



PACIFIC ECONOMIC REPORT

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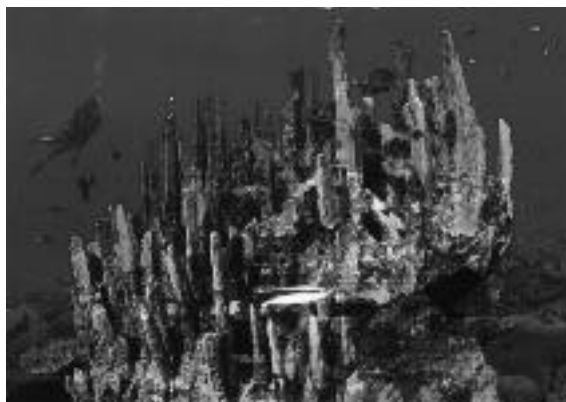
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Economic information about Hawaii and other Pacific economies is available on the Bank of Hawaii web site at <www.boh.com>

FEDERATED STATES OF MICRONESIA (FSM) ECONOMIC AND POLICY UPDATE



View from Nan Madol overlooking Sokehs Bay, Pohnpei's main industrial channel



An eco-tourist observes FSM's stunning underwater world Mangrove wood carving

GENERAL CHARACTERISTICS

Federated States of Micronesia (FSM) is a chain of 607 small islands in the Western Pacific about 2,500 miles west of Hawaii. Its total land area is only 270.8 square miles scattered over more than one million square miles of the Pacific, extending 1,700 miles from Kosrae in the east to Yap in the west.

The 130-square mile Island of Pohnpei is the largest in the FSM and the country's capital, as well as its civic and commercial center.

FSM is divided into four states: Pohnpei, Chuuk, Yap and Kosrae. Pohnpei includes the Island of Pohnpei, 25 smaller islands and another 137 widely scattered coral reefs. The state's total land area is 133.4 square miles of

which Pohnpei is 130 square miles. In 1994, the most recent year for which data are available, Pohnpei State had a population of 33,692.

Chuuk State consists of seven major island groups with its capital located on Moen, the state's largest island. Moen and the state's other 98 islands are surrounded by a coral reef ring that forms Chuuk Lagoon, the site of some fierce battles of World War II. The lagoon covers more than 800 square miles of the Pacific Ocean. Chuuk's total land area is 49.2 square miles. In 1994 Chuuk had a total population of 53,319, almost half of FSM's total population of 105,506.

Yap, the westernmost of the states, has four large and seven small islands plus another 134 islets. Yap has a total land area of roughly 45.6 square miles and its 1994 population was 11,178. Kosrae, the easternmost state, consists of five closely situated islands with a land area of 42.3 square miles and had the smallest state population of 7,317 in 1994.

While English is the common language of commerce and government, every state has a language of its own. At least eight major languages are spoken throughout the nation.

POPULATION GROWTH

As in other developing economies in the Pacific, population growth has remained high in recent decades. In 1920-35, population stayed virtually unchanged at slightly less than 30,000. In 1935-58, which spanned World War II and the economic dislocation it caused throughout the Pacific as well as the first decade of American political and

FSM POPULATION AND GROWTH RATES

| | Kosrae | Annual Growth Rate | Yap | Annual Growth Rate | Pohnpei | Annual Growth Rate | Chuuk | Annual Growth Rate | FSM | Annual Growth Rate |
|-------------------------------|--------|--------------------|--------|--------------------|---------|--------------------|--------|--------------------|---------|--------------------|
| 1920 | 786 | — | 8,338 | — | 5,748 | — | 14,788 | — | 29,660 | — |
| 1925 | 886 | 2.4 | 7,366 | (2.4) | 6,597 | 2.8 | 14,961 | 0.2 | 29,810 | 0.1 |
| 1930 | 990 | 2.2 | 6,486 | (2.5) | 7,051 | 1.3 | 15,200 | 0.3 | 29,727 | (0.1) |
| 1935 | 1,189 | 3.7 | 6,006 | (1.5) | 7,596 | 1.5 | 15,129 | (0.1) | 29,920 | 0.1 |
| 1958 | 2,367 | 14.8 | 5,540 | (1.6) | 11,258 | 8.2 | 20,124 | 5.9 | 39,289 | 1.2 |
| 1967 | 3,260 | 6.6 | 6,761 | 4.1 | 15,044 | 6.0 | 25,107 | 4.5 | 50,172 | 2.8 |
| 1973 | 3,952 | 3.9 | 7,870 | 3.1 | 18,926 | 4.7 | 31,609 | 4.7 | 62,357 | 3.7 |
| 1980 | 5,491 | 6.8 | 8,100 | 0.6 | 22,080 | 3.1 | 37,488 | 3.5 | 73,159 | 2.3 |
| 1989 | 6,836 | 4.5 | 10,153 | 4.6 | 30,664 | 6.8 | 47,871 | 5.0 | 95,524 | 3.0 |
| 1994 | 7,317 | 1.4 | 11,178 | 1.9 | 33,692 | 1.9 | 53,319 | 2.2 | 105,506 | 2.0 |
| 1958-94 Annual Percent Change | 3.2 | | 2.0 | | 3.1 | | 2.7 | | 2.8 | |

Source: Asian Development Bank, *Federated States of Micronesia 1996 Economic Report*, Table A1.

economic involvement in Micronesia, population growth rose from nearly zero percent to an annual average of 1.2 percent a year. As a result, population increased from 29,920 to 39,289 during that period.

In 1958-94, population growth rose to an average of 2.8 percent annually, ranging from a high of 3.7 percent in 1967-73 to a low of 2.0 percent in 1989-94. The 1958-94 period, when FSM's population grew 168 percent from 39,289 to 105,506, directly reflects the impact of American economic involvement in the area. First US aid (1947-86) and later rent payments for exclusive access to its waters (1986-2001) helped Micronesia achieve a higher material standard of living and improvement in general health and medical conditions that reduced mortality rates and increased life expectancy.

