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OMSN-27-c-80

THE PRESIDENT'S PERSONAL REPRESENTATIVE
FOR MICRONESIAN STATUS NEGOTIATIONS
WASHINGTON, D.C. 20240

August 7, 1980

MEMORANDUM FOR MEMBERS OF THE MICRONESIA INTERAGENCY GROUP

FROM: Peter R. Rosenblatt

SUBJECT: Palau's Funding Situation (U)

(U) Under cover of this memo I am forwarding an OMSN memorandum of July 23 concerning the current and future budgetary situation of the Government of Palau and the problem raised in connection with Interior's contingency budget for FY 82 (now being prepared in the event that the Trusteeship cannot be terminated by October 1, 1981). The contingency budget postulates Palau's minimum operations needs at \$10.5 million, an amount about \$2 million in excess of the maximum Palau could receive for operations under the Compact in that same year.

(U) I originally distributed the memorandum only to the Chairman of the IAG and to OMB because the High Commissioner's recommended FY 82 budget figure for Palau had just become available. Further discussion with Interior has convinced me that Palau's requirement for such a figure is real if we are to avoid a drastic reduction in basic government services.

(C) It is now essential that the IAG reach an agreed position on the matter at a very early date to allow for a request for an amendment of my negotiating authority if that is deemed necessary. Some adjustments in the amounts for the Marshall Islands and the FSM would also be necessary in the interest of equity and in order to prevent an unravelling of the negotiating situation.

(U) I would appreciate your submitting your agencies' written comments and recommendations to Chairman Ridgway, with a copy to me, by Friday, August 15.

Peter R. Rosenblatt
Ambassador

6/20/80 NARA
MLC-76-60
8/21/82

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WASHINGTON, D.C. 20240

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July 23, 1980

MEMORANDUM TO ROZANNE RIDGWAY

FROM: Peter R. Rosenblatt

SUBJECT: Palau Funding

A new problem has arisen with regard to USG funding levels for Palau. The issue affects the transitional period, the FY 1982 contingency budget and the Compact sums allocated to Palau. While the first two of these periods technically lie outside of the scope of my concerns, they are all completely intertwined.

I. Background.

As you know, the amounts which we offered to all three of the Micronesian entities under the Compact in June 1979 were the result of a complex interagency process in which the Department of the Interior participated as a full partner. Interior joined with all of the agencies in advocating higher Compact amounts than were ultimately approved by the President. However, neither before nor after the President decision (recorded in PD/NSC-49) did Interior ever take the position that the Compact amounts allocated to Palau or either of the other entities were insufficient to meet the administrative and human needs of Palau or any other Micronesian entity.

During our Guam meeting last month, the Palau Commission on Status and Transition (PCST) indicated it would ask for an increase in the Compact amounts allocated to Palau government operations. I replied categorically that this would be out of the question so far as the USG is concerned. In support of their position the Palauans made a point which was absolutely new to me; the cost of government in Palau now, in FY 80, is higher than the amounts Palau is to receive under the Compact starting in FY 1982.

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Further analysis discloses that the Government of Palau is now costing the TTPI Government about \$8.5 million in FY 80 and that it is projected to cost about \$8.7 million in FY 81 (these figures include a \$1.1 million deficit in FY 80 and fuel cost supplementals of \$1.1 million in each of FY 80 and 81). By contrast, the Compact contemplates that the Government of Palau will, during the first years of the Compact beginning in FY 82, receive \$7 million in cash payments for operations, and a presumed \$1 million share of the \$6 million fund established under Section 216 of the Compact, for a total annual cash grant of about \$8 million. As to Federal programs, Palau is estimated to be receiving a minimum of \$5 million in benefits in FY 80 and will presumably receive at least that much in FY 81 (this includes higher education scholarships which are not normally counted in evaluation of Federal programs applicable to the TTPI, but which will be affected by trusteeship termination). Under the Compact Palau would receive about \$1.5 million in Federal services under Section 221(a) of the Compact and an as yet undetermined benefit (assumed to be very roughly \$1 million) in health and education programs provided for under Section 221(b) of the Compact, for a total program component of roughly \$2.5 million.

