operations in or the departure of our cannery industry. While this would directly cause the loss of one-third of our private sector jobs, indirect (multiplier) effects would bring the total job loss to more than one-half the jobs in the entire territory.

It is difficult to imagine the ramifications of a fifty percent rate of unemployment especially with no unemployment compensation and very limited opportunity for migration. We need to begin addressing this issue very soon. This is a potential catastrophe that we cannot say, after the fact, we did not see coming.

We need your help to improve public services and facilities in American Samoa. We need your help in preventing or mitigating future economic shocks in the cannery industry by establishing a permanent tax credit program at the earliest possible time. An extension will not allow us to market a two year program to new investment from the U.S. We want to emphasize our desire to continue to market doing business in American Samoa to the U.S. businesses.

Thank you very much.

TERRITORIAL INDICATORS (2003)

	Virgin Islands	Amer. Samoa	Guam	CNMI
Population	109,000	58,000 (8% guest workers).	164,000	76,000 (50% guest workers)
Area (sq km)	352	200	541	471
Main industries.	Tourism, rum, oil refining..	Fish processing.	tourism, defense..	tourism, garments.
GDP	$2.5 Billion	$510 Million	$3.0 Billion	$1 Billion
Per capita income.	$13,139	$4,357	$12,722	$9,151
Federal expenditures.	$187.4M	$112.5M	$163.4M	$57.9M
Federal contribution.	20%	49%	33%	20%
Revenues	$817M	$197M	$658M	$283M
Expenditures	$871M	$171M	$703M	$303M
Surplus/deficit	($54M)	$26M	($45.7M)	($21 M)
Unemployment rate.	9%	5%	11%	4%

The CHAIRMAN. Thank you very much, Governor.

Senator Bingaman has arrived, as well as Senator Akaka. I did not make any opening remarks because of the shortage of time, knowing we have a vote, but I would defer if either of you would like to make any comments.

Senator BINGAMAN. Mr. Chairman, I'll defer also, just to hear as much of the witnesses as we can.

The CHAIRMAN. Senator Akaka? Same? All right. We're then going to proceed.

Governor from the Virgin Islands.

STATEMENT OF HON. CHARLES W. TURNBULL, GOVERNOR OF THE U.S. VIRGIN ISLANDS

Mr. TURNBULL. Good morning, Mr. Chairman and distinguished members of the Senate Committee on Energy and Natural Resources. I'm pleased to have this opportunity to testify on the economic and fiscal challenges facing the U.S. Virgin Islands.

When I assumed office in January 1999 the fiscal condition of the Virgin Islands Government, following the destruction of Hurricane Marilyn, was at a low point. The accumulated general fund deficit was $288 million. The structural deficit for the then-current fiscal year was projected to exceed $100 million. To prevent a financial collapse we rolled up our sleeves and went to work. We made tough and painful decisions to restore fiscal discipline and reduce Government spending. We imposed a strict hiring freeze and downsized the Government without resorting to the massive layoff that some people had urged. We cut our budget, refinanced our debt, reorganized the Government, attracted new businesses and capital investment to the territory, and increased government revenues.

Under my administration, general fund revenues have grown from $417 million in fiscal year 1999 to $633 million in fiscal year in 2005, an increase of 50 percent. Through fiscal discipline, general fund expenditures over the same period increased just over 4 percent from $559 million in fiscal year 1998 to $582 million in fiscal year 2005.

Our path through structurally balanced budgets was temporarily interrupted for 2 years following 9/11 and ensuing national recession. But by renewing our commitment to fiscal discipline and by focusing on private sector growth, the Government returned to fiscal balance in fiscal year 2004, earning surpluses in that year and in fiscal year 2005.

Equally important, we have learned to manage and timely account for the funds that we have spent. My administration has completed nine comprehensive audits, required by the Single Audit Act, in a 6-year period. The fiscal year 2004 audit will be issued in a matter of weeks.

Most importantly, however, we have taken steps to provide our financial managers with the modern financial tools they need to obtain and act upon real-time financial data and to improve our financial management of both local and Federal funds. We're using the financial surplus we have generated to fund procurement of a new state-of-the-art financial management system to replace our dated and inadequate system acquired from the Federal Government in the 1980's.

In spite of this undeniable progress, many challenges remain. The continued success of our EDC program has been under a cloud since 2004, when Congress enacted, without hearings or consultation, changes to our Federal tax laws that govern the relationship between the Virgin Islands and the United States. While these changes were aimed at preventing tax abuse by persons who neither lived nor worked in the Virgin Islands—and we agree with that—we believe, however, that the changes went too far, forcing many legitimate businesses to close their doors and causing the loss of many millions of dollars to our treasury.

Indeed, the director of the Virgin Islands Bureau of Internal Revenue 2 weeks ago estimated that, based on last quarter's tax payments, the territory could lose as much as $80 million in the current fiscal year. Losses of this magnitude will inevitably erode our budget surpluses and put at risk our hard earned fiscal solvency.

Accordingly, I respectfully urge the distinguished members of this committee to reassess the historic role of this committee on Federal tax issues involving the insular territories. In particular, I urge this committee to support our request for a legislative amendment to the Jobs Act to ensure fair and reasonable residency and income rules for our EDC program. I also request the support of this committee for our efforts to secure a permanent extension of the rum tax formula on which the Federal Government returned to the Virgin Islands Federal excise taxes collected on Virgin Islands rum, as well as elimination of the discriminatory cap on the amount of Medicaid funds provided to the Virgin Islands.

Mr. Chairman, my administration is prepared to make the tough decisions to maintain fiscal discipline, increased efficiency of our government, and improve delivery of essential services. We don't need a CFO bill, but we do need the help and support of this committee as we fight to protect our EDC program, grow the private sector, and generate the revenues we need to sustain the solvency of our Government. This concludes my testimony and I'll be pleased to answer any questions. Thank you very much for this opportunity.

[The prepared statement of Governor Turnbull follows:]

PREPARED STATEMENT OF HON. CHARLES W. TURNBULL, GOVERNOR OF THE UNITED STATES VIRGIN ISLANDS

Mr. Chairman and distinguished Members of the Senate Committee on Energy and Natural Resources, I am pleased to have this opportunity to testify on the economic and fiscal challenges facing the United States Virgin Islands.

Our economic and fiscal challenges are many. We are a small group of islands geographically isolated from the mainland of the United States and global commercial markets. We have no reservoir of natural resources to develop industry and manufacturing. We do not have full constitutional and political rights, including the right to vote for President; and we do not have voting representation in the United States Congress which wields plenary authority over our economic lives.

We are vulnerable to hurricanes and natural disasters. We are disproportionately affected by national and international economic conditions. Our ability to develop our economy and generate the revenues required to provide essential public services depends, to a large extent, on provisions of tax and trade law controlled, and subject to arbitrary change, by the United States Congress.

Notwithstanding these structural impediments, the Territory of the United States Virgin Islands has, since its acquisition in 1917, made significant progress under the American flag. While our per capita income is barely half of the U.S. median, we have the highest standard of living in the Caribbean and provide our people the broadest-array of public services of any country in the region. We are proud of our American citizenship and we are honored to have the privilege of serving in the United States armed forces around the globe to help defend the liberty of all Americans.

Our path to political and economic equality has not always been smooth, and it has not come without struggle. Our institutions are relatively new. We are still in the process of perfecting our democratic form of government. We have only had elective governors since 1970. We have only had authority to devise a government of our choosing, through the calling of a constitutional convention, since 1976.

Like many states and local governments, we have experienced fiscal problems over the years as a result of our historical underdevelopment, a relatively small economic and fiscal base, the immense structural damage caused by two major 100-year hurricanes over the last 15 years, and changes in federal tax laws which have slowed U.S. investment into the Territory.

I assumed office in January 1999 when the fiscal condition of the Virgin Islands Government, following the destruction of Hurricane Marilyn, was at a low point. The accumulated General Fund deficit was $288 million. The structural deficit for the then current fiscal year was projected to exceed $100 million. Vendors were owed over $100 million and taxpayers were owed similar amounts in income tax refunds dating back to 1995. Most of the Government's budget was committed to payroll costs, leaving insufficient funds for maintenance, supplies and materials required to ensure quality public services, as well as investment in, and the modernization of, our public infrastructure. The Government owed hundreds of millions of dollars to hardworking government employees for negotiated salary increases with no plan for payment. Revenue collections were on a steady decline, the Federal Government was owed nearly a quarter of a billion dollars in FEMA loans, and the specter of bankruptcy loomed large on the horizon.

To prevent a financial collapse, we rolled up our sleeves and went to work. We made tough and painful decisions to restore fiscal discipline and reduce government spending. We imposed a strict hiring freeze, and downsized the Government without resorting to the massive layoffs that some people had urged. We cut our budget, refinanced our debt, reorganized the Government, attracted new businesses and capital investment to the Territory, and increased Government revenues.

The success of our plan to grow the economy and cut government spending is reflected in the audited financial statements the Government prepares in accordance with the federal Single Audit Act. General Fund revenues, net of debt service, have grown from $417 million in FY 1999 to $633 million in FY 2005, an increase of 50 percent. [The increase in actual revenues is even higher but Government Accounting Standards require that certain tax revenues used to secure the Government's bonds be recorded as revenues in the Debt Service Fund rather than the General Fund.] The same audited financial statements record that, over the same period, General Fund expenditures increased just over 4 percent, from $559 million in FY 1998, the year before I assumed office, to $582 million in FY 2005. Over the same period, the growth of all State budgets increased almost nine times as much, or an average increase of more than 35 percent. Indeed, facing spiraling deficits, my Administration took swift action to cut spending 10 percent in Fiscal Year 1999 and an additional 7 percent in FY 2000. As a result of this fiscal discipline, we were able to narrow our structural deficit in FY 2000, and we achieved a significant surplus in FY 2001. This fiscal strengthening allowed the Government to increase spending in that year for long deferred or underfunded needs. This path to structurally balanced budgets was temporarily interrupted for two years following 9/11 and the ensuing national recession. By renewing our commitment to fiscal discipline and by focusing on private sector growth, the Government returned to fiscal balance in FY 2004, earning surpluses in that year and in FY 2005. The disciplined fiscal stewardship of my Administration is reflected in the 10-year revenue and expenditure chart attached hereto as Appendix A. This chart also shows that, while the Government experienced accumulated General Fund deficits for each of the four years prior to the commencement of my Administration, we have generated accumulated General Fund surpluses in each of the last four fiscal years.

The cuts in government spending were not easy and did not come without pain or political cost. We could not afford to fund every important program or to fill every critical position left open as a result of attrition. Yet, over the last seven years, we were able to shrink the size of government by 20 percent without resorting to mass layoffs. We cut spending while preserving the most essential services for the neediest in the Territory. I was not hesitant to wield my veto powers in order to restrain overspending by the Legislature. We paid overdue debts and long delayed salary increases to our hardworking government employees. But with 20 percent fewer employees in our government workforce, total employee compensation has grown less than five percent since 1999.

Equally important, we have learned to manage and timely account for the funds that we have spent. Prior to assuming office, the Virgin Islands had completed only one of the comprehensive annual audits required by the Federal Government over a fourteen-year period. Today, my Administration has completed nine such audits in a six-year period and the Fiscal Year 2004 audit will be completed and issued in a matter of weeks, putting the Government into compliance with the requirements of the Federal Single Audit Act. Under my Administration, this task has become an important, regular and ordinary responsibility of government service. In addition, my Administration has, over the course of the last several years, resolved the vast majority of the outstanding audit recommendations performed by the federal Office of Inspector General. And we have vastly improved the Government's overall audit compliance record on a going forward basis. Most importantly, however, we are taking steps to provide our financial managers with the modem financial tools they need to obtain, and act upon, real time financial data and to improve our financial management of both local and federal funds. I am pleased to report to you today that we are not waiting for long promised federal assistance. We are using the financial surplus we have generated to fund the procurement of a new state-of-the-art financial management system to replace the outdated and inadequate system acquired from the federal government in the 1980's.

Lastly, but not least important, we have strengthened the financial condition of the Government by eliminating, consolidating and refinancing our debt, including cancellation of nearly a quarter of a billion dollars of FEMA disaster loans. The FEMA debt relief alone, which involved creative and never-before-tried remedies under little known federal statutes, has saved the Virgin Islands over $30 million a year in annual debt service payments.

As a result of our fiscal and budgetary successes, the Virgin Islands is now positioned to make new, but measured investments in our schools, health care system, roads and transportation system, environmental, tourism and public infrastructure as well as the social services required by the neediest in our community. While we have made important improvements in our physical plants and social infrastructure over the course of my Administration, including the construction of new schools, wastewater treatment plants, health care and transportation improvements, the solid improvement in our financial condition will allow us to accelerate and increase our investment in these and other critical areas over the next several years.

In spite of this undeniable progress, many challenges remain. The strengthening of our Government's financial position has been fueled, in large part, by the success of our Economic Development Commission (EDC) program and the consequent growth of our private sector. Under this program, which was reorganized and revitalized in the second year of my Administration, the Virgin Islands provides tax incentives to qualified investors who establish businesses in the Territory and make qualified investments. A recent study by PricewaterhouseCoopers LLP found that this program generates almost one third of our total income tax revenues and creates, directly or indirectly, nearly 10 percent of total employment in the Territory. Indeed, the EDC program has the potential to completely transform the economy of the Virgin Islands, lessen our dependence on the Federal Government, and narrow the income gap between our residents and those on the mainland.

The continued success of our EDC program, however, has been under a cloud since 2004 when Congress enacted, without hearings or consultation, changes to the federal tax laws that govern the relationship between the Virgin Islands and the United States. While these changes were aimed at preventing tax abuse by persons who neither lived nor worked in the Virgin Islands, we submit that the changes went too far, forcing many legitimate businesses to close their doors and causing the loss of many millions of dollars to the Virgin Islands Treasury. Indeed, the Director of the Virgin Islands Bureau of Internal Revenue two weeks ago estimated that, based on last quarter's tax payments, the Territory could lose as much as $80 million in the current fiscal year. Losses of this magnitude will inevitably erode our budget surpluses and put at risk our recently hard-earned fiscal solvency. It will, at the very least, force a return to the fiscal austerity of the early years of my Administration and require further deferral of needed investments in our social and public infrastructure.

Over the past year, we have been working with the Congress to "rebalance" the tax rules governing the EDC in order to allow legitimate businesses to operate in the Territory while still precluding any possibility of tax abuse. The position of the Government of the Virgin Islands on these rules is set forth in a memorandum attached hereto as Appendix B. In this endeavor, I am pleased to report that we have the full support of the Department of the Interior, which testified in support of the changes we proposed at a Treasury hearing last July. We also have the support of individual members of the Senate Finance Committee, as well as the support of Members of this Committee who have visited the Virgin Islands and seen first hand the contributions of this important program to the economy and people of the Virgin Islands.

Mr. Chairman, I would like to note for the record that this distinguished Committee used to have jurisdiction over the tax systems in the U.S. insular territories. Indeed, the Revised Organic Act of 1954, as originally enacted, included the basic tax rules that were designed to lead to financial self-sufficiency for the Virgin Islands. The 1986 Tax Reform Act altered these rules but provided, after extensive consultation with the Government of the Virgin Islands, new incentives that formed the backbone of our EDC program. The American Jobs Creation Act of 2004 ("Jobs Act"), however, sharply cut back on those incentives and put at risk our hard-won fiscal gains and future economic development.

Accordingly, I respectfully urge the distinguished Members of this Committee to reassert the historic role of this Committee on federal tax issues involving the insular territories. In particular, I urge this Committee to support our request for a legislative amendment to the Jobs Act to ensure fair and reasonable residency and income rules for our EDC program. In addition, in order to give voice to our underrepresented citizens, I respectfully request that this Committee seek, in the future, sequential referral from the Committee on Finance of all tax matters affecting the insular areas, including, most importantly, issues relating to the taxing jurisdiction of the Virgin Islands and other United States Territories.

Similarly, the Revised Organic Act provided in 1954 that all taxes imposed by the United States on all products imported from the Virgin Islands into the United States shall be "covered over," or returned to the Treasury of the Virgin Islands. Under this provision, the United States returned to the Virgin Islands all of the federal excise taxes collected on Virgin Islands rum shipped to the United States. In 1984, Congress capped the amount of rum excise taxes returned to the Virgin Islands at $10.50 per proof gallon of rum, even though the federal excise tax on rum has since risen to $13.50 per proof gallon. Beginning in 1999, Congress increased the cap on the cover-over amount to $13.25 per proof gallon on a temporary basis, which requires Congress to affirmatively extend the rum tax formula on a regular basis. While the temporary extensions have played an important role in improving our fiscal situation, the uncertainty caused by the temporary nature of the increase makes it more difficult for the Government to develop long range budget plans and to use such revenue streams to securitize the bonds we issue to finance our public infrastructure. Accordingly, I respectfully request this Committee to reassert its original jurisdiction over such issues of tax jurisdiction and to work with the Committee on Finance to seek a permanent extension of the rum tax cap.

I also note that our ability to assure adequate health care to our residents is hampered by the discriminatory cap on Medicaid funds provided to the Virgin Islands and the other U.S. Territories. Medicaid is a federal-state program to provide for the health care needs of the poorest and neediest persons in our country. The quality of health care should not depend on whether an individual lives in California, Alaska or in a United States Territory. While Congress approved last year an increase in the amount of Medicaid funds provided to the Virgin Islands, such increases only narrow the gap between the funds allocated to the Virgin Islands and funds we would be entitled to if the Virgin Islands were treated as a State under the Medicaid formula. Again, I respectfully urge this Committee to work with us to make further improvements in the Medicaid formula and to ensure that our neediest residents receive no less favorable treatment than the neediest residents in the United States.