The most rapid growth in FSM's population occurred in 1967-73, when US aid increased rapidly. In 1973-80, population growth rate dropped to 2.3 percent, rising again to 3.0 percent in 1980-89 and dropping once again to 2.0 percent in 1989-94. The normal population growth rate, based on the 1958-94 trend, is near 3.0 percent.

The drop in population growth rate to below 2.8-3.0 percent, especially during the last period (1989-94) resulted primarily from emigration. In 1994, 5,742 persons (5.4 percent of the total population) lived overseas, with 47.1

percent living on Guam, 31.6 percent in the United States, 9.8 percent in the Commonwealth of the Northern Mariana Islands (CNMI) and the rest elsewhere. The 5,742 total is derived from a 1994 FSM census and may not reflect the complete count of FSM residents

living overseas. Anecdotal evidence places the actual number of Micronesian emigrants (from FSM, the Marshall Islands and Palau) at somewhere between 8,000 and 15,000.

In fact, emigration to Guam and CNMI, which are US territories, has often caused concern over the immediate financial impact of migration from Micronesia as well as long-term demographic impact on these economies. As FSM faces some of its most serious economic challenges since American involvement ensued after the War, emigration from Micronesia will likely increase in the next few years.

Emigration will in small measure reduce pressure on the FSM government to push for a market economy, but only in the short term. The FSM national government and its four state governments must seek a new path to a sustainable market economy that can be built upon existing institutional, resource and market structures.

GROSS DOMESTIC PRODUCT (GDP)

Current and accurate macroeconomic information on FSM is unavailable systematically. Information generated by global and regional organizations working on economic and technical assistance programs or project financing is practically the only source. A good portion of data and discussion in

this report is based on an economic report on FSM containing GDP data compiled by Asian Development Bank (ADB) in 1996. The ADB report provides a detailed account of GDP for 1990-95, which sheds light on the economy's makeup and performance for that period.

During four of the five years, the economy grew erratically, ranging from 1.0 percent to 5.7 percent annually. Real (adjusted for inflation) GDP growth averaged 2.2 percent in 1991-95, a rate that appears consistent with previous years and the economy's productive capacity and structural makeup. It is highly unlikely that GDP grew in 1996-97 because of government cutbacks, commodity price drops and a widespread drought attributed to El Nino.

As with other developing economies, FSM's economic growth has been influenced by commodity price changes. In fact, uneven economic growth rates in the Pacific's developing economies are influenced just as much, if not more, by global and regional price changes, as they are by changes in indigenous productive capacities.

Real per capita GDP growth as a measure of economic well-being, tells a different story. In 1991-95, real per capita GDP growth ranged from a negative 2.1 percent to a high of 4.7 percent annually, averaging a modest 1.2 percent. During the same time, population growth rate averaged 2.0 percent. Because per capita income growth did not keep up with population growth, an actual decline in the average standard of living in the FSM occurred. Again, this is not entirely surprising, as the economy is driven by fixed rent and aid (Compact) payments from the United States slated to end in three years, and commodity prices which fluctuate widely in regional and world markets.

To preserve and improve

FSM GROSS DOMESTIC PRODUCT (GDP, \$MILLIONS)

| | 1991 | 1992 | 1993 | 1994 | 1995 |
|--------------------------------------|-------|-------|-------|-------|-------|
| Compensation of employees | 79.9 | 82.0 | 97.0 | 104.4 | 112.4 |
| Wages & salaries | 76.9 | 78.9 | 93.6 | 100.6 | 108.2 |
| Government | 50.9 | 52.6 | 57.9 | 58.4 | 63.5 |
| Private sector | 26.0 | 26.2 | 35.7 | 42.2 | 44.7 |
| Social security | 3.0 | 3.2 | 3.4 | 3.8 | 4.2 |
| Operating surplus | 37.2 | 40.9 | 43.4 | 44.5 | 46.4 |
| Non-market production (subsistence) | 42.7 | 42.7 | 42.7 | 44.8 | 45.5 |
| GDP at factor cost | 159.8 | 165.6 | 183.1 | 193.7 | 204.3 |
| Indirect taxes | 12.2 | 13.0 | 16.5 | 15.3 | 14.8 |
| Less: subsidies | 4.2 | 4.5 | 4.5 | 3.5 | 3.3 |
| GDP at market prices | 167.8 | 174.1 | 195.1 | 205.5 | 215.8 |
| GDP per capita | 1,649 | 1,699 | 1,885 | 1,962 | 2,036 |
| Inflation rate (percent) | 4.0 | 5.0 | 6.0 | 4.0 | 4.0 |
| Real GDP growth rate (percent) | 4.3 | (1.2) | 5.7 | 1.4 | 1.0 |
| Real GDP growth per capita (percent) | 3.3 | (2.1) | 4.7 | 0.1 | (0.2) |

Source: Asian Development Bank, *Federated States of Micronesia 1996 Economic Report*, Table A9.

standards of living, a more rapid economic growth rate or a slower population growth rate must be attained. Neither one appears to be achievable in the near term. However, steps can be taken to invigorate the economy and restrain population growth, as detailed further in this report. An optimal solution would require some of both.

As far as shifts and changes in the makeup of GDP are concerned, there has been a noticeable increase in the private sector's share while the public sector's share dropped only slightly. The private sector's share rose from 15.5 percent of GDP in 1991 to 20.7 percent in 1995. The GDP share represented by government dropped only slightly from 30.3 percent in 1991 to 29.4 percent in 1995, after dropping to 28.4 percent in 1994.

As is widely known in the FSM, non-market (subsistence) production has declined as a share of GDP, although slowly. In 1991-95, non-market production dropped from 25.4 percent of GDP to 21.1 percent. Traditional leaders consider the drop in subsistence production an unfavorable development since it affects the community's food and fiber supply. However, such a change is not unreasonable as more people, especially the younger generation and better-educated individuals, choose to work in the money economy.

The shift from subsistence to the money economy also has important implications for the labor market. As more people choose to work in the money economy, which is dominant in urban centers, more migration from rural to urban areas will occur. Unless the money economy can generate enough economic activity to absorb this migration, the problem of underemployment will be compounded.

