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Enhancing Growth through Regional Integration in
the Micronesia Region: challenges and perspectives



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The Micronesian Region is geographically located in the North Pacific, and comprises five Small Islands Developing States (SIDS), which also happen to be Large Ocean Island States, namely the Federated States of Micronesia (FSM), the Republic of Palau (Palau), the Republic of the Marshall Islands (RMI), the Republic of Kiribati and the Republic of Nauru; and two territories of the United States of America (USA) (Guam and the Commonwealth of Northern Marianas Islands (CNMI)). In addition to being in the Micronesian geographical area, FSM¹, Palau and the RMI also share a common political history as Freely Associated States (FAS) to the USA, through a Compact of Free Association; and present several economic similarities.

2. This Paper provides an overview, challenges and perspectives of an ongoing sub-regional initiatives being undertaken by FSM, Palau and RMI to overcome their systemic challenges as SIDS, develop their capacity to trade with a view to gradually become self reliant economically and integrate into the world trading system.

I. The problem

3. The overall economic performance over the past ten years has been very poor. As a result, the three SIDS remain very vulnerable as they are highly dependent on external aid (received mainly from the US, through their respective Compacts of Free Association). US Grants represent a significant share of the GDP and total

¹ FSM is a SIDS in the North Pacific consisting of about 607 small islands with a total land area of about 701.8 square kilometers and an Exclusive Economic Zone (EEZ) of over 1 million square miles (2,589,988 square kilometers). The country consist of four separate island States namely Chuuk, Kosrae, Pohnpei and Yap with an estimate population of about 110, 000 people. Palau is the most western group of the Caroline Islands in Micronesia, about 500 miles equidistant from the Philippines to the west and from Papua New Guinea to the South. There are 340 Islands in Palau, but a total land area of only 188 square miles, of which Babeldaob, the largest island comprises 129 square miles. The EEZ extends over about 237,850 square miles and has substantial marine resources, particularly tuna stocks. RMI is composed of 29 coral atolls and low-laying islands located in the central North Pacific Ocean. The land area is 181 square kilometers spread over 1.94 million square kilometers of ocean. The two urban centers are located on Majuro, Majuro Atoll and Ebeye, Kwajelein Atoll. All other atolls and low-laying islands are classified as rural, outer-islands. RMI has a population of around 68,000 people spread out over 34 low-lying coral atolls, comprising 1,156 individual islands and islets. The most populous atoll is Majuro, which is also the capital. Palau 2020 Master Development Plan, P.2. RMI 2005 MDG Progress Report, P. 12.

revenue in the three SIDS (46% of FSM GDP and 67% of total revenue in 2010²; more than 50% of total revenue for Palau in fiscal year 2005/2006; and estimated at 42% of total revenue for RMI in 2007). The financial aid through the Compacts has been declining, and is scheduled to end in 2023 for the FSM and RMI.

4. In addition to being aid-dependent economies, FSM, Palau and RMI economies are net import economies with increasing trade deficit. Recent data suggest that the trade deficit was US\$ 127.6 millions for FSM in 2010³, 80.02 millions for Palau,⁴ and 56.1 millions for the RMI in 2006.⁵ FSM, Palau and RMI's trade deficit is evident by their relative capacity to produce and trade, which in turn is constrained by a number of key factors.
5. First, the private sector in all the three Countries is weak, not competitive, and mostly concentrated in the retail sector. Although the tourism industry is the main driver force of the economy in Palau, it remains underdeveloped in FSM and RMI, and is limited to small scale tourism industry. The few industries and producers that can potentially produce and export to neighboring countries, the US, EU and other markets lack experience and updated market information (namely on the US market).
6. Secondly, producers in FSM, Palau and RMI have not been able to meet rules of origins, sanitary and phytosanitary measures to take advantage of the generous trade provisions of the Amended Compact of Free Association with the US, the Cotonou Agreement with the EU, and the SPARTECA with Australia and New Zealand.

