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Can We Talk, Mom?



Island Topics #34
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When the kids are heading one way and the parents the other, there's a real risk of trouble. This drama makes a case for good communication between mother and daughter.

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ROUGH SEAS AHEAD:

THE FSM ECONOMY
DURING COMPACT II



FRANCIS X. HEZEL, SJ



Celebrations Past and Present

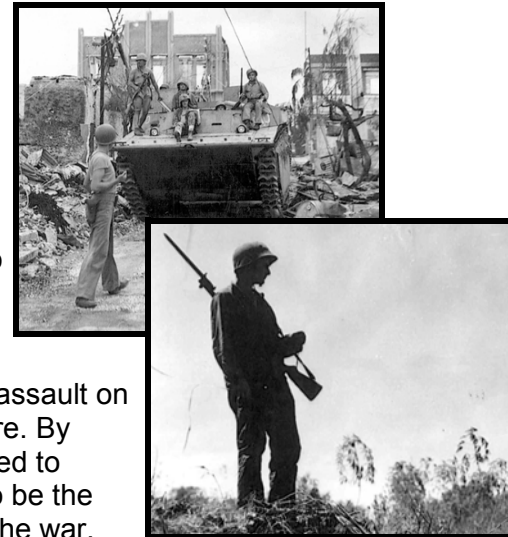
Do you remember where you were on November 3, 1986? I happened to be in Fiji where I joined a large group of Micronesians, at the invitation of the FSM Embassy, at a special dinner celebrating the signing of the Compact of Free Association. After all those years as a Mandate and then a Trust Territory and then a self-governing but not completely independent nation, the Federated States of Micronesia had finally taken its rightful place in the community of nations. That night we drank toast after toast to a new nation and its bright future.

In 1986, under the terms of the original Compact, the US agreed to provide annual grants for the next 15 years, 60 percent of which would be used for operational expenses. The other 40 percent came in the form of capital investment that could be used for building up infrastructure or as seed money for development projects to strengthen the economic self-sufficiency of the new nation. The annual US assistance was to be cut at the end of each five-year period, so that by the end of the 15 years the aid would be reduced to roughly two-thirds of its original level. The hope was that gradually, with the help of Compact funding, a solid foundation for economic growth would be laid.

Not long ago, 16 years later to the day, we held another party on Pohnpei to celebrate the initialing of a new funding agreement between FSM and the US. This new agreement extended Compact funding for another 20 years—perhaps not quite at the level FSM negotiators had hoped for, but with US annual contributions to a trust fund that could go a long way to offering financial security for many years in the future. Parties are supposed to be festive occasions, not opportunities for hand-wringing, laments about the past, and recriminations. I don't intend to spoil the party with any of that here. Just the same, it won't hurt to take an honest look at the economy at this juncture and what we must realistically face down the road.

War Comes to the Marianas

The Marianas, with its booming sugar industry, reached the height of its prosperity in the late 1930s under Japanese administration. Just a few years later the islands were engulfed in war. Two years after Pearl Harbor, Allied forces were sweeping westward across the Pacific in their assault on the Japanese island empire. By June 1944 they were poised to attack Saipan. This was to be the start of the final phase of the war. For the two opposing armies, and for the civilians caught between them, the battle for the Marianas was the most painful of times. (February, 2003)



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When Copra Was King

Copra: the fruit of the coconut palm, found everywhere in the Pacific. For over a century, copra was the backbone of the island economy—the main source of cash and trade goods in Micronesia. As coconut oil became a hot commodity for Europeans and Americans in the late 1800s, trading companies began to cultivate this resource in the islands. In this album we present the origins and early growth of this important industry in Micronesia. (December, 2002)

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First of all, the stable population envisioned for the future offers the government a chance to catch its breath at last. The government can consolidate and streamline its operations as it works to upgrade the quality of the basic services it provides for its people. This is nowhere more important than in the vital areas of education and health services.

Second, FSM can take ownership of its development, putting into place carefully thought out policies that look to future growth rather than simply respond hastily to outside initiatives. The nation has the time to work out forward-looking yet prudent legislation on land leasing and foreign investment incentives that will encourage solid development as opportunities arise in the future.

