PACIFIC ISLANDS POLICY 1

Is That the Best You Can Do?

A Tale of Two Micronesian Economies

FRANCIS X. HEZEL, S.J.

EAST-WEST CENTER

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Executive Summary

The Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI) became self-governing states in free association with the United States in 1986 and have other similarities that distinguish them from the Republic of Palau and the Commonwealth of the Northern Marianas. The latter are the other two entities in Micronesia that were also part of the former U.S. Trust Territory of the Pacific Islands. In this report, Francis X. Hezel, S.J., analyzes economic development initiatives and their underlying assumptions in the FSM and RMI. He poses a fundamental question: Are the small island states of Micronesia capable of achieving self-sustaining economies?

During the Trust Territory era, it was simply assumed that the United States would lead the islands to economic independence. The means were never specified, but, nonetheless, there was widespread optimism that a cash economy based on local resources would somehow grow alongside the subsistence economy. However, Trust Territory budgets barely covered the costs of administration, capital investment of any kind was virtually nonexistent, and local economies remained stagnant.

The early 1960s witnessed a major shift in policy, and conventional approaches to economic development were implemented. Initially it was assumed that an investment in human resources would produce the desired results. Within a decade, budgets were increased tenfold, and large sums were invested in education and health. In the 1970s, the emphasis shifted to infrastructure investment, the next hoped-for key to success. An unintended consequence of both initiatives was that the public sector became the largest source of aid employment. Wages and other government expenditures stimulated only modest development in the private sector, which remained disappointingly small. Most such efforts were marginally successful at best. In the last analysis, little in the way of economic development was achieved and the FSM and RMI became heavily dependent on the United States.

The arrangements for self-governance in the 1980s were set forth in the Compacts of Free Association for the two nations. Beginning in 1986, the

United States provided generous financial support for a period of 15 years, and it was anticipated that Micronesians would chart their own course to achieve some measure of self-sustainability. At the end of the allotted time that goal remained as elusive as ever. Funding was extended until 2004 when a second round of Compacts was negotiated for both nations. These cover a period of 20 years and provide an exit strategy for the United States, whose direct assistance will end in 2024. There is little optimism that self-sufficiency will be achieved within that time frame, and the United States is committed to establish trust funds that are intended to generate income sufficient to replace American subsidies.

The FSM and RMI have never been short of external advisers. Agencies of the U.S. government, the Asian Development Bank, and other international financial institutions have offered similar recommendations. All are based on notions common to conventional Western economic thought, and the minimal recommendations are standard fare: reduction of the public sector in favor of private sector growth, decreased dependency on overseas assistance by internally generated economic growth, greater transparency and impartiality in government, and the creation of a hospitable environment for investment, including the commoditization of land.

In earlier years, Hezel was comfortable with conventional approaches to economic development, but his observations in this paper reveal a change of heart. Conventional approaches have failed and Hezel has reservations about today's prevailing recommendations. These plans, he believes, conflict with traditional cultures that emphasize the communal values of sharing labor and resources within extended families and the larger community. The issue of land is particularly sensitive. Land is held by extended kin groups, and the very structure of social relations and organization is largely based on inherited rights to land. Attachments to ancestral lands are deep and spiritual-like in quality. Identities are rooted in land, and the products of the land represent security. Land is largely inalienable, not a commodity for the auction block. Hezel has come to doubt that the limited resources of the small islands will ever provide the means to support self-sustaining cash economies.

Hezel has also been influenced by the work of other researchers who have analyzed the so-called MIRAB economies first described for several Polynesian nations. These economies, and the acronym, are based on the now familiar elements of migration, remittances, aid, and bureaucracies. Migrants living and working abroad send remittances to their relatives back home. Financial assistance continues from overseas donors, and in some instances has been increased. Traditional economists view MIRAB economies as anomalies. It is argued that such economies are precarious because they are not based on local resources and are dependent on factors external to and beyond the control of the island nations. Such critics ignore the fact that the value of local resources and products offered for export are also determined by larger world markets. Furthermore, the elements that make up MIRAB economies are nowhere endangered or under threat. Those economies have proven stable over time and provide higher standards of living than predicted by traditional models. Trust funds are compatible with MIRAB economies and add a new variable to the equation.

The FSM and RMI have all the elements of MIRAB economies but one. As well as financial assistance, the Compacts of Free Association provide Micronesians with free access to the United States and its possessions, and many thousands have migrated to the United States, Guam, and the Commonwealth of the Northern Marianas. The migration of substantial numbers of Micronesians has been relatively recent, and to date, remittances have been negligible. Hezel suggests that while time and funds may be needed for migrants to get established in new locations, the potential to develop a revenue flow from remittances should not be overlooked. He encourages the island governments to explore incentives to accomplish that very end.

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The Plea to Grow an Economy

The lack of self-reliance in Micronesian economies is being decried today, as it has been for years. Leading the chorus is the U.S. Department of the Interior, with considerable support from the Congress and other elements in Washington. They believe it is high time that those island nations—once part of the U.S.-administered Trust Territory of the Pacific Islands—develop a viable domestic economy. The tune was played just a few years ago during the earliest round of negotiations between the United States and two Micronesian nations—the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI)—over an extension of funding from the United States under the Compacts of Free Association for another 20 years. At a meeting between the principals of the U.S. negotiating team and representatives from the FSM, the U.S. spokesman admitted from the outset that the low initial funding proposal made by the United States was "designed to show that too much funding in the first 15 years has created a 'lotus-eating society' in which there is no incentive to grow a private sector" (Stovall 2000). The U.S. negotiator was reflecting the feelings of public officials throughout Washington, who viewed compact funds to the FSM and the RMI during the first 15 years as poorly spent, if not wasted outright, and the attempt to promote economic self-reliance as a failed enterprise.

At the FSM Economic Summit held on Pohnpei in March 2004, a representative of the U.S. Department of the Interior commented on the disappointing results of the first compact period in typical fashion:

> The first economic assistance package under the Compact of Free Association provided over $1.5 billion to the FSM since 1986.… Most of that $1.5 billion, over $890 million, was spent on the day-to-day operation of the FSM State and National governments. No less than $334 million was spent on the "capital account" for capital improvement

> projects and economic development…. The use of Compact funding did not achieve the social gains or as much economic growth as all had expected in 1986. After 17 years of Compact assistance, levels of academic achievement and health care, the effectiveness of government services, the condition of the schools and hospitals, roads and ports, water and sewer, and even electrical services are not what the FSM's founders or any of us present today had hoped (USDI 2004).

There was a time when my voice was singing the same tune, perhaps just as loudly, even if to a less influential audience. Thirty or more years ago, as the money stream from Washington became a torrent, I worried that America's largesse would undermine the restraint to which the Micronesian leadership seemed to have committed itself as it prepared for self-government.[1] The formula, as it seemed to some of us then, "was simple and incontestable: economic development (increased productivity and reduction of imports) + cutback in cost of government = self-reliance = political autonomy" (Hezel 1982c, 144). Financial restraint seemed essential on the very eve of what was expected to be independence, yet it did not appear to enjoy much real favor either in Washington or in the islands, although it received lip service in both quarters.

Here, I address the question of what it might mean for the new Micronesian nations to "grow" suitable economies today—that is, economies marked by classical self-reliance—or whether this is even possible. I explore the economies of the FSM and the RMI, economies that have much in common with one another. The discussion will not include the Republic of Palau, another part of the former Trust Territory of the Pacific Islands, but one whose economy, political trajectory, and even date of independence show marked differences from the other two Micronesian nations. Before examining the current situation of these nations, I review some major policy decisions prior to their independence that might have helped to shape both the island economies and people's attitudes toward them. It is not my intention to blame any one country for the policy failures of the past or the present; some outcomes for small Pacific countries are inevitable, and for those that are not there is more than enough blame to go around. Finally, this essay is intended as a journey—one that follows the course not just of the two island nation economies, but also of various development formulae as well as my own personal musings on what it means to be a self-reliant nation.

[1] Several of my earlier papers—"Creation of a Colony," "The Micronesian Dilemma," "Taking the Long View," "The New Formula for Self-Reliance," and "Yesterday's Myths, Today's Realities"—may be found in *Reflections on Micronesia: Collected Papers of Father Francis X. Hezel, S.J.* (1982).