The rise in the private sector's share, however small, is the first major change in FSM's economic structure, an important first step toward creating a functioning market economy. But far more will be necessary to become a more dynamic economy that can respond rapidly to market changes.

Most of government spending cutbacks to reduce the public sector as a share of GDP occurred after the period for which ADB generated the macroeconomic accounts. It is reasonable to expect that government's share will continue to fall. A 20-percent spending cut was imposed for fiscal years 1998 (beginning in September 1997) and another 20-percent or so was anticipated for fiscal year 1999. FSM's national government dealt with the first adjustment by offering early retirement and other incentives to public workers to reduce payroll. Other schemes, including reduced work week, were also being considered in late 1997.

PROSPECTS FOR ECONOMIC CHANGE

Any economic strategy for FSM should recognize that the private sector creates value and wealth and an open market allocates resources efficiently. Without concrete steps toward creating a functioning market economy, FSM's

indigenous wealth-generating resources will remain idle while external rents and aid payment perpetuate a consumption economy. And while emigration from FSM to US mainland can be absorbed easily, emigration to the other small economies of Micronesia is potentially destabilizing to the region and a politically sensitive issue.

Twelve years of fixed payments under the Compact have not been long enough to transform a communal economy into a market economy, but it has been long enough to make a start. Also, as recent GDP data show, there has been movement toward a larger and productive private sector. While the remaining three years of the Compact will not be enough for a total transformation of the economy, the period offers FSM a chance to explore what its market economy is capable of generating. This transformation to a market economy will necessarily be gradual and needs sufficient support to avoid major dislocations for which there are no apparent remedies outside US rent and aid payments.

FSM is made up of small and isolated islands with little flat land suitable for the kind of mass cultivation that would generate economies of scale for both production and distribution. Without the use of modern technology, which cannot be justified under land constraints alone, the prevailing method of agriculture is subsistence production of small quantities for home consumption. Only minuscule quantities of produce reach commercial markets. Lack of storage and transportation facilities often makes it impossible to hold perishable products for any length of time. The crop either gets consumed or wasted.

Physically and technologically, the conditions have changed little in Micronesia since the 1950s. The prospect of a commercial agricultural economy producing mass quantities for mass markets is no more likely today than it was back then. Further, since

FSM WORKFORCE EMPLOYMENT STATUS IN 1994

| | Kosrae | Yap | Pohnpei | Chuuk | FSM |
|---------------------------|--------|-------|---------|--------|--------|
| Number of households | 964 | 1,925 | 5,298 | 7,043 | 15,230 |
| Persons per household | 7.2 | 5.5 | 6.3 | 7.5 | 6.8 |
| Population (15-year plus) | 4,251 | 6,754 | 19,500 | 29,068 | 59,573 |
| Labor force (persons) | 2,079 | 3,733 | 9,020 | 11,140 | 25,972 |
| Employed | 1,766 | 3,365 | 7,703 | 8,922 | 21,756 |
| Formal Work | 1,386 | 2,083 | 5,539 | 5,373 | 14,381 |
| Ag/Fishing | 380 | 1,282 | 2,164 | 3,549 | 7,375 |
| Subsistence | 98 | 1,249 | 1,408 | 3,119 | 5,874 |
| Market | 282 | 33 | 756 | 430 | 1,501 |

Source: Asian Development Bank, *Federated States of Micronesia 1996 Economic Report*, Table A3.

government jobs and other means of support from abroad have reduced the need to produce for home consumption, even the subsistence economy is not as large or diverse as it once was. Because of the FSM's current economic makeup, it cannot realistically become self-sufficient in food production anytime soon.

Institutionally, FSM is still largely a communal economy based on the concept of shared wealth, where the individual's economic productivity, regardless of amount and value, belongs to the extended family. This aspect of the culture and economy, not unique to FSM or the Pacific, has weakened the entrepreneurial drive inherent in market economies. Most entrepreneurs in FSM, not surprisingly, are expatriates. As foreign as the communal culture may appear to those accustomed to a market economy, it is the essence of FSM's cultural and economic stability. While this can be an advantage as economic change requires stability, such change in a communal culture takes place at a slow pace.

Economically, the FSM is an extension of the American system and of an American-style democracy that has been carefully and gradually blended into the communal system over 50 years. As a result of the uniquely close relationship between the US and FSM as well as other members of the former Trust Territory, these islands have benefited from the extraordinary reach of American influence and affluence. Many in the FSM have difficulty accepting that someday they will not be a part of the United States. Generations of

FSM leaders have witnessed the dramatic changes American wealth and security have brought to their region.

FSM leaders are keenly aware of the long-term potential problems arising from the sudden disruption in the money flow from the United States without first creating a functioning market economy. But creating such an economy out of a communal setup that

has been sustained by American taxpayers for 50 years also requires a careful calculation of the possibilities and the time it will take to achieve it.

If the United States were to leave FSM altogether, it would open the longest stretch in its long-standing security zone in the Western Pacific to the influence of others. Presently the United States maintains a missile range to the east of FSM in the Marshall Islands, which the US Army is unlikely to leave soon. To the west is Palau with which the United States concluded a 50-year compact in 1994. Guam, an US territory, and CNMI, an US commonwealth, lie to the north. Abandoning the 1,700-mile stretch of the Pacific from Kosrae to Yap in the midst of the US Pacific security zone appears inconsistent with US strategic and economic interests in the region. That leaves the question on what rent the two sides can agree.

Still, there are areas where economic change can take place, but not with an abrupt disruption of the economy's mainstay. Four areas offer the most realistic prospects for a gradual and orderly shift toward economic diversity.

INDUSTRIES OF THE FUTURE:

TOURISM

FSM's resources are its land, however limited, and the vast ocean. For over five decades now, FSM has mainly been a consumption economy funded by the United States. FSM has built only a small tourist plant over the years because it is farther away than Guam and CNMI from East Asian markets that supply virtually all of Micronesia's tourists. As a result, the area's biggest export, tourism services, has remained far below its potential.