² 2010 FSM Economic Review P.42. For Palau, see http://www.spc.int/prism/country/pw/stats/PalauStats/Economic/Gov_Fin/CenGov.htm [accessed on September 09, 2012], and for RMI, refer to <http://www.spc.int/prism/country/mh/stats/Economic/GovtFinance/govtexp.htm> [accessed on September 09, 2012]

³ Ibid P.31

⁴ 2002/2003 Palau Statistical Yearbook, P. 68

⁵ <http://www.spc.int/prism/country/mh/stats/Economic/BOP/bop.htm> [accessed on September 09, 2012]

7. Thirdly, FSM, Palau and RMI's capacity to trade is also constrained by the lack of appropriate institutions, legislations and infrastructure to treat, test, and certify exports to international markets. This is the case of fumigation rooms, dryers and packaging facilities, competent authority for catch and vessels certification and SPS and TBT point of contacts. One can also point out FAS' current trade and trade-related laws, which in most instances are outdated; and would require substantial support to be reformed. FSM and RMI Trade Policy Frameworks (probably also Palau, in the nearest future) identify the outdated trade and trade-related legislations that need to be updated and those that need to be instituted. Those include intellectual property rights, food safety laws and competition regime.
8. Over the years, the extreme reliance on aid has weakened the capacity to devise autonomous solutions to challenges facing the FAS, and has resulted in increased unemployment rate, continued migration to the US, reliance on remittances, decline of agricultural production, rise in food insecurity, and difficulty in raising the standard of living of people.
9. The most affected by this situation are people living in remote outer islands, most of whom have gradually lost faith in agriculture and small fishing activities. Unless the current trend is reversed, achieving the first MDG goal on poverty reduction, as well the overall self economic reliance and sustainable development goal will remain an endeavor of an almost impossible achievement in the three SIDS instead of a challenge that may mobilize governments, citizens and the business community.

II. The response

10. Considering the vulnerability of their economies and in particular the termination of US Compact Grants in 2023 in the case of FSM and RMI, national development plans, policies and strategies are being formulated to address the challenges faced

by their economies.⁶ These include trade, agriculture and energy policies, and export strategies.⁷

11. At the same time, considering the size of their economies, the commonality of the problems and a certain degree of complementarity among the three Countries, a joint initiative appears as a sound strategy for assertive and immediate response to their challenges. In this regard, the Leaders of the three FAS have identified development of trade and investments (in a broad sense, including goods, services and infrastructures) to boost trade exchanges within the sub-region, the Pacific and beyond, as one of the pillars under which a foundation of sustainable economic development could be established. In this respect, during the 7th Micronesia Presidents' Summit of September 2007, in Chuuk, Head of the States of FSM, Palau and RMI directed their Trade Ministers to formally establish the Micronesian Trade Committee (MTC).

12. The MTC was established in July 2008, in Pohnpei, through a Memorandum of Understanding (MoU), which is in the process of being upgraded into a legally binding trade arrangement. The MTC has the potential to contribute to integrating small economies, achieving economy of scale, and creating new opportunities for trade, investments, and accelerating reforms that can increase economic growth in participating SIDS. The MTC could be eventually extended to other Micronesian Countries and Territories (Guam, the Commonwealth of Northern Marianas (CNMI), the Republic of Kiribati, and the Republic of Nauru).

III. Anticipated results

13. Three main results are anticipated from the creation of the MTC: the first is the creation of a sub-regional market with around 300,000 consumers, and potentially

⁶ FSM Strategic Development Plan 2004-2023. The Next 20 Years: Achieving Economic Growth & Self-Reliance, Palau 2020 Master Development Plan, Issues, Options and Strategies for Palau's Development, and RMI Strategic Development Plan Framework for 2003-2018.

⁷ FSM and RMI adopted their national trade policy framework respectively in 2011 and 2012; and are in the process of implementing the recommendations put forward. Palau is in the process of finalizing its national trade policy framework.

close to one million consumers when the bloc is eventually extended to other Micronesian countries and Territories.

