Pacific Islands Trade and Investment Commission, Sydney
Creating Opportunities Between Australia and the Pacific

Doing Business in
The Federated States of Micronesia

Location

The Federated States of Micronesia with a total land area of only 700 kilometres squared is made up of 607 islands scattered over 3 million square kilometres of the Pacific Ocean. The country became a sovereign nation in May 1979 and is located just north of the equator in the western Pacific, approximately 5,000 kilometres west of Hawaii.

In 1991 the Federated States of Micronesia became a United Nations member and has a population of about 108,031. It is amongst the Pacific's most diverse in terms of people, languages, customs, traditions and institutions.

The ties leading to a unified political and economic body, still contentious at times were cemented in the 1970s and 1980s by the necessity to form a unified political body and enter into a Compact of Free Association with the United States in 1986 and of which it continues to remain as such.

English is the official language of the Federated States of Micronesia and is widely spoken. There are, however, at least eight major indigenous languages in the country, none of which are spoken across the island nation.

Each state has its own language and many of the older citizens are familiar with Japanese due to its occupation by Japan prior to World War II.

Government

The country has an American-style constitution, which incorporates a parliament composed of an executive branch, a legislative branch and a judicial branch. Each of the country's four states has an elected governor, a lieutenant governor and a legislative body. Most major government functions other than foreign affairs and defense are carried out by the State governments.

At a Glance:

Population: 108,031 (2007)*

Land Area: 700 square kilometres

EEZ: 2,978,000 square kilometres

Political Status: independent democratic government since 1979

GNP: US$211.7 million (2006 est.)

Major Industries: fisheries, tourism, agriculture

Merchandise Exports (Value): US$3.4 million (2006)

Major Exports: fish, banana, copra, kava, betel nut

Merchandise Imports (Value): US$137.9 million (2006)

Major Imports: food and beverages; mineral fuels; machinery and appliances, transport and equipment; textiles.

Currency: United States Dollar

Source: FSM Statistics Unit

*Projected figures

The National Congress is a single-chamber parliament and consists of fourteen members: ten of whom represent congressional districts in each state, who are elected for two year terms; and four members (one from each state) elected for four-year terms.

The congressional districts are divided according to population. Congress elects the President and Vice-President from its four-year members, and both serve a four-year term.

The current President is H.E Emanuel Mori and the Vice President Hon. Alik L. Alik. The Speaker of the FSM Congress is the Hon. Isaac Figir.

A third tier of government, municipal government, is island/municipality-based and, in some ways, represents the most important level of government. Heads of local governments are elected periodically based on their respective municipal constitutions and in conjunction with the state government elections.

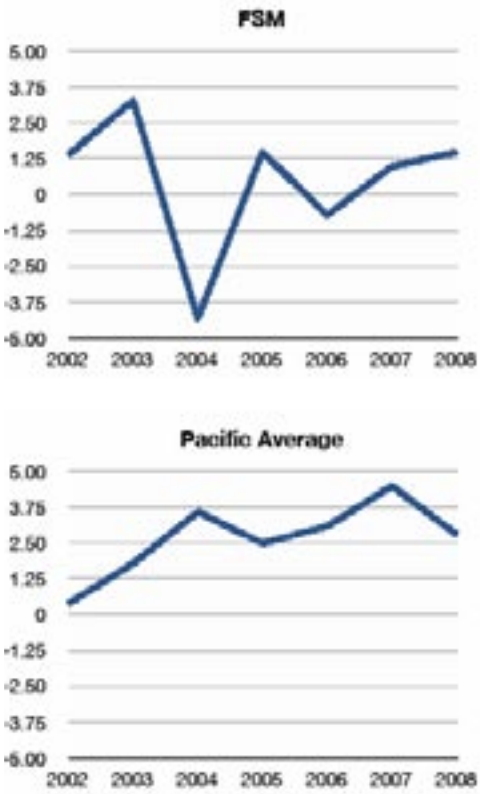
Each of the municipality has a hierarchy of traditional leaders, the highest title being the chief. Its main purpose is to keep the traditional culture current and functional. The council of chiefs has influence over legislation effecting traditional ways, and any shift perceived to change the culture could be challenged. In this sense, a complex and highly hierarchical system has been established over the centuries, which serve to curb rapid change and maintain social and political stability.

The Compact of Free Association is an arrangement that leaves the Federated States of Micronesia in control over all domestic and foreign policy with the exception of defence and security issues, for which the United States is responsible.

The Compact also provides finance to assist the development of the Federated States of Micronesia. The funding arrangements are complex, but in summary for the first Compact treaty, which was for 15 years, the United States government paid approximately US$60 million a year for each of the first five years (plus funding for ongoing projects), US$51 million for each of the next five years, and US$40 million for each of the last five years.

A renegotiated and amended Compact of Free Association with the USA came into effect in FY2004, with a 20 years financial assistance package. The United States government agreed to finance different sectors in the amount of US$92.7 million annually with a portion of the funds being deposited into a Trust Fund.

GDP Growth (%) 2002-2008



Source: ADB Asian Development Outlook, 2007. 2007 and 2008 are estimates.

Economic Profile and Performance

Agricultural exports, receipts from fishing licenses and tourism are the three major contributors to the economy; however, the country is still heavily dependent on aid (mostly from the USA) whilst performance has been driven by public sector expenditures.

In 2006, the economy contracted slightly by an estimated 0.7% despite significant per capita levels of financial grants.