Major barriers to tourism growth have been distance from mass markets, the distances among FSM islands themselves with scant means of transport and communication, inadequate infrastructure and the lack of desire among some islanders to develop tourism as an income source. Dated and inconsistent arrival data make it even more difficult to assess recent trends that could help determine future direction.

Consistent tourist arrival data for the FSM and its four states were available in late 1997, but only for the 1984-91 period. In late 1997, the only state for which consistent arrival data were available for 1984-95 was Pohnpei. Chuuk had data for most of 1984-95, but 1994 was missing. In the case of Kosrae, data for years 1991-93 were missing. Yap's data set covered 1984-92 but nothing has been reported since.

Tourist arrivals to FSM increased from 9,463 in 1984 to 26,129 in 1993. Although consistent data for 1991-92 and 1994-95 are missing, the trend shows a rather smooth and gradual rise over these periods. Looking at this trend in the context of a long-term growth curve, it is possible, even likely, that tourist arrivals to FSM exceeded 30,000 in 1997. However, there are no data to confirm this.

Looking at Pohnpei's arrivals, which rose from 4,323 in 1984 to 10,624

in 1993, then only slightly to 10,687 in 1994 and just a bit more to 10,853 in 1995, it is clear that Pohnpei reached a plateau. Tourist arrivals to other states show distinctly different patterns. Disregarding 1991-93 for which arrival data are not available, the rest of the trend (1984-95) for Kosrae shows a smooth and gradual rise in arrivals, increasing from 552 to 2,503. Again, extrapolating the trend, it is possible that arrivals reached 3,000 in 1997, but no information exists to validate this assertion.

Arrivals to Chuuk peaked in 1990 at 7,600 and dropped only slightly in the subsequent period. In 1995, the total was 6,816. Arrivals to Yap, for which data are available only for 1984-1992, indicate they rose consistently during the period, except for 1992 when they increased only slightly to 4,898 from 4,680 the year before.

These mixed and inconsistent trends do not offer a clear understanding of either present conditions for tourism or its potential. FSM's extrapolated tourist arrivals of 30,000 in 1997 represent only two percent of Guam arrivals (1.5 million a year). As Guam's arrival data and that of the CNMI (about 750,000 tourists a year) indicate, tourism is the West Pacific's economic mainstay. However, developing this source of income in more isolated markets such as FSM requires concerted efforts to attract tourists and offer them an unique experience different from that in large commercial markets.

Still, tourism offers some potential, particularly for specialty tourists who have an interest in diving and exploring the islands. Eco-tourism has recently become a buzz word in the Pacific islands. If eco-tourism means small groups of visitors whose main goal is anthropological research, it will not generate the economic and financial benefits FSM needs. If, on the other

hand, eco-tourism means modern tourist facilities that are both safe and friendly to the environment yet attractive to tourists with a variety of motives in seeking Pacific island settings, FSM has an equally good chance of capturing some of the market as other destinations.

FSM's existing tourist plant is inadequate and noncompetitive with destinations such as Guam, CNMI and Palau. As of 1995, the most recent year for which such data are available, FSM's entire tourist plant (hotels, motels and other accommodations) amounted to 513 rooms, 216 of which were on Pohnpei, 141 in Chuuk, 90 in Yap and 66 in Kosrae. With few exceptions, most accommodations are small, mainly family-owned businesses catering to the interstate visitor. Among the visitors from overseas, more than half are from the United States and about a quarter from Japan. These numbers suggest that both American and Japanese markets can be expanded with appropriate marketing and adequate infrastructure on the ground.

FSM's diversity of eco-systems and marine habitats including its world class diving sites make it a suitable destination to capture a good portion of the affluent tourist traffic from both North America and East Asia. But attracting tourists from these markets requires providing infrastructure such as roads, water and sewer systems, hotels and restaurants, shopping and other entertainment facilities, including cultural shows. At present the smaller states of Kosrae and Yap are less inclined to develop tourism on a scale more appropriate for the larger states of Pohnpei and Chuuk. However, if a consensus emerges on how to develop tourism and how much of FSM to develop for this purpose, there is a vast market in FSM's backyard to consider.

Economic and demographic analyses of North America and East Asia suggest that tourist traffic from each of these markets will rise in years ahead. Nearly 18 million Japanese travel overseas annually and this number is expected to continue to grow. FSM can

certainly attract a portion of this vast and lucrative market with competitive prices, high quality hotels and convenient air transport. Some of the remote, uncongested and aesthetically appealing islands may be turned into specialty destinations for meetings and other purposes. Another concept for potential gain may be to invite regional and international sporting competitions that can generate higher spending.

FISHING AND FISHERIES

Current infrastructure, management skills and use levels suggest that fisheries dominate the domestic productive economy and offer great potential for expansion. Given their importance, both the FSM and state governments have taken steps to encourage greater exploitation of the country's rich marine resources in its 200 mile Exclusive Economic Zone (EEZ). FSM has invested in port and other facilities to attract foreign fishing fleets to its shores. One direct result of increased access to the area's fishing habitats has been the rise in fees for fishing rights accrued by the FSM government. Total fees collected grew from \$10 million in 1989 to \$21 million in 1994, then dropped to an estimated \$17 million in 1995 and rose again to an estimated \$19 million in 1996. Total tuna catches in FSM's EEZ increased from 123,226 tons in 1989 to 229,846 in 1995.