14. Secondly, it is anticipated that the creation of a sub-regional market will contribute to boost domestic production both in terms of trade in goods and trade in services. Presently, data available show a small volume of trade among FSM, Palau, and RMI, which has been increasing gradually over the past years. Despite the weaknesses in the data collection system in the three Countries, official data available show that between 2000 and 2006 for example, FSM's exports to RMI increased slightly from US\$126,000 to 141,000. The main exports consisted of a wide range of agricultural and fisheries products, including banana, citrus, kava, betel nuts, root crops, reef fish, live clams, crab lobsters and copra; as well as textiles products such as local skirts. Exports from RMI to FSM are mainly handicrafts. During that same period, Palau exports to the FSM also increased significantly, from US\$99,000 to 125,000. Statistics also show a significant flow of trade between US Territories in the Micronesian region (Guam and CNMI) and the three FAS. In 2006 for example, FSM's exports to Guam represented nearly 10% of its total exports (US\$ 1.6 million); meanwhile exports to CNMI represented 5.4% of FSM's total exports (nearly US\$ 1 million).⁸

15. The above statistics suggest that a well crafted Micronesian Trade Agreement (MTA) could potentially lead to an increase of domestic production and trade among the FAS, and also between the FAS and US Territories of Guam and CNMI and other countries in the Micronesian region. For example in the case of FSM, exports to Guam could increase from 10% and up to as much as 20% of its total exports. Similarly, exports to CNMI could gradually increase to reach 10% of total exports.

⁸ Source: FSM Statistics, available at <http://www.spc.int/prism/country/fm/stats/Economic/Trade/Exp-country.htm> [accessed on September 09, 2012]; see also excerpt from the 2007 FSM international Trade Publication.

This target is easily achievable considering the current military build-up project in Guam and the high demand of the tourism industry.

16. With respect to trade in services, there are presently two small domestic air companies that could increase their operations as a result of the creation of a sub-regional market: one is Air Marshall Islands, which already provides air services to the outer atolls of RMI and Kiribati; and the other one is Caroline Islands Air which provides air services to the outer Islands of FSM. Other services sectors that could also benefit from the creation of a sub-regional market include construction, energy, real estate, and business services. Presently, there are construction companies and computer related services from RMI operating in the FSM. There are real estate companies from RMI established in CNMI; and one energy company from the FSM operating in Guam.
17. Increase of production will lead to income generation for the people of the three Countries, which in turn will contribute to assist the SIDS in achieving the MDG goals that are often difficult given the limited capacity and government financial resources available.
18. One particular aspect of production that would be enhanced under the MTC is in respect to the production of environmental goods and services. In effect, given their fragile ecosystems and environment, the Governments of the three Countries are envisaging to incorporating sustainable trade and sustainable development as a key principle of the future sub-regional market. This approach would supplement current work being undertaken in the context of the Micronesian Center for a Sustainable Future (MCSF), which comprises FSM, Palau, RMI, Guam and CNMI. In this regard, special consideration will be given to businesses operating in the production of environmental goods and services, or that use green technology in the production of their goods and services.

19. Thirdly, it is anticipated subregional integration through the MTC will constitute a building block to regional integration in the Pacific, as a stepping stone towards full integration into the world trading system. Henceforth, the MTC will provide a learning field for the domestic private sector to enhance their competitiveness. It is also anticipated that the MTC, by means of a joint representation and resources pooling in areas such as trade negotiations, business and investment promotion and private sector-friendly reforms, will provide participant countries to adopt sound policies and undertake necessary legislative reforms that are needed to create a level playing field for all the players.

IV. The weakness and challenges

20. In addition to the structural and institutional weaknesses identified in Section 1 (weak private and productive sector, inability to meet rules of origins, sanitary and phytosanitary measures as well as other non-technical barriers to trade, and lack of appropriate institutions, legislations and infrastructure to treat, test, and certify exports to international markets), Trade Ministers of the three Countries noted at their fourth Meeting that trade capacity building was a fundamental feature of international cooperation in support of trade negotiations and implementation of trade agreements such as the Micronesian Trade Agreement envisaged. Trade capacity building and supplementation are crucial, especially the case with the three FAS, given that they have very little exposure in international trade negotiations and lack expertise in that area.