Last fall, Lt. Governor Vargrave A. Richards testified before this Committee in support of S. 1829, legislation introduced by the distinguished Chairman of this Committee and the distinguished Ranking Member to repeal a 1936 federal statute which limits the authority of the Virgin Islands Government to assess and collect local property taxes. That statute, originally enacted in furtherance of a legislative objective long since relegated to the dust bins of a bygone colonial era, was generally believed to have been repealed by the Revise Organic Act of 1954. A recent court decision, however, breathed new life into the statute, overturning local laws designed to protect homeowners and generally wreaking havoc in the administration of our property tax laws. Accordingly, I respectfully urge this Committee to act quickly on this legislation, which is supported by the Department of the Interior, in order to assure that the Government is able to properly exercise its fiscal responsibilities, and to timely assess and collect property taxes in the Territory.

Mr. Chairman, I have focused my testimony today on the need to correct some of the structural impediments and other inequities that exist in our current relationship with the United States. Notwithstanding these impediments, I am proud of the progress we have made over the course of the last seven years to strengthen the economy of the Territory and improve the financial performance of the Virgin Islands Government. At the same time, I would like to provide a few brief comments on a House-passed bill (H.R. 62), referred to this Committee, which would remove the authority to manage essential budget functions from the elected Virgin Islands leadership, and place that authority for five years in the hands of an unelected bureaucrat who—as a practical matter—could not be removed from office and would not be accountable to anyone.

On behalf of the Government and people of the Virgin Islands, I would like to express my steadfast opposition to H.R. 62. This bill passed the House under suspension of the rules on March 14, 2005, without consultation with the Government of the Virgin Islands, without hearings, and without a committee report. In relying upon the record made in the previous Congress, the House ignored the fact that our Government has been in structural budget balance, that revenues are strong, and that expenditures are under control. The premise of this bill is that the people of the Virgin Islands are incapable of managing their affairs under a republican form of government, and that representative democracy has failed in our Territory. This premise is profoundly wrong and offensive as a matter of theory, and it is simply wrong as a matter of fact.

The bill would create the office of Chief Financial Officer (CFO) of the Government of the Virgin Islands. The CFO would assume the duties of the Director of the Virgin Islands Office of Management and Budget (VIOMB), and all VIOMB employees would report to him or her. Under the Virgin Islands Code, the Director has extraordinary powers of budget preparation and execution. Among other duties, the Director has the authority to mandate revision of the spending and operations plan of every department and agency. The Director also has the power under certain circumstances to modify or withhold appropriated expenditures at any time.

Under current law, the Director serves at the pleasure of the elected Governor. Under H.R. 62, the CFO would serve a fixed term of five years, and could not be removed from office except for "cause." The bill establishes neither a procedure nor a standard for removal from office. The practical effect would be that the CFO, absent criminal abuse of office, would have absolute control of fiscal and budget policy throughout his or her tenure.

Since I assumed office in January 1999, the Government has achieved significant improvements in financial performance and fiscal management. The budget is in balance. Revenues have increased while spending has been kept under control. Indeed, the Government has achieved budget surpluses in recent years. In contrast to practices prior to my Administration, the Government regularly completes audited financial statements. As a result of the Government's overall improvement in financial performance, the country's leading bond agencies have upgraded the ratings on our recent bond issues for Federally-mandated environmental infrastructure and other capital projects.

The Government is committed to making the tough decisions to maintain fiscal discipline, increase the efficiency of government, and to improve the delivery of essential public services to the people. The Government is not facing fiscal insolvency or collapse. There simply is no basis for removing from political accountability the essential functions of budget preparation and execution.

This concludes my testimony. I would be pleased to answer any questions.

The CHAIRMAN. Thank you very much for that testimony. Congressman Faleomavaega, excuse me for fouling up your pronunciation. Why don't you go next, please.

STATEMENT OF HON. ENI F.H. FALEOMAVAEGA, DELEGATE TO CONGRESS, TERRITORY OF AMERICAN SAMOA

Mr. FALEOMAVAEGA. Mr. Chairman, I want to thank you for extending this invitation for me to testify. I was going to have the honor of introducing our governor, who's also with us and traveled 9,000 miles to get here, and I would really appreciate it if I could defer to my governor, who's sitting right next to me, to testify before I do.

Senator BINGAMAN. I believe the Governor testified.

Mr. FALEOMAVAEGA. I'm sorry, Mr. Chairman, I came late. That's the problem with being late.

Well, thank you very much, Mr. Chairman. I want to thank you and the members of the committee for extending this invitation to have our governors and our congressional delegates testify concerning—as an oversight, concerning our insular areas.

As you know, Mr. Chairman, the Department of the Interior traditionally has always been the lead Federal agency on issues affecting territories and the insular areas. I certainly would like to commend Secretary Norton and Secretary Scarlett, and our Deputy Assistant Secretary David Cohen, who will be testifying later, for bringing together representatives of some 15 Federal agencies yesterday as part of our interagency group on insular areas for which we have met periodically, discussing some of the issues affecting the several territories.

Without saying anything further, Mr. Chairman, as you're well aware, sometimes we oversimplify the needs of insular areas thinking that one size fits all simply because we're from the—as insular areas. We, from American Samoa, certainly cannot speak for the other territories, but in American Samoa we have had a very unique—some 106 years now of a political relationship with the United States, quite separate and unique from the other territories because of the strong U.S. Naval interest in the 1800's. We finally were able to establish a U.S. Naval coaling station in 1900 whereby the traditional leaders, both in 1900 and 1904, by written treaties of cession, ceded the islands of American Samoa to the United States. And it was not until 1929 that Congress finally passed a ratification act whereby the administration of these areas—of these territories were transferred to the Secretary of the Navy and then by executive order by President Truman transferred the administration of American Samoa to the Secretary of the Interior, as it now stands.

Over the years we've also developed our own territorial constitution, under the authority of the Secretary of the Interior via the President. I think we've come up with some very unique accomplishments in terms of our political developments. Since 1977 we've elected our own Governor and in 1980 we elected our first congressional delegate to the U.S. House of Representatives.

Mr. Chairman, I intend to introduce some pieces of legislation affecting the current administration of the territory by the Department of the Interior as it was recognized by the Ratification Act of 1929. There are some common interests that affect all the insular areas and one area that I want to share with you is the fact that through the cooperation and working together with Ms. Bordello and Dr. Christensen from the Virgin Islands we were able to fund some additional assistance through our Medicaid program.

One of the problems that we're faced with now, Mr. Chairman, is that currently there is a restriction where we have to come up with a 50/50 matching requirement for these Federal funds to be given to the insular areas and, unlike some of the States, it goes up as high as 90 to 10—I mean 80 to 20 and 90 to 10 matching requirements. I would really appreciate certainly the help of the Congress and our colleagues in the House that we change this matching requirement.

In the meeting that we had yesterday with the interagencies, as I tried to collectively call some of the needs that were expressed by the insular areas, I think there's also serious problems of lands. It was taken during World War II, as it was expressed by leaders of the territory of Guam, and we have our own problems with land.

There are several other issues that I will not bother the committee with, but I certainly want to express again to you, Mr. Chairman, our appreciation that you called this oversight hearing. And I sincerely hope and look forward to working with you, at least from those of us who are from the other side, and hopefully we would draft an omnibus bill that will cover some of the various issues affecting all the insular areas in the coming weeks and months.

Thank you again, Mr. Chairman.

The CHAIRMAN. Thank you very much. Now we're going to go to the Honorable Donna Christensen, Delegate from the Virgin Islands.

STATEMENT OF HON. DONNA M. CHRISTENSEN, DELEGATE TO CONGRESS, U.S. VIRGIN ISLANDS

Ms. CHRISTENSEN. Thank you. Good morning, Chairman Domenici, Senators Akaka and Murkowski. Thank you for the opportunity to make an opening statement at this important hearing.

All of the insular areas are facing challenges to our local economies which could have a catastrophic effect on government and the revenues they receive. In the case of the Virgin Islands, I want to begin my remarks by asking the committee and Senate to quickly pass S. 1829 to repeal the section on the 1936 law whereby Congress regulates property taxes in the Virgin Islands, and also to support and help us reverse certain changes that were made by the U.S.A. Jobs Act, which Governor Turnbull elaborated on in detail in his remarks. I would simply concur by saying that this is a critical issue in terms of our economical prosperity going forward.

I'll take this opportunity, though, to focus the rest of my statement on another issue that is equally important to me as well as the majority of my constituents. Mr. Chairman, you have pending before your committee since a year ago this month H.R. 62, which I sponsored and which twice passed the House of Representatives, that would create a chief financial officer for the Virgin Islands. I would ask the chairman, and ranking members, and members of the committee, that you and the Senate pass H.R. 62 because of the critical role I believe it can play in strengthening the Virgin Islands' ability to better manage its scarce resources.

I believe as strongly as I did when I first introduced this bill almost 3 years ago, that a chief financial officer for the Virgin Islands can serve as an immeasurable resource tool for first rate financial management of our scarce territorial resources, freed from the constraints of day to day political pressures. All of us in Congress know how financial decisions made within a political context often do not yield the best results.

I want to say at the outset, also, Mr. Chairman, that my introduction of H.R. 62 is in no way an indictment of the job that Governor Charles Turnbull and his financial management team are doing. In fact, I want to publicly applaud the Governor for the job he has done in stewarding the territory through very perilous fiscal times. Further, the problems we are facing are not unique to the U.S. Virgin Islands, but plague many States and other territories and some of the causes of our fiscal challenges have been outside of our control, such as current catastrophic hurricanes and the tax cuts and credits passed by Congress.

In fact, when Governor Turnbull assumed the office of Governor in the Virgin Islands nearly 8 years ago, he inherited a Government that was swamped with debt and liabilities. As the Governor stated in his final State of the Territory address this past January, he and his team rolled up their sleeves and went to work with the assistance of the Congress, in particular this committee, as well as windfalls from the EDC companies and revenues realized from increased oil prices, and he and his team were able to end 2005 with a surplus and the territory in a strengthened financial position. But as commendable a job as the Governor has done, all is not as it could and should be with regard to our fiscal ship and we can and should do better.

Opponents of the bill, including the Governor, argue that having a chief financial officer who is appointed by the Governor, but does not serve at his pleasure, will be a step backward in our political development and an act of overt colonialism. Members and Mr. Chairman, nothing could be further from the truth. While my bill would be an act of Congress, it sets up a process that is entirely within the hands of Virgin Islanders and creates a position that sunsets in 5 years.

Mr. Chairman, some have also complained that if Congress were to pass my bill it would be interjecting yourselves into our local affairs, but it is not the Congress that conceived of this proposal and sought to impose it upon us, but I, the elected representative of the people of the Virgin Islands in Congress, buttressed from all indications by the strong support of my constituents.

When I first introduced my CFO bill, as it is known, I did so because I believed that something had to be done to prevent the Virgin Islands from fiscal collapse. I came to the conclusion that what we needed was an expert, impartial financial manager whose charge was to simultaneously foster sound financial management while preventing overspending. We have come a long way since I first introduced my bill, thanks in large part to the tremendous upswing in nearly all segments of our local economy. However, the practices and systems that led us to the brink of fiscal collapse during the down time still remain.

The financial practices which have led many of our local agencies to be put under severe grant restrictions or third party fiduciaries by agencies of the Federal Government existed long before the Turnbull administration came into being and will continue to exist long after it is gone unless we institute deep and far reaching reforms. I know because I have served as an official of the Virgin Islands Health Department more than 10 years ago and the practices that we're being criticized for by a number of our Federal grant managers existed then and continue to exist today.

While my bill is not a panacea, I believe that it will help chart a course for fiscal management that will keep us in good stead during good times—the good times that we appear to be in in the present—and help us prepare for darker days that are sure to be visited upon us in the future given current fiscal Federal deficits, national homeland security needs, and wars far away from home that are projected to continue for several years to come.

Again, I thank you for the opportunity to testify and I ask you and urge you to pass H.R. 62. Thank you, Mr. Chairman.

[The prepared statement of Ms. Christensen follows:]

PREPARED STATEMENT OF HON. DONNA M. CHRISTENSEN, DELEGATE, U.S. VIRGIN ISLANDS

Thank you, Mr. Chairman and Ranking Member, for the opportunity to make an opening statement at this important hearing on the financial challenges facing the governments of the U.S. Insular Areas.

Whether, one is looking at the CNMI and the possible loss of their garment industry or American Samoa and potential loss of Section 936 benefits or the tax changes in my own territory of the Virgin Islands, we are all facing challenges to our local economies which could have a catastrophic effect on government and the revenues they receive.

In the case of the Virgin Islands, I want to begin my remarks by asking for the committee's help in repealing section of the 1936 regulating property tax in the Virgin Islands and reversing certain changes that were made by the U.S.A. JOBS Act, P.L. 108 which has the potential of crippling our very successful Economic Development Commission program. This a program which grants certain tax benefits to persons who make investments in our territory.

Because both the federal and our own local government was not as vigilant they should have been in weeding out those who sought to use our successful program, which Congress provided to us to help us become more self-sufficient and to grow our economy, to avoid paying their fair share of taxes, Congress tightened the requirements for being considered a Virgin Islands resident as well as what type of income can qualify for reduction under the program.

We believe Congress went farther than was needed in its attempt to deal with abuses in the program and as a consequence the entire program, which accounts for 20% of government revenues, is at serious risk. Because we are not fortunate to have representation in this body, we have looked to you, Mr. Chairman and the members of this committee to be our champions in the Senate, as has been your historic role.

We have been working with a number of your colleagues on the Finance Committee to restore the language that was in the original Senate passed version of the JOBS Act which our EDC beneficiaries tell us is the absolute minimum requirement in terms of the number of days they would be required to be on the island in order to qualify as a Virgin Islands resident.

Governor Turnbull in his remarks will elaborate on this issue in greater detail but I will conclude by simply saying that this is the number one issue for us in terms of our economic prosperity going forward.

Now to another issue that is equally important to me as well as to a majority of my constituents! You have pending before your committee, Mr. Chairman, legislation which I sponsored and which twice passed the House of Representatives that would create an office of Chief Financial Office for the Virgin Islands. The bill, H.R. 62, last passed the House a year ago this month, and has been pending before this committee ever since. Because there hasn't been a hearing scheduled on this bill in all this time, I want to take this opportunity Mr. Chairman to urge you and your colleagues to pass H.R. 62, because of the critical role I believe it can play in strengthening the Virgin Islands ability to better manage its scarce resources.

We live in a time when no one can afford to waste one single penny. I believe—as strongly as I did when I first introduced this bill almost three years ago—that a Chief Financial Officer for the Virgin Islands can serve as an immeasurable resource tool for first rate financial management of our scarce territorial resources, freed from the constraints of day-to-day political pressures. We—all of us in this body know all to well—how financial decisions made within a political context often does not yield the wisest results.

I want to say at the outset, Mr. Chairman, that my support for and introduction of, legislation to create a Chief Financial Office for the Virgin Islands is in no way an indictment of the job that Governor Charles W. Turnbull and his financial management team has done in managing the finances of the Territory.

In fact, I want to publicly applaud the governor for the job he has done in stewarding the territory through very perilous fiscal times.

When Governor Turnbull assumed the office of Governor of the Virgin Islands nearly eight years ago, the territory was "technically insolvent" and on the brink of fiscal collapse.

He inherited a government that was "swamped with debt with total liabilities exceeding $1.12 billion, including a cumulative General Fund deficit in excess of $250 million and an annual deficit approaching $100 million.

As the Governor stated in his final "State of the Territory" address this past January, he and his team "rolled up their sleeves, went to work." And with the assistance of Congress, particularly this committee, as well as "windfalls" from the EDC companies and revenues realized from increased oil prices, he and his team were able to restore budget surpluses, and strengthened the territory's financial position."

But as commendable a job as the Governor has done all is not as it could and should be with regard to our fiscal ship and we can and should do better!

Opponents of my bill, including the governor, argue that having a Chief Financial Officer, who is appointed by the Governor but does not serve at his pleasure, will be a step-backward in our political development and would be an act of overt colonialism. Nothing could be further from the truth!

While my bill would be an act of Congress, it sets up a process that is entirely within the hands of Virgin Islanders. And most importantly, it creates a position that sunsets in five years.

When I first introduced my CFO bill as it is known, I did so because I believed that something had to be done to prevent the Virgin Islands from fiscal collapse.

Even with all of the work that Governor Turnbull has done, as recent as six years ago, our economy was not performing as it is today.

After carefully looking at the path that the District of Columbia took to pull itself out of its fiscal nightmare and consulting with District officials including the current DC Chief Financial Officer, as well as my friend and colleague, Eleanor Holmes Norton—who testified in support of my bill in the House—I came to the conclusion that what we needed was an expert impartial financial manager, whose charge was to simultaneously foster sound financial management while preventing "over-spending."

We have come along way since I first introduced my bill thanks in large part to a tremendous upswing in nearly all segments of our local economy. However, the practices that led us to the brink of fiscal collapse during down times still remain.

Mr. Chairman, I want to repeat that my proposal is not an indictment of Governor Turnbull or any member of his team.

The lax financial practices which have led many of our local agencies to be put under severe grant restrictions by agencies of the federal government existed long before the Turnbull Administration came into being and will continue to exist long after it is gone unless we institute new practices.

I know, because I served as an official of Virgin Islands Health Department some years ago and the practices that we are being criticized for by a number of our federal grant managers existed then and continue to exist today.

Mr. Chairman some have said that if Congress were to pass my bill you would be interjecting yourselves in our local affairs; a specious charge if I ever heard one. It was not the Congress that conceived of this proposal and sought to impose it on us, but the elected representative of the people of the Virgin Islands in Congress who has been calling for this proposal, buffeted from all indications, by the strong support of my constituents as I seek to return fiscal credibility back to the V.I. government, especially as it relates to federal agencies and their funding of projects and services in the territory.

Mr. Chairman it has not been easy for me to watch the fiscal health of the territory steadily decline since I have been in office. Since the middle 1990s, successive administrations and Legislatures have—for good reasons—not been able to maintain sound fiscal management and financial policies.

While some of the reasons for this condition have been outside of our control, such as recurrent catastrophic hurricanes and the tax cuts and credits passed by Congress, much of the blame for this condition can be traced to the unfortunate reality that the Territory's managers and lawmakers have not substantively addressed the imbalance between the needs and demands of the community and its revenues.