A variety of national and state government agencies are involved in local fisheries development and management. At present, fishing by local people is largely for subsistence, especially on the outer islands. Crabs, lobsters, clams and trochus are collected by hand for home consumption. Beyond subsistence fishing and gathering and a little local marketing, to restaurants for instance, FSM exports fresh fish to Guam, the US mainland, Japan, Taiwan and Korea. The estimated value of fish

FSM ANNUAL TUNA CATCH IN THE SPC STATISTICAL AREA (MT)

| | 1991 | 1992 | 1993 | 1994 |
|------------------|-----------|-----------|---------|------------------------|
| Australia | 11,452 | 9,339 | 7,430 | 3,426 |
| China | 721 | 2,350 | 5,391 | 12,425 |
| Cook Islands | — | — | — | 45 |
| Fiji | 5,263 | 4,732 | 4,032 | 4,652 |
| FSM | 11,322 | 15,451 | 17,328 | 21,472 |
| Japan | 268,846 | 263,578 | 239,566 | 251,683 |
| Kiribati | 224 | 551 | 293 | 125 |
| Korea | 248,941 | 208,539 | 147,425 | 224,496 |
| RMI | — | 14 | 69 | 70 |
| New Caledonia | 1,469 | 860 | 1,237 | 1,300 |
| New Zealand | 9,200 | 4,995 | 5,037 | 7,845 |
| French Polynesia | 1,045 | 1,160 | 2,119 | 2,371 |
| Papua New Guinea | — | — | 8 | 30 |
| Philippines | 26,321 | 33,340 | 33,340 | 33,340 |
| Palau | — | 75 | 75 | 75 |
| Solomon Islands | 48,578 | 32,773 | 29,813 | 35,299 |
| Russia | 3,715 | 2,126 | 8,714 | 6,722 |
| Tonga | 198 | 223 | 330 | 860 |
| Tuvalu | 29 | 8 | — | — |
| Taiwan | 192,419 | 258,990 | 196,506 | 210,880 |
| US | 219,478 | 206,239 | 203,787 | 208,160 |
| Western Samoa | — | — | 26 | 26 |
| Total | 1,049,221 | 1,045,343 | 902,517 | 1,025,302 ^a |

a) Comprising 668,224t skipjack, 266,793t yellowfin, 53,035t bigeye and 37,250t albacore. Fishing gear involved was 819,697t purse seine, 128,040t long line, 72,590t pole and line, and 4,975t troll.

Source: Asian Development Bank, *Federated States of Micronesia 1996 Economic Report*, Table A28.

exports more than doubled between 1991 and 1992 to \$20 million.

Still, nearly all commercial fishing in the country's EEZ is conducted by foreign fleets. Topping the list of countries fishing in FSM waters under foreign fishing agreements in 1993-94 was Japan, which paid roughly \$11 million of the nearly \$21 million of total foreign fishing fees. Taiwan was second with over \$5.5 million, followed by Korea with just over \$2 million, then China at over \$1 million, and finally the US at less than \$1 million.

It is widely believed that FSM has some of the Pacific's largest, most fertile skipjack tuna habitats, with potential yields far above what is being harvested currently. Although reliable data on the stocks of other fish varieties such as yellowfin, bigeye and albacore tuna are not available, indications are that their current harvest levels are sustainable.

As indicated by the rise in fishing rights fees and other information on fish

stocks, the fish supply is believed to be large and diverse enough to justify some kind of fish processing plant in the FSM, particularly in Chuuk, which needs more economic stimulation than the other three states. While both unemployment and underemployment rates remain high, creating what appears to be a deteriorating labor situation, Chuuk offers the largest labor market in the country. The capital necessary to fund a fish processing plant might come from the United States or Asia, but considerable efforts are necessary to attract the large sums needed.

GARMENT MANUFACTURING

Garment manufacturing and other light assembly of goods for sale in the United States is another option, as long as goods produced in FSM can be sold without import duty. Within certain restrictions, exporting locally-made goods duty-free to the United States remains a viable option. To make this option work at a scale that creates jobs and generates income for FSM residents requires large sums of capital for which FSM must compete in regional and global capital markets. But attracting capital under present competitive market conditions requires stronger incentives than before.

Nevertheless, FSM has certain advantages that can be turned into economic activities. The existing garment factory in Yap is a good example of such an activity and presents a case study of what does and does not work. Other light assembly using indigenous labor and foreign capital to produce goods for duty-free sale in the United States may also be viable. CNMI has developed garment manufacturing into its second largest source of income, following tourism, out of economic necessity. Tourism and garment manufacturing have made CNMI

Micronesia's second most prosperous economy after Guam, despite declining US aid.

UNDERSEAMINING

Another potential area of income in the next decade or two for FSM, and other Pacific economies, is undersea mining. The technology to exploit undersea mines while reducing the potential for environmental damage is being developed. Also, there are now far more effective tests for finding uses for the residue of mining undersea ore. Disposal of the residue (tailings) has been a major source of concern. As technologies develop making it possible, for instance, to convert tailings from manganese nodules into building industry products, the entire sea mining enterprise looks increasingly promising.

THE CHALLENGE AHEAD

All of these sources of income for FSM will grow more rapidly, and others will emerge, if the institutional structure in which the private sector works changes rapidly enough to show commitment to building a market economy. An area that needs attention is the regulatory environment, especially the land lease market. The FSM constitution prohibits non-citizens from acquiring land, most of which is communally owned. In some states there are 25-year limits on leases. Most foreign investment projects require approval by both the national and state governments.

Viewed separately these and other regulatory matters may not appear as serious obstacles to expanding the economy's productive capacity. However, together they amount to costly and time-consuming barriers which in some cases may not be overcome by the economic returns to investors. Certainly it will be useful to resolve the land lease issue by adopting a uniform policy with clear objectives and rules. In some instances, 25 years may not be sufficient to allow long-term investment. Keeping

pace with other Pacific economies, a more liberal lease arrangement of 55 years applicable in every state may be a significant incentive to attract foreign capital.

Apart from government spending cuts instituted over the last 18 months with more to follow in the months and years ahead, FSM's economy has not changed much since Bank of Hawaii's report in 1995. Meanwhile, factors such as El Nino (causing drought) and the present financial crisis in Asia, have contributed to a slowdown in production from indigenous resources. Public spending cuts and lower production have caused a perceptible drop in economic output and, therefore, income and tax bases. This situation is likely to continue for some time.


FSM faces both short-term and long-term challenges. The immediate challenge arises from economic reforms imposed by donors (including the United States) that include cuts in government, so far the largest employer and income source. The main reason for the imposed austerity is that the financial package of FSM's Compact of Free Association with the United States is due to end in 2001. Since becoming an independent nation in 1986 in free association with the United States, FSM has received a steady flow of income which, under present terms, ends in three years.

