***Current Status of Economic Capacity Building in FSM***

*Guam Nov 2015*

*Laying Out the Problem of FSM*

What do you do if you’re FSM, a small and remote island nation? How do you build an economy capable of sustaining the nation in a Pacific island group that has few resources and is distant from major markets?

* 1) Try to produce goods for export just the same, perhaps by going for a niche market.

The search for a economic engine was a frustrating one. Many projects tried in the past–copra, cacao, trochus, pepper production, coconut shell buttons; banana and breadfruit chips; cultivation of clams, sponges, and black pearls; local fishing and even bottled water. [FXH 2006:33]. But these were without any significant impact on the economy.

* 2) Try to offer services that other nations will pay for.
* Off-shore banking is tempting (eg, Palau in 1999), but not favored by US and other big nations.
* Register commercial fishing vessels (eg, RMI), but revenues limited to one or two million. Likewise use of domain name for a fee–eg, TV for Tuvalu and FM for FSM–but the fees collected are negligible.
* Tourism: become desired vacation spot. But the visitor figures for the whole of FSM are virtually unchanged since the early 1980s, 30 years ago–fewer than 20,000 a year. You can invite visitors, but they may not come. (Comparison of FSM with Palau and CNMI)
* Rentals, such as military bases or strategic denial. This has been the mainstay of the FSM economy since the start. Compact funds might be considered a rental, not just humanitarian gesture by US.
* Rental of fishing rights to other nations’ commercial fleets–a source of income from the start ($12-24 million yearly), but this has now reached a record high and is projected to grow in the future.
* 3) Reduce the size of government, and the services it provides, so that the cost is manageable. This is hard to do when we consider the mounting pressure to expand and improve government services to make them match the expectations of the world community (eg, MDG).
* 4) Resign itself to a measure of economic dependence–either surrender independence and offer itself as a colony again to some power (if there are any takers), or depend on foreign aid as a significant part of its GDP.

*Parallels with Guam*

* Guam faced a similar situation: no raw materials for export, no manufacturing industry; but an economy that would depend on services and rentals–especially military bases. The island also had additional support from US federal government (tax rebates, federal programs, etc).
* In 1980, after Vietnam War, Guam had a top-heavy economy with as many government jobs as private sector positions (16,000 in each sector). Government spending fueled much of the private sector at that time. Period of stagnation: no great increase in the number of jobs and economy between 1975 and 1984.
* Rapid development of tourist industry from 1984 on, with nearly 1.5 million visitors yearly today. Private sector employment on Guam showed enormous gains after 1984, with the addition of 11,000 new jobs in four years. Overall, private sector employment increased from 15,680 positions in 1983 to almost 30,000 in 1988–the number doubled in less than five years (Gov Guam 1986: 110).
* Today, Guam has a healthy economy supported by rentals (US military) and tourism, with US government aid thrown into the package. The tourism component was critical. Is this good luck, or the natural outcome for an island that is a transportation center? Could we expect FSM to duplicate this achievement?

*Development Attempts in FSM*

* FSM was the remains of what had once been the TTPI. Those island groups with features of special interest to the US military (Marshalls with Kwaj, Palau with harbor and military training reserve on Babeldaob, Marianas with Tinian training area) left to sign their own deals with the US. FSM was, in effect, what was left over.
* Compact arrangement with US (1986-2001): based on understanding that US would supply each year for 15 years, with 40% going into infrastructure and economic development projects. Reduction of Compact funds after each five-year period. Rationale was that as the economy grew, US funds would be reduced–ideally to zero.
* In 1995, as third funding tranche began, ADB began a project to shrink the government sector. It worked after a fashion. By 2003, government jobs provided just 37% of total employment, although the percentage crept back up during the next decade. By 2014, government jobs provided 46% of all employment.

Meanwhile, there was no significant growth in the private sector. The size of the economy remained steady over that time, but 1,500 jobs were lost. (FSM Economic Report: 2014, Statistical Tables, 7b)

* Out-migration for jobs was an option offered by the Compact. With the failure of the economy to grow, people from FSM left in greater numbers. Increasing numbers head for the mainland. Now 35 % of all FSM people live outside their country.

Initially there was hope that the remittances would grow substantially as they have in Samoa and Tonga. But remittances, which came close to $16 million a year in 2006, dropped off sharply to a current level of $2m or $3m a year.

*Positive Signs in Recent Years*

* Measure of self-reliance: percentage of government income coming from foreign aid. In 1984, two years before independence, the figure was about 90% (Schwalbenberg 1984). In 2003, 20 years later, the figure was 70%. (FXH 2006: 17). In 2009 it was 63% (FXH 2012: 22). In 2014 it was 60% (EconMap 2015: 21, Table 4).
* Another measure of growth: grants from US and other governments as percentage of the total economy (GDP). Figure dropped from nearly 100% in 1987 to less than 30% in 2014 (Figure 21 in the 2014 FSM economic report)

Note: But the size of the economy in constant dollars has remained unchanged for the past 20 years at a little over $300 million (FSM Economic Report: 2014, Statistical Tables, 1b).

* Recent upsurge in the economy. What’s responsible for this very recent growth in FSM economy, such as it is? Attempts to generate a local fishing industry have failed, as have most of the projects initiated to market island products.

On the other hand, FSM has registered recent gains in services:

* Fishing license fees, long hovering between $24m and $12m, have leapt to $48m in 2014, thanks to the new agreements (eg, Nauru Agreement) that are being made by groups of PICs. These fees are projected to increase in the future.
* Corporate taxes provide sizable income from time to time, including $30m just a year ago. This is an occasional windfall, but projections are that something like it will occur every three years.
* Total of perhaps $60 million projected from these sources, in addition to smaller sums from exports and the like. Hence, services to foreign nations has been the largest boon to the economy.

*The Future*

* Can rentals and services be expanded in the future? What else can FSM offer other than its EEZ waters for commercial fishing, and its location for strategic denial?
* How about its beaches for tourism? No gains here for the past 30 or 40 years.
* Additional foreign aid in the future? US is currently against extending the Compact funding period. Trust Fund will provide some limited help. (Other PICs in the south depend heavily on foreign aid for support.)
* Where does FSM go from here?