21. The Trade Offices in the three Countries have few personnel, and none has a staff with a background in international trade law. FSM is supported by a Trade Policy Adviser through the Hub & Spokes Project under the Commonwealth Secretariat. However, given the scope and amount of work to be undertaken at the national level, it is very difficult and challenging for the Adviser to fully support and assist the MTC Interim Secretariat, which is currently headed by the FSM. Even the support provided by the Regional Trade Policy Adviser based at the Pacific Islands Forum Secretariat, who has helped to progress a number of issues, remains insufficient;

given the amount of work that needs to be undertaken to negotiate and start implementing the Micronesian Trade Agreement envisaged.

V. Opportunity to overcoming the challenges and role the Commonwealth Secretariat can play

22. In order to overcome the above challenges, Trade Ministers of the three Countries during their Fifth Meeting in Majuro in July 2012, considered and endorsed a *Proposal for Assistance Request to Negotiate and Start-up a Micronesian Trade Agreement*. The overarching goal pursued through the proposal is integration of the economies of FSM, Palau and RMI, with a view to contribute to economic growth and their long term economic self-reliance and sustainable development, and accelerate their gradual integration into the world trading system. In a nutshell, the project will enable the Member States, by means of trade capacity building to undertake the following: (1) undertake negotiations of a MTA effectively supported and successfully accomplished; (2) complete wider regulatory policies and procedures required under the MTA, and put in place duly and well-functioning management structures to administer the MTA, and; (3) support to the private sector capacity to take advantage of the opportunities emerging out of the MTA, in a worldwide trade context, enhanced in line with sector best practices.

23. It is important to note that under the proposed project, which is currently estimated at around US\$ 4 million for the first three years, FSM, Palau and RMI envisage to cover 10% of the total cost of the project, as owner of this venture. The three Countries are looking for potential donors countries and partners organizations to support this noble initiative. In order to ensure the sustainability of the proposed initiative, FSM, Palau and RMI also envisage to gradually increase their participation to the cost of the Project, and to take over after the funds committed by donors countries and organizations cease. The proposed project will integrate operational principles, including the promotion of gender equality and female empowerment, in particular women in outer islands of the three FAS, given their role in their communities (looking after children's health, managing household budgets, doing

much of the farming, serving as community and business leaders, and holding families and communities together...).

24. Given that core objectives of the proposed project to negotiate and start a sub-regional market among the Micronesian countries are in line with the main missions of the Commonwealth, including supporting Small Islands Developing States in the promotion of sustainable, broad-based economic growth, and supporting the private sector to drive growth, we believe that the Commonwealth Secretariat can certainly help FSM, RMI and Palau, at least at two levels: the first level is the provision of trade capacity building assistance. Such trade capacity building assistance is required to negotiate a Micronesian Trade Agreement with a view to create sustainable sub-regional market opportunities, enhance private sector capacity to increase their exports, and strengthen government institutions to create and maintain the appropriate business-enabling environment that contribute to reduce the cost of doing business, stimulate entrepreneurship and private sector led growth. In this regard, FSM would like to request that Advisers under the Hub & Spokes Project or any of the Commonwealth Secretariat Programs be assigned to the MTC Secretariat to assist with the negotiations and implementation of the Micronesian Trade Agreement.

25. The second is level of support is raising awareness and sensitizing the international community, donors countries and organizations the numerous challenges facing SIDS in the Micronesian Region to develop their capacity to trade, become self reliant economically and integrate into the world trading system. In this regard the FSM Government would like to convey its appreciation to the Commonwealth Secretariat for the kind invitation to attend this important conference; and the excellent arrangements, even though the FSM is not a Commonwealth Member State. The Conference provides an opportunity to raise awareness on the issues affecting the FSM and the Micronesian Region, and the opportunities available. It is our sincere hope that when we convene for the third Global Biennial Conference on Small States, we will report on what we have been achieve with the support of the

Commonwealth Secretariat to overcome some of our challenges, and enhancing Growth through Regional Integration in the Micronesia Region.

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