

DUTIABLE STATUS OF WATCHES, CLOCKS, AND TIMING APPARATUS FROM INSULAR POSSESSIONS

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Mr. LONG of Louisiana, from the Committee on Finance, submitted
the following

REPORT

[To accompany H.R. 8436]

The Committee on Finance, to which was referred the bill (H.R. 8436) to amend the Tariff Schedules of the United States (TSUS) with respect to the dutiable status of watches, clocks, and timing apparatus from insular possessions of the United States, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

SUMMARY OF COMMITTEE AMENDMENT

The committee amendment imposes a quota on the number of watches¹ and watch movements containing any foreign components which may be imported duty free from the U.S. insular possessions. Under the quota (which will be imposed on a calendar year basis) an amount of watches equal to one-ninth of total U.S. watch consumption for the preceding year is to be allocated among the possessions with the largest share going to the U.S. Virgin Islands. Specifically, seven-eighths of the quota is to be for the Virgin Islands. The remaining one-eighth share is to be divided—two-thirds for Guam and one-third for American Samoa. On the basis of anticipated watch consumption for 1966, the 1967 quota amount for each of the possessions would be 4,083,334 from the Virgin Islands, 388,891 from Guam, and 194,442 from American Samoa.

GENERAL STATEMENT

A. Background.—Under paragraph (a) of general headnote 3 of the TSUS articles, the growth or product of a U.S. insular possession

¹ Generally, whenever the term "watches" is used in this report, unless the context indicates to the contrary, such term includes watch movements.

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outside the customs territory of the United States, are free of duty when imported into the U.S. customs territory if they do not contain foreign materials to the value of more than 50 percent of their total value. This duty-free rule for the possessions was enacted in 1954 (sec. 401 of Public Law 83-768, the Customs Simplification Act of 1954). Prior to this amendment, all products of Guam and American Samoa were duty free whereas products of the U.S. Virgin Islands were subject to duty if they contained over 20 percent of foreign material.

The 1954 statute not only provided uniformity of treatment among the possessions but it was calculated to, and in effect has, stimulated the development of light industry in the possessions. The development of light industry has helped the economy of the possessions, particularly the Virgin Islands, where numerous new businesses have been established to produce or assemble various articles for duty-free shipment to the United States. The following table indicates articles which have qualified for duty-free entry from the possessions.

TABLE 1.—*Assembled articles which qualify for duty-free entry from insular possessions*

[Compiled from Bureau of Customs]

Ball point blanks.....	Brass blanks manufactured in United States, shipped to Virgin Islands where sapphire ball is placed in tip to form a ball point.
Bonded or laminated piece goods.	
Button blanks.....	Drilling and finishing.
Cellulose sponges.....	Consisting of foreign cellulose material.
Chemical composition....	Consisting of diethanolamine salt, and diethanolamine, unreacted (inert).
Costume jewelry.....	Consisting of beads, crude castings of alloy metals, to be electroplated and assembled.
Clinical thermometer blanks.	Consisting of capillary stem glass, glass tubing, and possibly mercury.
Cravenetting of piece goods.	
Dyestuff intermediate....	In the form of naphthol solution.
Dye pigments.	
Fire hose.....	Consisting of heavy linen yarn.
Fishing rods.....	Component parts.
Floral arrangements....	Assembled from leaves, flower heads and stems and containers.
Keyholders.....	Consisting of (a) swivel; (b) jump ring; (c) sliding part; and (d) key ring.
Herbicide.....	Consisting of acid mixed with dimethylamine.
Knitted fabrics.....	Consisting of fine count dyed worsted knitting yarns.
Lace.....	From cotton yarn.
Medicinal tablets.....	Consisting of isonicotinic acid hydrazide, para-amino-salicylic acid, sodium paraaminosalicylate.
Nerosol black RF.....	Consisting of acid chrome black ET Ex. Conc., anhydrous sodium sulfate and sulfamic acid.
Pocket knives.....	Consisting of two sides of the knife, two blades, spring, and rivet wire.
Polyester beads (plastic)..	Coated with pearl lacquer.
Power transmission belts.	
Revolvers.....	Consisting of (a) barrel; (b) 6-shot cylinder and (c) frame assembly.
Rifles.....	Consisting of (a) 22 inch 30-06 barrel; (b) bolt-type rifle action; and (c) semifinished walnut stock.
Scissors and shears.....	Consisting of plated forgings of top blades with a recessed hole and bottom blades with a threaded hole, and steel screws.
Shavers and scissors.....	Assembled into completed products.