Third, the economic lull will buy time for FSM to develop a nation that extends beyond its own national boundaries into the new homes of its emigrants. FSM can do this by encouraging the vital relationship between its citizens who have gone abroad and those who have remained in the islands. The increased traffic should not be regarded as one-way, for it can also bring to the islands of FSM new resources: the skills of those who have successfully adapted to US ways, and the money in the form of remittances that they send home.

The future is far from bleak. In the years ahead FSM faces rough seas, but the nation has the opportunity to plot its own course and determine its own directions at last.



A previous version of this article was written for The Nature Conservancy.

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Economic Growth during the Last 15 Years

The first ten years of the Compact seemed to fulfill some of the promise of development in an economy that had been fueled by government payrolls since the start of Trust Territory days. From 1986 through 1995 the economy grew by an impressive 4.3 percent yearly. Even more surprisingly, the private sector expanded by 7.1 percent, as the number of jobs in the private sector surpassed those in government for the first time ever. Even after the first step-down in US funding assistance in 1991-1992, economic growth continued. As governments borrowed against the remaining Compact funds, the negative impact of this cutback in aid was greatly softened.

From 1996, at the time of the second funding step-down, the economy went into a sharp decline. The cumulative effect of the two step-downs in funding, coupled with the reforms in the public sector and the resulting reduction in the government payroll, choked the flow of money through the government. As a result, the economy declined by an average of nearly 1 percent yearly through the last five years of the Compact. The private sector also lost ground during this period, although the decline was not as sharp as in the government sector.

Overall, the economic growth during the fifteen-year Compact period was marginal. Gross Domestic Product (GDP) grew by 1.6 percent yearly. Employment increased at about the same rate, with almost all the growth occurring during the first ten years. There were real gains in the private sector that survived the final step-down in US funding, but the last five years saw business expansion come to a halt.

Economic performance during the first Compact period varied widely from state to state. Yap, famous for its strong fiscal discipline, showed a 3 percent average annual growth in GDP. Pohnpei, with its growth rate of 2.8 percent yearly, was almost as strong. Kosrae, which has always depended nearly exclusively on the government as its economic mainstay, showed almost no growth at all in its private sector. Its GDP grew by only 0.6 percent a year



during the Compact period. Chuuk, the most economically troubled state, suffered two financial crises—one in the mid-1990s and another just last year. At present the state has accumulated debts of more than \$20 million due to weak fiscal management. In Chuuk alone, the GDP has shown a net annual decrease (0.4 percent yearly) over the Compact period.

Future Compact Funding

US and FSM negotiators have been meeting over the past two years to work out an agreement that would provide funding to FSM for another twenty years (2004-2023). The financial package presented by the US in this new funding agreement would offer FSM a total of \$92 million annually. Of this package \$16 million during the first three years, and an increasing amount each year thereafter, would go into a trust fund to be used to sustain the government at the end of this twenty-year period. Over the coming months, the Compact agreement will go before US Congress for official approval.

US assistance during this second Compact period is lower than funding during the past 15 years and has conditions attached that US funding for the first Compact period did not have. During 2004, the first year of the new funding period, \$76 million will be provided for current government expenses. This represents a slight drop from the \$80.2 million (excluding the “bump up” funds received during the past two years) that the US has recently been giving FSM.

What this means, of course, is that the government sector, which was struggling to shrink its budget in keeping with US aid cuts, can expect no relief in the near future. The US annual subsidy will continue to decline over the next twenty years, but because the reduction will be very gradual there should be no jolts of the kind felt in 1996 at the time of the final five-year step down in funding. Gross GDP, which grew by a modest annual average of 1.6 percent during the first Compact funding period, is projected to increase by 1.4 percent annually during the next twenty years. This is to say that if the economy is to grow to any significant degree, it must look to something other than the government to propel this growth.



government resources can finally be used to strengthen education and health systems rather than simply expand them.

Education will be even more important in the future than it has been before. It may not be regarded as the key to jobs in the islands, which will continue to be scarce, but it will be the means of upward mobility for those who migrate to the US. A good education may be the difference between a career as a cashier in a supermarket or a cook in a fast-food place and a chance at a job higher up the economic ladder.