Interior has already begun the initial analysis which will lead to the formulation of an FY 1982 TTPI contingency budget. This budget is intended to give the Federal Government the resources it will need to support the TTPI in the event that the Compact has not been fully implemented by the beginning of Fiscal 1982, on October 1, 1981. I certainly agree with the need for such an arrangement. However it is essential that this contingency budget not exceed the total amounts allocated to the TTPI entities under the Compact lest we create a disincentive to their prompt approval of the Compact. I therefore asked Interior to bring me into the process. They have consequently briefed me on the budgetary analysis which has emerged from their preliminary work. Two serious problems emerge from that review:

A. Federal Programs. Compact Section 221(a) identifies certain Federal technical services which will continue under free association and these have been costed out for the Compact period. Section 221(b) provides that

certain health/education Federal programs will continue under free association, but these have yet to be negotiated. All Federal programs other than those provided for in Sections 221(a) and (b) are to be discontinued at the end of the trusteeship.

Accordingly, since current Federal programs in the TT are virtually impossible to quantify, we can neither project the cost of Federal programs under the 1982 contingency budget nor do more than roughly estimate the Federal programs which would apply in 1982 under the Compact; we know only that the cost under the Compact would be significantly lower because far fewer programs would be available to the Micronesian entities under the Compact. The problem is complicated by the fact that many of the programs that will terminate with the trusteeship will be considered luxuries which the Micronesians will not seek to replicate out of their own funds under free association. Others, however, perform functions they may consider essential. Therefore any comparison between 1982 contingency levels and the Compact will need to be based on assumptions as to which of the Federal programs now operating in the TTPI will be replaced by the Micronesians out of their Compact grant funds.

In working out the 1982 contingency budget Interior is ignoring Federal programs altogether. It is simply establishing 60% of the Compact grant funds in each entity (the maximum proportion of the Compact grant funds which the Compact permits the entities to use for government operations) as the ceiling for the proposed 1982 TT contingency budget. Accordingly, Interior's computations fail to take into account the indeterminate additional benefits which the TT entities will receive through Federal programs in FY 1982 if the Compact is not effective by then.

B. Palau. As previously stated, the amounts allocated to Palau through the TTG in FY 80 and 81 exceed the sums offered Palau under the Compact even without taking into account the approximate 50% reduction Palau is expected to sustain in Federal programs after trusteeship termination. Because of the effects of inflation the High Commissioner has already proposed a \$10.5 million allocation for Palau under the 1982 contingency budget, or

roughly 20% more than the cash grants which would come to Palau under the Compact. Officials at the working level of Interior therefore conclude that the PCST is correct in its negotiating position that Palau cannot live on the amounts offered in the Compact.

II. The FY 1982 Contingency Budget.

The Interior analysts state that roughly 70% of Palau's money is now going for health/education, public works and fuel and that these proportions are projected to obtain through the end of the trusteeship.

-- They believe that the amounts spent for health and education could be reduced only by reducing services (viz., eliminating schools in remote areas, reducing medical referrals, etc.) but that even such reductions would not close a gap of the magnitude that we are confronted with.

-- Reductions in public works expenditures would have an immediate impact on Palau's ability to maintain the infrastructure currently in place and being constructed under the CIP programs.

-- Despite its much smaller population Palau uses about a third of the fuel consumed by all three of the entities. This is evidently because it has a more highly developed economy and because its population is largely concentrated in the Koror area, all of which receives electrical service. Whatever the reasons, a reduction in fuel expenditure would require a further reduction in the already severely curtailed electricity hours which was one of the basic complaints addressed by our recent exercise in interim financing.

The Interior analysts' overall conclusion is, therefore, that the allocation to Palau can only be cut back if the Administration is prepared to undertake responsibility for reductions in basic, highly visible functions such as electricity generation, medical care, schooling and infrastructure maintenance. Such cutbacks usually elicit prompt responses from the Hill, if not from the Executive Branch.