While our economic future looks bright at the moment, if we continue the ways of the past our bright future can turn to dark days in a blink of an eye.

While, my bill is not a panacea, I believe that it will help chart a course for fiscal management that will keep us in good stead during good times as the present and help us prepare for darker days which are sure to be visited upon us in the future. I urge you to support passage of H.R. 62.

The CHAIRMAN. Thank you very much. Governor Turnbull, we won't ask you a question about H.R. 62, we'll just ask you to comment in the record for us, in writing, give us your views on that.

With reference to H.R. 1829, I have introduced it here, as you know, it is pending. You asked about that. It has been introduced by the chairman. We'll see what happens to it here.

We're going to move quickly now to the Territory of Guam, Madeleine Bordallo, Delegate. Glad to have you here, ma'am.

STATEMENT OF HON. MADELEINE Z. BORDALLO, DELEGATE TO CONGRESS, TERRITORY OF GUAM

Ms. BORDALLO. Thank you very much. It's a real opportunity for me to be able to testify, Mr. Chairman, Senator Akaka, Senator Murkowski.

Thank you very much, Mr. Chairman, for calling this hearing on the economic and financial state of the U.S. territories. Ensuring that the U.S. territories continue to develop and strengthen economically should remain a very important part of overall U.S. policy, and I appreciate the opportunity to share my views on both the challenges facing Guam and the many opportunities within reach for our island.

Today I will address three specific issues for which I believe this committee should exercise oversight. These issues touch upon the need to improve public utilities and infrastructure in the territories to better the business climate and quality of life on our islands. Workforce development and support for greater access to the Federal marketplaces for small businesses are also important priorities for which I seek this committee's support.

Tourism and the military presence on Guam drive the island's economy and will continue to serve as areas of growth for the foreseeable future. Our visitor arrivals are on the increase. We hope this positive trend continues so that our visitor and hospitality industry will continue to grow and diversify.

Additionally, the military presence on Guam will significantly increase in the years ahead. Recent bilateral talks between the United States and Japan yielded an agreement to reposition Marines from Okinawa to Guam. This means that up to 8,000 Marines will arrive on Guam over the next several years beginning in 2008. A significant investment of Federal dollars is planned to accommodate the Marines and to support additional naval and Air Force assets on the island. An exact dollar figure for the level of investment has not been announced. Recent estimates reported by various media outlets range on the conservative side from $3 to $4 billion over the next 10 years. This level of investment promises to create many new jobs and the increased military activity will stimulate a sustained period of economic growth.

There is concern that Guam's work force is not adequately developed to meet the surge of both military and off-base construction. So to meet these labor demands, the Federal Government should increase assistance for job training programs on Guam. The Agency for Human Resources Development and the Department of Labor within the government of Guam locally administers the Workforce Investment Act and training programs. The Guam Community College offers vocational and technical training. These programs should receive increased Federal support in order to develop the work force needed to meet the demands in the future years. Additionally, I believe that the establishment of a job corps center on Guam would help fulfill future labor demands.

Increasing Federal support for local job training and vocational education programs is one way to meet demand for labor. Guam's aggregate work force, however, will in all likelihood not be able to provide all of the labor required to meet our future needs. Presently, U.S. law prohibits the use of foreign labor on military construction projects on Guam. This restriction is unique to Guam and serves as a constraint which should be reviewed. While there may be security concerns regarding military construction projects, these concerns can be met in a number of ways, including limiting foreign labor to non-sensitive projects and recruiting the H2-B visa labor pool from reliable allies. We will be developing this approach with the appropriate committees of jurisdiction.

Additionally, I want to state for the committee my support for the re-authorization and raising of the national H2-B visa cap. That cap should be set at a level that better reflects the needs of American businesses. In that vein, Mr. Chairman, under current law, return workers under the H2-B visa program are not counted against the cap, and I urge that this provision be continued.

Infrastructure improvements financed by military construction funds will not address all of Guam's critical infrastructure, essential services, and economic development needs. Financing from other sources must be sought and received. Securing this financing, however, is not easy. Alone, Guam cannot attract the capital and does not have a sufficient debt ceiling to underwrite the loans that we require for these infrastructure improvements. The other territories face similar challenges in gaining access to capital to finance infrastructure improvements.

Establishing a U.S. territories bond bank that pools territorial resources and issues combined debt in the form of tax exempt bonds is a possible solution to this challenge that I support. Proceeds from these bond sales will be reissued in the form of loans aimed to finance reconstruction projects. Bond banks serve at least 12 States today. Like those banks, a U.S. territory bond bank will use Federal grant money as collateral to guarantee the loans. Only by pooling our resources can the territories access the capital that we need to improve the lives of their residents. I'm committed to developing legislation that maybe deemed necessary for the implementation of the territorial bond bank proposal.

One of the concerns our local Government has is the tax status of off-island contractors who may be performing work on the military bases, and whose corporate domicile is off-island. This is a complex issue that relates to our status as a mirror code jurisdiction. We have been exploring this issue and believe that a mechanism, whether initiated through administrative action or by legislation, is needed to inform the local tax jurisdiction of Federal contract awards. So I will be raising this issue with the Armed Services Committee and I am prepared to offer an amendment.

The CHAIRMAN. Madam, your time has expired. Could you put your statement in the record?

Ms. BORDALLO. Thank you. I wish to have it entered into the record, Mr. Chairman.

[The prepared statement of Ms. Bordallo follows:]

PREPARED STATEMENT OF HON. MADELEINE Z. BORDALLO, DELEGATE TO CONGRESS, TERRITORY OF GUAM

Mr. Chairman, Ranking Member Bingaman, and Members of the committee: Thank you for calling this hearing on the economic and financial state of the U.S. territories. Ensuring that the U.S. territories continue to develop and strengthen economically should remain an important part of overall U.S. policy. I appreciate the opportunity to share my views on both the challenges facing Guam and the many opportunities within reach for our island.

Today I will address three specific issues for which I believe this Committee should exercise oversight. These issues touch upon the need to improve public utilities and infrastructure in the territories to better the business climate and quality of life on our islands. Workforce development and support for greater access to the federal marketplace for small businesses are also important priorities for which I seek this Committee's support.

Tourism and the military presence on Guam drive the island's economy and will continue to serve as areas of growth for the foreseeable future. Our visitor arrivals are on the increase. We hope this positive trend continues so that our visitor and hospitality industry will continue to grow and diversify. Additionally, the military presence on Guam will significantly increase in the years ahead. Recent bilateral talks between the United States and Japan yielded an agreement to reposition Marines from Okinawa to Guam. This means that up to 8,000 Marines will arrive on Guam over the next several years, beginning in 2008.

A significant investment of federal dollars is planned to accommodate the Marines and to support additional naval and Air Force assets on the island. An exact dollar figure for the level of investment has not been announced. Recent estimates reported by various media outlets range on the conservative side from $3 to 4 billion over the next ten years. This level of investment promises to create many new jobs and the increased military activity will stimulate a sustained period of economic growth.

There is concern that Guam's workforce is not adequately developed to meet the surge of both military and off base construction. To meet these labor demands, the Federal Government should increase assistance for job training programs on Guam. The Agency for Human Resources Development (AHRD) and the Department of Labor within the government of Guam locally administers the Workforce Investment Act (WIA) and job training programs. The Guam Community College (GCC) offers vocational and technical training. These programs should receive increased federal support in order to develop the workforce needed to meet the demands in the future years. Additionally, I believe that the establishment of a Job Corps center on Guam would help fulfill future labor demands.

Increasing federal support for local job training and vocational education programs is one way to meet demand for labor. Guam's aggregate workforce, however, will in all likelihood not be able to provide all of the labor required to meet future needs. Presently, U.S. law prohibits the use of foreign labor on military construction projects on Guam. This restriction is unique to Guam and serves as a constraint which should be reviewed. While there may be security concerns regarding military construction projects, these concerns can be met in a number of ways, including limiting foreign labor to non-sensitive projects and recruiting the H2-B visa labor pool from reliable allies. We will be developing this approach with the appropriate committees of jurisdiction. Additionally, I want to state for the Committee my support for the reauthorization and raising of the national H2-B visa cap. That cap should be set at a level that better reflects the needs of American businesses. In that vein, under current law, return workers under the H2-B visa program are not counted against the cap. I urge that this provision be continued.

Infrastructure improvements financed by military constructions funds will not address all of Guam's critical infrastructure, essential services, and economic development needs. Financing from other sources must be sought and received. Securing this financing, however, is not easy. Alone, Guam cannot attract the capital and does not have a sufficient debt ceiling to underwrite the loans that we require for these infrastructure improvements. The other territories face similar challenges in gaining access to capital to finance infrastructure improvements.

Establishing a U.S. Territories Bond Bank that pools territorial resources and issues combined debt in the form of tax-exempt bonds is a possible solution to this challenge that I support. Proceeds from these bonds sales would be reissued in the form of loans aimed to finance reconstruction projects. Bond banks serve at least twelve States today. Like those banks, a U.S. Territory Bond Bank will use federal grant money to as collateral to guarantee the loans. Only by pooling our resources can the territories access the capital we need to improve the lives of their residents. I am committed to developing legislation that may be deemed necessary for the implementation of the territorial bond bank proposal.

One of the concerns our local government has is the tax status of off island contractors who may be performing work on the military bases and whose corporate domicile is off island. This is a complex issue that relates to our status as a mirror code jurisdiction. We have been exploring this issue and believe that a mechanism, whether initiated through administrative action or by legislation, is needed to inform the local tax jurisdictions of federal contract awards. I will be raising this issue with the House Armed Services Committee and I am prepared to offer an amendment to the National Defense Authorization Act so that each State and Territorial Tax Commissioner is notified of federal contracts awarded for work in their jurisdiction that may be subject to state, territorial, or local tax law. Compliance with this proposed requirement should be relatively simple as federal contact award data is already collected and logged into the Federal Procurement Data System (FPDS). Additionally, most federal agencies, including the Armed Services, customarily send courtesy notifications to Members of Congress of contracts awarded for work in their district. My proposal would simply require that the notification generated for this purpose also be reported to the appropriate State or Territorial Tax Commissioner. The State and Territorial Tax Commissioners would be responsible for enforcing the local tax law and by doing this we have created a mechanism by which federal contractors can be notified of their tax obligations.

Last year, Congress enacted legislation that I proposed along with Congressman Faleomavaega and Congresswoman Christensen that effectively designates our entire islands as Historically Underutilized Business Zones. The HUBZone program, administered by the U.S. Small Business Administration, is an important federal contracting tool that may be used to ensure that small businesses have competitive access to the federal marketplace. Prior to the enactment of this legislation last August, Guam had only four HUBZone certified firms. Today, 54 firms on Guam are HUBZone certified, an astounding 1300% increase in just seven months. In fact, one of the first HUBZone certified companies has since been awarded two HUBZone set-aside federal contracts. Utilizing the HUBZone small business contracting preference and set-aside rules is the best way to ensure that local businesses can be empowered by the hundreds of millions of federal contact dollars planned for Guam in coming years. I urge the Committee to support the HUBZone Program and to encourage federal agencies to promote small businesses by utilizing this initiative.

In closing, I want to reiterate that the improvement of public infrastructure, workforce development, and support for greater access to the federal marketplace for small businesses are the three policy areas for which federal support is needed to further develop and diversify Guam's economy. Thank you again for the opportunity to testify today. I appreciate the opportunity to share my views on Guam's continued economic development.

The CHAIRMAN. Governor, we gave you the wrong time. We told everybody 9:30, but we didn't get that word to you here on time. So it's your turn now. Proceed, Governor Camacho.

STATEMENT OF HON. FELIX PEREZ CAMACHO, GOVERNOR, TERRITORY OF GUAM

Mr. CAMACHO. Thank you, Mr. Chairman and Senator Akaka.

The CHAIRMAN. You have 5 minutes.

Mr. CAMACHO. Mr. Chairman and members of the committee, thank you for inviting me to participate in your hearing on the state of the economy and the fiscal affairs of the Pacific island territories, specifically the island of Guam. I'm Mr. Camacho of Guam.

My testimony today is to present to you the current state of our economy and what the future holds for our island as we enter a period of prosperity. I stand before you less than a week after my annual report on the state of the island of Guam. It offered a synopsis of where we've been, what we had to overcome and how far we've gone, and most importantly where we are headed. As I told my people, and as I share with you here on Capitol Hill, the state of our island is growing stronger.

Guam is expected, absent major adverse disturbances, to continue its recovery and expansion of economic activities in fiscal years 2006 and 2007, as it has in each fiscal year following the depressed levels of fiscal year 2002. Given the number of private, Federal defense, and government of Guam construction projects already planned, permitted and contracted, it is likely that the pace of the economic expansion will continue to accelerate.

Economic activities and tax revenues are anticipated to continue to recover so that by fiscal year 2007 these levels will more closely approach those achieved in fiscal year 2001, prior to being severely impacted by the repercussions of the terrorist events of September 11 and subsequent super typhoons and other national and global events.

I must premise the following details with an overview of Guam's economic structure. Our visitor industry accounts for more than 60 percent of total activity, with our strongest markets pegged on the Japan and Korea outbound traveler market. Our second largest industry is the military, accounting for more than 30 percent of the activity. Other industries include telecommunications, retail, service, construction, aviation and more.

The recovery from the depressed levels of 2002 was initially fueled by a combination of gradual but significant rebound in tourist arrival numbers and by substantial Federal typhoon assistance in a variety of forms, including temporary employment and reconstruction assistance. Substantial capital investment commitments are in place for private businesses, government of Guam, and Federal Government projects. The simultaneous combination of increasing public and private capital investment in construction, expanding defense personnel numbers, in addition to modestly increasing tourist arrivals, increasing civilian employment, consumer and investor confidence in spending is a catalyst for continuing expansion.

While the number of large defense activities and infrastructure improvements are under consideration or being planned for Guam, the realization and timing of the implementation of these projects is cause for substantial uncertainty and variability in the estimates of growth levels in the coming years. As decisions on these activities are finalized and projects scheduled, there will be a better ability in the future to produce more precise forecast.

Various economic indicators are showing that the Guam economy continues to recover and simultaneously is expanding. Building permits provide an important leading economic indicator of the type and level of construction activities planned and likely to occur, as well as the type of activities and employment which may occur in the buildings once completed. The dollar value of the building permits in 2005 is $168 million, or a 36 percent increase from the previous year. The value of total permits increased by more than 75 percent over the last 3 years. Both residential construction and government of Guam projects have nearly doubled from 2004 to 2005.

Our government of Guam projects, planned or scheduled, would infuse hundreds of millions of dollars into the local economy and provide for the construction of new schools, senior centers, public safety buildings, health care centers and an expanded runway at our airport, the closure of an old landfill—or dump, as we call it—and the opening of a new one, an overhaul to the water and wastewater systems and major renovations to the power system. These improvements, while adding to the demand for more jobs and construction and other technical fields, also help to improve Guam's quality of life. Federal Government construction projects on military bases are not included in the building permit data. In lieu of this, construction budgets and projects contracted provide important indicators of future construction. Roughly $100 million in construction projects are planned by the Air Force over the next 2 years. A contract has been awarded for $29 million for the construction of a new Department of Defense high school, elementary and middle school. A contract for wharf improvements at our naval station exceeding $10 million has also been awarded.

The planned relocation of 8,000 Marines from the Third Marine Expeditionary Force from Okinawa to Guam will have a major impact on our economy. Numbers are roughly 16,000, inclusive of family and support personnel. Mr. Chairman, the cost and timing of this relocation and related activities has not yet been fully outlined as plan details are being discussed between the U.S. and Japanese Governments.

The Pacific Air Force has committed to basing a global strike force at Anderson Air Force Base. It is estimated that approximately 3,000 additional military, civilian and contract personnel will be based at our Anderson Air Force Base as a result. The action would begin in 2007 with facility construction projects, and be completed around 2016 at a cost of more than $2 billion.

Major renovations to and expansion within the visitor industry is a result of visitor arrival numbers jumping to levels not seen since 1997. Our real estate transactions have doubled over the past 3 years and the median sale price of a home is at its highest level since our tracking data began in 1999.

The CHAIRMAN. Thank you very much, Governor. The rest of your statement will be made a part of the record.

Mr. CAMACHO. Thank you, Mr. Chairman.

[The prepared statement of Mr. Camacho follows:]

PREPARED STATEMENT OF FELIX PEREZ CAMACHO, GOVERNOR, TERRITORY OF GUAM

THE STATE OF THE ECONOMY AND FISCAL AFFAIRS IN THE U.S. TERRITORIES

Mr. Chairman and Members of the Committee, thank you for inviting me to participate in your hearing on the state of the economy and fiscal affairs in the Pacific Island Territories, specifically the island of Guam. My name is Felix Perez Camacho, Governor of Guam. My testimony today is to present to you the current state of our economy and what the future holds for our great island as we enter a period of prosperity.

Mr. Chairman, I would like to express my appreciation to you and to the members of the Committee for holding this hearing to better understand the needs and concerns of the Pacific Island Territories on this most important issue for the people of Guam and our Pacific Island brothers and sisters.

I stand before you less than a week after my annual report on the State of the Island of Guam. It offered a synopsis of where we've been, what we had to overcome, how far we've gone and, most importantly, where we are headed. As I told my people and as I share with you here on Capitol Hill, the State of our island is growing stronger.

Guam is expected, absent major adverse disturbances, to continue its recovery and expansion of economic activities in Fiscal Years 2006 and 2007 as it has in each fiscal year following the depressed level of FY 2002. Given the number of private, federal defense and government of Guam construction projects already planned, permitted and contracted it is likely that the pace of the economic expansion will continue to accelerate.

Economic activities and tax revenues are anticipated to continue to recover so that by FY 2007 these levels will more closely approach those achieved in FY 2001 prior to being severely impacted by the repercussions of the terrorist events of September 11, 2001, subsequent super typhoons and other national and global events.