Villagers, however, will still feel the need for a solid cash crop to replace copra. It is these rural people, closest to the land, who ironically pose the greatest threat to the resource base in their islands. Industrial polluters present a large target and are easy to spot in their misdeeds, whether disposing of fish offal, creating oil slicks, or pumping waste products into off-shore waters.

The major problem is not with these offenders, who can be controlled, but the ordinary villager who is struggling to provide for his family with what he can find. It is these people, not the fish exporters, who dynamite coral reefs in Chuuk, who find ways to beat the surveillance and hack through the watershed so they can plant sakau on Pohnpei, who cut down mangrove in Kosrae for firewood.



M. Vitarelli

So Where Does Hope Lie?

If the challenges in the near future seem daunting, we ought to keep in mind that what we face in the future is no worse than what many other Pacific nations have already survived. It might also help to remember that old piece of wisdom: the reverse side of every challenge is an opportunity. The future that has been described here offers FSM at least three advantages.



Consequences of a No-Growth Economy

Economic stagnation and the lack of new jobs will almost certainly cancel the effects of the once high rate of population increase through emigration. A near zero-growth population scenario has a number of consequences impacting still further on economic conditions in FSM.

The money flow from people living abroad, in the form of remittances, should increase in the years ahead. In many nations in the South Pacific—Samoa and Tonga, for instance—remittances provide one of the main sources of income. This could well happen in Micronesia as well.

We can expect to see much less home construction in the future and probably less road-building; this should mean less damaging effects of excavation on slopes and ecologically fragile areas. There will also be less clamor for rapid and large-scale economic growth—in the form of resort hotels, golf courses, garment factories, etc—regardless of the social and environmental cost. With the option to go abroad to earn a living, blind economic development will seem less urgent than it once did.

Heavy emigration and its result on population growth rates will certainly lighten the pressure on public service systems. Elementary school enrollments in FSM peaked as early as the mid-1990s, as we have noted in another paper.[†] No longer will it be necessary for the government to build new classrooms simply to provide for ever increasing enrollments. Scarce



[†]Hezel, Francis X. & Hilda Heine. "Here's Where We're Headed: Which Way Should We Be Going?" *Micronesian Counselor* #28. June 2000.



The State of the Economy

Despite some progress during the early years of the Compact, particularly in the expansion of the private sector, the nation's economic performance is still heavily dependent on government spending. Most of the private sector itself consists of goods and services provided exclusively for domestic consumption, goods and services that would be unmarketable were it not for government spending. What we once referred to as exports and is now being termed "traded goods and services" is a tiny part of the current FSM economy. Fisheries, tourism and commercial agriculture combined account for a mere 5 percent of the total FSM economy. After thirty years of trusteeship, ten years of self-government, and fifteen years of full independence, FSM is a nation still searching for an industrial base capable of supporting its economy. The country's prospects for economic prosperity are not particularly bright, for there is no major industry in FSM today and none in sight for the future.

One of the three development areas targeted by FSM at the onset of the Compact was fishing. This would seem to be an obvious avenue for development in view of the extensive marine area that FSM controls. During the early 1990s, the national and state governments invested heavily in the fishing industry, often in partnership with outside interests. The investments, totaling \$56 million, included the purchase of purse seiners and long line fishing boats, establishment of on-shore processing facilities, and the lease of planes for shipment of the product to market. None of the public sector investments in fishing has turned a profit. Despite cumulative losses of \$21 million between 1993 and 1998, the governments have been reluctant to sell off these enterprises. Hence, far from generating revenue, the investments continue to drain off critical government funds to sustain





them. The only source of revenue earned from fishing has been from the annual license fees that FSM negotiates with outside nations proposing to fish in its waters. This has brought in a substantial \$212 million over the Compact period.

Tourism, the second targeted area of development, is more a distant hope than a reality. Visitor entry figures for FSM have been hovering between 15,000 and 18,000 for the past five years. This represents roughly one-quarter of the yearly visitor total in Palau, the new rising star in the area, and about one-fortieth of the yearly trade in the Northern Marianas. High fares and limited tourist facilities have been impediments to the development of a major tourist industry, but the potential exists for growth in this area.