The long-term challenge is to create a self-sustaining production economy within FSM's limited natural and human resources. The Compact requires negotiations beginning in October 1999 over the future course of political and strategic relationship between the United States and FSM. Given the change in the area's geopolitical value to the United States in the post-Cold War era, it is highly unlikely that Washington would be as generous with its aid and rent payment (for exclusive access to FSM waters) as it was at the peak of the Cold War in the 1980s.

However, it is also unlikely that the United States will end its special relationship with FSM beyond 2001 and

create a power vacuum in the area. In the meantime, the uncertainty arising from what the two sides will or will not agree to in 1999 is among the reasons that emigration will rise in the near term. Businesses operating in FSM have also adopted a wait-and-see attitude.

Addressing both the short- and long-term challenges effectively calls for a business plan that includes a clearly stated outline of both the human and natural resources as well as the institutional structure of FSM, and the production possibilities achievable within them. The business plan would state both the job and income needs, and provide realistic details on production and distribution possibilities. The plan should specify as accurately as possible how a market economy can come into being, through existing institutions as well as creation of new ones. For instance, to attract capital for the construction and operation of world class hotels and other pertinent facilities that will help develop tourism, FSM needs to show a plan to offer certain financial incentives, modify land lease systems and put in place a market-driven bidding and contracting process.

This business plan would cover all areas of economic activity that offer the greatest opportunity for generating income and jobs for FSM residents so they will choose to stay there and participate fully in the transition to a self-sustaining market economy. After review and discussion, the plan should be adopted as a national strategic plan and presented to the United States for consideration during the negotiations that start in October 1999. The plan would specify how the United States and other development partners can help the process of creating a self-sustaining market economy. The result of the plan's implementation would be an historic achievement in creating a self-sustaining market economy that can generate sufficient economic activity to meet the demands of a relatively small labor force for an adequate standard of living. 

PACIFIC ISLAND FACT SHEET

US DOLLAR-DENOMINATED ECONOMIES

| | Population | Land Area (square miles) | Notable Geographic Characteristics | Capital/ Distance from (miles) | Currency |
|---|------------|--------------------------------|---|---|-----------|
| GUAM | 153,700 | 212 | One island. Major US naval base and regional trans-shipment center at Apra Harbor. In hurricane path. | Agana/ Honolulu 3,800 Tokyo 1,600 | US dollar |
| COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS (CNMI) | 63,000 | 177 | Saipan the largest island, Tinian and Rota next, 14 others in the chain. 125 miles north of Guam. US territory closest to Asia. | Garapan, Saipan/ Honolulu 3,700 Tokyo 1,500 | US dollar |
| FEDERATED STATES OF MICRONESIA (FSM) | 105,506 | 270 | 607 islands and atolls, Pohnpei 130 square miles, other major islands Kosrae, Yap and Chuuk. The 4 FSM states span 1,700 miles from east to west. | Kolonia, Pohnpei/ Honolulu 3,100 Hong Kong 3,100 | US dollar |
| REPUBLIC OF PALAU | 18,146 | 170 | 343 islands, the main group encircled by a hundred mile reef. Babeldaob 136 square miles. 8 other inhabited islands. Rock Islands. | Koror/ Honolulu 4,600 Tokyo 2,000 Hong Kong 1,700 | US dollar |
| REPUBLIC OF THE MARSHALL ISLANDS (RMI) | 62,924 | 70 | 34 coral islands, 870 reefs, highest elevation 33 feet above sea level, average elevation 7 feet. | Majuro/ Honolulu 2,300 Guam 1,800 | US dollar |
| AMERICAN SAMOA | 58,900 | 76 | 5 islands, 2 atolls. Pago Pago Harbor. Home of newest US national park. In hurricane path. | Pago Pago, Tutuila/ Honolulu 2,600 Los Angeles 4,800 | US dollar |
| TOTAL/AVERAGE | 462,176 | 975 | | | |

NON-DOLLAR ECONOMIES

| | | | | | |
|------------------------|-----------|---------|--|--|------------------------------|
| FRENCH POLYNESIA | 229,200 | 1,609 | 130 islands, mostly atolls in 5 archipelagoes. Tahiti the largest island, 400 miles square, maximum elevation 7,464 feet. | Papeete, Tahiti/ Honolulu 2,700 Los Angeles 4,100 Paris 10,400 Tokyo 5,900 | French Pacific franc (F CFP) |
| NEW CALEDONIA | 196,800 | 7,376 | Main island, Grande Terre 250 miles by 30 miles (larger than the Hawaiian Islands together), mostly mountainous. Several small islands. | Noumea/ Honolulu 3,900 Paris 10,400 Brisbane 900 | French Pacific franc |
| WALLIS AND FUTUNA | 14,800 | 106 | 2 main islands, highest elevation 2,493 feet. | Wallis Island/ Honolulu 2,700 Paris 10,000 | French Pacific franc |
| PAPUA NEW GUINEA (PNG) | 4,141,800 | 179,490 | Eastern half of the island of New Guinea. Largest by far Pacific island-state land mass. Other main islands New Ireland, New Britain and Bougainville. | Port Moresby/ Honolulu 4,300 Cape York, Australia 300 Tokyo 3,100 Hong Kong 3,100 | Kina |

