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Statement of
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before the
Subcommittee of Public Lands and National Parks
House Interior and Insular Affairs Committee
on
Micronesian Economic Development
and
Capital Improvement Activities

Mr. Chairman and Members of the Subcommittee:

We are pleased to discuss today our January 1983 report, The Challenge of Enhancing Micronesian Self-Sufficiency, and other matters pertaining to Micronesian capabilities to develop an economic base to become more self-sufficient. Our report covers conditions that existed in 1982 when this Subcommittee requested GAO to (1) determine the institutional capability

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of the Micronesian governments (the Republic of Palau, the Federated States of Micronesia, and the Republic of the Marshall Islands) to plan and administer economic development and infrastructure projects and public sector programs to foster greater self-sufficiency, (2) assess the condition of public works systems, and (3) evaluate the capability of the governments to operate and maintain current and future systems.

To ensure the Subcommittee has the best information available, we have provided questions to the staff to obtain updated information from executive branch agencies involved in Micronesian affairs. Our testimony and the updated information from others testifying today will give the Subcommittee a picture of economic conditions in Micronesia. On the basis of our ongoing work it is likely the fundamental problems identified in 1982 are still problems now.

The central conclusion of our review was that the Micronesian governments lacked sufficient management and technical expertise and capability to efficiently plan, implement, and monitor public sector programs and services on their own; nor had they identified, in any systematic fashion, the technical assistance required to enhance their institutional capabilities.

The Department of the Interior had not made a systematic assessment either.

Accordingly, we recommended that Interior, before the Trusteeship is terminated,

--conduct assessments of Micronesian technical assistance requirements;

- identify what technical assistance can be provided by Interior, other federal agencies, international organizations, the private sector, and colleges and universities; and
- develop an action plan to guide the provision of all U.S. and other technical assistance to the Micronesian governments.

Interior concurred with our conclusions and recommendations.

STATUS OF GAO RECOMMENDATIONS

Interior has not yet completed a listing of technical assistance sources--federal, international, public or private; or developed an action plan to interface potential sources with Micronesian technical assistance needs. Interior officials have told us that they are still working on compiling a listing of federal technical assistance sources and that it will be available shortly. We believe a comprehensive technical assistance plan will provide a foundation for the long-term development of Micronesian institutional capabilities to effectively manage their resources.

IMPORTANCE OF KEY PROVISIONS IN THE COMPACT OF FREE ASSOCIATION

On March 30, 1984, the President submitted to Congress the Compact of Free Association an agreement initialed by the United States and the Micronesian governments of the Marshall Islands and the Federated States of Micronesia. Under the Compact, the Micronesian governments will assume the authority and responsibility for their internal and foreign affairs; and the U.S. will exercise plenary security and defense authority.

Under Title 2 of the Compact, the United States will provide economic assistance through annual grants dedicated to economic development projects, capital improvements, and government operations. Approximately \$2 billion will be provided over a 15-year period to the Federated States of Micronesia and the Marshall Islands.

In our view, a critical component of the Compact is the provision, under Section 211(b), for an official overall economic development plan to be provided by each Micronesian government. These national plans are to identify the policy and projects necessary to meet specific goals and objectives and to include an analysis of population trends, human resource requirements, social needs, gross national product estimates, resource utilization, infrastructure needs and expenditures, and specific private sector projects required to develop the local economies. In effect, the national development plans will be a blueprint for building more self-sufficient economies and government operations called for under the Compact. It is especially important that the development plans, expertise, and institutional structures be put in place as soon as possible because, under the Compact, direct U.S. funding assistance will be greater in the first 5 years, than in the second and third 5-year periods.

At the time of our review, such institutional capabilities were inadequate. We do not know the current status of Micronesian governments' efforts to put their plans and institutions

in place. However, because of the problems we identified, the national economic development plans should be scrutinized by the U.S. government to ensure that adequate provisions are made to obtain the technical assistance and training necessary to implement and monitor economic development, capital infrastructure, and government operations. Since the United States will be committed to 15 years of funding, it becomes especially important that the national economic development plans are reviewed by the appropriate federal agencies and Congress prior to final approval of the Compact.

MICRONESIAN GOVERNMENTS FACE SERIOUS
OBSTACLES TO BECOMING SELF-SUFFICIENT

The economies of Micronesia are dominated by the public sector and are heavily dependent upon U.S. funds to subsidize economic development and social services. Each Micronesian state has a weak economic base characterized by limited natural resources, inadequate infrastructure, a generally undeveloped and unskilled work force, and a significant trade imbalance. These islands lack sizable markets and are remote from the major Asian and U.S. markets. Micronesia has not been successful in developing a strong private sector to produce revenue or in attracting much outside investment. Public sector employment ranges between 40 and 57 percent of total employment and accounts for a large portion of total wages. Private sector employment is concentrated in the wholesale/retail trade and construction firms which depend on public sector wages and capital improvement funds for most of their income.

The inability of the Micronesian governments to expand private sector development is reflected in their continued reliance on federal funds to support the local economies. According to Interior, the Micronesian states received 82 percent of their total fiscal year 1983 revenues from federal sources.

PROBLEMS WITH MICRONESIA CAPITAL IMPROVEMENT PROGRAMS

Since 1966 the United States has invested over \$400 million in Micronesian capital improvements.

From 1966-75 the United States spent about \$137 million on projects such as upgrading health facilities, constructing schools, and developing transportation facilities. In 1975, serious problems were identified with management of capital improvement projects, resulting in the Navy's Officer in Charge of Construction being assigned full responsibility to complete Micronesia's proposed infrastructure.