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TABLE 1.—Assembled articles which qualify for duty-free entry from insular possessions—Continued

Shirts and other clothing	Made from cloth imported from Japan or Europe.
Shoelaces	Consisting of cotton yarn.
Shoelaces, plastic or metal tips.	Consisting of imported braids.
Showerproofed piece goods.	
Silverplated tungsten wire	To be electroplated.
Slacks and shorts, women's.	Cloth from Italy, cut and sewn in Virgin Islands.
Sports and casual wear	Consisting of cloth made of cotton, linen, a mixture of linen and rayon, and possibly silk.
Starter pistols, blank	Assembled in Virgin Islands.
Sulfadiazine tablets	Powder form.
Trousers	Imported woolen material.
Tungstic acid	Made from imported tungsten ores and/or concentrates.
Universal joints	Consisting of component parts imported into Virgin Islands.
Vat-color print paste	Mixing of various ingredients.
Watch assembly.	
Whiskey and sherry wine	Rectified under formulas approved by the Alcohol and Tobacco Tax Division.
Wine	Consisting of grape wine of United States and sherry wine from Spain.
Zippers	From zipper chains in 100-yard lengths.

(Compiled by the staff, Senate Committee on Finance, from data submitted by the Bureau of Customs.)

Under present law, if not more than 50 percent of the total value of an article produced in the insular possessions is of foreign origin, it qualifies for duty-free treatment provided it has been subjected to some processing in the islands. The largest of the industries which have sprung up in the possessions as the result of the 1954 change is the watch assembly industry. This industry was first established in the Virgin Islands late in 1959 and since then has shipped virtually its entire output of watches to the United States free of duty. From barely 5,000 units in 1959, shipments rose to 3.6 million units in 1965 and current production in the Virgin Islands is at a rate well in excess of 4 million units a year. A comparison of apparent United States watch movement consumption with imports from foreign countries and from the Virgin Islands since 1958 is shown in the following table:

TABLE 2.—Apparent U.S. consumption of watch movements

(In millions)

	U.S. consumption	Imports from—	
		Foreign countries	Virgin Islands
1958.....	19.8	10.4	0
1959.....	24.8	13.5	0.005
1960.....	22.7	13.2	.044
1961.....	22.5	12.6	.173
1962.....	26.1	13.8	.420
1963.....	26.0	12.7	1.1
1964.....	27.4	13.0	2.4
1965.....	34.4	17.1	3.6

(Compiled by staff of Senate Committee on Finance, May 16, 1966.)

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These watches are assembled from parts and subassemblies obtained principally from Japan, West Germany, and France. An increasingly large volume of Soviet parts are also utilized in the assembly process. The value and source of these watch parts since 1960 are shown in the following table.

TABLE 3.—*Value and source of Virgin Islands imports of watch parts*

(In thousands of dollars)

Country	1960	1961	1962	1963	1964	1965
Japan.....	306	428	1,167	2,047	3,568	5,498
West Germany.....	10	14	69	444	1,389	1,773
France.....	17	114	460	722	1,401	1,741
Switzerland.....	270	159	131	116	28	43
Hong Kong.....					9	285
U.S.S.R.....			98	369	521	686
Other.....		2	6	31		21
Total.....	603	717	1,931	3,729	6,916	10,047

(Compiled from data supplied by Tariff Commission, May 16, 1966.)

In 1965, approximately 85 percent of the watch movements assembled in the Virgin Islands were 17-jewel movements, a small percentage of which had self-winding devices. Import duties on 17-jewel movements entering the U.S. customs territories from foreign countries range from \$2.60 to \$3.85 per movement if not having self-winding devices and from \$3.35 to \$4.60 per movement if having such devices. The most popular import from the Virgin Islands is a lady's 17-jewel movement, 0.6 to 0.8 inch in width without a self-winding device. If imported direct from a foreign country the import duty on this watch would be \$3.375. The foreign parts and subassemblies needed for it cost about \$3. Upon assembly in the possessions, it may be sold in the United States for about \$6.13 with a resulting tariff savings of \$3.375.