The Postwar Economics of Austerity

At the end of World War II, the United States assumed administration of what had once been a League of Nations Mandate under Japanese rule. The Mariana Islands (with the exception of Guam), the Carolines, and the Marshalls were placed under the authority of the U.S. Navy, which governed them on behalf of the United Nations from 1947 to 1951 as the Trust Territory of the Pacific Islands. The Pacific Charter, as it was called, stipulated that the U.S. administration was to lead the islands to "economic independence"—understood to mean a slow-paced approach to development that would safeguard local interests (Richard 1957, 282). This policy was continued for another decade, even after administration of the islands was transferred from the Navy to the Department of the Interior in 1951. A paper I wrote in 1968 describes the thinking behind this policy:

> [During the early years of the U.S. administration] there was widespread optimism…that self-sufficiency was a realistic goal for the Trust Territory. This belief was sustained in part by the impressive record of Japanese accomplishments in these islands prior to World War II. With the help of imported labor from Okinawa, the Japanese had succeeded in making Micronesia an entirely self-supporting colony with a favorable balance of trade.[2] This was again to be the goal of the U.S. trusteeship, but with certain qualifications. The pace of development was to be geared to the desires and the capacity of the people, respect was to be paid their fondness for the traditional patterns of life, and wages were to be kept consistent with the productivity of the economy. Government appropriations for health and educational services were carefully controlled in the hopes of fashioning a self-contained economy. Capital investment on the part of the U.S. government was called for; however, private investment was discouraged, as it was in other Pacific colonies, for fear of exploitation and eventual alienation of the land. In all, this philosophy of economic development was a cautious one that was on guard against the "creation of a mendicant economy and the growth of a subservient spirit among the indigenes" (O'Connor 1952, 4). It rested on the assumption that limited quantities of foreign imports could become "incentive goods" to spur the native population on towards ever greater productivity. Meanwhile,

[2] The economic success of the colony was due not only to imported labor but also to the substantial transport subsidies granted by the Japanese government (see Yanaihara 1940).

their commercial economy, which would develop side by side with the subsistence economy, was based on cash income from copra, fishing, and several small-scale agricultural ventures.[3]

This policy had much to recommend it, even if it was never fully implemented by the administration. Blame for the failure to implement it, however, cannot be assigned entirely to the administration. The annual appropriations allocated to the trust territory by the U.S. Congress were in the neighborhood of $5–6 million (in 1960 dollars), barely enough to maintain the existing operations. Furthermore, expenses were necessarily multiplied by the unavoidable inefficiency that resulted from the duplication of facilities throughout the disparate archipelago. Nevertheless, a modest attempt at economic development was made, and until 1956 the income from Micronesia's exports actually exceeded the cost of its imports.[4]

By 1960, however, certain hard facts had become evident. Export values had reached a plateau at about $2 million. There appeared to be little hope that economic growth could be accelerated from within the present internal structure; a large capital outlay was needed from without for this purpose. All over the Pacific, colonial powers were awakening to the fact that the solution to the problem of their dependencies' self-support did not lie in diversification of crops, as all had once believed (Barrau 1962). A large increase in subsidy was needed; but this also meant that the powers must prolong their ties with their island holdings, where once they had dreamed of a rapid economic maturity and an early severance of bonds (Hezel 1982a, 2–3).

There appeared to be little hope that economic growth could be accelerated from within

[3] The proponents of this economic policy were chiefly O'Connor (1952) and Oliver (1951). Both works had a strong influence on government planning in the early years of the Civil Administration in Micronesia.

[4] To be fair, it should be noted that the major export in 1955 was phosphate ($2.7 million) from Angaur, Palau, where mining operations were begun by a German company in the early twentieth century and continued by the Japanese. Copra, the one dependable export throughout those early years, accounted for $1.3 million. Sale of fresh produce and handicraft brought in $0.1 million, while trochus shell exports were nearly the same. Scrap metal from the war constituted another major export during those early years, but this and the remaining phosphate on Angaur were exhausted by the mid-1950s. Export figures from USDS (1955).

About-Face in the 1960s

In the early 1960s, during the Kennedy administration, the United States reversed its policy of the previous 15 years in favor of a fast-track approach to development in the islands. Washington policymakers were stung by the 1961 United Nations Visiting Mission's report that found "considerable dissatisfaction and discontent" among the islanders and the team's complaint that the Micronesian economy had "been allowed to remain static for too long" (UNTC 1961, 12). At that critical point in the Cold War, when the Berlin wall was being erected and the Soviets were attempting to arm Cuba, the United States saw itself as engaged in a key struggle to win the sympathy of the Third World. How could it expect to gain the confidence of these nations if it could not even properly manage its own Pacific territory? Moreover, development theorists of the day were just beginning to promote a new approach—"investment in man," as it was then called—as opposed to the mere accumulation of savings that could be used as investment capital. By investing in social services, particularly education and health, the nation would create a population that would see to its own development (Hezel 1995, 299–302).

The United States made a sudden shift in direction and decided, with the full approval of the island people, to speed up its development program in Micronesia. In doing so, the administration doubled its annual budget in 1963, then doubled it again the following year, increasing it tenfold by the end of the decade.

> The capital expenditures in the new development program undertaken by the United States in the 1960s were concentrated largely on the expansion of health, education, and governmental facilities…. Funds were poured into the construction of new hospitals, schools, and teachers' housing. Money was set aside for the hiring of many additional American contract teachers and medical supervisors. For the first time, the ideal of universal education for Micronesians became a working norm. The quality of education was also stepped up. Not only did the percentage of population enrolled in school rise sharply during those five years, but the per capita expense on elementary school-children increased fourfold (Hezel 1982a, 5).

The effect of this policy shift was an immediate improvement in the quality of educational and health facilities, greater availability of supplies, and the hiring of new trained personnel to work in the schools and hospitals. Educational standards seem to have improved during those years, although there are no reliable figures to document this impression inasmuch as there were no standardized tests at any educational level that could be used for comparison. The beginning of self-rule in 1978, however, saw a gradual decline in educational standards (and perhaps in delivery of health services as well), according to most people. If this is indeed the case, then the progress made even in the targeted areas of education and health was not sustainable over the long haul.

The policy change also led to the incorporation of the village schools and dispensaries, formerly supported entirely by the local communities, into a centralized system. As a result, local communities have never reasserted their ownership over what were once very much their own institutions, so that even today village elementary schools are regarded as the responsibility of the government. Local community input into these services has diminished to the vanishing point.

The administrative structure of the government grew in size throughout the 1960s as the number of those employed by the government doubled by 1966, and then quadrupled by the end of the decade. This growth created thousands of new jobs that were filled by Micronesians, but it also gave rise to the bloated bureaucracy that became a standard feature of island governments for years afterwards. The rapid growth of the government workforce also generated a service economy in the private sector—restaurants, stores, bars, movie theaters, and the like—that has ever afterward relied on government spending to fuel it.

The inevitable result was a growing distance between sharply rising imports and flat-line exports, leading to the trade imbalance that is today the subject of frequent admonitions. As I tried to describe the impact years ago:

> Whatever effect all this may have had on the economy of Micronesia, it did not bring about any striking increase in the production of marketable goods…. The value of imported goods, on the other hand, doubled from 4.5 million dollars in 1961 to 9 million dollars in 1966 …. The trade deficit leapt from two million to six million dollars in five years.[5]
>
> What happened, it appears, is that the imported goods which were to act as an incentive to greater economic productivity have been consumed far beyond the economy's ability to pay for them with its own produce. The rabbit is now chasing the dog. The "want development" that is described by economists as a natural part of the maturing process of a developing country has outrun the industrialization that it

[5] In fact, the value of exports for 1966 swelled to $3.6 million, while imports for that year were recorded at $8.9 million, producing a trade deficit of $5.3 million; the ratio of imports to exports was 2.5:1 (USDS 1966).

> was meant to pursue. In order to finance its needs, Micronesia must rely ever more heavily on government employment (Hezel 1982a, 6).

Additional pressure was placed on the government bureaucracy by the education explosion that was occurring as dozens of new elementary schools were built and as a high school education was offered to hundreds more students.

> As the education process in Micronesia continues to turn out thousands more potentially valuable employees, the government is forced to expand to absorb as many as possible into the administrative structure. Many others it simply cannot employ. The payroll grows longer, while the cost of providing for the growing social services threatens to devour an ever greater percentage of public funds. It has been observed already that the cost of social services is rapidly outstripping the capacity of the economy to afford them…. Such a pattern is not terribly unsettling, provided there is a rich uncle around to collect the bills. But if a self-supporting economy is still the goal of both the administering authority and the territory, then the trend must be reversed and proper emphasis given to economic development needs (Hezel 1982a, 7).

