



THE COUNSELOR
DEPARTMENT OF STATE
WASHINGTON

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MEMORANDUM FOR: Dr. Zbigniew Brzezinski
The White House

FROM: Matt Nimetz /mm
Chairman
Micronesia Interagency Group

SUBJECT: Revision of Negotiating Instructions

We believe we may be nearing the end of our political status negotiations with the three entities in Micronesia -- the Marshall Islands, the Federated States of Micronesia and Palau. The draft agreement under negotiation provides for a relationship whereby the U.S. would have complete defense and security authority, including a defense-based veto over actions by the Micronesian governments. The Micronesians would manage their own internal affairs and foreign relations.

PD/NSC-11 authorized a maximum annual USG commitment of \$75 million, the provision of certain federal services, and one-time payments totalling \$18 million over the fifteen year period of the Compact of Free Association. However, during the long years of these negotiations, USG appropriations for Micronesia have mushroomed: the total will amount to approximately \$141 million in FY 79, including \$61 million for capital improvements. Given the recent growth of these expenditures, the total USG commitment in FY 81, the expected last year of the trusteeship, could amount to a figure significantly greater than \$141 million.

The Micronesia Interagency Group, after long and careful consideration, has concluded that our stated policy of termination of the trusteeship in 1981 and agreement on the free association relationship which we are currently negotiating will most effectively guarantee our security and defense interests in the Pacific. In order to achieve these objectives and in light of the fact that in January in

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Saipan the Micronesian negotiating commissions rejected our offer based on PD-11, the Interagency Group believes that we must be able to offer greater financial assistance than is authorized in PD-11. Without such additional authorization, it is probable that we would be unable to conclude these negotiations in a satisfactory way. The alternative of not ending the trusteeship would present serious problems at the United Nations and could lead to serious and continuous confrontation with the Micronesians. The other alternative -- independence -- would make it difficult to ensure strategic denial for that area of the Pacific, and to guarantee access to the area for U.S. military forces and continued use of our Kwajalein Missile Range in a stable political environment.

There are four elements for which we need a revision of earlier instructions.

First, the negotiator's limit for the average annual payment (which includes grant assistance plus a number of miscellaneous services and activities) should be raised to \$112 million. (Breakdown is at Tab A.) As noted above, this is still below the FY 79 expenditure of \$141 million. Although it is impossible to quantify the financial request made by the Micronesians at our January negotiating session, their proposals would amount to three or four times our initial offer of \$65 million.

Recommendation:

The Micronesia Interagency Group* recommends approval of annual average payments of \$112 million. (OMB's alternative recommendations of \$73 million plus inflation adjustment or \$88 million with no adjustment are outlined at Tab C.)

Approve _____

Disapprove _____

* Micronesia Interagency Group consists of the following Departments and agencies: State, Interior, Defense, Justice, Commerce, Transportation, Energy, NSC, JCS, OMB, Office for Micronesia Status Negotiations. (Justice reserves its comments on all recommendations until it can review OMB's position paper at Tab C.)

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Second, we should commit a greater portion of total U.S. funding during the first five-year period of the relationship than during the second or third five-year periods because:

-- The Micronesians could realize very large economies in major new construction projects by utilizing contractors presently mobilized in the Trust Territory;

-- Economic development (and, thus, a potential lessening of dependence on the U.S.) would be promoted earlier in the post-termination period through greater investment in development projects. (However, even under the most favorable conditions, it is unlikely that all of the Micronesian entities will reach a stage of economic take-off in the foreseeable future, though some could. Financial dependence on the U.S. probably could not decline dramatically because of rapidly rising population.)

-- We believe that such "front-end loading" is essential to obtain Micronesian agreement to the Compact.

Recommendation:

The Interagency Group recommends authorization to "front-end load" the \$94 million annual cash grant portion (for operations and infrastructure development) of the \$112 million annual average for a maximum total allocation of \$141 million in each of the first five years (32% over the proposed average annual sum.) There would be commensurately lower amounts in the later periods. (OMB recommends limiting "front-end loading" to 25%.) (Justice points out that there is a substantial risk that after five years we will be faced with potentially irresistible demands from the Micronesians not to reduce this "front-end loaded" figure, and, therefore, the total cost of the 15 year package will probably be significantly greater than the amount outlined in the proposed agreement.)