The method of assembly used in the islands does not vary greatly from plant to plant. A concern usually obtains all parts for a particular type of movement from the same foreign supplier; the parts are received both as unassembled parts and as subassemblies. Generally the major share of the parts are already assembled. The subassemblies and other parts are assembled into a complete movement which is then sold in the United States either to a parent organization or to retailers of private brands or other importers at prices ranging from \$4 to \$8 per movement. Virtually all of such movements are incorporated in watches that are sold at retail at prices ranging from \$12 to \$25. Most of the movements assembled in the islands are comparable in quality to the lower priced jewel-lever movements imported from Europe and Japan.

Because of the advantages available to a watch assembly operation in a possession, 16 companies have set up factories in the Virgin Islands. Four of these companies, accounting productionwise for more than 43 percent of the watches assembled in the Virgin Islands, also enjoy tax exemption. They receive 90 percent customs exemption, 75 percent income tax exemption, and 100 percent local tax exemption.

It is understood that at the present time 5 plants (all tax exempt) are assembling watches in Guam with tariff-free parts. No watches are currently being assembled in American Samoa.

The relative significance of the watch assembly industry to other industries in the Virgin Islands which export to the United States is shown in the following table:

TABLE 4.—General imports into the United States from the Virgin Islands, of specified commodities, by specified years—Value only

Commodity	1959	1962	1964	1965
Sugar.....	\$1,412,159	\$1,337,846	\$1,064,506	\$1,061,680
Wines and liquors.....	668,847	1,047,291	1,473,460	1,228,332
Yarns and fabrics of wool.....	0	8,962,249	2,004,303	3,911,746
Tungstic acid.....				434,606
Sodium compounds.....			270,446	608,621
Cosmetics and toilet goods.....	232,884	541,704	793,857	674,226
Unwrought tungsten alloys.....				651,485
Clinical thermometers.....	*206,369	*456,912	500,202	446,971
Watch movements.....	*26,035	2,796,909	14,168,504	21,374,055
Jewelry.....	1,282,566	1,369,918	1,376,829	1,500,273
Total.....	3,828,860	16,512,829	21,651,807	31,822,095
Grand total all commodities.....	\$5,467,205	\$19,038,647	\$23,684,602	\$34,573,839

Source: Compiled from Ft-800 (U.S. Department of Commerce) except figures noted by asterisk (*) which were taken from FT-161.

As can be seen from the table, watches accounted for a very small portion of the \$5 million of exports in 1959 but by 1965, they comprised two-thirds of total exports of \$34.5 million. This table also indicates that textile shipments from the Virgin Islands are again turning sharply upward.

In an effort to control the watch assembly operations and to forestall congressional legislation which would have prohibited duty-free importation of watches assembled in the possessions, the Virgin Islands Legislature, on August 30, 1965, enacted legislation (bill No. 2638) designed to limit watch assembly there for export to the United States to a quantity roughly equivalent to one-ninth of total apparent U.S. watch consumption for the preceding year. This local quota statute was attacked in the courts, and on March 14, 1966 was declared invalid by the U.S. District Court of the Virgin Islands (*Virgo Corporation v. Paiewonsky*, Civil No. 165-1965). The decision is being appealed. In the meanwhile, on March 16, 1966, a special session of the legislature passed a new statute to overcome the objections raised by the district court. On March 29, this new statute was attacked and on June 3, it too was declared invalid by the same district court (*Virgo Corporation v. Paiewonsky*, Civil No. 37-1966). This decision also is being appealed.

B. *The House bill.*—Shortly after the Virgin Islands Legislature enacted its quota law in August 1965, this bill was considered by the Committee on Ways and Means. In recognition of the local quota which had just been approved, H.R. 8436 was amended by that committee to exclude the Virgin Islands from the prohibition against duty-free treatment for watches imported from the possessions which the original legislation contemplated. It was understood that at that time no watch assembly operations were being carried on in any other possession and so a prohibition would not harm their economies.