Social development, and the theories underpinning it, drove the expansion of the 1960s in Micronesia. The guiding assumption was simply: Educate people and give them a taste of the good life, and they will find ways to sustain themselves and their economy in years to come. But from today's vantage point it appears that what is now termed "fiscal discipline" suffered a serious setback when U.S. policy in the islands shifted.

On the Eve of Independence

By 1970, Micronesian leaders were beginning serious negotiations with U.S. officials for an end to the trusteeship and a permanent political status. Political self-determination and some degree of self-government—whether full independence, U.S. territorial status, or something in-between—were within islanders' reach at last. Even so, the insistence on budgetary restraint that had guided the development pattern of the territory during its early postwar years had vanished. As I described it in an article written in 1979:

> There are a few diehards who now and then still invoke that quaint old principle of self-reliance, but they are fast becoming an endangered

> species. For the most part, Micronesians and expatriates espouse a different creed: "Eat, drink and enjoy your ample government services, for in a couple of years we'll all become fully self-governing anyway." The outdated vision of the sixties has given way to a new formula: political autonomy can be bought cheaply without the sacrifices and austerity measures that were once thought necessary. The cost of government need not be slashed after all. We can have all the services to which we have grown accustomed and the full number of jobs that they bring. There is a new and painless way to achieve political maturity while maintaining the present level of government services (Hezel 1982c, 145).

It was assumed that new productive industries could be grafted onto the existing economy without any cutback in government services. Indeed, U.S. annual subsidies increased steadily throughout the 1970s, even as a U.S.-funded capital improvement program was mounted. With the firm backing of Micronesian leaders, the U.S. administration rushed to complete the infrastructure that was thought to be necessary before the islands were given self-government. The supposition was that once a suitable infrastructure was in place, the task of achieving economic development would be that much easier. During that decade, from 1970 to 1979, the United States allocated a total of $250 million to build airfields, pave roads, construct dock facilities, and put up new schools, among other things (Hezel 1984, 37–40). The immediate impact of this rapid buildup of infrastructure on economic productivity was minimal, as registered in the balance of trade. In 1977, the year before self-government was to begin, the ratio of exports to imports was 1:4.[6]

In the mid-1970s the United States made a well-intentioned but ill-timed decision to extend President Lyndon Johnson's War on Poverty initiative to the islands. The trust territory became eligible for federal assistance under a myriad of different programs, all of which were over and above the ordinary yearly subsidy. Just as the islands were supposedly preparing for self-government, the administration extended the Hot Lunch program to schoolchildren throughout

[6] The *Annual Report on the Administration of the Trust Territory of the Pacific Islands* for 1977 gives imports as $39.7 million and exports as $10.3 million (USDS 1978). The figure for exports represents a marked increase over past years and was due to three new commodities: tuna, coconut oil, and copra cake. Tuna exports, valued at $4 million, came from shipments from the Van Camp plant in Palau but represented little economic gain for the islands. The copra cake and coconut oil were products of a mill that opened in Palau, but which would close a few years later (Hezel 1984, 41).

the islands (some islands refused it outright, but most did not). The Women-Infant Care Program provided benefits for nursing mothers, while the Aging Program offered "Meals on Wheels" and other services for senior citizens who would normally have been entrusted to the care of their own families. Between 1974 and 1979, the trust territory received about $120 million in such funds (Hezel 1984, 41).

Was there ever a move better calculated to create dependency than this extension of unnecessary services to a population that was being readied to face the challenge of belt tightening as it assumed full authority over its own government? How could anyone have possibly imagined that the array of new programs funded could be sustainable? Writing from my usual conservative economic policy position, I reflected:

> The net effect of such well-intentioned but misguided efforts can only be to make these dependencies even more dependent than formerly. With each Federal program dollar, even if given in the name of humanity for the aging or the handicapped, the future island states of Micronesia move ever further away from the stated goal of self-reliance and political autonomy.... For well-meaning U.S. legislators and bureaucrats to dangle an attractive array of costly social programs before the Micronesian people is to seduce them from a more austere, but sounder path of economic growth that is to their best interests in the long run (Hezel 1982e, 157).

But who was seducing whom? If Washington, out of compassion or conviction, was offering Micronesia a stunning array of new program funds at the very time that cutbacks seemed called for, people were happy to receive these funds. What's more, astute island leaders—who by this time knew which office doors to knock at—invariably came back for more. By the time the United States got around to formulating a single consistent position calling for modest government spending in line with the avowed goal of self-reliance, the very Micronesians who once spoke eloquently of keeping costs under control had become the main proponents of large government and high budgets.

> No one set out expressly to subvert the goal of self-reliance; it was just a star a bit too distant and faint to steer by. A thousand government functionaries and political leaders found something of real value in the here-and-now purchases and programs that fired their imagination. Bookmobiles, new college facilities, longer airport runways, and extra file clerks or secretaries were all good and useful things, and the money

> was available—so why not? Somewhere along the way, that romantic old notion of self-reliance was allowed to pass into the shadows and [be] gradually forgotten. It was always something of an embarrassment anyway in this modern age of satellite communication and the global village (Hezel 1982c, 145)!

Under Compact Funding Today

Here we are 25 years later, following eight years of self-government prior to the implementation of the compact, the 15-year period of Compact 1, and (for the RMI and the FSM at least) a three-year interlude before the 20-year period of Compact 2 took effect in 2004.[7] Washington, which has been casting about for an "exit strategy" with respect to Micronesia, has made it clear that this extension of compact funding for its former wards will be the last. The island nations can expect no direct assistance from the United States after 2024, when the current Compact 2 funding period will end. To cushion the shock, however, the United States has agreed to establish trust funds for the FSM and the RMI on the condition that both nations make initial contributions of $30 million toward the capitalization of the funds. In addition to offering yearly grants for government operations, the United States is committed to making annual contributions to the trust funds throughout the compact period.

The Amended Compact Funding Agreement for the Marshall Islands, concluded in 2003, provides for annual grants of $35 million a year to be used for predetermined sectors of government operations. In addition, the United States is to put into a trust fund $7 million a year. Each year of this funding period the U.S. contribution to the trust fund will increase by $0.5 million, while the annual operations grant is to be reduced by the same amount. The United States offers select federal program funding in addition to providing another $6.1 million yearly to replace the federal programs for which the Marshalls will no longer be eligible under this new funding agreement.

[7] The Compact of Free Association, an agreement between the United States and each of the three island nations to deny access to Micronesia and its waters to nations unfriendly to the United States and to grant that nation certain military rights in the area, has no specified termination date; it can be terminated at the request of either party upon six months' advance notice. U.S. grants, however, are for a limited period, as agreed by both parties. The first compact period began with the formal implementation of the Compact of Free Association in late 1986 and concluded in 2001. The second compact funding period was initiated in 2004 and will conclude in 2024.

Under a similar funding agreement with the FSM, the United States is providing annual sector grants of $76 million for current operations, in addition to an annual contribution of $16 million to the trust fund. In an arrangement similar to that of the Marshalls, the annual contribution of the United States to the trust fund will grow by $0.8 million annually, while the sectoral grants money will decrease by that amount. The FSM, like the RMI, is still qualified to benefit from certain federal programs and will also receive buy-out funds of $12.2 million each year for those programs that have been cut.