Guam's Chief Economist reports to me that the economy definitely is trending toward pre-9-11 strength, ending a half decade of decline and offering hope to my people, who have worked so hard to overcome the challenges that came at the dawn of the Twenty-first Century.

I must premise the following details with an overview of Guam's economic structure. Our visitor industry accounts for more than 60 percent of total activity with our strongest markets pegged on the Japan and Korea outbound traveler. Our second largest industry is the military, accounting for more than 30 percent of activity. Other industries include telecommunications, retail, service, construction, aviation and more.

At the bottom of the recession in early 2003 when I came to office, all industries were in decline, the War on Terror and the storms kept tourists away and federal and military relations were strained.

The recovery from the depressed level of FY 2002 was initially fueled by a combination of a gradual but significant rebound in tourist arrival numbers and by substantial federal typhoon assistance in a variety of forms including temporary employment and reconstruction assistance as well as private insurance payments. As activity has stabilized, further economic growth is being paced by other sources of financial stimulus.

Substantial capital investment commitments are in place for private businesses, Government of Guam and Federal Government projects. The simultaneous combination of increasing public and private capital investment and construction, expanding defense personnel numbers in addition to modestly increasing tourist arrivals, increasing civilian employment, consumer and investor confidence and spending is the catalyst for continuing expansion.

While a number of large defense activities and infrastructure improvements are under consideration or being planned for Guam, the realization and timing of the implementation of these projects is cause for substantial uncertainty and variability in the estimates of growth levels in the coming years. As decisions on these activities are finalized and projects scheduled, there will be a better ability in the future to produce more precise forecasts.

Various economic indicators are showing that the Guam economy continues to recover and simultaneously is expanding. Building Permits provide an important leading economic indicator of the type and level of construction activities planned and likely to occur as well as the type of activities and employment which may occur in the buildings once completed. The dollar value of building permits in 2005 at $168 million is a 36 percent increase from 2004, the highest level since 2000. The value of total permits increased by more than seventy-five percent over the last three years. Both residential construction permits and Government of Guam projects have nearly doubled from FY 2004 to FY 2005.

Government of Guam projects planned or scheduled will infuse hundreds of millions of dollars into the local economy and provide for the construction of new schools, senior centers, public safety buildings, health centers, an expanded runway at the International Airport, the closure of the old landfill and the opening of a new one, an overhaul to the water and wastewater systems and major renovations to the power system. These improvements, while adding to the demand for more jobs in construction and other technical fields, also help to improve Guam's quality of life.

Federal Government construction projects on military bases are not included in the building permit data. In lieu of this, construction budgets and projects contracted provide important indicators of future construction. About $100 million in construction projects are planned by the Air Force over the next two years. A contract has been awarded for $29 million for the construction of a new Department of Defense high school and Elementary & Middle school. A contract for wharf improvements at U.S. Naval Station Guam exceeding $10 million dollars has also been awarded.

The planned relocation of up to 7,000 Marines from the III Marine Expeditionary Force in Okinawa to Guam will have a major impact on our economy. The costs and timing of this relocation and related activities has not yet been fully outlined as plan details are being discussed between the U.S. and Japanese governments. Pacific Air Forces has committed to basing a Global Strike Task Force (GSTF) on Andersen AFB. It is estimated that approximately three thousand additional military, civilian and contractor personnel would be based at Andersen AFB as a result. The action would begin in 2007 with facility construction projects and be completed around 2016, at a cost of more than $2 billion.

Major renovations to and expansion within the visitor industry is the result of visitor arrival numbers jumping to levels not seen since 1997 and increased spending per tourist. Real estate transactions also have doubled over the past three years and the median sale price of a home is at its highest levels since data tracking began in 1999.

To place the Guam economy into perspective and to show how significant improvements are affecting my people, I want to turn your attention to the workforce situation. From the December reporting period the month before I came to office until the last reporting period in 2005, more than 3,700 private sector jobs have been added to the workforce—a 10 percent increase to the job market! Weekly earnings in eight of 13 reporting industries also have increased over the same period and the pace of the economic expansion is such that our industries are concerned about the availability of a skilled workforce to meet growing job demands. Local labor officials are networking with the private sector and U.S. Immigration authorities to address the anticipated shortfall.

SUMMARY

Mr. Chairman and members of the Committee, Guam has risen to the challenge of building our island from the chaos and destruction of its darkest moments following natural disaster and man-made despair; but there is so much more that is being done to ensure that Guam stays on a course to prosperity. Together as a people, we have achieved so much and, together, we are poised to bring our island into a period of unprecedented prosperity. I share your values, your priorities and your concerns as leaders of our great Nation and today, I ask you to stand with the people of Guam as we take our island to new heights and build a greater Guam better and stronger than we've ever seen.

Thank you for your attention. I welcome any questions.

The CHAIRMAN. As you know, we have a vote light up, but we still have a few minutes, so we're going to go to the Honorable Pedro Tenorio, Representative of the Commonwealth of the Northern Mariana Islands.

STATEMENT OF HON. PEDRO A. TENORIO, RESIDENT REPRESENTATIVE TO THE UNITED STATES, THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

Mr. TENORIO. Thank you. Good morning, Chairman Domenici. Senator Akaka, aloha. Senator Murkowski. Thank you for this opportunity to be here today. On behalf of Governor Benigno Fitial, I extend his apologies for not being able to be here with us today.

This hearing is extremely important. We are hopeful that it will be beneficial to our commonwealth and to our sister territories as well. We are deeply encouraged by your committee's initiative to conduct this historic hearing for we have much to share with you regarding the state of the economy and the fiscal affairs of the Northern Mariana Islands. This also ensures hope that by the end of this hearing you will appreciate the enormity of our problems and also the efforts and sacrifices we are undertaking to address them head on. While we are making progress, we recognize our limitations.

I'm here today on behalf of the American citizens of the Northern Marianas to ask you for your help in our time of hopelessness and despair. The CNMI lacks valuable natural resources like oil or minerals. This limitation plays a major role in the design of our long term economic strategy. Our most important objective has been economic and financial self-sufficiency. By 1992 we had achieved this objective through a strategy based on tourism and garment manufacturing as our primary economic machines. This made a lot of economic sense to us since we are located very close to population centers in Asia and we have the ability to export duty- and quota-free into the United States. These industries combined provide directly or indirectly roughly 80 percent of all employment, 96 percent of all exports, and 85 percent of all economic activity. In addition, they directly provide approximately 50 percent of the CNMI government's tax base.

However, both of these industries are extremely fragile and are susceptible to external changes. For example, the CNMI garment industry is threatened by international trade agreements that limit its competitiveness and viability. The visitor industry is subject to changes in financial conditions in Asian countries. Just last October a major Japanese airline decided to terminate its operations in the Northern Marianas after operating for more than 23 years.

These two industries, Mr. Chairman, have declined and have generated a negative multiplier effect permeating the entire private sector. Garment sales to the United States have fallen by 34 percent, tourist arrivals are down 25 percent and gross business revenues are down by 23 percent. Tax collections are likewise affected, and by 2002 the government experienced a 20 percent reduction and have generated a $74 million deficit.

The CNMI government has tried for years now to make ends meet through austerity such as deferred maintenance of public facilities, delayed or deferred payments of the government's share over time and contributions, and delayed or nonpayment of utility bills, and to private vendors and government contractors. These austerity measures have left our public schools and hospital in deplorable and unsafe conditions. The CNMI government owes $85 million to the retirement system which repeatedly faces shortages and the possibility that it cannot meet monthly annuity payments.

The record high fuel oil prices have left the government-owned agency, the Utilities Corporation, near bankrupt and requiring a minimum $24 million bailout just to keep the lights on until the end of this year—this fiscal year. Facing a now-estimated $100 million deficit, the new administration is implementing new and stricter austerity measures which we fear would impose significant negative effects on the economy. Our government is in the process of laying off personnel, reducing work hours, reducing salaries and office operations, and reducing many other essential services provided by the private sector. These adverse actions will only have the opposite effect of increasing unemployment, increasing the growing burden of food stamps and Medicaid, and will further erode the tax base.

In short, Mr. Chairman, our once prosperous economy is sick. Although being cared for intensively, the prospects for recovery are weak and the toll on the people of CNMI is increasing. However, with the assistance of the U.S. Congress, I am positive that our economy will improve and possibly flourish once again.

I have brought a short list of proposed actions for your consideration. These are our lifeline. First, I strongly recommend that Congress approve this year S. 1951, sponsored by Senator Craig and Senator Akaka, which amends General Note 3(a)(iv) to grant insular possessions equivalent treatment to U.S. free trade partners by extending to all products, including textile and apparel, the requirement that original products contain at least 30 percent, instead of the current 50 percent, U.S. and local content. This will keep the CNMI garment industry viable for approximately the next 10 years.

No. 2, the CNMI has estimated that the United States has withheld or taxed income of CNMI residents in excess of $71 million for the period of 1978 to 2002, with $38.8 million in interest. Section 703(b) of our covenant with the United States Public Law 94-241 and 48 U.S.C. section 1842 call for proceeds of taxes collected from CNMI residents be covered directly upon collection into the treasury of the CNMI. These provisions have never been fully implemented. I respectfully request the Congress and your committee to immediately direct the U.S. Treasury to reimburse the CNMI the amount now due them.

No. 3, revisit the standing authorization for covenant funds, which may include funding for government operations and will provide direct assistance to meet the most crucial public health needs, including construction, medical equipment, personnel and maintenance.

Mr. Chairman, that concludes my statement. I stand ready to work with this committee to develop detailed plans of the issues I addressed for submission to Congress and for its consideration and to also answer questions from you. Thank you very much.

[The prepared statement of Mr. Tenorio follows:]

PREPARED STATEMENT OF HON. PEDRO A. TENORIO, RESIDENT REPRESENTATIVE TO THE UNITED STATES, ON BEHALF OF HIMSELF AND THE HONORABLE BENIGNO R. FITIAL, GOVERNOR OF THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

Good morning, Senator Domenici, Senator Bingaman, committee members, Governor Camacho, Governor Tulafono, and Governor Turnbull. My name is Pedro A. Tenorio; I am the Resident Representative to the United States from the Commonwealth of the Northern Mariana Islands. On behalf of Governor Benigno R. Fitial, I extend his apologies for being unable to be with us today. He is facing many challenges in the CNMI and has asked me to speak on his behalf and on behalf of the people of the CNMI.

It is both an honor and a rare privilege for me to be testifying in your committee in order to familiarize you with the CNMI's economic and financial problems. I have so much to report to you, Mr. Chairman, and I hope that by the end of my presentation that you will appreciate the enormity of our problems and the important role that this Committee will play in helping us minimize the damage and further erosion of our economy, and help us prevent further loss of critical government revenue that provides vital public services and jobs. This hearing is very timely for the Northern Marianas as well as, I am sure, for our sister territories. As I speak, our economy is rapidly deteriorating and our government is on the verge of bankruptcy. Please allow me to explain.

BRIEF OVERVIEW OF ECONOMIC CONDITIONS: THEN AND NOW:

More that a quarter of a century ago the people of the Commonwealth of the Northern Mariana Islands exercised their inalienable right of self-determination and freely entered into a political union with the United States. Congress, through the enactment of Public Law 94-241, formally approved the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America. The Covenant placed the people of the Commonwealth under the sovereignty of the United States, and the Constitution and treaties and laws of the United States became applicable to the Northern Mariana Islands.

For many years the economy of the CNMI was a success story. For a period of time the CNMI not only achieved but surpassed its goal of economic self sufficiency. In 1978, at the beginning of our political relationship, we began with a small private sector with minimal business gross receipts, and twelve years later in 1990, CNMI businesses reported 1.2 billion in business gross receipts. Our economic achievement was so great by 1992 that our government was able to voluntarily relinquish its Covenant entitlement of $10.3 million in guaranteed annual federal funds for government operations. By 1996 business gross receipts exceeded 2.6 billion dollars as the private sector was thriving largely due to extensive Japanese investments. Unfortunately during the last seven years, our economy began to decline, first slowly then at an accelerated rate.

While our economy thrived during these early years from foreign investments, we realized that a permanent tax base must be put in place in order to prepare for unexpected changes in the global economy. Largely because of our geographic location and the absence of valuable natural resources like oil, minerals and other commercial resources, the CNMI economy had to be necessarily based upon two industries. Many economic experts advised us to aggressively promote garment manufacturing and tourism, both very attractive and conducive to our islands because of proximity to tourist markets and an abundant workforce from neighboring Asian countries. Since the early years of our Commonwealth government, these two industries have been our government's most important source of tax revenue. Asian countries are the primary market for our tourism, and our apparel products are imported to the United States due to then existing trade advantages the CNMI had over other nations. We realize, nevertheless, that both industries, however, are still highly susceptible to external factors such as changes in international trade agreements, the economic stability of the U.S. and foreign countries, airline and shipping strikes, political instability in our region, and disastrous typhoons and drought, to name but a few.

Our options for other more viable and permanent investments were limited despite the advantages provided by our Covenant in control of immigration and our exemption from federal minimum wage. In retrospect, the CNMI would not have been as successful economically had these exemptions been terminated early in our political relationship as some in Congress have maintained. We would have been forced to continue receiving the Covenant-guaranteed government operations subsidy, and would not have accomplished so much in infrastructure improvements utilizing locally raised funds.

In 1996, 736,117 tourists visited the CNMI primarily from Japan and Korea. It is estimated that visitors spent approximately $581 million in our retail stores, restaurants, in hotels and other tourist amenities. Our hotels' average occupancy rate was 85.6%. In 1997 the East Asian economic bubble began to deflate, the number of tourists began to decline, and the length of their stay and the average amount they spent decreased. In August of that year, a Korean Airlines jet crashed on our neighboring island of Guam, and immediately suspended all flights to Guam and the CNMI. In September of 2001, the terrorists' attacks on the World Trade Center and the Pentagon caused an immediate reduction in the number of tourists to the CNMI. In 2003, the SARS outbreak in Asia severely curtailed travel throughout the region, and our tourist arrivals steeply declined. There is truth to the saying that when Asia develops a cold, the small pacific islands develop pneumonia demonstrating how vulnerable our tourism sector is to events in Asia.

The visitor industry had stabilized with approximately 500,000 visitors annually until October 2005 when Japan Airlines announced a complete withdrawal from the CNMI market attributable to consistent operating losses which forced it to make drastic business decisions. While other airlines are attempting to pick up those routes out of Japan and make up for the loss, little progress has been made and the effects of the JAL pullout appear to be long term. JAL represented 40% or 237,222 seats of the CNMI's total air seat capacity out of Japan or a potentially permanent loss of 167,000 visitors a year. The garment industry recorded its best year in 1999 when its total sales to U.S. buyers exceeded $1 billion. Since that time, there has been a consistent downward trend resulting in an overall drop in sales of 34% to date. Declines in production since 1999 are attributed initially to the negative impact due to the implementation of the African Growth and Opportunity Act (AGOA) and the Caribbean Basin Trade Partnership Act (CBTP). Most recently, the elimination of quotas under the World Trade Organization on countries importing to the United States, such as China has greatly added to the loss in sales. The initial advantage provided by General note 3(a) of the Harmonized Tariff Scheduled is no longer an effective factor in maintaining competitiveness with apparel products from foreign countries bound to the United States. In 1999 there were 34 factories in the CNMI. This number dropped to 28 in 2003, and today there are only 19 producing factories with two more set to close in the near future. If there had been no import safeguards implemented by the U.S. last year, that kept our factories operating, it is predicted that by the end of 2007, most if not all our factories would completely shut down.

These declines in garment manufacturing and the sudden withdrawal of a major airline serving our visitor industry have devastating negative multiplier effects in other segments of the CNMI economy as well. In fact, shipping companies, and assorted small businesses such as grocery stores, retail stores, insurance companies, security companies, and all manner of support industries have also suffered, and many of these businesses are expected to downsize and some will even shut down. Rather than going into a detailed description of our economic and financial ills, Mr. Chairman, I am including for the record these reports and statistics for your reference.

THE NEGATIVE IMPACT OF A WEAK ECONOMY ON GOVERNMENT REVENUE/ SERVICES

The CNMI government is the third largest employer in the Northern Marianas with a combined workforce of about 5000 civil service and contract employees. Since the installation of Commonwealth government in 1978, it has operated our power generation facilities, water systems and water and wastewater treatment facilities, the public school system, the Commonwealth Health Center (our only hospital), health clinics, a community college, three airports, three seaports, and provides for the public safety of the residents, including operation of prison and correctional facilities. Because we have three populated islands, namely Saipan, Rota and Tinian, many government services must be duplicated for each island.

The CNMI government is funded by taxes and the collection of fees for various services. In 1990 CNMI General Fund Revenues accounted for $116.7 million. Revenues peaked in 1997 at $248 million. However, five years later, due to a noticeable decline in manufacturing, visitor arrivals spending, General Fund collections had dropped 20% to about $200 million, in 2002. As revenues declined the government began imposing cost cutting and austerity measures and was able to reduce expenditures. While some measure of budgetary and expenditure control were instituted, they did not substantially improve the financial picture and cash flow, and as to be expected, *by the end of September 30, 2002 the CNMI was faced with a cumulative deficit of $74.8 million.* I have been informed by the Secretary of Finance that the deficit as of January 2006 exceeded $100 million. Some austerity mechanisms used over the past six years to curtail spending included deferred maintenance of public facilities, delayed or deferred payments of the government's share of retirement contributions, and delayed or nonpayment of government utility bills, private vendors and government contractors. More drastic austerity measures which will subject many people to suffering and increased indebtedness are now being implemented by the new administration as described later in this testimony.