Thus, as the bill passed the House, no watches could be produced or assembled in Guam or American Samoa for duty-free shipment into the United States while the operation in the Virgin Islands would be allowed to continue and also would be permitted to grow and share

in the continually expanding U.S. watch market. The principle of uniformity of treatment between the possessions, which was an important objective of the 1954 duty-free statute, would be substantially disrupted if the House bill is approved without amendment.

C. Reasons for the committee amendment.—In the interval since the House acted, a number of events occurred. First, two attempts by the Virgin Islands Legislature to establish local quotas have been struck down as invalid. Secondly, five watch plants have been established on Guam. As for American Samoa, the Department of Interior reported to the committee:

Several watch firms had been negotiating with the Governor of American Samoa last year looking toward their early entry into that territory. Once H.R. 8436 was introduced in the House of Representatives, however, the Governor broke off discussions with such firms, believing it inconsistent with his position as a Federal official to be engaged in an action which might be construed as an attempt to frustrate the Congress, or to take advantage of the Congress' need to weigh and consider the matter in deliberate fashion. Due to the very limited land available in American Samoa, and because of certain tax and quota powers vested in the Governor, the prior consent of the Governor of American Samoa is needed, as a practical matter, before substantial new activities are started.

These events, and the explanation of the lack of watch operations in American Samoa, convince the Committee on Finance that the premise on which the House passed the bill is not valid today. Moreover, the committee is convinced that uniformity of tariff treatment among the possessions is highly desirable and should be adhered to to the fullest extent. For that reason it believes that to the extent watch operations are to be permitted to continue on a duty-free basis, all the possessions should share in the economic stimulation this industry brings.

The committee gave particular attention to the growth of the watch industry in the Virgin Islands as compared to (1) growth in apparent watch consumption in the United States, and (2) watch imports. As shown in table 2, imports from the U.S., Virgin Islands in 1965 were 720 times the 1959 level; 8.6 times the 1962 level.

In sharp contrast, apparent U.S. watch consumption increased only 39 percent from 1959, and only 32 percent from 1962. These rates of growth would be even smaller were it not for the importation from Europe—apparently as a fad—of some 3 million pin lever pendant watches in 1965.

The rate of growth of imports of watches from foreign countries has also lagged far behind the growth in the possessions operations. The 1965 imports increased only 27 percent from 1959 and only 24 percent from 1962. Had it not been for the pin-lever pendant watches (which compete only to a degree with jewel-lever watches) 1965 imports would have shown practically no growth over the last 3 years.

The Committee on Finance recognizes that it may be appropriate to favor our insular possessions over direct imports so long as no domestic industry is harmed by the policy. During hearings before the committee, it became clear that there would be few additional watches manufactured domestically to replace those heretofore brought in duty

free from the possessions. To the contrary, it appeared that the principal beneficiary of a prohibition of duty-free treatment would be foreign watch manufacturers which previously have supplied the parts and subassemblies used in the Virgin Islands assembly operations.

On the other hand, it became equally clear that, if left unchecked, the Virgin Islands assembly operation soon would become little more than a convenient device for funneling foreign watches into this country—without payment of any duty whatsoever—and this would have a substantial adverse effect on domestic production of jewel-lever watch movements. Such an impact would be contrary to the purpose of today's relatively high duty on watches and watch movements.

This duty was fixed in a 1954 escape clause action rescinding most of the tariff concessions which had been granted in trade negotiations. The escape clause procedure calls for tariff increases for industries seriously injured by import competition as the jewel-lever watch industry has been. Unrestricted duty-free shipments from the insular possessions not only serve to deny the domestic watch industry the protection of the escape procedure, but also upsets normal trade patterns for direct imports of foreign watches and watch movements.

More importantly, if the Virgin Islands operation—which depends for its existence on high U.S. watch tariffs—is allowed to go unchecked, it would soon overpower the domestic industry. With the domestic jewel-lever watch industry gone the need for escape-clause protection would vanish and our trade policy would then dictate lower watch tariffs. If our tariffs come down, watch assembly operations in the insular possessions could not survive. In a very real sense, it would have been in its own executioner. This would be particularly ironic since it was the 1954 escape-clause proceeding which raised U.S. watch tariffs to the level where Virgin Island operations became profitable. Without that protection, the insular industry might never have been founded.