The funding arrangement under Compact 2, then, provides slowly decreasing yearly grants to both island governments to assist them in their operational expenses. The diminished grants attempt to achieve what the step-downs in U.S. funding each five years during Compact 1 tried to do—namely, encourage the nations to generate replacement funds—but without the shock of sharp drop-offs. To mitigate its negative impact, the decrease in operational funding is small but continual. Moreover, the funding arrangement during Compact 2 has as a key component the cushion provided by the trust fund. For the RMI the U.S. contribution is $7 million the first year, with an increase of $0.5 million each year thereafter. In gratitude for official recognition by the Marshall Islands government, Taiwan has pledged to donate an additional $2 million a year into the RMI trust fund during this 20-year period. Assuming that the trust fund will have an annual return rate of 6 percent, the RMI is expected to have a corpus of $930 million by 2024, while the FSM ought to have a total of $1,013 million in its fund. The hope is that the trust funds will generate approximately enough money each year to replace the annual U.S. grant at its 2024 level. The FSM's trust fund is expected to generate about $57 million yearly, while that of the Marshalls is expected to yield $32 million.[8]

The funding arrangement provides slowly decreasing yearly grants to both island governments

The original expectation that the FSM and the RMI would be able to generate an economy capable of supporting their governments without U.S. aid has been modified in the light of experience through the first 15-year compact funding period. If the island nations could not make more headway then,

[8] Data on the RMI trust fund are taken from RMI (2002). The projection for the size of the fund at the end of Compact 2 ($930 m) differs from the U.S. projection ($575 m), perhaps because of the failure of the latter to take into account Taiwan's yearly contribution and its reinvestment strategies. The projection of the FSM (and RMI) returns and the size of the corpus in 2024 are derived from the statement of Susan Westin before the Subcommittee on Asia and the Pacific, House Committee on International Relations, published in GAO (2003, 14–15).

despite the generous funding and broad latitude they had to use this funding, there is little hope they will become domestically self-reliant by the end of the next 20-year period. Hence, the trust funds are meant to serve as a safety net at the conclusion of Compact 2 to guard against an economic free fall.

Overview of the Economies

Table 1 gives a broad overview of the state of the economy in these nations.[9] Total revenue—including taxes of all kinds, fishing license fees, and ship registry fees—accounts for 30 percent of the FSM government's total income and 37 percent of that of the RMI government. Grants and foreign aid of all types account for the remainder of the income of both nations. U.S. compact funds bring in 60 percent of the FSM's income; annual compact operational grants represent 33 percent of the total income of the RMI, but well over 50 percent when other compact payments are included. Both countries, then, are heavily dependent on outside grants for their support, with compact funds a major source of income.

The total gross domestic product of the RMI for fiscal year 2004 was estimated at $131 million, while that of the FSM in fiscal year 2003 was placed at $219 million. The per capita gross domestic product of the Marshalls is $2,177, slightly higher than FSM's at $2,031 (FSM 2002, 56; RMI EPPSO 2005, 228). The per capita figures for both countries are well above those of most other Pacific Island nations, thanks in great part to the role of U.S. grants.

Although it has shrunk in the last decade owing to policy intervention by the Asian Development Bank (ADB) to shrink the public sector, the role of the government in the economy of both countries is still very large, as measured by the percentage of total employees working in the public sector. Of the 8,899 making a regular salary in the Marshall Islands, 41 percent are employed by the government; while in the FSM 37 percent of the 15,640 total employees work for the government.

Although it has shrunk in the last decade, the role of the government in the economy of both countries is still very large

The private sector in both nations is still largely based on services offered to residents. Productive industries and the exports they generate are few. In the Marshalls, copra exports were valued at $1.2 million for 2004. The tuna loining

[9] Sources are FSM (2002a, 68); RMI EPPSO (2005, 217). The FSM figures in the text are projections for fiscal year 2003 as included in the report (GAO 2003).

Table 1. **Sources of Government Finance**

	Federated States of Micronesia (2003), million $	*Republic of the Marshall Islands (2004), million $*
Tax revenue	28.5	21.9
Other revenue	7.5	7.8
Compact grants	98.8	27.5
Other grants	16.5	22.0
Fishing license fees	12.4	0.9
Ship registry fees	–	1.0
Other	–	2.5
TOTAL	163.7	83.6

Sources: FSM 2002a, 68. RMI EPPSO 2005, 217.

plant on Majuro was exporting some $3.7 million worth of fish and animal feed before it was closed in 2005 (RMI EPPSO 2005, 366, 369). Tourism is negligible, with visitor arrivals to the Marshalls totaling only 9,000 in 2004.[10]

Exports from the FSM included $3–4 million a year in clothing assembled at a now-closed garment factory in Yap that was staffed largely by Asians and contributed very little added domestic value. Transshipment of fish caught in FSM waters once accounted for several million dollars a year—although the economic value to the FSM was a mere fraction of the market value of the fish—but this has fallen off sharply in recent years. In 2002 the value of fish shipped to Japan was recorded at $8.8 million (FSM 2004, 47). Perhaps a better measure of what is being produced locally and sold abroad can be found in agricultural exports; in 2002 these included copra ($0.2 million), sakau ($0.2 million), betel nut ($0.9 million), and cooked food ($0.2 million) (FSM 2004, 50). Many of the last two items, along with reef fish and lobsters valued at $0.3 million, were shipped off-island in cartons and ice chests to be sold to emigrants living in Guam and Hawai'i.

The trade balance in both the FSM and the RMI suffers from the low value of exports. For a recent three-year period, 2001–2003, the FSM recorded a yearly average of $111.1 million in imports and $22.6 million in exports (ADB 2005, 58). The ratio of imports to exports is now 5:1, up considerably from what it was in the late 1970s when the trade imbalance turned so many heads.

During a similar three-year period, 2002–2004, the RMI showed an average of $75.2 million in imports annually (RMI EPPSO 2005, 224). No figures

10 RMI EPPSO (2005, 338). Only about one-third of these came in as tourists on holiday, according to Marshall Islands Visitors Association figures.

are offered for exports in recent sources, but Meto 2000, a development plan for the Marshalls published in 2001, gave the total value of exports in 1999 as \$7.7 million (including the re-export of diesel fuel at \$5 million), while imports were valued at \$68.9 million (ADB 2001, 212). This would indicate an import-export ratio of 9:1.

If the trade imbalance is used as an indicator, the economic situation in these two small Micronesian nations has worsened over the past 40 years. As discussed above, imports began to outstrip exports in the early 1960s with the infusion of larger U.S. aid payments into the trust territory. Aid increased still more in the 1970s during the era of U.S. federal programs and infrastructure development, and it has risen still higher since national independence. The ratio of imports to exports was 3:1 in 1966, 4:1 in 1977, and is now 5:1 in the FSM and even higher in the RMI. These two countries are no more successful now than they ever were in finding ways to keep exports apace with their consumption from abroad. But then again, they are not compelled to, since grants account for such a large percentage of their national budget, and government spending keeps the wheels of the private sector turning.

Diagnosis and Remedies for Ailing Pacific Economies

Every economic report on the FSM and the RMI produced in the past 20 years has arrived at the same diagnosis of their economic ills:

- Huge imbalance of trade, with imports far outweighing the exports and leading to sizable trade deficits.
- Poorly developed private sector, compared to bloated government sector, which is large not only in terms of employees, but also a salary scale that is disproportionate to both the private sector and the output of work by employees.
- Inhospitable environment for investment, stemming from absence of secure land tenure, unnecessarily difficult procedures for obtaining foreign investment licenses, and lack of transparency and impartiality in government.
- Heavy dependence on overseas aid, accompanied by reduced urgency to generate internal economic growth.[11]

[11] Duncan, Cuthbertson, and Bosworth (1999, 8) lists general characteristics of Pacific Developing Member Countries (PDMC) economies. Nearly the same list can be found in any of the classical sources on the Pacific, such as ADB (2005, 90–96) and ADB (2001, 12).

These problems seem to reflect those of most, perhaps all, Pacific Island nations today. The Asian Development Bank's 1999 strategy for reform in the Pacific listed many of the same economic features in Pacific Developing Member Countries (PDMC) throughout the region:

> In one sense, the challenge of economic reform in the PDMCs is much like the challenge facing transition economies moving from central planning to a market orientation. This is because both have little in the way of institutions that support private market activities. The private sector of the PDMCs [is] a very small part of the formal economy. In most of them, the government has a very large share of gross domestic product (GDP), is a very large employer, and carries on most of the business activity (Duncan, Cuthbertson, and Bosworth 1999, 3–4).

There are, of course, other basic hindrances to economic development in the Pacific Islands as well. These natural constraints include the countries' "distance from markets, their small size, and vulnerability to the whims of nature and the like" (Duncan, Cuthbertson, and Bosworth 1999, xv). They also include the relative lack of natural resources, the scattered populations, and the cultural environment of the Pacific. But development economists tend to deemphasize these natural constraints for fear of engendering a fatalistic attitude toward development on the part of the local populations. Such constraints, they argue, "provide no basis for not striving for the best set of policies and supporting institutional arrangements. Location and nature are quite constant, but policy and the investment environment can be changed" (Duncan, Cuthbertson, and Bosworth 1999, xv).