These austerity mechanisms should only be used temporarily as a crisis management tool as long term use only adds to the government's financial fiasco. In addition, short term solutions and strategies to revive our economy have not been effective or fruitful. Sadly, and unfortunately, the CNMI government is now seriously and unavoidably confronted with a potential economic and social calamity unless some external assistance is provided. Our public schools and hospital are in deplorable and unsafe conditions. We have the highest student teacher ratio in the country. Our retirement system repeatedly faces shortages and the possibility that it cannot meet monthly annuity payments. The CNMI's debt to the Commonwealth Utility Corporation has left it with a lack of operating capital and its own mounting debt, and has led to the lack of power plant maintenance, unscheduled outages, and brownouts. This coupled with the record high prices in fuel oil have left this government owned utility near bankrupt, and requiring a minimum $24 million government bail out just to keep the lights on until the end of the fiscal year. Let me also add that during brownouts and power outages our water system shuts down, closing down schools and offices, creating unsanitary conditions, and creating potential wide spread public health crises. Additionally, the CNMI is facing several fines for violating EPA regulations due to deferred maintenance, delay in the improvement of our water system to conform to federal standards, faulty sewage treatment facilities discharging effluent not meeting federal standards, and lack of construction funds to construct waste incineration in conformance with EPA standards. These are but a few environmental penalties that are being considered by EPA, and more 4 notices for administrative compliances are expected.

CNMI GOVERNMENT'S INITIATIVES TO ALIGN SPENDING WITH TAX REVENUES

Because of the worsening nature of the economy and the lack of realistic prospects for additional revenues to keep the government working and delivering public services, the newly sworn in administration of Governor Fitial has implemented unprecedented and unpopular austerity measures in order to reduce spending and to retire the deficit. Adjustments in the FY2006 operating budget calling for an approximate 20% spending reduction has already been implemented. The Government is now in the process of laying off personnel, freezing new hires, promoting early retirement, and reducing both civil service and contract employees working hours. Government agencies are being consolidated to further reduce costs and contain expenditures of boards and commissions. Autonomous agencies' budgets are being tapped to provide critical funds to perform needed public services. The government is also drastically reducing the number of government funded phone lines, and cell phones, terminating car leases, rental spaces, and so forth. While these actions will result in curbing expenses and thus saving funds in the short run, they might invariably and undoubtedly make matters worse, somewhat resembling a catch-22 scenario.

Reducing the number of workers or decreasing pay of remaining workers will strain federally funded entitlements such as food stamps, and would further decrease the already reduced tax base of the government. Reducing expenditures for privately run services such as phone lines or cell phones decreases the income of private sector businesses that rely on government contracts to survive. Business Gross Revenue will decline, tax payments will decline, and costs to the private sector will go up as businesses struggle to remain viable. These factors have not been factored into the economic equation and will result in a chain reaction of negative cash flow and reduced tax revenue. Accurately computing projected government revenue to meet expenses to the end of the year will be a nightmare, and at best only a guesstimate. It is comparable to squeezing any remaining water out of a sponge that has been left out in the sun to dry.

NEGATIVE AND UNDESIRABLE IMPACTS ON THE PEOPLE OF THE CNMI

The most telling data is that which reflects the status of the average man, woman, and child in the CNMI. The apparel and tourism industries account for either directly or indirectly 80% of all employment, 96% of all exports, and 85% of all economic activity. Changes in any of these affect everyone.

The CNMI does not participate in some of the most common forms of welfare or assistance in the United States. CNMI residents are not eligible in Temporary Assistance for Needy Families (TANF), nor are they eligible for unemployment benefits. The CNMI does participate in the Nutrition Assistance Program, Food Stamps and Medicaid, but the amount of federal dollars provided to the CNMI for Medicaid is capped.

In the 2000 U.S. Census of the Northern Marianas it was reported that 46% of the population was living below the poverty line with a per capita income of $9,151, and a steady 13% unemployment rate for the permanent population. All data that I have looked at in preparing this testimony indicates that these statistics will only continue to worsen.

In 1992, an average of 565 families per month were enrolled in the Nutrition Assistance Program. By 2005, the average enrollment was 2,276 per month, a dramatic increase of 303%. This number will only continue to increase as the economy worsens, and the CNMI will be obligated to once again appeal to the federal government to accommodate new and desperate recipients of this program.

I fear for the health and safety of the people of the CNMI. Our health care services are already stretched to the breaking point. The Commonwealth Health Center has leaky plumbing, inadequate water treatment facilities, faulty back up power systems, a shortage of doctors and nurses, and a lack of funds to adequately operate the facility. The cost to repair CHC and bring it into compliance is estimated to be $18.35 million.

Medicaid enrollment has steadily grown. Between 1999 and 2004 Medicaid participation increased by 83%. Unfortunately there is no safety net for Medicaid. The cap for 2004 was $2.4 million, and costs totaled $9.3 million. The CNMI government exceeded the required matching by $4.5 million. Money the CNMI does not have.

With the loss of the garment industry, consumer prices are expected to increase dramatically. Overall shipping and wharfage costs in the CNMI have historically been fairly constant due to the large volume of inbound raw materials and outbound finished garment products. With this volume rapidly diminishing, inbound and outbound shipments will be placed on smaller vessels which cost more per ton to ship, and ports fees and handling charges are expected to escalate in order to meet the Commonwealth Ports Authority debt service requirements. By 2010, it is estimated that the cost of consumer goods will increase by 40%, a burden that few will be able to bear.

REMEDIES FOR THE CNMI'S ECONOMIC WOES:
OUR REQUEST TO CONGRESS FOR ASSISTANCE

The people of the CNMI are very proud, and have done well as a territory of the United States. We appreciate the work of Secretary Gale Norton and Deputy Assistant Secretary Dave Cohen to introduce new investors and investment opportunities to the CNMI and other territories. They recognize our challenges and have proven their leadership by helping us solve our own problems, but more assistance is needed to promote economic and financial normalcy. Governor Fitial is working untiringly to put the finances of the government back in order, to find new investors and new industries and to rebuild our tourism base. Despite all these efforts and the tough decisions, and enormous sacrifices that all of our people are asked to accept, we deeply feel that federal assistance is the only option that we can realistically seek to put us on the right path towards recovery. While we have done so much to help ourselves, we must admit that we do not have the means to generate additional financial resources to continue to provide for our people on our own. I am here on behalf of the people to request the assistance of the U.S. Congress. Section 701 of the Covenant anticipates that "the government of the United States will assist the Government of the Northern Mariana Islands in its efforts to achieve a progressively higher standard of living for its people as part of the American economic community and to develop the economic resources needed to meet the financial responsibilities of local self government."

Mr. Chairman, we had begun to achieve this goal, but due to economic disruptions that have confronted us over the last several years, and to some extent, carelessness and lack of foresight on our part, we are now experiencing the most regressive period of our history. We are gravely concerned that our people will suffer more before things get better and especially if nothing is done soon. It is with tremendous grief, embarrassment and enormous hesitation on my part, personally, and I know on the part of our Governor and our people, to appeal for help, and we believe that appealing to Congress for help is our only realistic recourse right now.

I would like to share with you what we sincerely feel are actions that the U.S. Congress can consider taking, which will greatly help the CNMI economy to stabilize at the present level, will gradually assist in its recovery, and will hopefully flourish once again, and these are:

1. Approve this year Senate Bill 1951 sponsored by Senator Craig which amends General Note 3(a)(iv) to grant insular possessions equivalent treatment to free trade partners by extending to all products, including textiles and apparel, the current requirements that eligible product contain at least 30% U.S. and local content. This will keep the CNMI garment industry viable for approximately the next 10 years. During this time other industries can be developed in the CNMI to replace it.

2. The CNMI has estimated that the U.S. has withheld or taxed income of CNMI residents in excess of $71 million for the period of 1978 to 2002. The loss of these funds has caused significant harm to the CNMI as taxpayer liability and refunds are based upon recognition of all funds withheld whether in the CNMI or U.S. Treasury. Section 703(b) of the Covenant (Public Law 64-241) and 48 U.S. Code Section 1842, call for proceeds of taxes collected from CNMI residents be covered directly upon collection into the treasury of the CNMI. These provisions have never been fully implemented. Applicable Internal Revenue Code regulations were used to project interest rates on these funds at $38.8 million. I respectfully request Congress to immediately direct the U.S. Treasury to reimburse the CNMI the amount now due them. These funds could either help retire the current deficit or assist with infrastructure inadequacies, construct or repair classrooms and institute workforce development activities to provide a stronger basis for new economic opportunities.

3. Revisit the standing authorization for Covenant funds which may include funding for government operations, and or provide direct assistance to meet the most crucial public health needs including construction, medical equipment, personnel and maintenance. I stand ready to work with the committee to develop a detailed submission to Congress.

4. Assist us with various transportation issues that would remove constraints on foreign airlines landing in the CNMI established by certain bilateral agreements and unrealistic passenger thresholds that prevent the installation of instrument landing systems for Tinian and Rota. These would allow the CNMI to accelerate development of its tourism potential with Asian markets.

My last request from Congress is not about our economic or financial conditions, per se. I am requesting that this body help the people of the Commonwealth of the Northern Marianas achieve their quest for parity with the other territories and grant the CNMI a nonvoting Delegate to the U.S. House of Representatives.

Mr. Chairman, it has been stressful but a pleasure to have testified in your committee wearing two separate hats, as a Resident Representative and as our Governor's Representative. I am prepared today and any day, as my office is here in Washington, to answer any questions the committee members may have.

The CHAIRMAN. Thank you very much, Representative. Let me say, the bill you referred to, we have been pursuing that with the Finance Committee, which has jurisdiction.

Mr. TENORIO. Yes.

The CHAIRMAN. We do not. We'll push it as vigorously as we can.

Mr. TENORIO. Thank you, Mr. Chairman.

The CHAIRMAN. Let me repeat, we don't have jurisdiction over the bill that you referred to that you need for reinvigorating your economy, but we are pushing it with the Finance Committee and we will continue to pursue that.

Mr. TENORIO. Yes, I understand that. Thank you very much, Mr. Chairman.

The CHAIRMAN. Now, we're going to have to close down, but David Cohen, let me ask if you would do this, if you would put your statement in the record, and if you would add for me—you have heard the witnesses, and if you could comment on behalf of the administration on the various items that they have indicated they are in need of and give us the administration's position with reference to the various positions they have taken. And, in addition, as you heard their testimony, if you can share with us your views on what the committee should be considering with reference to the problems that they have discussed with us, we would appreciate that, and if you can do that as soon as possible.

Governor Turnbull, if you would comment on the legislation that Representative Christiansen talked about, in writing, we would like to know your view. We understand there's a disagreement and we certainly are going to take that into consideration before we pursue it.

With that, I wish we had more time, it's just that's the way it is. Before the year's out we'll get a little more involved and see if we can be more helpful. We thank you very much for your time and for coming here and appearing with us today.

Senator Akaka, did you have any closing remarks?

Senator AKAKA. Thank you very much, Mr. Chairman. I want to thank you for holding this hearing. As you know, this committee frequently considers legislation that focuses on specific issues in one of the eight territories and also the freely associated states and it is also important to step back as we are and examine the broad policies and trends that affect all of these insular areas, and the questions that the chairman is asking fall in this area and we certainly want to be updated on all of these. I thank you all for coming. Governors, you've traveled far to get here. Others work in the city, but we're delighted to have all of you in this hearing.

And with that, I want to say thank you so much. This hearing is adjourned.

[Whereupon, at 10:23 a.m., the hearing was adjourned.]

[The following statement from the Department of the Interior was received for the record:]

PREPARED STATEMENT OF DAVID B. COHEN, DEPUTY ASSISTANT SECRETARY OF THE INTERIOR FOR INSULAR AFFAIRS

Mr. Chairman and members of the Committee, thank you for the opportunity to offer thoughts on the economies and fiscal affairs of American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), Guam, and the United States Virgin Islands.

In summary, while there is room for optimism in the long run, three of the four territories are facing economic challenges, and all four are facing fiscal difficulties. We are not certain how these will unfold, but they require attention.

Before discussing the specific case of each territory, I will highlight the challenges they face in common. Although the four territories are distinct from one another, they share important characteristics. Each has very limited land and resources. Each has a small population, and a limited pool of expertise to address the community's critical needs. Each is located in an area that is highly prone to destructive typhoons, cyclones, or hurricanes. Each is relatively new to self-government.

Because of remoteness and a lack of resources, each territory faces high transportation costs to import the basic necessities. Each territory is heavily reliant on air links to the outside world, but these links are often characterized by a lack of competition, high prices, and unreliable service. With the exception of Guam, each of the territories has the challenge of providing a full range of government services that cover multiple islands. These services must be provided with a very limited pool of trained and experienced personnel. Each territory has a fairly limited private sector that is dominated by one or two major industries. Minimum wage rates are high in comparison to the low-wage regions of the world in which they are located. As a result of all of these factors combined, each of the territories has a standard of living that is lower than that of any state-in most cases significantly so.

These challenges are exacerbated by the generally poor quality of critical infrastructure in the territories. Guam and the U.S. Virgin Islands are both subject to consent decrees that require improvements in their drinking water and wastewater systems. Saipan, the largest island in the CNMI and its civic, business, and government center, is the only community of its size in the United States that does not have 24-hour access to potable water. Each territory faces serious solid waste disposal issues. Guam is under a Federal consent decree to shut down its current landfill and build a replacement.

Most of the power grids and generating systems in the territories are old, inefficient and vulnerable to the tropical cyclones that regularly occur in the Caribbean and the Pacific. The territories depend, almost entirely, on imported fossil fuels for their energy needs. Increases in the price of oil have added significantly to the financial burdens all the territories must endure. Fuel costs, in addition to problems with maintenance and financial management, have led to rolling blackouts on Saipan.

AMERICAN SAMOA

Of the four territories, American Samoa has the narrowest economic base and the most static economy. The territory's private sector is anchored by two tuna canneries that have been in business in the territory for more than five decades. According to a December 8 2005 letter by Congressman Eni Faleomavaega the canneries account, directly or indirectly, for over 80 percent of the private sector economy of the territory.

It is easy to illustrate the importance of the canneries to the economy of American Samoa. In 2004, according to the U.S. Department of Labor, the canneries directly employed 4,738 workers (38.6 percent of all surveyed workers in the territory), paid an average hourly wage rate of $3.60, and accounted for 24.5 percent of the territory's total wage bill for all workers. The American Samoa Government (ASG), on the other hand, employed 5,124 persons (41.8 percent of all surveyed workers in American Samoa) at an average hourly wage rate of $7.99, and represented 58.9 percent of the territory's total wage bill in 2004. The third largest employer in American Samoa, the trade and services sector, made up only 8.3 percent of the total wage bill while employing 10.3 percent of all surveyed workers. Not included in these statistics are workers who are exempted from coverage of the Federal Fair Labor Standards Act.

Because of the territory's reliance on the canneries, if they leave American Samoa precipitously, the economy of American Samoa would be devastated. The demise of the canning industry would leave American Samoa with no viable industry and no major employer other than the local government and the merchants that sell to it and its employees. At least in the short run, this would leave American Samoa almost wholly dependent on direct assistance from the Federal government. It would likely result in an increase in Federal assistance to the territory, as well as significant migration by U.S. national residents of the territory to Hawaii or other west coast states in search of work and benefits. In addition, without the high volume of tuna shipments from the territory, the cost of shipping essential goods into the territory would likely increase. This would cause prices to rise at a time when aggregate income in the territory would be falling, exacerbating the challenges even further.

In the long run, it is likely that the advancement of free trade regimes under which foreign nations receive access to the U.S. market on terms comparable to what American Samoa currently enjoys will eventually cause the canneries to leave. In addition to its isolation from major trade routes, American Samoa is at a great competitive disadvantage in labor costs as compared to countries such as Thailand and the Philippines. The American Samoa canneries have reported that labor rates in 2001 for those two countries were 67 cents and 66 cents per hour, respectively. The canneries paid an average of $3.60 an hour in 2004. To counter the wage rate disadvantage, the canneries have relied on the possessions tax credit under section 936 of the Internal Revenue Code and on duty-free access to the U.S. market.

The possessions tax credit for the canneries expired at the end of 2005, but a one year extension is provided in the House version of the Tax Reconciliation bill, which is about to be considered in conference. On November 9, 2005, the Secretary of the Interior sent a letter to the Chairs of the House Committee on ways and Means and Senate Finance Committee expressing the Administration's support for a temporary extension of the possession tax credit to allow the American Samoa Government to develop a diversified private sector economy. American Samoa is really in a race against the clock before the trade advantages currently enjoyed by the American Samoa tuna canneries are expanded to other countries and regions. The territory urgently needs to wean its economy from excessive dependence on the canneries before they actually depart.

As we face the prospects of a post-cannery American Samoa, it is noteworthy that the residents of the territory today have the lowest per capita gross domestic product (GDP) of any state or territory in the American political family. Preliminary estimates of the U.S. Census Bureau in 2005 (based on 2002 data) showed American Samoa's GDP at $558.8 million, or $9,041 per capita. American Samoa's per capita GDP is equal to only 34.4 percent of the lowest of the states and 22.8 percent of the national average.

Fiscally, the ASG continues to face challenges, but is making progress. In response to the Department of the Interior's concerns about financial management issues and the broader goal of advancing fiscal discipline in the territories, the Secretary of the Interior and the ASG entered into a Memorandum of Agreement in 2002 which requires a fiscal reform plan for bringing annual operating expenses in line with revenues. In 2005, the Office of Insular Affairs issued a high-risk grantee declaration for the ASG. The declaration, a statement of warning, was centered primarily on the independent auditors' opinions of financial statements that identified severe and material weaknesses in internal controls over reporting and compliance with Federal grant program requirements. The conditions for lifting the high-risk designation include a requirement that the local government produce its annual single audits in a timely fashion with no material qualifications for at least two consecutive years. As of September 30, 2005, the ASG identified a cumulative unaudited surplus of $8.8 million, but a more recent report for fiscal year 2006 showed a first quarter shortfall of $4.86 million. As these numbers suggest, the fiscal health of the ASG remains unpredictable.

COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS

The CNMI economy is besieged by changes in regional tourism markets and the advancement of free trade. During the last two decades, the garment industry has been one of the two pillars of the CNMI economy, along with tourism. The garment industry succeeded, and even surpassed tourism at its peak in the late 1990s, because of two trade provisions: (1) quotas on imports from low-cost producers of garments, and (2) duty-free export of goods manufactured in the CNMI to the United States. Also, the CNMI has benefited from its ability to control its immigration and establish its own minimum wage. With virtually no military installations and very limited military spending, the CNMI's ability to import labor and set its own minimum wage has been essential to its economic survival.