| Major Languages | GDP/GNP (US\$ million current) | Per Capita GDP/GNP (US\$) | Major Income Sources | Political Status | Major Sources of External Investment | Major Sources of Future Income |
|--|---------------------------------------|----------------------------------|---|---|---|---|
| English, Chamorro, also Tagalog, Japanese | 3,109.0 | 20,228 | Tourism, military, trade and services | US territory since 1898. Guam Organic Act of 1950 conferred US citizenship. Some push for commonwealth status. | US, Japan, Korea | Tourism, services |
| English, Chamorro, Carolinian | 650.6 | 10,327 | Tourism, garment manufacturing, trade and services | After WWI under Japanese mandate. In 1947 became part of US Trust Territory of the Pacific. Since 1978 a Commonwealth of the US. Islanders are US citizens. | Japan, Korea, Hong Kong, US | Tourism, services |
| English, 8 major local languages | 215.8 | 2,045 | US payments, government services, fisheries, tourism | After WWI under Japanese mandate. In 1947 became part of US Trust Territory. Became sovereign in 1979. In compact of free association with US as of 1986. | US, Japan | Compact status uncertain as of 2001. Fisheries development, tourism |
| English, Palauan, Sonsorolese-Tobian | 159.8 | 8,806 | US Compact payments, tourism | After WWI under Japanese mandate. In 1947 became part of US Trust Territory. Became sovereign in 1994, in compact of free association as of 1994. Compact ends 2044. | Japan, US | Compact money, tourism |
| English, Marshallese dialects | 102.1 | 1,623 | US payments, Kwajalein Missile Range, government services, copra, fisheries | After WWI under Japanese mandate. In 1947 became part of US Trust Territory. Became sovereign in 1979. In compact of free association since 1986. | US, Japan | US military. Compact status uncertain as of 2001. Fisheries. |
| English, Samoan | 253.0 | 4,295 | Tuna canneries, government services, remittances from Samoans overseas | US territory since 1899. Samoans are US nationals. | US | Canneries, remittances, US entitlements |
| | 4,490.3 | 9,716 | | | | |
| French, Tahitian | 3,418.3 | 14,914 | Payments from Metropolitan France, tourism, Tahitian pearls | French controlled from the 19th century. Overseas territory of France since 1957. Active independence movement. | Metropolitan France | French transfers, tourism, pearls |
| French, 30 Kanak dialects | 3,017.0 | 15,330 | Payments from Metropolitan France, nickel, agriculture and ranching, tourism, aquaculture | 1853 became a French possession. Overseas territory of France since 1946. Relation to France under review. | Metropolitan France | French transfers, nickel, tourism, agriculture, aquaculture |
| French, East Uvean, East Futunan | 25.0 | 1,689 | French transfer payments, trochus shells | French controlled from the 19th century. Overseas territory of France since 1961. | Metropolitan France | French transfers |
| English, Tok Pigin, Hiri Motu, hundreds of vernaculars | 4,600.0 | 1,111 | Minerals, oil and gas, forestry, agriculture, tourism | Under Australian & German control before WWI. Administered by Australia after WWII. Independent within the British Commonwealth since 1975. Strong separatist movement in Bougainville. | Australia, UK | Minerals, oil, timber, fisheries, tourism |

PACIFIC ISLAND FACT SHEET (continued)

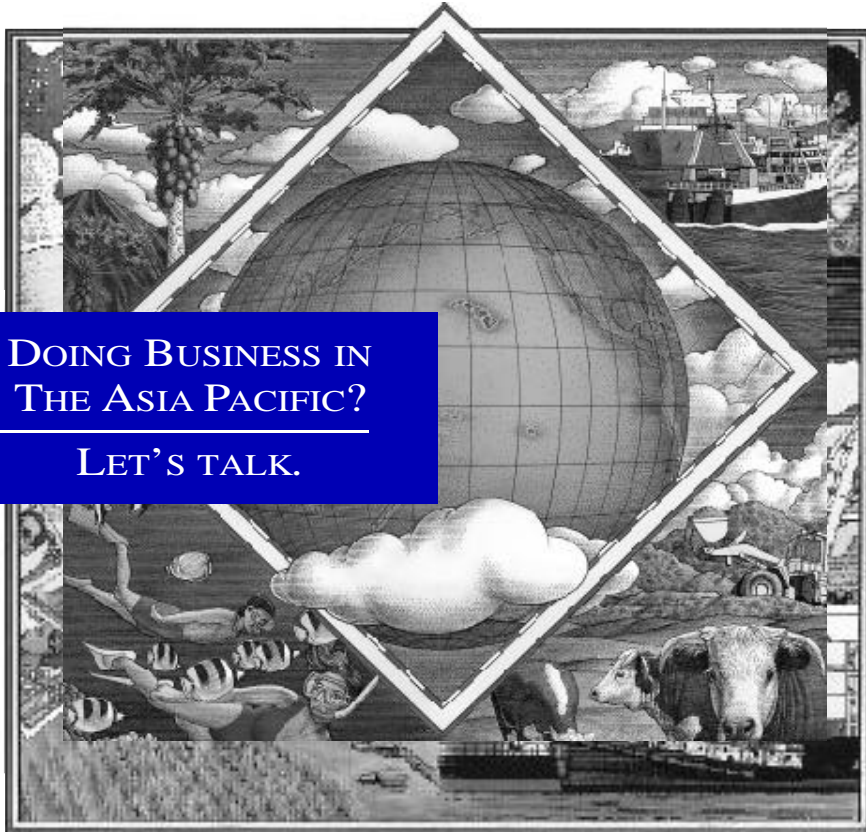
| | Population | Land Area (square miles) | Notable Geographic Characteristics | Capital/ Distance from (miles) | Currency |
|---------------------|------------|--------------------------------|--|--|-----------------------|
| COOK ISLANDS | 19,600 | 92 | 15 widely dispersed islands including volcanic peaks and atolls. Rarotonga the largest island 26 miles square. In hurricane path. | Rarotonga/ Honolulu 3,000 Wellington 2,000 | New Zealand dollar |
| SAMOA | 170,000 | 1,158 | 4 inhabited islands, 5 uninhabited. Highest point 6,100 feet, Mt. Silisili on Savai'i. In hurricane path. | Apia/ Honolulu 2,600 Suva 700 Brisbane 2,500 | Tala |
| FIJI | 800,500 | 7,055 | 320 islands. Viti Levu 4,000 miles square, Vanua Levu 2,100 miles square. Major islands are mountainous and forested to windward. | Suva/ Honolulu 3,100 Sydney 2,000 Tokyo 4,500 | Fiji dollar |
| KIRIBATI | 82,400 | 266 | 33 islands scattered 2,400 miles east to west, 1,300 miles north to south. Almost entirely low-lying atolls, Christmas Island the largest. | Tarawa/ Honolulu 1,300 Tokyo 3,900 | Australian dollar |
| SOLOMON ISLANDS | 395,200 | 11,197 | 850 mile long double island chain. 6 mountainous main islands, Guadalcanal 2,080 miles square. | Honiara, Guadalcanal/ Honolulu 3,960 Port Moresby 900 | Solomon Island dollar |
| TONGA | 99,000 | 386 | Main islands volcanic, some 150 coral atolls, 36 permanently inhabited. | Nukualofa/ Honolulu 3,100 Brisbane 2,000 | Pa'anga |
| VANUATU | 173,900 | 4,707 | 80 scattered islands, several active volcanoes. Largest island Espiritu Santo 1,500 miles square, highest point 6,158 feet. | Port Vila, Efate/ Honolulu 3,500 Tokyo 4,100 | Vatu |
| NAURU | 11,200 | 8 | A single island with a 100 foot high central plateau of now nearly exhausted phosphate-bearing rock. | Nauru/ Honolulu 2,800 Banaba, Kiribati 200 | Australian dollar |
| NIUE | 2,500 | 101 | Coral island rising 65 feet from the ocean and another 130 feet to a central plateau. | Alofi/ Wellington 1,800 Suva 800 | New Zealand dollar |
| TOKELAU | 1,800 | 4 | 3 atolls with islets 10 to 16 feet above sea level. In hurricane path. | Nukunonu/ Honolulu 2,300 Wellington 3,800 | New Zealand dollar |
| TUVALU | 10,200 | 10 | 5 atolls, 4 coral islands, maximum elevation 16 feet above sea level. | Funafuti/ Suva 700 Sydney 2,500 | Australian dollar |
| TOTAL/AVERAGE | 6,348,900 | 213,565 | | | |
| GRAND TOTAL/AVERAGE | 6,811,076 | 214,540 | | | |
| HAWAII | 1,205,126 | 6,423 | 4 main islands. Island of Hawaii 4,028 miles square, highest point of Mauna Kea 13,796 feet. Mauna Loa and Kilauea on Hawaii both active volcanoes. Maui 727 miles square, Oahu 597 (Waikiki), Kauai 552. In hurricane path. | Honolulu/ San Francisco 2,400 Los Angeles 2,600 Washington 4,800 Tokyo 2,500 | US dollar |