The assumption underlying the basic approach that the ADB is taking in the Pacific is unimpeachable: Whatever the constraints under which Pacific Island nations labor, they should be encouraged to do everything in their power to engender a climate favorable to economic growth. The reform package that the bank, like most other international financial institutions, advocates is aimed at creating an environment favorable for investment. The bank insists that land must be available for private investment purposes, which in turn supposes that a secure land tenure system is in place, that land ownership is properly recorded, and that a leasing system exists that will provide land to investors for sufficient time to allow them to recoup their investment and make a reasonable profit. Furthermore, the bank seeks to persuade governments to simplify and standardize the procedures

Most international financial institutions advocate creating an environment favorable for investment

for obtaining a foreign business investment permit, since many small island nations seem intent on protecting themselves from outside business by erecting hurdles rather than facilitating investment.[12] Finally, the bank and other international financial institutions seek to promote good governance—that is, governance marked by transparency and consistency. In addition to its obvious value to the local population, good governance is an essential condition for an investor-friendly environment. Throughout the Pacific Islands, the ADB argues, governments also have to be discouraged from taking too active a role in the economy and thereby stifling the emergence of a healthy private sector.

The reform package is aimed at improving what can be changed in a Pacific nation. Although promoted to attract investment from abroad, the recommended reforms would accomplish more: They would reduce inefficiencies in the economy, improve the quality of public services, and allow the private sector to develop free of government interference. Such reforms are intended to prepare the groundwork for a successful economy and to create the conditions in which a productive economy might flourish. But they cannot create the economy itself.

Even if all the reforms were scrupulously implemented, would the investors appear?

In this age of globalization, money can cross national borders with ease, but it can be withdrawn just as easily should investors lose confidence. The reforms that appear on the standard list are aimed at making the Pacific Island nations competitive with other nations around the world, all of which are increasingly tied into the global economy. Island nations, however small or otherwise disadvantaged, must play by the same rules as everyone else—competitive wages, a productive and skilled work force, a high quality product—if they are to claim a share of this world market. The rule applies regardless of whether the topic under discussion is tourism, high-end agricultural produce like pepper, or tuna fishing.

The conventional wisdom today holds that the island nations will never be self-reliant unless they develop a productive economy that is adequate to support a tax base large enough to finance their governments and provide their populations with the public services they have come to expect. In turn, this process depends largely on attracting the seed money and expertise needed to grow the economy. To attract such investment in the face of today's global

[12] The U.S. administration in the trust territory had barriers against foreign investment for the first 30 years of its rule. Only in 1974, with the enactment of the Foreign Investment Act, was foreign investment permitted for the first time (Hezel 1995, 359).

competition, a nation must implement whatever reforms are required to create a suitable environment for investment. If these conditions are met, any nation will be in a position to overcome its natural drawbacks and become a success story like Singapore or Switzerland.

The assumption is that once the environment is sufficiently friendly investment will occur. But even if all the reforms were scrupulously implemented, would the investors appear? And if they did, just what would they invest in? With few resources and a comparative disadvantage because of their geography, could small Pacific nations ever hope to develop a large industrial base? Or do Pacific Island nations like the FSM and the RMI, which appear to obstinately balk at implementing reforms designed to build up their private sectors, know something that the banks don't know? Something about the limitations of economic growth in a resource-poor country, where subsistence affluence and the patterns that grow up around it tend to stifle rather than encourage economic competition?

Redefining the Issues

Reflecting on the economies of the FSM and the RMI, while looking outward to the Pacific region as a whole, spurs the following questions:

1. Is a sufficient measure of development possible, aside from aid and remittances, to support a small Pacific nation at a level that would provide a modern government and the rather expensive public services it must offer in today's world, given its lack of resources, its geographical drawbacks, and the serious handicap of small size that denies it an economy of scale?
2. Are the additional cultural constraints—such as a small community with emphasis on personal relationships, social disincentives to accumulate surplus, and subsistence affluence—so powerful as to deny these island states the possibility of effecting a modern-day economic miracle of the sort that resource-poor places like Switzerland and Singapore achieved?
3. Must these island nations still face the same terrible choice today that they have so often been presented with in the past: either become economically viable and self-reliant, or surrender their political autonomy? Or is there a third option for such places?
4. Are development economists forcing Pacific Island nations onto a procrustean economic bed in presenting to them the present development

formula? Or, on the other hand, would relaxing these rigorous demands and exempting island nations from standards that appear to apply elsewhere in the world simply provide a convenient excuse to Pacific peoples for accepting the status quo and making no effort to reform?

Is Development Possible?

With respect to the first issue, Pacific nations such as the FSM and RMI face battles on many different fronts. They are struggling to make badly needed improvements in their educational systems so as to close the educational gap between their populations and those of the developed societies to which so many of their own people are migrating. They are also conscious of the need to provide better primary health care to their people in the villages while upgrading their hospitals and central health facilities, all the while struggling against both the more traditional infectious diseases and the newer noncommunicable diseases such as diabetes and cardiovascular illnesses. At the same time, they are called on to improve public safety, reform the justice system, provide transportation to the more remote segments of their population, improve accounting procedures, and develop a modern information flow system. Even the demands of national representation in regional organizations and international bodies add to the price tag of a modern nation state.

The island nations are asked to increase production despite their comparative disadvantage on the world market

To support such improvements, the island nations are asked to increase production and augment their exports despite their comparative disadvantage on the world market. Is it any wonder that they despair of growing a private sector robust enough to achieve these goals, and instead commit to maintaining a strong public sector? In many Pacific Island nations the private sector is untested and perhaps unreliable, while the public sector is a proven source of services and jobs.

Cultural Constraints

Regarding the second issue, Pacific Island nations may wonder whether they have the capacity to pull off the sort of economic miracle accomplished by the thrifty burghers of Swiss cantons or the hard-driving Chinese of Singapore or even the European-descendant population of Norfolk Island. Some resource-poor areas of the world have been transformed by hardworking and economically ambitious people into models of development. The question is whether the same could be achieved by Pacific peoples, who as the beneficiaries of subsistence affluence have never had to eke a living out of the soil or face starvation. Due to the munificence of nature, development economist E. K. Fisk noted in 1982 that families in the Pacific can produce all that they can consume and provide for other needs with only a few man hours a day. This is what is meant by *subsistence affluence*, a term Fisk coined. In addition, land and family constitute the bedrock of the island economy, with very few islanders in serious need of either item. When all else fails, individuals can count on the productivity of the land and the support of their kin group. Thus, the subsistence sector may present a ready and sometimes attractive alternative to wage employment for Pacific Islanders; after all, they are not dirt farmers desperate to escape the unremitting drudge and hardscrabble life on land that is not even their own.

This is not to suggest that Pacific Islanders are unable to run a successful business empire or accumulate a good surplus, but that somewhere along the way other social values would very likely intervene to slow down their growth well before they arrived in the Fortune 500. Culture is a factor in development and should be acknowledged as such. It might not preclude strong economic gains in the Pacific, but it will not aid in the working of miracles.

Hard Choices

Must Pacific Island nations become self-reliant or surrender their political sovereignty? The FSM and the RMI depend on substantial inflows of foreign aid to support themselves; they have also planned their medium-range future around inflows in the form of trust fund earnings from the aid contributed by the United States during the second compact period. Although the degree to which they depend on external aid may be higher than in most other Pacific nations, they are by no means alone in this respect. World Bank figures show that foreign aid represented 60 percent of the FSM's gross domestic product and 55 percent of the RMI's during the years 1990–1995. During the same period, foreign aid was a vital element in the economy of most other Pacific Island nations: Kiribati (39%), Vanuatu (15%), Tonga (15%), Solomon Islands (15%), and Samoa (13%) (Duncan, Cuthbertson, and Bosworth 1999, 9). Some 25 years ago, aid accounted for an average of 19 percent of the gross domestic product of all Pacific nations; since that time "aid has increased in absolute terms and at a faster rate than productive sources of income." Today, as in the past, Pacific Island nations receive more aid per capita than any other region in the world (Campbell 1992, 59, 61).

In addition, several Pacific Island nations have to come to rely on remittances from those who have moved abroad as a major source of income. Recent figures show that remittances account for 24 percent of Samoa's gross domestic product and 45 percent of Tonga's.[13] Even Fiji, long reliant on its sugar cane and tourist industries as major components in its economy, has become increasingly dependent on remittances over the past two or three years, with $200 million yearly derived from this source.[14] With overseas populations estimated at 30,000 and 20,000 respectively, the FSM and the RMI have a solid resource base to tap into in the future, even though there is no sign of significant remittances to date.