With its labor, immigration and export advantages, the CNMI established a successful garment manufacturing industry in the 1980s. At its peak in 1999-2000, the industry shipped well over $1 billion worth of garments to the United States and employed around 16,000 mostly foreign workers directly. It also paid roughly $79 million in taxes and fees into the CNMI treasury, about 35 percent of total public revenues at the time. In 2004, shipments to the United States were down to $807 million, followed by $677 million in 2005. Since the taxes and fees the garment-makers pay to the CNMI treasury are a fixed percent of sales, losses in sales volume show up directly in public revenues.

Import quotas were lifted on January 1, 2005 under provisions of a new global trade regime for textiles and clothing under the agreement that established the World Trade Organization in 1994. Some quotas were re-imposed on China by President Bush on a temporary basis and then through a bilateral agreement with China, but these quotas will expire after 2008. In the mean time, in anticipation of the new trade regime, the garment industry had already begun consolidation and some relocation of operations, causing decline in both production and the payment of taxes and fees. It now looks increasingly likely that the garment industry in its current form will not survive in the long term.

During slowdowns in tourism since the 1990s, arising from the Asian financial crisis, the effects of the terrorist attacks on the United States, SARS, and other factors, the garment industry kept the economy and government afloat. In fact, of all four territories, the CNMI has so far been the most self-sufficient in terms of local tax revenues. The decline of the garment industry could change that.

Between April 2004 and February 2006, nine of the 27 garment factories on Saipan have closed, leaving 18 still operating. An estimated total of 3,842 jobs have been lost.

What makes the CNMI's challenges more compelling is that both of its major industries are declining at the same time. Just as the CNMI's tourism industry was recovering from a period of stagnation and decline, it was dealt a serious blow in October 2005 when Japan Air Lines (JAL) discontinued its scheduled flights between Japan and Saipan. Since Japanese tourists make up about 73 percent of all tourists and JAL carried about 40 percent of all Japanese tourists to the CNMI, JAL's decision cut about 29 percent of tourists to the islands. As a result, total arrivals in 2005 were down to 506,846. At its peak, just before the 1977-98 Asian financial crisis, the CNMI welcomed 736,117 tourists, according to the Mariana Visitors Authority.

Still, the CNMI tourism market has made some progress since JAL's pullout. For example, Northwest Airlines, which has had a daily flight between Tokyo and Saipan, will increase that frequency to 10 flights per week in April.

Like American Samoa, the per capita GDP of the CNMI is lower than that of any state. In 2005, the U.S. Census Bureau's preliminary estimate of the CNMI's GDP was $1 billion. With a total population of 75,066, the CNMI's per capita GDP was an estimated $13,350, a figure 50.9 percent of the lowest state per capita GDP, and 33.7 percent of the national per capita GDP.

Fiscally, the CNMI is experiencing declining revenues and government cutbacks. For fiscal year 2006, the outgoing Governor proposed a total budget of $213 million. This figure was revised downward to $198.5 million by the current Governor, with the consent of the Legislature. CNMI economic challenges should be expected to result in continued fiscal challenges as well.

GUAM

Like the CNMI, Guam relies heavily on two major industries. In Guam's case they are tourism and national defense.

From 2001 to 2003 several factors adversely affected Guam's economy. These included the Asian financial crisis, the effects of the terrorist attacks on the United States on September 11, 2001, and those arising from regional economic and financial and public health concerns. In 2003, tourists to Guam numbered fewer than one million for the first time since 1993. Since then tourism has been on the rise. In addition, there have been unusually destructive typhoons in the last five years which have caused significant damage to the urban infrastructure as well as the natural environment. It may be years, perhaps decades, before some of this damage can be repaired.

In contrast to the CNMI, present-day regional and global changes seem to be working in Guam's favor. The overall economic outlook appears much brighter than at any time in recent years.

Guam's major business, tourism, is on the rebound, mainly because of the resurgent Japanese economy. Because nearly 80 percent of the tourists visiting Guam annually are from Japan, improvements in that country's economic and financial fortunes have a direct effect on Guam. JAL's decision to realign its service between Japan and the Mariana Islands has resulted in some flight cutbacks, but it did not halt scheduled service altogether, as it did to the CNMI. Also, other carriers, mainly American carriers, have picked up some of the routes JAL left behind. As recent figures show, Guam's tourism appears poised for growth.

In 2005 as a whole, Guam received 1.2 million tourists, up 5.8 percent from the year before. With the Japanese economy rebounding and a record 18 million Japanese planning to travel in 2006, according the Japan Travel Bureau, the likelihood is that Guam will benefit from some of this increase.

Guam's other major source of income, the military presence on Guam, is also on the rise. The Department of Defense recently unveiled plans that call for the transfer of up to 6,000 Marines and their dependents from Okinawa, Japan, to Guam over the next six years. This move would increase the number of military personnel on Guam to over 10,000 and raise Department of Defense spending levels on the island substantially.

Base improvements, including those in anticipation of the Marines moving to Guam, have added fuel to local construction industry. It just may be that the military's transfer of personnel and dependents to the island will take Guam back to its economic heyday.

Although Guam has a stronger economic base than the either American Samoa or the CNMI, its per capita income continues to be lower than of any state. In 2005, the U.S. Census Bureau estimated that Guam's GDP was roughly $3.7 billion and, with a total population of 162,326, had a per capita GDP of $22,661. That amount would be 86.3 percent of the lowest for a state, and 57.1 percent of the nation as a whole.

Fiscally, Guam has struggled with continuing deficits for the last decade. In fiscal year 1996, GovGuam had a surplus of $19.6 million that helped pare down its cumulative deficit of $165.2 million that it carried over from the previous year. Despite recent efforts, from early retirement programs to closing down whole government agencies (the Department of Commerce) and other measures, the deficits have persisted.

In the Governor's Executive Budget for fiscal year 2006, the cumulative deficit reached $361.9 million. Some of this shortfall is the result of GovGuam meeting the needs of citizens after natural disasters, some of it is attributable to slower than anticipated growth in revenues, and some of it attributed to the inability of leaders in the relevant branches of government to reach consensus on the need to reduce the size of government. It is not clear how or when this large deficit will be eliminated, but the overall future of the economy looks better than any time in the last decade.

UNITED STATES VIRGIN ISLANDS

The economy of the U.S. Virgin Islands is relatively more diversified and has performed more favorably in recent years than the economies of the Pacific territories. However, the fiscal and economic health of the territory face a potentially serious short-term challenge, the magnitude of which is difficult to predict.

In 2001, new territorial law added incentives for attracting new businesses to the islands. Service businesses, such as financial services providers, were sought to help diversify the economy. This incentive program is operated by the territory's Economic Development Commission (EDC), and is commonly referred to as the EDC program.

The enhanced provisions of 2001 attracted many businesses to the U.S. Virgin Islands, bringing large amounts of startup capital funds to build infrastructure and housing units. The Government of the Virgin Islands credits the EDC businesses with bringing approximately $100-120 million annually to the Virgin Islands treasury. This is a significant portion of its $600 million in total annual revenue. These figures do not include taxes paid by employees of these companies or by other businesses and employees that rely upon the economic activity generated by the EDC businesses.

When Congress enacted the American Jobs Creation Act of 2004, however, it cast into doubt the future of the EDC program. The statute appeared to disqualify many EDC beneficiaries, especially those that had relocated to the Virgin Islands after the program was expanded in 2001, from receiving the benefits of the program. The U.S. Department of the Treasury and the Internal Revenue Service recently issued regulations to provide guidance on certain provisions of the statute. Regulations on other important provisions of the statute are still being prepared. Virgin Islands officials are concerned that a significant number of EDC beneficiaries may close their Virgin

Islands operations as a result of the statute and regulations. The result of such closure would be a corresponding loss of tax revenues, jobs, construction activity, other economic activity, and charitable giving, the magnitude of which is difficult to estimate.

Although the Virgin Islands has succeeded in attracting some high net worth individuals in recent years, the territory on average has a lower per capita income than in any of the states. In 2005, the U.S. Census Bureau estimated that the U.S. Virgin Islands had a GDP of $2.8 billion and a per capita GDP of $25,815 which would be 98.3 percent of the lowest of the states, and 65.1 percent of the nation as a whole.

ROLE OF THE PUBLIC AND PRIVATE SECTORS

It is clear that the territories will not be able to address the significant challenges they face unless they significantly strengthen their economies. This cannot occur unless the private sector in each of the territories is strengthened sufficiently to wean the economy from unsustainable reliance on the public sector. That is why the Secretary of the Interior has stated that her top priority for the territories is to promote private sector economic development. Under the Secretary's leadership, the Department of the Interior has been implementing a comprehensive program to advance this priority.

Despite the many challenges they face, the territories still have competitive advantages in certain areas. The adaptable companies can prosper in the territories. The Office of Insular Affairs has devoted significant effort to finding those companies and to facilitating interaction between these companies and the territories' relevant private sector and government representatives. We have conducted extensive research through our Island Fellows Program, in which M.B.A. students from prestigious institutions such as Wharton and Harvard have identified industries and companies that fit well with the unique needs and competitive advantages of the territories. The Secretary has hosted two conferences at which these companies have met with potential local business partners and government officials from the territories. A third conference is scheduled for November. We have also organized Business Opportunities Missions, taking business people to the territories to conduct onsite due diligence. Our first Business Opportunities Mission, to Guam, Saipan and Palau, was led by Deputy Secretary Lynn Scarlett in May 2005. During the period of March 5-10, Deputy Secretary Scarlett will lead General Electric, Microsoft, Marriott, and other top companies on a Business Opportunities Mission to the Virgin Islands. A Business Opportunities Mission to American Samoa is planned for May.

As a result of our facilitation efforts, a number of business opportunities in the territories have either been consummated or are being actively pursued. The most important result of our program, however, is the realization by territorial leaders that there is no alternative to this type of effort to strengthen the private sector, and that they need to be leading it themselves.

Because of the special fiscal and economic challenges faced by the territories, several successive administrations, like this Administration, have supported tax and trade provisions that help the territories generate sufficient economic activity and tax revenue to meet the most basic needs of their people. Notwithstanding these incentives, each of the territories continues to experience economic and fiscal difficulties.

Longstanding special tax provisions for the territories manifest an important underlying principle of Federal territorial policy; namely, the Federal Government does not treat the territories as sources of revenue. The Federal government has a strong interest in maintaining and enhancing the economic and fiscal well-being of the territories.

A fiscal and economic crisis in any of the territories would weaken the effect of investments that United States taxpayers have already made in the areas of housing, education, health, social welfare, fiscal management and other areas. For example, the U.S. taxpayer has already made sizeable investments in the territories to ensure that housing needs for the poor are addressed, that schools have the resources to retain accreditation, that minimum health and environmental standards are met, that critical infrastructure is constructed and that basic standards of social welfare are satisfied. Active Federal agencies have been the Departments of the Interior, Housing and Urban Development, Education, Health and Human Services, Agriculture, Transportation and Homeland Security, and the Environmental Protection Agency.

It should be noted that three of the territories are on the United Nations Committee on Decolonization's list of only 16 non-self-governing entities in the world. Although the United States rightly rejects this characterization, America's critics would not hesitate to use any deterioration in living standards in the territories to buttress their attempts to de-legitimize United States sovereignty in the territories.

Mr. Chairman, there are many good reasons for the average American to care about the well-being of the territories. Let me add one more: The tremendous sacrifice that men and women from the territories have made to keep our country free. Mr. Chairman, I made the sad calculation a couple of months ago that a resident of American Samoa was over 15 times more likely to have been killed in action in Iraq than a resident of the nation as a whole. This, our smallest territory, has lost seven men and women in the conflict, approximately one for every 9,000 people who live in the territory. The Governor's own daughter recently returned from a one-year tour of duty in Iraq. Throughout the islands, families are making tremendous sacrifices to defend freedom. The U.S. Virgin Islands has lost four servicemen in Iraq. Guam has lost four. The Northern Mariana Islands has lost three soldiers, and I attended the funeral for each one.

Mr. Chairman, this Administration is committed to working with you to ensure that the Federal policy towards the territories contributes positively to communities that have contributed so much to our nation.

APPENDIX

RESPONSES TO ADDITIONAL QUESTIONS

AMERICAN SAMOA,
OFFICE OF THE GOVERNOR,
Pago Pago, American Samoa, March 10, 2006.

Hon. PETE V. DOMENICI,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR SENATOR DOMENICI: I want to thank you and your Committee for the opportunity to testify before the Senate Committee on Energy and Natural Resources on March 1, 2006.

We were very pleased and honored to give testimony regarding the state of the economy and fiscal affairs in the Territory of American Samoa.

Attached please find responses to the questions raised in your letter of March 6, 2006.

If there is anything else we can provide for the Committee, please do not hesitate to contact me.

Sincerely,

TOGIOLA T.A. TULAFONO,
Governor of American Samoa.

[Enclosure.]

RESPONSES TO QUESTIONS FROM SENATOR DOMENICI

Question 1. What plans does your government have to respond to the possible loss of the fish processing plants and to promote private sector development?

Answer.

ASG RESPONSE TO POSSIBLE LOSS OF FISH PROCESSING PLANTS

- We have completed an OIA funded project to review the current U.S. tax structure and propose substitute or alternative incentives which may replace the current IRC Section 936 tax incentive for the territory. We have shared the findings of that effort with our Congressman and your committee.
- We have applied for a technical assistance grant from DOI to conduct a thorough analysis of the following:

What would be necessary to retain the canneries as long as possible?

What would be the comprehensive income, employment and population impacts of cannery closures?

What would be the temporary and longer-term economic recovery needs of the Territory? What are the best economic development potentials to compensate for cannery losses?

We have good statistical and information programs to help us estimate these economic impacts, but we need better tools. We have recently established the American Samoa Income and Product Account (ASIPA) system. We seek to add an Input-Output Model for economic impact analyses and forecasting which is important to cannery analysis.

In the interim we are estimating the potential effects, as we are able and attempting to seek out sources of transitional and other forms of assistance including preparing for acceleration of CIP plans for recovery efforts.

We are working hard on a territorial incentive package in anticipation of the loss of the section 936 territorial tax incentive benefits.

We have also accelerated our private sector economic development programs.

ASG EFFORTS TO PROMOTE PRIVATE SECTOR DEVELOPMENT

a. External Investment and Development

OIA is increasing its efforts to encourage private investment in the Territory through investment and trade promotion programs for the Territories. An Island Business Opportunity Mission (IBOM) is a collaborative effort with the DOI, ASG and the private sector to attract foreign investors in prioritized industries.

We are improving our promotional programs with new investment brochures, a private sector development website, and a Geographic Information System (GIS). In addition we are in the process of streamlining our permitting system, the "One Stop Shop" project, to make setting up a business in American Samoa less onerous and complex for entrepreneurs.

American Samoa has met with companies that have a keen interest in locating key businesses in the territory. In February 2006, American Samoa hosted an evaluative visit from a U.S.-based company Safelite AutoGlass (Safelite). Through a private/public collaboration, a group from Safelite traveled to American Samoa to evaluate the possibility of locating a call center operation in the territory, an operation which would have located at least 200 local jobs in the territory. Safelite evaluated the territory's available target workforce, and telecommunications capabilities relative to call center requirements. American Samoa's available human resources were rated among the best that Safelite has reviewed. Unfortunately, our current system of satellite-based telecommunications was determined to be inadequate to service the call center.

b. Internal Development

We are very receptive to outside investment while remaining mindful and committed to developing our own natural and entrepreneurial resources. External investment often comes with large-scale immigration, which reduces the potential benefits to our people.

We are especially interested in local industries in which we enjoy a healthy comparative advantage. Among these industries are fisheries and tourism. To this end, we have strengthened our programs in local finance and small business training including a reinvigorated American Samoa Development Bank and Small Business Development Center.

American Samoa is pursuing aggressively the establishment and development of e-commerce in the territory and information technologies as a whole. Every commission and task force that has reviewed American Samoa's economic development options has suggested focused development of this specific sector of the economy.

Currently, members of the ASG workforce are undergoing training as part of the Pacific Information and Communications Technology Academy (PICTA), in order to bring technical expertise to the government and the territory. Thirty ASG workers will be sufficiently skilled at the end of the academy to enable them to test for certifications offered by Microsoft, Oracle and Cisco.

As a result of the Safelite visit earlier this year, which identified the shortcomings of the territory's telecommunications capacity, American Samoa has begun to pursue aggressively, a connection to existing undersea fiber-optic cable which would provide a broader, more substantial telecommunications capability than our current satellite based system offers. American Samoa has identified at least three different fiber-optic cable options from which the territory may connect. Further, discussions have begun with the entities that administer these cables in order to procure a node for connection and service to American Samoa.

The territory will likely not be able to shoulder the cost of connectivity on its own. Therefore, American Samoa is investigating and requesting federal assistance in landing fiber optic cable in the territory. Federal support, especially with regard to the high cost of connectivity is greatly needed in this endeavor. The interest in American Samoa for businesses and applications that would utilize this connection currently exists. This connectivity would bring those interests and more to fruition for the territory.

The territory also seeks to encourage more privatization of government operations where it is beneficial to the territory as a whole.

c. The Need for Coordinated Federal Economic Development Support for the Territories

It would be remiss not to mention the need for Federal economic development support.

This need has been referenced in many Federal reports in recent years including the American Samoa Economic Advisory Commission, the U.S. Government Accountability Office, and the Intergovernmental Group on Insular Areas.

In general these reports recommend the formation of federal territorial economic policy and monitoring, remedying, establishing and coordinating federal policies affecting territories.

Other ideas include consideration of omnibus economic legislation for the territories or establishing law or policy requiring impact analysis of U.S. trade/investment agreements on territories.

The demise of Section 936 without remedial Federal programs may be the best evidence of the need for coordinated federal policy regarding the Territories.