D. *Explanation of committee amendment.*—For the reasons described above, the committee has approved a quota arrangement under which the Virgin Islands, Guam, and American Samoa may share in the assembly of watch movements for duty-free transshipment into the United States. The annual quota for each calendar year will be based on the “apparent U.S. consumption” of watch movements in the preceding calendar year, as determined by the Tariff Commission. The Commission has been determining the apparent U.S. consumption of watch movements for almost of the years since 1936, and especially since 1954 in connection with the various investigations relating to the increased rates of duty imposed on watch movements in 1954 as the result of “escape-clause” action. It is intended that, for the purposes of this act, the Commission will continue to use for its determination of apparent U.S. consumption the same basis as it has used for the aforementioned investigations. After determining the apparent U.S. consumption, the Commission will publish it and compute and publish the number of watches and watch movements which could be assembled in the possessions in each quota year for duty-free export to the United States. This overall quota would be subdivided by the Tariff Commission among the possessions as follows:

(1) Seven-eighths of each annual quota is to be for the Virgin Islands; and

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- (2) The remaining one-eighth share is to be further divided—
(a) Two-thirds for Guam; and
(b) One-third for American Samoa.

On the basis of the best estimates available at this time as to the level of watch consumption in the United States for 1966, this quota arrangement will permit the following number of watch movements to enter duty free from each of the possessions for the first quota year, beginning January 1, 1967:

Virgin Islands.....	4, 083, 334
Guam.....	388, 891
American Samoa.....	194, 442
Total, all possessions.....	4, 666, 667

This division of the quota, in the committee's judgment, adequately balances the historical development of the assembly operation in the Virgin Islands with the need for economic expansion and industrial development diversification of Guam and American Samoa in a manner consistent with the restraining objective of a quota arrangement.

The quotas allocated to each of the possessions would be further allocated jointly by the Secretary of Commerce and the Secretary of the Interior to the individual concerns assembling watch movements in the possessions. By providing for joint administration of this new quota in Washington rather than in the possessions the committee amendment insures that the commercial and industrial expertise of the Department of Commerce will coordinate with the territorial expertise of the Department of the Interior so that all factors important to the proper allocation of the quota among each possession's producers will be weighed in proper perspective. Their joint efforts will contribute to the "fair and equitable" allocation which the committee amendment requires.

In allocating the quota among the producers in each possession the committee expects that the Secretaries will act in a manner best calculated to reflect and preserve the established character of the industry in the Virgin Islands. The committee recognizes the unusual situation existing in the watch assembly industry in that possession: Its producers have been under production restraints. The restraining ordinance has been set aside by one court but the decision is being appealed to another. Some producers have begun to exceed the production levels allotted to them under the local restraints while others are continuing to limit their output to the previously authorized levels. These unsettling factors have upset the normal pattern of production in the islands.

Production experience should be an important factor in allocating production quotas under the committee amendment. However, it should be recognized that the quota allocated to the Virgin Islands does not differ substantially from the restraints to which its producers have previously been limited. Company allocations under the local restraint were fixed through a formula which recognized prior production but which gave more weight to payroll. Your committee believes the cost of direct labor involved in the assembly of a watch is a factor which well might be taken into account by the Secretaries in making the "fair and equitable" allocation called for by the statute. This factor is a measure of the economic contribution being made

by the assembly process, and also is an indication of the degree of assembly work being performed in the islands.

The Secretaries, in administering this quota law, may also take into account whatever additional factors they find to be warranted and may apply these factors over whatever production period they determine to be appropriate. The Secretaries might further find it advisable to conduct hearings at which watch companies engaged in the assembly process might contribute their views as to the determination of a fair and equitable allocation.

Their allocations, whether made on the basis of an entire year, or for a shorter period, are to be final. It is the committee's desire that the administration of this quota arrangement should not be delegated to the field but should be exercised in the national offices.

CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

TARIFF SCHEDULES OF THE UNITED STATES

GENERAL HEADNOTES AND RULES OF INTERPRETATION

1. **Tariff Treatment of Imported Articles.** All articles imported into the customs territory of the United States from outside thereof are subject to duty or exempt therefrom as prescribed in general headnote 3.