For years economic planners have held out the hope that Pacific exports might be increased, but the usual items—copra, fruits and vegetables, shells, and handicrafts—appear to have peaked, with some of these products now in decline. Mineral resources, too, are limited; phosphate supplies in Nauru and Kiribati have been exhausted, and gold mining in Fiji has dropped sharply (Fairbairn 1987). There has never been a substantial amount of manufacturing in the area. In recent years many small island nations have looked to the sea as a source of capital. But with the few fish canneries in the Pacific threatening to move elsewhere, Pacific nations can count on taking in only about 5 percent of the total value of fish caught in their waters by foreign fleets. Neither fishing, nor any of the smaller industries on which they have depended in the past, seems capable of generating the cash needed to maintain these nations. If this is true of countries like the FSM and the RMI, with very low population growth, it is all the more true of larger Pacific nations with relatively high growth rates and limited opportunities to emigrate. Where does this situation leave Papua New Guinea, the Solomon Islands, and Vanuatu?

Is There Another Option?

Twenty years ago two New Zealanders, economist Geoff Bertram and geographer Ray Watters, coined the term MIRAB to describe the type of economy they found prevalent throughout the Pacific (Bertram and Watters 1985). The acronym derives from the elements that drive most Pacific economies: migration and remittances, aid, and bureaucracy. In their groundbreaking article introducing the term, Bertram and Watters pointed out that in each of the five Pacific

[13] Figures for remittances, or gross private transfer receipts, are provided for each major island nation by year for the period 1990–2002 in Connell and Brown (2005, 9).

[14] The sudden appearance of a strong remittance component in Fiji's economy was a topic of much discussion at a recent conference in Canberra. I was told that remittances now surpass sugar exports, and probably tourism as well, as a major component of Fiji's gross domestic product (John Connell, personal communication, October 2005).

countries they studied, the trend toward dependence, which they regarded as going hand in hand with modernization, began during the colonial period.

> In each of our five economies, the rent-driven "takeoff" of imports occurred prior to decolonization, not afterwards. The colonial powers, as an act of policy, set target living standards which they felt to be appropriate for South Pacific island populations, with high priority given to public goods such as health, education, and communications. Expanding government sectors were the natural result—a process which can be described as "welfare-state colonialism" (Bertram and Watters 1985, 508).

Colonial administrations almost everywhere in the Pacific, it seems, did what the United States did in Micronesia: established a relatively large government with an ample bureaucracy and watched with satisfaction as imports escalated. The satisfaction derived from their belief that it was just a matter of time before consumption stimulated greater productivity, no matter how slender the country's resource base. Yet, productivity—at least as traditionally defined—could only carry island nations so far, and so they turned toward the "rental" economy that has come to be known as a MIRAB economy.

The MIRAB economy, then, is not simply an artifact of development theorists in the Pacific; it is a reality today in many parts of the Pacific and would undoubtedly be even more widespread if emigration opportunities were available to the large Melanesian nations. At least half of the MIRAB formula (aid and bureaucracy) is nearly universal in the islands. All Pacific nations, with the possible exception of Fiji, are heavily dependent on foreign aid, and those in a position to do so rely on remittances as well. Even the wealthier island dependencies with relatively robust economies, such as Guam and the Commonwealth of the Northern Mariana Islands, could not manage without outside help. The same is true of the few countries like Papua New Guinea and other Melanesian nations that are richly endowed with mineral and other natural resources. None are entirely self-reliant in the classical sense and depend to some extent on the features of a MIRAB economy.

Even the wealthier island dependencies with robust economies could not manage without outside help

When the MIRAB model was introduced, it generated considerable controversy and strong reaction from some quarters. After all, the label seemed to suggest that the Pacific economies were mired in a permanent state of dependence on the outside world. How legitimate is it to have to depend on foreign aid and the spending of the government bureaucracy it employs to generate a local economy? And then to have to rely on the remittances of those who moved abroad to seek what they could not find on their home island?

Self-reliance, along with more material prosperity, has always been touted as the purpose and end of economic development. Nonetheless, Micronesians have enjoyed a fair measure of prosperity for years without coming close to achieving what others would consider economic self-reliance. If at the end of the fiscal year the current account balance sheet shows that the national income has equaled national expenditure, the governments are satisfied. In their view, there is no point in worrying about the source of the income; whether it is in the form of grants or export earnings, the end result is the same. Americans and other Westerners react indignantly to this pragmatic approach. Where is the local passion for making it on their own?

Self-reliance has always been touted as the purpose and end of economic development

Writing 25 years ago, soon after Micronesia became self-governing, George Kent turned the question around as he made these observations about self-reliance:

> Self-reliance is frequently described as a major objective of development throughout the Pacific and, indeed, throughout the world. Such statements of objectives warrant close critical attention since it appears that there is no widespread agreement on their implications. What if, in fact, the islands simply cannot be self-sufficient unless they revert back to pre-contact ways? The goal of self-sufficiency should be suspect when other, far more richly endowed territories are not self-sufficient and do not really aspire to self-sufficiency. Self-sufficiency is not its own reward. It makes little sense to argue that the poor should learn to be self-sufficient if the rich continue to be supplied and subsidized in one way or another by the prevailing social system (Kent 1982, 18).

His words are every bit as applicable today when the United States, with its rich and diverse resource base, must depend on China to underwrite its current debt.

Kent went on to argue that the new nations-to-be of Micronesia should do what they could to strengthen their domestic economy on the path to what he called "increasing self-sufficiency," but they should not labor under the illusion that they would soon be in a position to provide entirely for their own needs (Kent 1982, 19).[15]

Should Standards Be Relaxed?

The fourth question posed earlier asked whether relaxing the rigorous demands for self-reliance and exempting island nations from worldwide development standards would be conceding too much and simply provide a ready excuse for inactivity? Many of the reforms urged on the FSM and the RMI are inherently valuable in their own right, as was noted previously. There is an increasingly loud clamor for government transparency and evenhandedness in these societies, and even the governments are slowly learning through experience that the best way to kill a development project is to entrust it to the government. The public uproar that was caused when the FSM Congress introduced its infamous "Amnesty Bill" and the mandate for government reform that voters in the Marshall Islands issued during the last two congressional elections are testimony to the desire for responsible and honest governance.[16]

If Micronesian nations draw the line at implementing changes with respect to land use and liberalizing foreign investment procedures, it may be because they do not see a benefit commensurate to the risk they are taking in letting go of means they have used for years to protect their own interests. The ADB booklet assessing the results of Pacific Island nations in attempting to meet their development goals again and again describes the outcome as "disappointing" (see Duncan, Cuthbertson, and Bosworth 1999). Pacific nations have the rule book, courtesy of donors and international financial institutions, but they have yet to witness firsthand an unqualified success in the region.

However, Tuvalu is a small island state that has made significant progress since gaining independence from Britain in 1978 and may provide a useful example. A nation of only nine atolls, Tuvalu was initially discouraged from seeking independence because of its meager resources and very small population. Determined to chart their own course, Tuvaluans have selectively engaged the global community without undermining their strong cultural foundations. Launched with external assistance, Tuvalu has developed an innovative, well-managed trust fund that has witnessed sustained growth over the last two

[15] Kent's use of the term *self-sufficiency* here may be confusing; it seems to mean what I have been calling "domestic self-reliance"—that is, living within a nation's means but in such a manner as to include exchange of goods and services abroad. Kent understands this as a condition for full self-government.

[16] The "Amnesty Bill" was a congressional bill, introduced in January 2004, which would have granted general amnesty to any and all individuals charged with the misuse or misappropriation of any government funds throughout the Compact 1 period (Hezel 2004).

decades. The small nation's merchant marine academy trains skilled seamen and some 400 are employed around the globe. The marketing of Tuvalu's Internet domain name designation—.tv—produces significant revenues (Finin 2002). Tuvalu is better off today than it was at the time of independence. The greatest threat to the tiny nation today is global warming and related rises in sea level.

In any event, countries like the FSM and the RMI simply struggle to do the best they can within the limitations under which they operate. This is not to deny that there are serious inefficiencies in their economies and a great deal of room for improvement in their governance, investment climate, and licensing procedures. But I sometimes think that the largest underlying reason for inactivity on these fronts is skepticism as to whether a self-reliant economy would result, even if the reforms advocated were fully implemented.