Question 2. The GAO has provided the Committee with data derived from the single audits on the fiscal condition of your government up to 2003. Would you please provide the Committee with your estimates for revenues, expenditures, end of year fund balance and net assets for 2004 and 2005 so that we can follow the most recent trends?

Answer. Attached herewith as "Enclosure 1"* American Samoa's 2004 Comprehensive Annual Financial Report which contains the Territory's final numbers on revenues, expenditures, end of year fund balance and net assets for 2004. Also attached herewith as "Enclosure 2" is American Samoa's 2005 4th Quarter Revised Report to the Department of Interior, which contains the most recent information requested above for Fiscal Year 2005.

Question 3. What steps is your government taking to address the timeliness of the single audits and the weaknesses reported in those reports?

Answer. ASG has developed a comprehensive audit follow-up system which includes the following:

- The Department of Treasury has prepared an action plan for each auditable section. The plan delineates the required task and documentation, assigned deadline for preparatory work, and the specific staff member responsible. The action plan is scheduled according to the auditors work plan, and conforms to the fiscal reform plan set by DOI. Treasury's action plan is an open document shared by the external auditing firm, managers within Treasury, and supervisors within each auditable section. Treasury has appointed an Audit Liaison responsible for managing the progress of the action plan, and for coordinating the collected documentation. The Liaison provides weekly updates to the Treasurer and section managers on the progress of the plan.
- Treasury has built into its audit response schedule a sufficient amount of time to address prior year's weaknesses, and consequently, findings. Our successful efforts to reduce the past qualified opinions typically involve negotiations with the auditors, diligent and immediate research to produce documentation, and additional explanation or justification for an action or entry. The Treasurer has taken an active role in this process by prioritizing all audit-related activity and response at the highest level.
- The number of findings and the dollar amount of the question costs for each consecutive single audit has been reduced. Specifically, of the total findings:
  - 2001—34% or $390,122 were questionable costs
  - 2002—9% or $114,125 were questionable costs
  - 2003—16% or $211,484 were questionable costs

    NOTE: $202,280 of this total was related to a federal case of fraud and embezzlement.
  - 2004—4% or $51,076 were questionable costs

    NOTE: $35,549 of this total was a previously identified overpayment in the process of being corrected.

  The steady decline of questionable costs over the past four years reflects the serious dedication of ASG to fiscal reform and accountability.
- The Audit Liaison coordinates with the auditors their scheduled visits and the expected outcomes of each visit. The collation of all preparatory work, files, documents, authorizations, entries, system-generated schedules and balances falls within the Liaison's purview. The Liaison facilitates the flow of information and documentation between the auditors and various sections of the government. Meetings and any special arrangements or requirements are attended to and followed up by the Liaison.

Question 4. We understand that reliable air service has been a concern that you have raised with the Administration. Would you please describe the issue and your approach in more detail?

Answer. The Territory of American Samoa faces very serious problems with air travel to Hawaii, the U.S. mainland and other parts of the world. A single carrier

* All enclosures have been retained in committee files.

serves American Samoa to the U.S., which service has proven infrequent, unreliable and extremely expensive.

The Government of American Samoa is investigating the possibility of requesting that the U.S. Department of Transportation grant approval to a foreign carrier to serve American Samoa. American Samoa has brought this issue specifically before the Interagency Group on Insular Affairs (IGIA), under the auspices of the Department of Interior, for assistance. However, this is a long drawn out process and may take months, even years to accomplish. One potential approach that has also been identified as beneficial to American Samoa is getting Essential Air Service support from the federal government in order to provide relief to travelers resulting from the monopoly on air service.

In the meantime, my administration has contacted Hawaiian Airlines (HAL) with the hope that it will see the handwriting on the wall and bring its fares in line with its cost of serving the territory. As it presently stands, HAL has publicly stated that it currently uses, and will continue to use, captive markets that produce high revenues to support its markets that are losing millions annually. The Government of American Samoa is an avid supporter of the free market system; however, the situation with HAL contravenes fairness and the results are devastating to the territory with reduced travel to and from our islands because of artificially inflated airfares.

The Government of American Samoa will ask that the U.S. Department of Transportation consider reversing the deregulation of HAL on its American Samoa route. Again, this is a protracted process, and every day the citizens of American Samoa suffer. Other alternatives that the Government of American Samoa is exploring are in the area of funding through DOT in the form of grants that assist small communities in the aftermath of deregulation. Grant funds can be used to subsidize airfares and improve facilities.

Question 5. Please describe what type of financial management system ASG has, whether it meets your needs, and any plans you may have to upgrade it?

Answer. Sungard Bi-Tech's "IFAS" or Integrated Financial and Administrative Solution software for the public sector has been the American Samoa Government's financial accounting software since the beginning of the fiscal year 1997. The American Samoa Government deploys the following IFAS modules: General Ledger, Budgeting, Purchasing, Encumbrance System, Accounts Payable, Bank Reconciliation, Fixed Assets Inventory System, Stores Inventory (Warehouse), Security, Human Resources Information System, Payroll, Workflow, Easy Laser Forms, 7i Farm. The American Samoa Government will be moving into Contract Management, Bid and Quote Management, Online Document in the near future.

The American Samoa Government has recently completed a full upgrade of IFAS from Reflections to the web-based 7i platform. We are presently running version 7.4 and upgrading to version 7.6 within a few months. IFAS is driven by an Informix engine and is supported by an extensive fiber-optic network within the Executive Building that houses the Executive branch of government.

The seamless integration of the modules with the General Ledger has made IFAS the system of choice for the past nine years. It holds the record as the longest running accounting system to be utilized by the government. American Samoa is so far satisfied with this financial management system as it currently meets our financial and accounting needs.

More recently, IFAS has been deployed to remote sites such as the Department of Education in efforts to allow online inquiries on status of accounts and to run reports on the numerous Federal Grants managed by the department. This trend of connecting the remote sites to our mainframe will continue into the future as funding becomes available.

THE UNITED STATES VIRGIN ISLANDS,
OFFICE OF THE GOVERNOR,
Charlotte Amalie, VI, March 21, 2006.

Hon. PETE V. DOMENICI,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: I want to thank you again for the courtesies you and the other distinguished members of the Committee on Energy and Natural Resources extended to me during the recent hearings on the economic and fiscal challenges facing the United States Territories, including the U.S. Virgin Islands. During the hearings, you asked me to comment on Delegate Christensen's remarks in support of her bill to establish a Chief Financial Officer (CFO) for the United States Virgin Islands.

As I indicated in my written statement submitted for the' hearing record, I as steadfastly opposed to H.R. 52, the proposed CFO bill, for several reasons. First, the financial condition of the Virgin Islands does not warrant limiting representative government in the Virgin Islands and the transfer of essential budget functions to an unelected bureaucrat accountable to no one. As detailed in my written statement and accompanying Appendix A, the Government of the Virgin Islands is not facing fiscal insolvency or collapse , Our budgets are in balance and we have ended the last two fiscal years with solid surpluses. We have ended each of the last five fiscal years with a substantial accumulated General Fund surplus. Our General Fund revenues, net of debt service, have grown from $417 million in FY 1999 to $633 million In FY 2005, an increase of 50 percent. At the same time, we have held General Fund expenditures to a 4 percent increase, from $559 million in ET 1998, the year before I assumed office, to $582 million in FY 2005. During this period, through government reorganization and agency consolidation, we cut the number of government employees by 20 percent while also raising salaries to more competitive levels.

Equally important, we have learned to manage and timely account for the funds that we have spent. prior to assuming office, the Virgin Islands had completed only one of the comprehensive annual audits required by the Federal Government over a fourteen-year period. Today, my Administration has completed nine such audits in a six-year period and the Fiscal Year 2004 audit will be completed and issued in a matter of weeks, putting the Government into compliance with the requirements of the Federal Single Audit Act. Under my Administration, this task has become an important, regular and ordinary responsibility of government service. In addition, my Administration has, over the course of the last several years, resolved the vast majority of the outstanding audit recommendations made by the federal Office of Inspector General. And we have vastly improved the Government's overall audit compliance record on a going forward basis. Most importantly, however, we are taking immediate stops to provide our financial managers with the modern financial tools they need to obtain, and act upon, real time financial data and to improve our financial, management of both local and federal funds. I am pleased to report to you today that we are not waiting for long promised federal assistance. We are using the financial surplus we have generated to fund the procurement of a new state-of-the-art financial management system to replace the outdated and inadequate system acquired from the federal government in the 1980's.

Second, the proposed remedy does not fit the problems identified in Delegate Christensen's remarks. Indeed, Delegate Christensen stated that, "[w]hen [she] first introduced her CFO bill, [she] did so because [she] believed *something* had to be done to prevent the Virgin Islands from fiscal collapse." (Emphasis added). Delegate Christensen, however, also conceded that, by relying on the normal processes of government, my Administration has been "able to restore budget surpluses and [has] strengthened the [T]erritory's financial position." Thus, Delegate Christensen has been forced to alter the reasons for continuing to press her bill, now citing "lax financial practices," without identifying any that might potentially lead to "dark days in a blink of an eye." The real dangers to our fiscal solvency and stability, however, are not the prospects of overspending, but rather are the ones that I believe both Delegate Christensen and I share: the threat to our private sector economy caused by Congressional overreaching in the American Jobs Creation Act and the unfortunate but real threat of natural disasters posed by the accident of our physical location in the middle of the Caribbean sea. Should our revenues fall as a result of either natural or man-made disasters over which we have no direct control, we would of course be forced to make adjustments in our spending as we successfully managed to do in FY 1999 and FY 2000—including cuts in essential public services such as education, health care and public safety. But, in a democracy, tough choices such as these are best made in the hands of elected representatives in a republican form of government guaranteed, since 1954, to the people of the Virgin Islands by Congress in our Revised Organic Act. Allocation of scarce resources to competing social demands by an unelected and unaccountable bureaucrat should only be considered if democracy has failed or if the government literally cannot operate. Happily, as Delegate Christensen has conceded, that is not the case here.

Third, enactment of a federal bill, neither requested nor supported by the elected leadership of the Virgin Islands Government, represents a significant step backwards in our political development. Delegate Christensen disputes this characterization, arguing that "[w]hile [her] bill would be an act of Congress, it sets up a process that is entirely within the hands of Virgin Islanders . . ." Her argent, however, ignores the fact that, if the process were in fact entirely within the hands of Virgin Islanders, there would be no reason for federal legislation. The Governor could certainly request, and the Legislature has full power to enact, local legislation to establish a Chief Financial Officer or to establish the. current Office of Management and Budget as an independent office.

Finally, even if the Government of the Virgin Islands were in fiscal extremis, the remedy proposed by Delegate Christensen is simply unworkable. The essence of H.R. 62—indeed, the bill's fundamental purpose is to usurp the authority of the elected Governor under local law under the terms of the bill , the CFO would be given the responsibilities of the Director of the Virgin Islands Office of Management and Budget (VIQMS). Among other duties, he or she would assume extraordinary powers norma4y reserved to elected officials of budget preparation and program execution, including the power to withhold appropriated funds and to revise departmental priorities otherwise sat by the Governor.

There is one major distinction between the powers of the Director of the VI0MB under current law and the functions of the CVO under the terms of H.R. 62 which is fatal, to the intended purpose of the bill. Under current law, the Director Is accountable to the Governor, and through him, to the people of the Virgin Islands , Under H.R. 62, the CFO is not accountable to the people of the Virgin Islands. If the proposed. CFO were to disregard the Governor's policy or budget directives, there would be no practical remedy. Neither the elected Governor nor the electorate would have an affective way to reconcile the priorities of the majority with the power to allocate scarce resources. The sole power to decide such inherently political choices would rest with an unelected and unaccountable bureaucrat. In short, the unwieldy process for selecting the CFO after consultation with virtually every interested party in the Territory simply eviscerates the prerogatives and authority of the Office of the Governor. More compellingly, the exercise of unchecked powers by an unelected CFO, accountable to no one, could threaten the very existence of the republican form of government put into place by the Revised Organic Act, and which Congress and the people of the Virgin Islands have steadfastly sought to perfect over the lest half century.

If the CFO were to impose his or her own priorities, the Governor would be left with two unworkable choices: either to defer to, and to substitute, the unelected CFO's judgment, or to attempt to create a budget impasse with the complicity of the Legislature. There would be no practical way, as exists in any democratic form of government, to remove the offending CFO; the terms of H.R. 62 would not permit it. if on the other hand, the CFO were to defer to the Governor on all policy and programmatic decisions, there would be no reason for having created the office in the first place. Together, these provisions of H.R. 62, no matter how well intentioned, are a prescription for a dysfunctional, government in the Virgin Islands.

As I indicated in my written statement, the Government of the Virgin Islands is committed to making the tough decisions to maintain fiscal discipline, increase the efficiency of government, and to improve the delivery of essential public services to the people. The Government is not facing fiscal insolvency or collapse. There simply is no basis for removing from political accountability the essential functions of budget preparation and execution.

Once more, thank you for your' assistance in the past and for your courtesies during our last meeting. Please let me know if you have any questions with respect to my position, or if I can provide you with any further information.

Very truly yours,

CHARLES W. TURNBULL,
Governor.

RESPONSES OF THE COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS TO QUESTIONS FROM SENATOR DOMENICI

Question 1. Last year, the Committee held a hearing on S. 1831, legislation requested by the CNMI regarding submerged lands and the resolution of claims under the Covenant. Does the CNMI still support enactment of these two provisions in S. 1831?

Answer. Yes. Three days ago the United States Supreme court denied the CNMI's petition for a writ of certiorari on the CNMI vs. United States, 399 F. 3rd 1057. The United States now has paramount ownership of some 264,000 square miles of submerged lands in the Northern Mariana Islands. Now our only recourse is through the legislative process. 5.1831 grants the CNMI the same jurisdiction as most coastal States and the territories.

The objective of Section 2 of S. 1831, as I understand it, is to resolve the outstanding tax cover-over issue (Section 703(b) of the Covenant, Public Law 94-241). Section 703(b) clearly provides for the cover-over to the CNMI of income taxes and taxes on articles produced in the Northern Mariana Islands, as well as the "proceeds of any other taxes which may be levied . . ." As written Section 2 of S. 1831 would provide the authority to the Secretary of the Interior to request assistance from the Department of Treasury to expeditiously resolve the longstanding claim of the CNMI on the issue of tax cover-over under Section 703(b) of the Covenant.

Though tax cover-over issue is extremely important to the CNMI, so is submerged land. Tying the two together in one piece of legislation might be the most advantageous to the passage of both under certain circumstances, however since the Administration seemed less than supportive of Section 2 of S. 1831 at the hearing last October, it might be better to deal with them separately. I will leave it to the Committee's best judgment but urge passage of Section 1 as soon as possible, and continue to seek the committee's help on resolving the tax cover-over issue.

Question 2. The GAO has provided the Committee with data derived from the single audits on the fiscal condition of your government. Would you please provide the Committee with your estimates for revenues, expenditures, end of year fund balance and net assets for 2004 and 2005 so that we can follow the most recent trends.

Answer. The CNMI Secretary of Finance has provided (see attachment)* elected pages of the draft copy of the FY 2004 single audit report as well as the FY 2005 report of revenues and expenditures provided to the CNMI Legislature.

It should be noted that the large increase in the 2004 General Fund deficit resulted from recording a $19 million penalty assessed by the Retirement Fund and $8.5 million in bad debt expense associated with various accounts receivables.

In January 2006, the new administration reduced the estimated 2006 revenue available for general government operation from $213 million to $198 million due to the continued decline of the garment industry and reduced tourism levels.

Question 3. What steps is your government taking to address the timeliness of the single audits and the weaknesses reported in these reports.

Answer. The CNMI Secretary of Finance has provided me with the plan of action (see attachment) they are using to address these concerns. High priority has been place on compliance with the Single Audit Act and addressing questions raised in these audits.

Question 4. In your testimony you request that the Congress direct the U.S. Treasury to immediately reimburse the CNMI the amount (which you present as $71 million plus $38.8 million in interest) pursuant to Section 703(b) of P.L. 94-241. Please provide the Committee with a summary of your discussion with Treasury on this issue including copies of important communication and analysis to and from the Treasury Department.

Answer. Unfortunately, we do not have many documents in our office relating to this issue. During the administration of former Governor Juan N. Babauta, the Office of the Attorney General took the lead on this issue and I understand participated in several discussions with Office of Insular Affairs and the Department of the Treasury. I had previously requested the new CNMI Attorney General, Matthew Gregory, to provide me with a status report from those discussions and the work completed so far based upon the records in his office. I am attaching the reply I received dated March 21, 2006. I am also attaching a copy of the opinion issued by the Treasury Department last year on the question of cover over of estate taxes to the CNMI.

RESPONSES OF HON. FELIX PEREZ CAMACHO TO QUESTIONS FROM SENATOR DOMENICI

Question 1. The GAO has provided the Committee with data derived from the single audits on the fiscal condition of your government up to 2003. Would you please provide the Committee with your estimates for revenues, expenditures, end of year fund balance and net assets for 2004 and 2005 so that we can follow the most recent trends?

Answer. I have enclosed a copy of the Government of Guam's Fiscal Year 2004 audit for your review.* The Management Discussion and Analysis (pp. 4-12) explains the major financial activities and results for 2004. Also included are copies of the Government of Guam's Audited Fund Balances for Fiscal Year 2004 and Unaudited Fund Balances for Fiscal Year 2005.

Question 2. Your government has made significant improvement in the timeliness of audit reporting and resolving weaknesses. Would you please describe the strategies Guam has used to improve accountability, internal controls and compliance, and what further steps you intend to take in the future?

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*All attachments have been retained in committee files.

*A copy has been retained in committee records.

Answer. Thank you for recognizing the hard work that the Government of Guam has undertaken over the past four years to improve accountability, internal controls and compliance with local and federal audits. A broad array of strategies, actions, and policies has greatly contributed to our progress in this area and also we have also been fortunate in some other ways that have helped improve our financial operations. We have been able to stabilize the leadership of our key financial departments. My Director for the Department of Administration has lead the agency for three years. In the previous three years, DOA had twelve different directors.