SOURCES: Central Intelligence Agency, *The World Factbook*, 1994; Norman and Ngaire Douglas, editors, *Pacific Islands Yearbook*, 17th edition, Suva, 1994; Europa, *The Far East and Australasia*, 1994; Gary L. Fitzpatrick and Marilyn J. Medlin, *Direct-line Distances, International Edition*, New Jersey, 1986; International Monetary Fund, *International Financial Statistics*, June 1996; David Stanley, *Micronesia Handbook*, Chico, California, 1989; David Stanley, *South Pacific Handbook*, 5th Edition, Chico, California, 1993; State of Hawaii Department of Business and

| Major Languages | GDP/GNP (US\$ million current) | Per Capita GDP/GNP (US\$) | Major Income Sources | Political Status | Major Sources of External Investment | Major Sources of Future Income |
|--|--------------------------------|---------------------------|---|---|--------------------------------------|---|
| English, Cook Islands Maori | 50.9 | 2,596 | Government aid, services, tourism | Self-governing since 1965 in association with New Zealand. Cook Islanders are citizens of both Cook Islands and New Zealand. | New Zealand | Tourism |
| English, Samoan | 170.0 | 1,000 | Agriculture, remittances from abroad, tourism, manufacturing | Under German control before WWI, New Zealand after. New Zealand trusteeship after WWII. Independent since 1962. | New Zealand, Japan | Agriculture, tourism, light manufacturing |
| English, Fijian, Hindi | 1,801.1 | 2,250 | Sugar and other agriculture, tourism, forestry, fishing, mining, garment industry | Annexed by Great Britain in 1874. Became independent within the Commonwealth in 1970, left the Commonwealth as an independent republic in 1987. | Australia, New Zealand, EU, Japan | Agriculture, tourism, mining, light manufacturing |
| English, Micronesian | 54.6 | 662 | Agriculture (copra), remittances, aid | Annexed by Britain in 1919. A republic within the British Commonwealth since 1979. | NA | Fisheries development |
| English, Solomon Islands Pijin, more than 80 vernaculars | 208.9 | 529 | Agriculture, timber sales, fishing and fish canneries, aid | British protectorate as of 1873. Politically independent within the Commonwealth since 1978. | Australia, Japan | Agriculture, fisheries, tourism |
| Tongan | 124.9 | 1,262 | Agriculture, tourism | British protectorate as of 1900. Independent monarchy within the Commonwealth since 1970. | NA | Tourism, agriculture |
| French, English, Bislama | 187.4 | 1,078 | Agriculture and ranching, tourism, Offshore Finance Center, services | Anglo-French New Hebrides Condominium in 1906. Republic of Vanuatu within the British Commonwealth established in 1980. | Australia, Japan | Tourism, agriculture |
| English, Nauruan | 80.7 | 7,205 | Phosphates and investments from phosphates | From 1919 administered by Australia. Became an independent republic in 1968. | NA | Investments from phosphate |
| English, Niuean | 7.1 | 2,825 | Subsistence activity, government aid | Self-governing since 1974 in free association with New Zealand. | NA | Tourism |
| English, Tokelauan | 1.2 | 667 | Subsistence activity, government aid | Non-self-governing territory administered by New Zealand beginning 1925. | NA | Subsistence activities, government aid |
| English, Tuvaluan | 3.8 | 373 | Subsistence activity, government aid | Independent state within British Commonwealth since 1978. | NA | Subsistence activities, government aid |
| | 13,750.9 | 2,166 | | | | |
| | 18,241.2 | 2,678 | | | | |
| English | 35,146.4 | 29,164 | Tourism, services, trade, government | Taken as a US territory in 1898, became a US state in 1959. | US, Japan, Australia | Tourism, defense, services, trade, government |

Economic Development, *Data Book 1995*, Honolulu, 1996; Peter W. Thomson, *Trade and Investment in the South Pacific Islands*, Honolulu, 1989; World Bank, *World Development Report*, 1996; various Bank of Hawaii economic reports, 1992–97, and other sources. (Rev. 4/22/98)

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