Meanwhile, these and many other Pacific nations fall back on the traditional strategies for survival even in an economy that is modernizing. Here are a few notable examples:

- While Pacific Islanders are famed for their welcoming reception to strangers, they are generally wary about offering outsiders too large a stake in the economy, especially when this could translate into local loss of political power or an erosion of the system of social relationships that undergirds island life. Redistribution and reciprocal exchange are used to reaffirm these relationships, as Hooper and James have reminded us (1994). This is true not only in what is called the "subsistence sector," but the same basic attitude interpenetrates the modern political sphere and the local business community.[17] The introduction of a sizable foreign business elite that directed the flow of goods and services simply to maximize profit without regard to these other ends would threaten the very foundations of the society. This cultural norm might explain, at least in part, the reluctance of Micronesians to dismantle the hurdles to obtaining foreign business investment permits.
- Micronesians, like other Pacific Islanders, place the highest importance on safeguarding their most valuable asset, land. The almost mystical ties that people have had with their land are as much a reason for this

[17] "Traditional social relationships and the economic norms of redistribution, reciprocity, and generosity that animate and give them substance are not confined solely to the traditional. They color and influence relationships in other spheres as well…." (Hooper and James 1994, 6).

attitude as the practical importance of land as a fallback for survival.[18] Measures undertaken to reform the land tenure system, especially the attempt to individualize land tenure, or to open up land for long-term lease or even outright ownership by non-islanders, have a short life expectancy in the Pacific. Protection of their land sometimes puts islanders at odds with the land reform part of the package that is being promoted by the banks.

- Micronesian atoll dwellers, who lived on a narrow margin, had to balance the population of their small islands with the available resources according to the carrying capacity of the island. When the population outgrew this carrying capacity, the people might arrange for young men and women to go and live elsewhere. Emigration, then, is an old island strategy for dealing with scarcity; it is being used today as a means of siphoning off excess population and redirecting it toward areas where jobs can be found and a good living made. The expectation in the past, as now, is that those who leave will retain their ties with their old home and send back goods to keep these ties alive and strong. Herein perhaps lie the roots of the migration and remittance strategy that is widespread in the Pacific.

A Course for the Future

The productive economies of the FSM and the RMI are already heavily dependent on foreign aid—if I may use this term to refer to compact funds—and they will continue to rely on it for the foreseeable future through the trust funds that are expected to generate a revenue stream after the current compact funding period. Both nations can continue to benefit from the limited but constant flow of money through fees—fishing license fees for both the FSM the RMI, and ship registry fees for the RMI. Exports play a very small role in each economy. The FSM's exports (fish, agricultural produce, and the "invisible export" of tourism) accounted for a total of 5 percent of its total gross domestic product a few years ago, and the corresponding figure for the Marshalls would have to be even lower. Both nations have invested considerable sums of money in the tuna fishing industry—the FSM alone invested at least $77

[18] The nonquantifiable importance of land to Micronesians is a point that anthropologists in the area have made repeatedly and a theme that I have tried to underscore in some of my own writings (see, for example, Hezel 1999).

million during Compact 1—but neither has a great deal to show for its investments (Jacobs 2002). The tourist industry, too, has shown little growth to date; the visitor figures for both countries have been virtually unchanged for the last 20 years. Chuuk and Yap in the FSM and Bikini Atoll in the Marshalls may be world-acclaimed scuba-diving spots, but the paucity of visitors reflects a small niche market. With visitor figures to both nations a mere fraction of those in neighboring Guam, Saipan, and Palau, it is fair to say that the "FSM still lies outside the charmed circle of high-profile tourist destinations" (Hezel and Lightfoot 2005, 10). Fishing and tourism may grow in time to the point where they yield a substantial part of the national income, but it would seem unwise to count on this happening.

The agricultural sector in both nations has attracted little attention despite its significant contribution to their economies. As a recent publication on the FSM economy put it:

> Perhaps our first mistake was in thinking of agriculture as primarily commercial. We had ignored the importance of subsistence agriculture and household production, activities in which an estimated 45 percent of the FSM population engage.... The monetary value of local production is estimated at about $50 million a year, or one-fourth of the total value of the FSM economy (Hezel and Lightfoot 2005, 12).

Apart from its role in the subsistence sector, agriculture provides much-needed opportunities for cash cropping to those unemployed people living in villages and outer islands who would otherwise have no direct access to the cash economy. The government of the Marshalls has honored its long-standing commitment to subsidize copra prices so that people on the outer atolls have at least a minimal cash income. Copra production has dropped sharply in the FSM as market prices have fallen, but recent years have seen exports of other produce grow: sakau, betel nut, and even cooked local food that is sold to fellow islanders living in Guam, Saipan, or Hawai'i (Hezel and Lightfoot 2005, 13). In all, agricultural produce has shown a surprising resilience in these otherwise troubled economies. Besides continuing to provide food for a considerable segment of the local populations, it offers a number of cash-crop opportunities for people who are without paid employment.

Emigration is offering a cash income to many Micronesians who would otherwise not have had very good prospects for employment

Emigration is another area that needs further exploration in view of the fact that there are now an estimated 20,000 Marshallese and 30,000 citizens of

FSM living overseas.[19] Emigration is offering a cash income to many Micronesians who would not otherwise have had very good prospects for employment. With relatively few jobs available in either island nation since 1995, when the cutbacks in government employment were implemented and the ripple effect was felt in the private sector service area, emigration has increased. Since then, about 2,000 people leave the FSM each year, and some 1,000 depart from the Marshalls to seek their livelihood elsewhere.[20] The impact of this emigration on the islands is great. Population growth has dropped to almost zero in recent years; pressure has been taken off the government to expand schooling and other social services so that it can focus on improvement in these areas; and the ranks of the unemployed in the islands are not swelling as they otherwise might.

There is yet another aspect to this widespread emigration:

> Emigration on the scale we have seen for the last twenty years represents a real resource for the nation, providing we continue to think of those who have left as part of our own community rather than fugitives from the islands. Other countries in the South Pacific depend heavily on the remittances emigrants send home to support their families, churches and other institutions…. If each of the 8,000 FSM citizens working abroad were to send back $1,500 to family and friends in the islands, the sum of remittances would total $12 million, or about the same amount that the nation is now obtaining each year from fishing license fees (Hezel and Lightfoot 2005, 5).

If other Pacific Island nations benefit so much from remittances, why shouldn't the FSM and the RMI? Anecdotally, Micronesians speak of the resources flowing in the opposite direction—out of the islands rather than in—because of the support that new emigrants need in paying for travel, setting up households, and so forth. Yet, the tide of resources could reverse in time, as it has in other Pacific nations such as Tonga and Samoa. This would require some encouragement, however.

[19] These are my own estimates based on several unpublished surveys of the Micronesian populations in Guam, Saipan, and Hawai'i done by Michael Levin and on census figures for the RMI (RMI 1999) and the FSM (FSM 2002b).

[20] These numbers are based on the "missing population" for FSM and RMI—that is, the difference between the expected population, assuming a 2 percent annual growth rate, and the de facto population in the islands.

> Government leaders might consider what steps they could take to encourage this—not by mandating remittances by law, but by offering emigrants other incentives to remain linked to their home islands. Citizenship, the right to vote, and retention of land rights in the islands might be a place to start. Sponsoring periodical events to which emigrants are invited to return home and join the celebration, as is done on Christmas every fourth year on Kosrae, is also a good strategy to keep links strong (Hezel and Lightfoot 2005, 5).

Concern is expressed in some quarters about "remittance decay" over time—that is, the decline of remittance payments as families living abroad become more removed from their kin who have remained at home. Many Americans can attest that cash remittances to Europeans in the old country did not survive the first generation, and in some cases they may have ended far sooner than that. But the links between European emigrants and their home country may have been quite different from those between Pacific Islanders and theirs. For one thing, air travel allows today's emigrants to return home easily and inexpensively, especially for weddings, funerals, and other family events. The travel back and forth across the Pacific "highway" allows emigrants to renew their kin ties, friendships, cultural stake, and even business interests on their home island. The results are incontrovertible: The remittance stream into islands like Tonga and Samoa has persisted, even increased, over a two-generation span by this time, and there are no signs of it decaying anytime soon.

The positive impact of remittances on Pacific nations is evident. Indeed, the single most effective contribution Australia and other regional developed economies could make would be to open up their economies to workers from the Pacific Island states. This act would not only help the Pacific Islands, but it would also help address the conundrum posed by the aging populations in these rich economies.