We stabilized and enhanced our information systems. Our progress in this area has allowed us to improve internal controls, improve accountability, and manage our financial information more effectively and efficiently. We have dramatically enhanced our financial management system to improve the timeliness, accuracy, and completeness of our financial data. The Department of Revenue and Taxation has implemented a point-of-sale system and has provided electronic filing of tax returns and tax-related documents to manage our revenues and serve its constituencies better. The point-of-sale system also improves our controls over cash payments and other revenue receipts from the public.

The Department of Administration has begun to use performance measures to manage its operations. These measures let DOA managers and executives know what is being done, how well it is being done, and how much it costs to do each task. The use of these performance measures significantly improves our accountability and internal controls.

The three departments responsible for managing our finances—the Department of Administration (DOA), the Department of Revenue and Taxation (DRT), and the Bureau of Budget and Management Review (BBMR)—implemented project management and configuration management disciplines to improve communications, coordinate their activities better, share operational problems and develop cross-agency solutions, and focus organizational resources and attention on improving financial operations and audit results. The practice of these disciplines has allowed the departments to achieve critical strategic goals, implement major organizational changes, and significantly improve financial operations across departmental lines.

We developed and implemented a strategic plan for financial management improvement. This plan was originally developed in 2003 and was updated in 2005. It identifies the key strategic goals we have for financial management improvement and lists a series of specific short-term actions we can take to improve financial operations almost immediately. The Department of Administration (DOA), the Department of Revenue and Taxation (DRT), and the Bureau of Budget and Management Review (BBMR) have been extremely successful at implementing these plans and accomplishing our strategic goals. This success has been directly responsible for much of our improvement in financial operations, accountability, internal controls and compliance with professional and federal standards and regulations. Our success with implementing financial management improvement plans helped develop a sense of empowerment and a willingness to change in our departments that was not there before. Our staff and managers are beginning to believe they can make a difference in improving their lives and the operation of their agencies. Our managers and executives are instilling a culture of continuous improvement and personal accountability that can lead us to ever better performance and customer service.

We have also been fortunate to receive significant funding and technical assistance from the Office of Insular Affairs at the Department of Insular Affairs, the Graduate School, USDA, and its regional office, the Pacific Islands Training Initiative (PITI). The Office of Insular Affairs has provided funding for technical assistance and training from the Graduate School, USDA, and the Pacific Islands Training Initiative. Without their continued support over the past three years we would not have made as much progress as we have.

Question 3. The recent and on-going expansion of military activity in Guam presents both benefits and challenges for your government. Would you briefly describe for the Committee what you see as the major challenges, and what steps you are taking to meet them?

Answer. With the increase of U.S. military assets to Guam expected over the next 10 years, the Government of Guam has begun the preparation to receive an estimated 8,000 individuals and their dependents and ensure that a quality level of service is provided to all of our residents.

According to U.S. Census Bureau estimates, Guam's population is expected to increase from 168,564 in 2005 to 180,692 in 2010, this without factoring the recently announced increase to the local military population. The increases are enough to direct capital improvement as locations are expected to develop more rapidly than others especially in those areas being looked at to be used for expansion by military planners. Older infrastructure has been identified throughout the island as needing to be replaced. Major maintenance projects are also being looked at simultaneously as older water, wastewater, power and transportation systems need to be replaced to maintain or improve current and future service levels. The improvements to the junctions which adjoin military and civilian facilities have also been slated for improvement. Millions of dollars in capital improvement projects have been identified in the civilian community with funding being sought for more than half of the projects. Because of a limited amount in resources, individual agencies within the Government of Guam continue to seek funding sources, including bond financing, to support these projects which is believed will improve the quality of life for all residents. The Government of Guam is taking cost-cutting measures and approaches to maximize limited funding opportunities afforded the island as a U.S. Territory.

My office is leading efforts to produce a 10-year Consolidated Infrastructure Improvement Forecast. This document will guide the Government of Guam and the island's U.S. military commands in understanding what is needed in our water, power and transportation infrastructure and service areas to respond to this tremendous growth and the certain impacts to our community now and into the future. The document, to include brief descriptions of the respective 10-year Capital Improvement Projects, construction costs and timelines for these critical areas is being formulated and is expected to be completed in mid-May, 2006.

We will be working with our military partners in securing funding to make the upgrades necessary in anticipation of the increase in U.S. forces here.

Question 4. The GAO review of audits shows that, in 2003, Guam had a year end funds deficit of $191 million. How has this condition changed since then and how has Guam meeting it cash needs?

Answer. The Government of Guam current funds deficit is about $345 Million. In recent discussions with the Guam Legislature, my Administration unveiled a Debt Recovery Plan to borrow in order to manage our growing debt. The Guam Economic Development and Commerce Authority has prepared on my behalf a spreadsheet incorporating debt repayment to begin FY2008 and an expenditure plan which factors in cost containment. The Plan is currently under review by the government's bond counsel and expects feedback in the coming weeks. Also, the U.S. Ninth Circuit Court of Appeals has ruled in favor of my Administration plans to move forward to secure a Debt Refinancing Bond, which had been opposed by the Attorney General of Guam for over two years, to close the gap on what is owed the tax payers of Guam.

As for the Government of Guam's cash situation, the government continues to manage its cash carefully to ensure bills are paid although many vendors have to wait 90 days or longer to receive their payment. The Guam Department of Administration from time to time will pay well within this timeframe but it does not happen often enough to keep vendors from applying pressure on DOA. Cash management remains the key to keeping the government afloat.

UNITED STATES VIRGIN ISLANDS,
OFFICE OF THE GOVERNOR,
Charlotee Amalie, VI, May 4, 2006.

Hon. PETE DOMENICI,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: Please find attached the response of the Government of the Virgin Islands (GVI) to the questions submitted in your March 6, 2006 letter to me regarding the state of the economy and fiscal affairs of the United States Virgin Islands.

Please let me know if you have any questions with respect to the GVI responses.

Very truly yours,

CHARLES W. TURNBULL,
Governor.

[Enclosure.]

RESPONSES OF GOVERNMENT OF THE VIRGIN ISLANDS TO QUESTIONS FROM SENATOR DOMENICI

Question 1. In your statement, you have detailed your concerns regarding the EDG businesses. Would you also describe for the Committee your outlook for the other key industries in the USVI such as tourism and oil refining?

Answer. While recent changes to the tax laws governing the Virgin Islands Economic Development Commission (EDC) program have caused U.S. investment in the

Territory to slow and EDC-generated revenues to decline, traditional sectors of the Virgin Islands economy, including tourism and oil refining, have fared relatively well in the last two years. The tourism industry, in particular, has been one of the strongest performers and a major contributor to the Territory's economic performance during this period. The industry employs 30 percent of the Territory's workforce and generates more than $4 billion of economic activity each year. Total visitors to the Territory reached a record 2.6 million in Fiscal Year 2004, an increase of 12 percent over FY 2003. Total visitors increased to 2.7 million in FY 2005 and are projected to top 2.8 million in FY 2006.

Tourism is expected to continue to grow as a result of the Government's investments in the Territory's tourism infrastructure, including port development, renovation of historic Island structures, and construction of cultural attractions and beautification projects, as well as nearly $1 billion in new private sector tourism related developments over the next several years. These include major hotel and time-share projects on all three islands.

The oil refining industry has prospered in recent years as a result of higher oil prices and increased world demand. The value of refined petroleum products manufactured by the Hovensa refinery on St. Croix—one of the largest refineries in the world—increased by 40 percent in Fiscal Year 2004 to reach $6.7 billion. As a result, Hovensa eliminated its net operating losses (NOLs) carried over from previous years and began paying corporate income taxes for the first time in FY 2005. Hovensa is also completing construction of a $200 million desulphurization unit at its refinery on St. Croix, which will allow the Company to meet EPA standards and better compete with mainland refineries.

The Territory's rum industry is enjoying record production and sales into the United States. The territory's rum distillery on St. Croix, which generated more than $80 million in federal rum excise taxes for the Government's coffers in FY 2005, was recently acquired by V&S, a distilling conglomerate owned by the Government of Sweden.

While the above sectors have done well, economic uncertainties still exist, primarily because of the continuing cloud over the EDC program. Much of the private sector investment in the Territory in recent years has been fueled by EDC beneficiaries who have reinvested their EDC profits back into the local economy. These investments have included not only the acquisition and establishment of new businesses in the Territory, but also construction of new office space and private homes. Thus, the key to the Islands' economic future remains a fair resolution of the federal tax rules that govern this vital economic development program.

Question 2. The GAO has provided the Committee with data derived from the single audits on the fiscal condition of your government up to 2003. Would you please provide the Committee with your estimates for revenues, expenditures, end of year fund balance and net assets for 2004 and 2005 so that we can follow the most recent trends?

Answer. Governor Turnbull's written statement submitted to the Committee on Energy and Natural Resources on March 1, 2006 included, as Appendix A thereto, a revenue, expenditure and fund balance sheet for the period FY 1995 to FY 2005.* This chart, which is in a different format than Table 1 of the draft GAO report, provided in the opinion of Banc of America Securities LLC, the financial advisers to the Government of the Virgin Islands who prepared the chart, a more relevant, if not more precise, view of the Government's financial condition at any point during the 10-year period in question. The 10-year span, which focuses on recurring revenues and expenditures in the Territory's General Fund, provides a longer period than the GAO report in which to assess revenue, expenditures and financial trends.[1]

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*Appendix A has been retained in committee files.

[1] The Banc of America chart focuses on the Government's General Fund and does not include restricted or special funds. As detailed in footnote 2 to the chart, the statement of revenues for each fiscal year includes individual income taxes, corporate income taxes, gross receipts taxes, real property taxes, excise taxes, stamp taxes, and other fees and taxes. Taxes are net of amounts pledged for debt service on outstanding bond issues and net of income tax refunds. Amounts reflected in "Operating Transfers from other Funds" in the audited financial statements are thus combined with revenues for purposes of clarity and easier trend analysis. The operating transfers are generally comprised of gross receipts taxes and rum excise taxes in excess of amounts required for debt service or outstanding bonds to which they are pledged. The gross receipts taxes and rum taxes in the official audited statements are first-recorded in the Government's Debt Service Fund and the excess above the debt service requirement is transferred to the General Fund as an "Operating Transfer from Other Funds." Gross receipts taxes and rum excise taxes, however, are generally understood to be recurring revenues for the Government which is the reason Banc of America has aggregated such taxes with other "revenues" in its chart. Similarly, the statement of expenditures in the chart includes "Operating Transfers

The Banc of America chart, a copy of which is attached hereto, is also based on the Government's audited financial statements for Fiscal Years 1995 and 1998 through 2003. FY 1996 and 1997 figures are derived from unaudited financial statements prepared by the Virgin Islands Department of Finance (agreed upon procedures, but no financial audit were performed for those years in satisfaction of the Single Audit Act requirements by agreement with the Office of Inspector General). FY 2004 figures are taken from the unaudited financial statements prepared by the Department of Finance (it is anticipated that the FY 2004 audited statement will be released by mid May 2006). FY 2005 figures are estimates based on unaudited revenue and expenditure reports provided by the Department of Finance.

As reflected in the Banc of America chart, General Fund revenues, net of debt service and tax refunds, have grown from $417 million in FY 1999 (the first year of the Turnbull Administration) to an estimated $633 million in FY 2001, an increase of approximately 50 percent. The chart also records that General Fund expenditures increased just 4 percent over roughly the same period, from $559 million in FY 1998 (prior to the cost cutting policies imposed in the Turnbull Administration's first year) to an estimated $582 million in FY 2005. The chart also shows record revenues in FY 2001, which allowed the Government to achieve a budget surplus and authorize payment of deferred salary increases to government employees beginning in the subsequent fiscal year. However, projected revenues in FY 2002 did not materialize as a result of 9/11 and the ensuing national recession, which, combined with the increased (largely salary-based) expenditures authorized in the previous fiscal year, caused the Government to slip back into deficit. By holding expenditures relatively flat while revenues recovered, the Government returned to surplus in FY 2004 and FY 2005. A surplus is also projected for FY 2006.

The Banc of America chart also shows positive General Fund balances for the last 5 years. The chart shows a positive General Fund balance at the end of FY 2003 of $97.1 million, increasing to an estimated $119.4 million in FY 2004 and an estimated $170.7 million in FY 2005.

*Question 3.*What do you see as the key steps to addressing the timeliness of the single audits and the weaknesses reported in those reports, and to ending the "high-risk" designation of USVI departments by Federal departments?

Answer. Prior to the commencement of the Turnbull Administration in January 1999, the Government of the Virgin Islands had completed only one of the comprehensive audits required by the Federal Single Audit Act over a 14 year period. Since then, the Government has completed nine such audits (including, agreed upon procedures for FY 1996 and 1997) in a six year period. The FY 2004 audit is expected to be completed and released by the middle of this month. Notwithstanding this record, the Government has been late by several months each year in issuing the required annual audits, primarily because of the lateness of certain of the Government's independent agencies in submitting their respective audited financial statements. To remedy this problem, the Turnbull Administration is preparing legislation which would expressly authorize the Government to withhold locally appropriated funds from delinquent agencies until such agencies issue their audited statements.

The Virgin Islands Department of Education (V.I. DoEd) has, since 2000, been designated as a "high risk" grantee by the U.S. Department of Education (U.S. DoEd) as a result of identified deficiencies in the management of federal grants. Many of these deficiencies have been corrected pursuant to a compliance agreement entered into by the U.S. DoEd and the V.I. DoEd. The most serious remaining deficiency is the lack of an adequate financial management system that can timely track the receipt and expenditure of federal funds. This deficiency is not limited to the V.I. DoEd, but is government-wide.

The Government's current financial management system was provided by the U.S. Department of the Interior in the late 1980's. It is out-of-date and inadequate. The Government is currently in the process of procuring a state-of-the-art Enterprise Resource Planning (ERP) and financial management system after a lengthy and involved RFP process. The new ERP system, Phase I of which should be installed and implemented by October 1, 2006, will provide the Government's managers with the modern software and financial tools to obtain, and act upon, real time financial data. Together with the Government's commitment to provide increased training for

to Other Funds" and "Operating Transfers to Component Units" which are listed as separate line items on the official audited statements. "Operating Transfers to Component Units" include transfers from the General Fund to independent agencies such as the University of the Virgin Islands and the Government-owned hospitals. Since these agencies are generally funded by appropriations from the General Fund, such transfers are similarly aggregated with other "expenditures" in the Banc of America chart for purposes of clarity and trend analysis.

its managers, the new financial system will improve the Government's ability to manage both federal and local funds. By addressing this deficiency, it is the Government's goal to be relieved of its "high risk" grantee status by the end of the next fiscal year.

Question 4. GAO's review of the single audits shows the USVI's net assets at $300 million in liabilities. WOuld you please describe these to the committee and your approach to dealing with them?

Answer. As a result of GASB 34,[2] the Government's audited financial statements beginning with statements issued for fiscal year 2002 now include a statement of the Government's assets, liabilities and net assets, which together with the statements for fund balances, provides a more complete picture of the Government's financial condition. The Governments FY 2003 audited financial statement, which states that the Government had $300 million in excess liabilities over assets for such fiscal year, is somewhat misleading due to the fact that the requirements of GASB 34 will not be fully implemented until FY 2006.[3] Nevertheless the largest component of the Government's liabilities in FY 2003 (and previous years) was $375 million for retroactive salary increases for government workers as a result of union settlements and compulsory arbitration awards dating back to the beginning of the last decade. As reflected in Management's Discussion and Analysis Section of the FY 2003 audited financial statement, "[c]arryforward expenditures consist mainly of retroactive salary increases, which accumulated following Hurricanes Hugo, Marilyn and Bertha in the years of 1990 through 1998." The Government's policy is to keep salaries current based on existing salary scales and to address any retroactive liabilities through negotiations with affected unions as surplus Government Fund revenues are realized and become available. In the absence of this retroactive salary liability, the Government's FY 2003 statement would show a positive balance in its net assets account.

The Government's unaudited FY 2004 financial statement shows an increase in the Government's excess liabilities over assets to $335 million, reflecting an increase in the Government's retroactive salary liability to $384 million and a one-time charge of $29 million for landfill closure costs not yet incurred. In the absence of these particular liabilities, the Government's FY 2004 statement, as well as the 2005 statement, would be expected to show a positive balance in the Government's net assets account.

[Responses to the following questions were not received at the time the hearing went to press.]

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC, March 6, 2006.

Hon. GALE NORTON,
Secretary, Department of the Interior.

DEAR MADAM SECRETARY: I would like to take this opportunity to thank you for sending Mr. David Cohen to testify before the Senate Committee on Energy and Natural Resources on Wednesday, March 1, 2006, to give testimony regarding the state of the economies and fiscal affairs in the Territories of Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the United States Virgin Islands. Enclosed herewith please find a list of questions which have been submitted for the record. If possible, I would like to have your response to these questions by Friday, March 24, 2006. Thank you in advance for your prompt consideration.

Sincerely,

PETE V. DOMENICI,
Chairman.

[Enclosure.]

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[2] In June, 1999, the Government Accounting Standards Board (GASB) issued Statement No. 34 (GASB 34) ("Basic Financial Statements and Management's Discussion and Analysis—for state and local governments"), which mandated sweeping changes in the presentation and contents of government financial statements.

[3] In particular, the Government's FY 2003 statement includes debt for the acquisition of certain infrastructure assets but does not include the depreciated value of the assets themselves.

QUESTIONS FROM SENATOR DOMENICI TO GALE NORTON

Question 1. Would you please provide the Committee with a list of which Federal departments have assumed control over the expenditure of their funds in a Territory, or designated any of the Territories' as "high risk" grantees, with a brief description of the efforts to resolve these problems?

Question 2. Would you briefly describe those DOI activities that are designed to improve accountability in the Territories, the role which the DOI Inspector General and GPRA have in these efforts, and if there are any changes in law that you would recommend to make DOI's efforts to improve accountability in the Territorial governments more effective?

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