Commercial agriculture, which has never been a significant factor in the economy, today brings in about \$2 million a year, accounting for merely 1 percent of the economy. Over the decades there has been a long list of commercial crop failures. To this list must be added pepper, the production of which has all but ceased on Pohnpei despite its early promise. The copra industry, which for years provided a source of ready cash for people living off the land, is also nearing extinction, a victim of falling prices.

Not only is there no major industry, then, but the islands lack even a viable cash crop since the demise of the copra industry. For decades, villagers and outer islanders could make copra to earn a few dollars as occasion or need arose. This was an important means of stabilizing the subsistence sector, in which an estimated half of the population is engaged.



so as not to overtax the slender resource base of the islands. Yet, what a plethora of community education programs have not been able to achieve, a serious economic downturn accomplished. In less than a generation, population growth was brought down from one of the highest in the world to nearly zero.

TABLE 3: POPULATION CHANGE IN FSM

	1980-1989	1989-1994	1994-2000
Chuuk	2.7%	2.2%	0.1%
Kosrae	2.4%	1.4%	0.8%
Pohnpei	3.7%	1.9%	0.4%
Yap	2.7%	1.5%	0.1%
FSM	3.0%	1.9%	0.2%

SOURCE: FSM Economic Review, Oct 2002

The reason for this, as we have seen, is widespread emigration. Since there is no reason to believe that economic prospects will brighten greatly in the near future, we can assume that population growth in FSM will be negligible over the next ten to twenty years.

Micronesians may feel powerless to create economic growth, for they control neither the size of the US funding stream that is so critical in supporting their government nor the investment that could generate a major industry. They can, however, employ the strategy that they have used for generations to adjust the balance between resources and the numbers of people these resources are expected to support. They have done this by modulating the population levels so as not to overburden the resource base—the same strategy used when young people are sent off to marry and live on a more productive island. In their cash-strapped nation today they are doing the same thing by waving farewell to family and friends who are departing for California or Oregon. There is no reason to think that Micronesians will abandon this time-tested strategy as long as they have the option of using it.



the Compact, 1987-1994. The obvious conclusion is that as jobs become scarcer, a growing segment of the population leaves to find them elsewhere.

TABLE 2: FSM EMIGRATION

	1987-1994	1995-2000	1987-2000
No. emigrants	8,750	11,800	20,550
Yearly outflow	1,100	1,970	1,430
Yearly outflow rate	1.0%	1.8%	1.3%
Migrants as % of FSM-born population	7.7%	9.9%	16.1%

NOTE: 1987—1994 figures are based on FSM emigrants to Guam and Saipan.

SOURCES: Hezel & Levin, "New Trends in Micronesian Migration," *Pacific Studies* 19:1 (1996): 95-98; FSM 2000 Population and Housing Census Report.

There are now at least 20,000 FSM-born islanders living overseas. Given the no-growth scenario projected here, it is reasonable to assume that large numbers of Micronesians will continue to emigrate in search of jobs, and perhaps also to afford their families a standard of health care and education that they will not easily find at home because of the increased financial pressure on government services. Assuming that the US continues to offer FSM citizens the right to live in US states and territories, it is likely that future emigration will match the level reached in the final years of the first Compact funding period.

Population

Table 3 reveals the sharp downturn in population growth rates everywhere in the FSM during the past twenty years. From an annual growth rate of 3 percent during the 1980s, FSM has dropped to a growth rate of only 0.2 percent yearly. As Table 3 shows, the sudden reversal of population trends has occurred in every state. Economic planners have been sounding the alarm for years about the need to take action to control the excessive population growth rate



Families could support themselves from the land and sea, while earning a modest cash income to supplement their livelihood. Moreover, copra production could easily be integrated into the ebb and flow of village life. With the decline of copra, villagers are resorting to the sale of other local produce: in Pohnpei sakau, in Yap betelnut, in Kosrae bananas and taro, and in Chuuk reef fish and local food.