The FSM and the RMI should be encouraged to join the ranks of Pacific nations with a MIRAB economy. In fact, the two Micronesian nations are already three-quarters of the way there. Aid and bureaucracy are strong features of their economies, and the heavy out-migration is a third feature that they share with many other countries in the Pacific. Why not go all the way and implement policies that might cultivate remittances in the future? If the large emigration from both nations is viewed as exported labor, it seems reasonable for the exporting nations to expect some return to help them provide for their own development needs. MIRAB may fall well short of the ideals of full self-reliance that were championed during the era of independence in the Pacific, and are still being echoed today, but in this age of globalization that classical definition of self-reliance may be outmoded anyway. Whatever the case, MIRAB is a formula that has worked for a number of Pacific nations.

Rethinking Our Position

The United States, which still provides substantial annual grants to the Micronesian nations, has insisted that these islands develop an economy capable of underwriting the costs of government. In its insistence, the United States is joined by the Asian Development Bank and other international financial institutions that are promoting a formula for economic growth culled from their experience with other nations. Washington has expressed chagrin at the little progress that the FSM and the RMI made in developing a viable economy during the first 15-year compact period. To be sure, both nations have made some serious mistakes in the ways in which they have handled compact funds, as most of their senior government officials would readily admit. However, most of the "bad" investments were made in attempts to increase production and exports. Money has been spent unwisely at times, priorities have been overturned for political reasons, and productivity has been so-so at best. Nonetheless, for these nations to confess that they could have done much better is not tantamount to admitting that they squandered the real opportunity to overhaul their economies and generate a level of productivity that would allow them to support themselves from their own revenues.

Projects by the dozen have been tried in the islands: commercial growth of crops like cacao, pepper, Philippine mahogany, and decorative plants; manufacture of coconut shell buttons, furniture, and zoris; processing of banana and breadfruit chips, pickled papaya, Pohnpeian sakau, and bottled soft drinks; cultivation of clams, sponges, tropical fish, milkfish, and seaweed; sale of wood products through lumbering and sawmill operations; garment manufacturing and ferro-cement boat-making. This is just the start of a list that might go on longer than the present essay, and it does not even mention the many attempts made to establish a viable fishing industry in the islands. There are would-be tourist hotels in every stage of decay on all the major islands in the FSM, and a few others on Majuro and one or two of the outer atolls of the Marshalls. Was it lack of capital that frustrated all such attempts? Or a perverse resistance by local entrepreneurs to making the business work? Or other factors that have never been seriously enough considered in assessing what will and will not work in the

The economic woes of the FSM and the RMI are not due to the failure of these countries to explore different possibilities

Pacific? Whatever the conclusion, it is assured that the economic woes of the FSM and the RMI are not due to the failure of these countries to explore different possibilities.

During its administration of its trust territory, the United States made a number of policy decisions that negatively affected the growth of the nascent economy in the islands. Because funding levels were at times determined by geopolitical considerations (as during the Cold War era of the early 1960s) or by humanitarian concerns (as when federal programs were extended to the islands just a few years before self-government was to be initiated), progress toward stated economic development goals was seriously retarded. That this happened with the general support of the island population does not entirely exculpate the administration for its failure to craft and follow a single long-term policy regarding Micronesia.

The point here, however, is not to lay blame for past failures on either the United States or the island nations. It is to track the journey that the two island nations have made on their paths toward economic self-support that gives real meaning to their political autonomy.

Development theories have changed along the way—from the days of E. E. Rostow's emphasis on the importance of national savings to provide the capital needed for "takeoff" to the shift in emphasis by Gunnar Myrdal and others on human capital through investment in education and health so that the "crust of custom" could be broken to the present-day stress on creating a favorable climate for investment with the reform package that is frequently urged on nations. Thus, we've moved from capital to human capital and back to capital again. But, in our own day, the human capital is integrated into the overall picture.

Debunking the old notion of self-reliance should never be taken as an excuse for a smug resistance to moving ahead

Meanwhile, the Pacific Island nations themselves have changed. Once colonies entirely dependent on metropolitan countries like the United States and Britain, they have become self-governing nations. They listen with some respect as consultants and advisers repeat one development refrain or another, yet at the end of it all they are still faced with the perennial question of how they will pay the bills at the close of the fiscal year.

Finally, the position of those who cheered on these nation states, myself included, in the belief that any new nation, regardless of the difficulties it faced, could become entirely self-reliant has changed. Debunking the old notion of self-reliance should never be taken as an excuse for a smug resistance to moving ahead. It is merely a challenge to the assumption that any country, no matter how resource-poor or disadvantaged from a market perspective, can, in compliance with traditional standards, grow an economy that will in time attain classical self-reliance.

We who believed that a national sense of purpose could overcome any natural adversity have been forced to modify our position after watching the FSM and the RMI struggle to find an industrial base for their economy over the years. Many factors remain beyond the control of the small island nations intent on growing an economy—the vagaries of the tourist market, the world price of tuna, and the latest health kick (whether kava or noni). Perhaps we all believed a little too ardently in the conventional wisdom of the day: that economic self-reliance was attainable if only island nations would try just a bit harder to maintain an equilibrium between exports and imports. We may have been wrong—those island political ideologues of the 1960s, the U.S. government, the banks, and myself. But the mistake can always be corrected.

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The Author

Francis X. Hezel, S.J., has lived and worked in Micronesia for over four decades. Originally from Buffalo, New York, he first arrived in the islands in 1963 as a classroom teacher at Xavier High School in what was then Truk District, the U.S. Trust Territory of the Pacific Islands. In 1969, he was ordained a priest in the Jesuit order, and in 1972 was appointed director of the Micronesian Seminar, now located in Pohnpei State, Federated States of Micronesia. Hezel became the Regional Superior of the Jesuits in Micronesia in 1992.

The Micronesian Seminar is a nonprofit organization that serves the people of the four Micronesian political entities that emerged with the dissolution of the former trust territory. They are the U.S. Commonwealth of the Northern Marianas and the three nations that are self-governing in free association with the United States: the Republics of the Marshall Islands and Palau and the Federated States of Micronesia. The Micronesian Seminar has flourished under Hezel's leadership. It engages in a wide variety of educational initiatives, conducts research, sponsors seminars and other opportunities to stimulate public debate and reflection on current issues, and offers a world-renowned library collection.

A self-taught historian, Hezel's influence on Micronesian studies has been described as formidable. He has published six books and more than sixty articles on Micronesia and is frequently consulted within and beyond Micronesia by government officials, educators, researchers, and development specialists. Hezel has received honorary doctorate degrees from the University of Guam and Fordham University, his alma mater. Most recently, he has been conducting research with Micronesians living in the United States.

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About this Issue

In this report, Francis X. Hezel, S.J., reviews the history of development initiatives in the Federated States of Micronesia (FSM) and the Republic of the Marshall Islands (RMI), both of which were part of the U.S. Trust Territory established after World War II. Early on, funds were limited and little in the way of development was accomplished. When funding dramatically increased the conventional approaches implemented produced disappointing results and the islands became heavily dependent on the United States.

In 1986, the FSM and RMI became self-governing nations under the provisions of the Compacts of Free Association with the United States. Generous financial support was provided for 15 years with the hope that the Micronesians would chart their own course to achieve self-sustainability. That goal proved as elusive as ever. The second compacts were implemented in 2004 and direct assistance will end in 2024. In the likely event that self-sufficiency is not achieved by then, the United States is establishing trust funds that hopefully will generate income sufficient to replace American subsidies.

Hezel is skeptical about the advice offered by development economists and other outside experts. The track record of conventional approaches to development has not been impressive. Recommendations offered by experts often conflict with traditional cultures that emphasize communal values and the inalienable quality of ancestral land. Drawing upon the work of other researchers in the Pacific, Hezel offers suggestions for alternative courses to development.

About the Author

Francis X. Hezel, S.J., arrived in Micronesia in 1963 to teach high school in what was then Truk District, the U.S. Trust Territory of the Pacific Islands. In 1969, he was ordained a priest in the Jesuit order, and in 1992 became the Regional Superior of the Jesuits in Micronesia. In 1972, Hezel became director of the Micronesian Seminar, a nonprofit organization that serves the people of the four Micronesian political entities that emerged with the dissolution of the former trust territory. He has published widely on Micronesia and serves as a consultant to government officials, educators, researchers, and development specialists. Hezel has received honorary doctorate degrees from the University of Guam and Fordham University.

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