Approve _____

Disapprove _____

Third, we should apply a limited inflation adjustment formula. The Micronesian negotiating commissions have each

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requested application of the method employed in our Commonwealth Covenant with the Northern Marianas -- that is, unrestricted inflation adjustment based upon the annual change in the Gross National Product Implicit Price Deflator (GNPIP) using FY 81 as the base year and compounding the adjustment annually over the fifteen year period.

Although the Micronesians' proposals do not appear unreasonable, practical concerns suggest a more limited approach whereby the annual adjustment factor would be the percentage change in the GNPIP or 3%, whichever is lower. The adjustment factor would be measured additively, rather than compounded, from the base year of 1981 and, because of the heavy "front-end loading", would commence only on the sixth year.

In addition, the USG would agree to a bilateral review every five years to consider the impact of inflation on the U.S. financial package. There would, however, be no specific USG commitment to make further adjustments.

Recommendation:

The Interagency Group recommends approval of this limited inflation adjustment formula and a commitment to review after the fifth year. (OMB's views are at Tab C.)

Approve _____

Disapprove _____

Finally, there are a number of one-time expenditures and other financial authorities that have arisen during the negotiations. These are summarized at Tab B, including OMB's recommendations.

Recommendation:

The Interagency Group recommends approval of one-time expenditures and other financial elements listed at Tab B. (OMB's views at Tab B.)

Approve _____

Disapprove _____

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Attachments:

- Tab A - Components of \$112 Million Annual Average
- Tab B - One-time Expenditures and Other Financial Authorities
- Tab C - OMB Comments

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Components of \$ [redacted] Million Annual Average

Interagency Group Recommendations (In Millions)

OMB Recommendations Present Authority

\$ [redacted]	\$ [redacted]	\$ [redacted]	\$60
10	10	10	10
[redacted]	[redacted]	[redacted]	0
[redacted]	[redacted]	[redacted]	5
[redacted]	0	0	0
\$ [redacted]	\$ [redacted]	\$ [redacted]	\$75

Yearly average grant assistance. For operations and infrastructure development. (Change from \$60 million.)

Annual cost for Kwajalein Missile Range requirements. (No change.)

Scholarship fund for post-secondary education. [redacted]

Fishery zone surveillance. [redacted] PD-11 authority of \$5 million yearly on matching basis.)

Value of health and medical services currently provided. (New authority.)

Aif Micronesians insist on inflation adjustment.

Bif Micronesians will drop the inflation adjustment and agree to no review during the life of the Compact.

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Interagency Group Recommendations:
One-Time Expenditures and Other Financial Authorities

Postal, weather FAA, CAB and Communication Management services. Interagency Group authorization to extend similar limited technical services. (Slight expansion of services)

One-time grant for capital investment for fishery zone surveillance and enforcement. (Reduced from present instructions) \$2 million

Use of military construction units (such as military Civil Action Teams in Palau) (To be funded from \$94 million yearly grant) (Their use in Palau would be contingent on negotiating specific land use arrangements with Palau.)

One-time grant to re-locate Trust Territory headquarters. To be channeled through Department of Interior budget. (Change only in timing) \$15 million

U.S. Coast Guard conversion of eighteen specified buoys to civilian use. (New authority) \$750,000

Accord special tax treatment to investment in Micronesia by US persons and special tax treatment of US income derived by Micronesian persons. (New authority)

Disaster relief on same basis as currently extended. (New authority)

One-time payment to extinguish land claims resulting from US nuclear weapons testing program in Northern Marshalls. (New authority) \$10 million
OMB recommends decision be deferred without prejudice.

Authorization to continue and extend health care, compensation and monitoring activities from nuclear testing program. (Continue and extend existing activities) OMB recommends decision be deferred without prejudice.

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