The proposed infrastructure, commonly referred to as the 1976 5-year capital improvement program (CIP), was intended to provide the minimal infrastructure (airports, docks, roads, utilities) necessary for economic development. The 5-year program remains uncompleted, although Interior officials have indicated that it will be fully funded with the fiscal year 1985 budget request of \$22.6 million. Assuming the fiscal year 1985 request is approved, the United States will have contributed approximately \$307 million to fund the program.

Despite this level of funding, we found that

1. The goals of the 5-year CIP have never been clearly defined. No established benchmarks exist to measure achievements or to determine whether or not the United States has proved an adequate level of infrastructure development. We found that no description existed of what U.S. and Micronesian governments agree is an adequate infrastructure foundation to provide economic and social development.
2. There did not appear to be much linkage between infrastructure development and a comprehensive economic development program. CIP projects were not tied into a comprehensive economic development effort which would provide a basis for greater economic self-sufficiency.
3. Infrastructure development efforts in Micronesia had been undertaken without much attention given to whether revenues will be available to support them. As the level of infrastructure increased, so did the need for operation and maintenance funds, mainly from the federal government. As a result, the local governments did not generate enough revenue to properly operate and maintain the new systems built.

4. Many completed projects had not provided intended services, particularly utility projects. For example, despite \$26 million in federal funding for water projects, Micronesia lacked a safe, reliable and adequate supply of water. Similarly, \$21 million was spent on sewer systems which were drastically underused. One major reason was that the original sewer projects did not provide for household connections, and the local governments had not provided hookups.

5-YEAR CIP FUNDING REQUIREMENTS

At the time of our review, the Micronesian governments contended that the 5-year CIP was underfunded. Their arguments focused on the reduction in scope of several projects originally identified. The Trust Territory government estimated \$100 million would be required to fund full scope restoration of the 5-year CIP. The administration subsequently stated that other estimates show the 5-year program could be fully funded with an amount substantially less than \$100 million. Interior currently claims the program will be fully funded on the basis of its fiscal year 1985 request for \$22.6 million.

We were unable to determine how much it would cost to satisfy Micronesia's minimal construction and repair needs, or whether money provided in the Compact will meet future capital infrastructure and economic development requirements. Again,

the economic development plans called for under the Compact will be the primary basis for identifying such requirements.

OPERATIONS AND MAINTENANCE PROBLEMS

Micronesia's infrastructure and support equipment were deteriorating and not operating effectively. Although an increasing amount of funds was spent improving capital infrastructure, insufficient funding was provided for the required operations and maintenance of the improvements. The Micronesian governments lacked technically capable professionals and skilled personnel, and operations and maintenance planning and work-control programs to ensure operational reliability, protection, and preservation of facilities and equipment.

Inadequate operations and maintenance appears to be a pervasive problem throughout Micronesia. Utilities, roads, buildings, and equipment all suffered from poor maintenance.

Inadequate funding is one reason for poor operations and maintenance. For fiscal years 1979-83 we estimated that federal and Micronesian governments provided only 85 percent of required funding to adequately operate and maintain facilities and utilities. The magnitude of the shortfall was undoubtedly greater, since our estimate excluded funding for health, communications, transportation and some other infrastructure areas. We do not know to what extent overall operations and maintenance of capital improvement projects have improved as a result of expenditures made since 1982.

Operational practices and rate structures for public utilities were not sufficient to provide for revenues to cover operations and maintenance costs. The Micronesian governments heavily subsidized their utility systems. In fiscal years 1980 and 1981, revenues covered only 10.8 percent of utility costs. In addition, many utility users were not metered. The difficulty in reducing utility subsidies is compounded by the fact that the largest consumers are government agencies. Subsidies could be reduced by establishing more realistic rates to private users, and encouraging greater conservation of utility usage by government agencies. Recent efforts have been made to increase rates, meter customers, and conserve utility usage.

Nevertheless, the Micronesian governments will have to take a hard look at their operational and subsidy practices if they are to achieve greater financial self-sufficiency and protect their infrastructure investment.

NEED TO DEVELOP MANAGERIAL AND TECHNICAL EXPERTISE

Micronesia lacks enough technically capable professionals, qualified trade skill personnel, and managers to effectively plan, design, operate and maintain development and infrastructure projects. At the time of our review, major capital improvement projects were administered and managed by the Navy's Officer in Charge of Construction. Because the Navy's role in

Micronesia is decreasing, each Micronesian government must develop an in-house capability or contract with outside experts to carry out future projects. The costs of obtaining outside assistance to acquire such expertise can present a substantial financial burden as shown by the recent power plant agreements with the British in Palau and the Marshalls. Virtually all of the Marshall's local revenues for FY 1984 are budgeted to pay off debt services to the British for the power plant.

CONCLUSION

The capacity of each Micronesian government to develop the institutional capability to effectively manage economic development activities to promote economic growth and financial self-reliance hinges on their ability to develop and implement the economic development plans called for under the Compact. The plans should address operations and maintenance requirements and the basis to obtain necessary technical, financial, and managerial assistance to ensure capital improvements do not deteriorate at the expense of economic and social needs. Furthermore, the plans should assure that capital investment contributes to, rather than subtracts from, the fulfillment of such needs.

Because the Compact represents a long-term U.S. commitment it important that Congress be able to review the plans which will ostensibly guide Micronesian development.

This concludes our statement, we will be happy to answer any questions.