I have told Interior that it is unacceptable from my standpoint for Interior to propose an FY 1982 budget higher than the amounts allocated to the same purposes under the Compact, both because this would undermine the Administration objective of achieving success in the negotiations and because it would constitute a statement by one part of the Administration that another part has taken insufficient account of what are described as the basic needs of Palau.

I conclude that the problem can be resolved only by (a) accepting the flak and reducing the amounts allocated to Palau under the 1982 standby budget; or (b) increasing the amounts allocated to Palau under the Compact.

III. The FY 1981 Budget.

For all the reasons stated above, the Interior analysts conclude that the amounts allocated to Palau in FY 1981 will also have to be increased, probably by a supplemental. Since the projected FY 1981 expenditures are in the same order of magnitude as the FY 1980 budget plus deficit, the Interior officials conclude that inflationary pressures are likely to produce an FY 81 deficit, particularly if fuel prices continue to increase. It will be necessary not only to avoid a new deficit in FY 81, but to liquidate the accumulated deficits from FY 79 and 80 if 1981 is to be the last full fiscal year of the trusteeship. Accordingly, they say, it is evident that the FY 81 budget will have to be substantially increased to avoid a new deficit and to liquidate the accumulated deficits.

An increase in the FY 1981 budget beyond that which is necessary to liquidate the accumulated deficits would have as damaging an effect on our Compact negotiating position as a 1982 contingency budget which exceeds the Compact amounts allocated to Palau; unless, that is, the Compact ceilings are increased commensurately.

IV. The Negotiating Situation.

As you are aware from our reports on our June negotiating session with the PCST, the single most important obstacle to a rapid conclusion of agreement with Palau on the draft Compact of Free Association seems to be

their claim that financial assistance allocated to Palau under the Compact is insufficient for their needs. The argument they have advanced in support of this position is that current levels of support for Palau through the TTG (not to speak of Federal programs) is higher than that which we contemplate under the Compact. Frankly, I find that argument compelling. There are other important issues with Palau as well; identification of USG military land requirements and final resolution of the nagging constitutional issue. I am at this point satisfied that the two latter issues can be resolved this summer. Accordingly, if we are able to reach agreement on financial support with the new Palau leadership we could well be in a position to initial the Compact with them by the end of the summer.

If USG experts are now advising that Palau cannot be run on the amounts allocated for that purpose under the Compact, it is neither conscionable nor logical for me to adhere in my negotiations to the position that Palau should agree to settle for those amounts.

If we were to agree to an increase in the sums allocated to the Palau operational budget under the Compact, it would not be politically possible to avoid at least a token gesture toward the other two entities. An increase in the Compact allocation for Palau would distort the rough per capita balance we achieved in our offers to the three entities and would subject us to the charge that we were rewarding Palauan obduracy in refusing to initial the Compact until now, while penalizing earlier initialers. Since attainment of the President's 1981 trusteeship termination objective requires initialing of the Compact by both Palau and the FSM by this fall, we need to avoid the delay which would result from this kind of a dispute. It is even possible that a further economic concession to Palau alone could stimulate new demands by the FSM and the Marshalls which might wreck the negotiations altogether. Since our current difficulties in getting the FSM to initial the Compact derive mainly from their financial reservations a token additional allocation to the FSM would, in my estimation, facilitate early and favorable FSM action. The Marshallese situation is complicated by negotiations which are now about to commence between the

Department of Defense and the MIG for renewal of the Kwajalein Interim Use Agreement. This requires separate analysis.

V. The Marshallese Interim Use Negotiations. The Marshallese are expected to make a number of demands as their price for renewal of the Kwajalein Interim Use Agreement at the negotiations which commence at DOD Thursday. Most of these demands would serve to benefit the people of Kwajalein Atoll, approximately one-quarter of the Marshallese population and an indispensable component in Marshalls President Amata Kabua's governing coalition. The Kwajalinians, however, have a complicated relationship with President Kabua which is dependent upon a whole series of interlocking arrangements.