The absence of a viable cash crop is a serious issue, no less so than the absence of an industry. The exigencies of modern life have made it impossible for that fifty percent of the population that lives a village life to remain there without at least a small cash inflow. Unless these people are able to find a replacement for copra, there is the danger that the rural population will become increasingly uprooted and add to the stream of emigrants abroad. On the other hand, there is the contrary danger that villagers may satisfy the need for a cash income in a way that does violence to the natural resources from which their children must live.

Prospect of Economic Expansion

What would it take to build a firm industrial base in FSM? Despite the disappointments of the past decade, fishing and tourism may remain solid footings on which to build an economic foundation. FSM has still done very little to market itself internationally as a tourist destination, even to the limited numbers of diving enthusiasts prepared to explore its world-class undersea wonders. Likewise, it has done little to appeal to the lucrative Asian tourist market, the very market that has been the base of the tourist boom in Guam, Saipan, and more recently Palau. Commercial fishing, too, might be explored further, perhaps making use of Asian fishermen on contracted boats. Ting Hong, a Chinese firm that operated out of Pohnpei during the mid-1990s, showed that a company supplying fresh sashimi to the Japanese market could make a decent profit. Even high-end agriculture, as in the case of Pohnpei pepper, could be turned into a successful business. There is room for FSM to carve out for itself small-niche specialities if it should choose to do so.



For such development to take place, a major effort would be required utilizing both foreign investment and outside managerial talent. The investment climate in FSM today, however, is not such as to encourage foreign entrepreneurs to do business in the islands. Restrictions on the length of land leases, uneven court enforcement of contracts, lack of tax incentives, and multiple bureaucratic requirements imposed on outsiders all make investment unattractive. All of this could be changed, of course, but it would have to be done over time. During the next few years it is unlikely that the climate will change significantly enough to make the islands favorable to foreign investment. Hence, there is little hope that the FSM economy will show any substantial expansion in the next five or ten years. Accordingly, FSM faces the prospects of a stagnant economy for the next ten years or longer.

Jobs and Migration

To predict the reaction in FSM to a stagnant economy, we need only review what happened during the last few years of the first Compact funding period. The step-down in US aid and the public sector reforms, as we have seen, put the brakes on the impressive growth that the private sector showed during the first ten years. Consequently, employment between 1996 and 2001 showed virtually no growth, moving from 15,304 jobs in 1996 to 15,392 in 2001.

Such a no-growth job market is unprecedented in recent history. For the previous twenty-five years, employment had been continually rising in FSM, as Table 1 shows. The increase for each five-year period between 1970 and 1995 ranged between 1,000 and 2,800 jobs, regardless of political status changes and fluctuations in economic policies. FSM citizens had come to expect a growing job market, no matter what else might happen. The tail end of this Compact funding period, with its employment increase of a paltry 88 jobs, was a shock that they had never before experienced.



TABLE 1: EMPLOYMENT GROWTH IN FSM (1970—2000)

YEAR	EMPLOYMENT	CHANGE
1970	4,702	
1975	6,964	+2,262
1980	9,760	+2,796
1985	12,630	+2,870
1990	13,734	+1,104
1996	15,304	+1,570
2001	15,392	+88

SOURCES: US Annual Report to UN, 1981; FSM First Nation Development Plan, 1985; FSM Economic Review, Oct 2002.

The public reaction can be measured in the comparative census figures for 1994 and 2000. During this six-year period, the total FSM population grew by only 1,502. This represents a growth rate of only 0.2 percent annually, a large decline from the FSM growth rate of 3 percent for 1980-1989 and 1.9 percent for 1989-1994. On the basis of recent fertility rates for FSM, we can assume a natural population increase rate of 2 percent yearly disregarding migration, which would have yielded a population of 118,816. The “missing population” of 11,808 gives us a reasonable estimate of the number of FSM emigrants during the six years between 1994 and 2000.

Put simply, nearly 2,000 FSM citizens a year were leaving the islands to take up residence in Guam, Saipan, Hawaii and the mainland US to find the jobs there that were not available to them at home. Assuming that the ratio of dependents established in a 1997 survey of FSM residents in Hawaii holds for this population, then over 4,000 of these emigrants found jobs abroad during this period.

The annual emigration rate from FSM during the late 1990s was about 1.8 percent of the population. This is a significant increase over the emigration rate of 1 percent noted for the first eight years of