2. **Customs Territory of the United States.** The term "customs territory of the United States", as used in the schedules, includes only the States, the District of Columbia, and Puerto Rico.

3. **Rates of Duty.** The rates of duty in the "Rates of Duty" columns numbered 1 and 2 of the schedules apply to articles imported into the customs territory of the United States as hereinafter provided in this headnote:

(a) **Products of Insular Possessions.**

(i) **[Articles]** *Except as provided in headnote 6 of schedule 7, part 2, subpart E, articles imported from insular possessions of the United States which are outside the customs territory of the United States are subject to the rates of duty set forth in column numbered 1 of the schedules, except that all such articles the growth or product of any such possession, or manufactured or produced in any such possession from materials the growth, product, or manufacture of any such possession or of the customs territory of the United States, or of both, which do not contain foreign materials to the value of more than 50 percent of their total value, coming to the customs territory of the United States directly from any such possession, and all articles previously imported into the customs territory of the United States with payment of all applicable duties and taxes imposed upon or by reason of importation which were shipped from the United States, without remission, refund, or drawback of such duties or taxes,*

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directly to the possession from which they are being returned by direct shipment, are exempt from duty.

(ii) in determining whether an article produced or manufactured in any such insular possession contains foreign materials to the value of more than 50 percent, no material shall be considered foreign which, at the time such article is entered, may be imported into the customs territory from a foreign country, other than Cuba or the Philippine Republic, and entered free of duty.

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SCHEDULE 7. SPECIFIED PRODUCTS; MISCELLANEOUS AND NONENUMERATED PRODUCTS

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Part 2. Optical Goods; Scientific and Professional Instruments; Watches, Clocks, and Timing Devices; Photographic Goods; Motion Pictures; Recordings and Recording Media

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SUBPART E.—WATCHES, CLOCKS, AND TIMING APPARATUS

Subpart E headnotes:

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6. Products of Insular Possessions.—(a) *Except as provided in paragraph (b) of this headnote, any article provided for in this subpart which is the product of an insular possession of the United States outside the customs territory of the United States and which contains any foreign component shall be subject to duty—*

(i) *at the rates set forth in column numbered 1, if the countries of origin of more than 50 percent in value of the foreign components are countries to products of which column numbered 1 rates apply, and*

(ii) *at the rates set forth in column numbered 2, if the countries of origin of 50 percent or more in value of the foreign components are countries to products of which column numbered 2 rates apply.*

(b) *If the requirements for free entry set forth in general headnote 3(a) are complied with, watches (provided for in item 715.05) and watch movements (provided for in items 716.08 through 719.—) which are the product of the Virgin Islands, Guam, or American Samoa and which contain any foreign component may be admitted free of duty, but the total quantity of such articles entered free of duty during each calendar year shall not exceed a number equal to 1/9 of the apparent consumption of watches during the preceding calendar year (as determined by the Tariff Commission), of which total quantity—*

(i) *not to exceed 87.5 percent shall be the product of the Virgin Islands,*

(ii) *not to exceed 8.33 percent shall be the product of Guam, and*

(iii) *not to exceed 4.17 percent shall be the product of American Samoa.*

(c) *On or before April 1 of each calendar year (beginning with 1967), the Tariff Commission shall determine the apparent consumption of watches during the preceding calendar year, shall report such determination to the Secretary of the Treasury, the Secretary of the Interior, and Secretary of Commerce, and shall publish such determination in the Federal Register, together with the number of watches and watch movements which are the product of the Virgin Islands, Guam, and American*

Samoa which may be entered free of duty under paragraph (b) during the calendar year.

(d) The Secretary of the Interior and the Secretary of Commerce, acting jointly, shall allocate on a fair and equitable basis among producers of watches and watch movements located in the Virgin Islands, Guam, and American Samoa the quotas for each calendar year provided by paragraph (b) for articles which are the product of the Virgin Islands, Guam, and American Samoa, respectively. Allocations made by the Secretaries shall be final. The Secretaries are authorized to issue such regulations as they determine necessary to carry out their duties under this paragraph.