DOD seems inclined to meet some, at least, of the anticipated demands because they see them as an inescapable price for tranquillity at this important facility. I am personally opposed to concessions in these negotiations which would undermine the KMR post-trusteeship arrangements already agreed to in the Compact.

If Defense is inclined to give something away in the context of the Interim Use negotiations anyway, I would certainly prefer that they avoid granting additional pre-termination benefits to the landowners within the context of the Interim Use Agreement. Instead, I would advocate an increase in the Compact allocation to the Marshallese Government that would (a) balance a like adjustment awarded to Palau and (b) be recognized by the Marshallese Government as the quid for renewal of the Interim Use Agreement.

VI. Conclusions.

In light of the foregoing, I urge consideration of the following immediate steps:

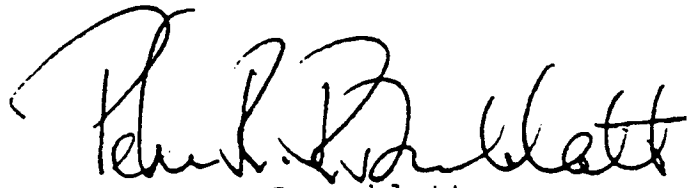
A. Rigorous but very rapid analysis of Interior's tentative conclusions with regard to the sums required by Palau in the FY 1981 budget and the FY 1982 standby budget. This must be completed rapidly because of the extreme time pressure we are under in the negotiations.

B. If the conclusion is reached that Palau needs more money reasonably to sustain itself in FY 1981 and 1982 than is allocated under the Compact, the U.S. Compact offer to Palau should be adjusted accordingly.

C. If the amounts for Palau are increased, the amounts for the FSM should be increased to some roughly comparable extent. The increases could be described as USG recognition of the additional fuel costs already being met in the FY 1979, 1980 and 1981 budgets as a result of the recent "transitional funding" decision.

D. A similarly small amount should be added to the Marshallese allocation upon the same ground, but with the additional understanding that there will, in return, be a renewal of the Interim Use Agreement without additional financial consequence until December 31, 1981.

E. Finally, an analysis of Federal program expenditures anticipated in 1982 must be undertaken. The results thereof must be taken account of in establishing the proposed funding levels in the 1982 contingency budget.



Peter R. Rosenblatt



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July 23, 1980

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MEMORANDUM FOR ROZANNE RIDGWAY

FROM: Peter R. Rosenblatt

SUBJECT: Palau Funding, Executive Summary

You will recall my mentioning at our meeting on July 11 a new problem which had just come to my attention. Interior's planned level of funding for Palau government operations in FY 81 and the projected level in the FY 82 contingency (assuming no Compact) budget exceed the levels provided for in the Compact. Estimates of the essential figures are as follows:

FY 80:	\$8.4 million (including \$1.1 million deficit)
FY 81:	\$8.7 million
FY 82:	\$10.5 million (proposed contingency, in event trusteeship continues)

These figures are only those directly allocable to Palau and they include additional moneys Palau will get for FY 80 and 81 to meet the added cost of fuel. They do not include the cost to the U.S. Government of TTPI-wide Federal programs from which Palau also benefits. By contrast, the Compact provides only \$7 million a year in operating costs for the first ten years of its life and \$6 million per year for the final five years, with an inflation adjustment of not more than 7% per annum from the 1981 base year, an estimated \$1 million per year as Palau's pro-rata share of certain region-wide funding schemes, and a limited number of Federal programs and services--far fewer than those which apply now and until trusteeship termination.

If Palau will require \$10.5 million in operating expenses in FY 82 in order to survive--and Interior's budget-analysts genuinely believe it will--then we cannot reasonably offer must less than that in the Compact. Furthermore, my negotiating position becomes untenable if the USG agency charged with the management of the TTPI


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implicitly recognizes--as the Interior budget submission would--that the Compact amounts we are offering are seriously insufficient.

The attached paper analyzes the situation and furnishes detail in justification of the recommendations which appear in its conclusion.



Peter R. Rosenblatt

Attachment a/s

cc: Wallace Green, TIA
Ron Cogswell, OMB

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