The slight weakness in the economy reflect partly a reduction in funding under the terms of the amended Compact and the added fiscal pressures created by stricter controls on the use of the Compact funds which will continue to be channeled into a trust fund.

Like many Pacific nations, the FSM has a persistent trade deficit because it is highly import dependent and produces few exports. Services account for about 70% of total employment while agriculture and fisheries for less than 10%. Inflation was reported at 4.9% in 2006 and external debt service indicators suggest that external debt is manageable however this will come under pressure as receipts from grants under the compact decline from 2007.

The development of exports and, more broadly, of the private sector, is also hindered by certain policy settings, in particular access to land and in restrictions on foreign investment. High costs and irregular transport also limit export potential.

The regular flow of Compact funds reduces pressures to promote growth sectors and develop revenue sources, however, the National Government is expending serious efforts in working with individual State Government to review foreign investment and land leasing policies.

Economic Outlook

Policies aim to building both the skills of potential migrants and links between emigrants and their homeland may assist in the long run. Forecasted figures show low levels of growth of about 1.0 – 1.5% expected in 2007 and 2008 because of the fiscal pressures.

The difficult adjustments required suggest that the economy will continue to face important budgetary and economic constraints over the medium term. Yet it will be crucial to push ahead with reforms as otherwise the private sector will remain stagnant and the economy heavily reliant on the public sector, supported by aid.

Without a significant upturn it is unlikely that the economy can be self-reliant on trust fund income by 2023, given low trust fund returns received to date and a likely lack of a budget surplus to build the fund.

Source: ADB Asian Development Outlook, 2007

Industry Sectors

The major economic sectors of the Federated States of Micronesia economy are:

- ***Agriculture:*** Activities in this sector is limited to the small-scale subsistence growing of fruit and vegetables with surplus harvests sold at local markets and retailers in the major centres. It also exports in small quantities to its regional markets of Guam and Marshall Islands.

  This includes copra, bananas, citrus, kava, betel nuts, root crops and piper leaves. It has been regarded that for this sector to expand the formation of land-use cooperatives is vital.

- ***Construction:*** Small-scale construction projects are well taken care of by a few local companies, whilst large infrastructure-type projects are tendered for by overseas companies.

- ***Fisheries:*** An immense contributor in this sector is the annual licensing fees paid by foreign vessels for tuna fishing in one of the Pacific's largest (2,978,000 square kilometres) exclusive economic zones, said to be the most fertile skipjack tuna habitats in the Pacific Islands.

  Due to its extensive coral reefs and lagoons, mariculture and aquaculture is seen as a feature industry including farming of giant clams, eucheuma seaweed, sponges, pearls, green snails and other species. A positive outlook lies ahead for this sector given its strategic location to Japan and the USA and with increased development for its supporting infrastructure.

  The Western and Central Pacific Fisheries Commission is headquartered in Pohnpei, contributing to stock management and a sustainable FSM fisheries industry

- ***Manufacturing:*** Manufacturing is a very small part of the economy. Handicrafts and other small processing outlets are far from becoming a large income source. The FSM is seeking to develop this sector further.

- ***Retail/Wholesale:*** This sector is small; however there are a large number of small retail outlets handling mostly imported products. Major United States retailers also have outlets in Pohnpei, especially in hardware and construction materials.

- ***Tourism:*** The four states of the FSM provide distinctly different worlds surrounded by spectacular beauty of the islands and the sea. The country attracts the more adventurous traveler, sports divers, underwater photographers, hikers, sport fishermen and backpackers.

  The annual visitor arrivals have averaged around 17,700 between 1997 and 2006. Official figures for 2006 show visitor arrivals at 19,136. In 2006 the composition of total arrivals was made up of 68% tourists and visitors, mainly from the USA and Japan.

Imports/Exports

Exports from the Federated States of Micronesia in 2006 were valued at US$3.4 million, while total imports in the same year was US$137.9 million.

Major exports comprised of fish, bananas, copra, kava and betel nut. Major imports included food, mineral fuels, machines, transport and equipment, manufactured goods, textiles and electrical appliances.

Labour and Human Resources

The latest available labour market figures (2000) showed 37,414 people (58.0%) in the labor force with projections for 2006 up by 16,454.

While government employment remains significant, it has declined over the years whereas formal private-sector employment has increased slightly.

The education curriculum is modeled on the United States' system and provides free primary education (Grades 1–8), attendance is compulsory; for those passing an examination, free secondary education is also offered.

The College of the Federated States of Micronesia (COM-FSM) in Pohnpei offers two-year courses in teaching, accountancy and business, marine science, hospitality and tourism. It runs programs for degree, certificate and vocational levels.

COM-FSM also has state campuses in each of the individual states to provide access to the larger populace, especially with the island state being separated.

The Federated States of Micronesia has flexible rules in relation to the use of expatriate labour where it is necessary. However, the use of expatriate labour is subject to the availability of local workers and preference is given to local hiring for all jobs.

If an investor wishes to bring in outside labour, application must be made to the FSM Department of Resources and Development.

Minimum wage rates have been established for government workers with Pohnpei having a minimum hourly wage rate of US$2.00 for government workers and US$1.35 for private-sector workers.

The other three states have minimum hourly rates only for the government workers starting from US$0.80 for Yap, US$1.25 for Chuuk and US$1.49 for Kosrae.

Infrastructure

The major centers are well maintained, whilst the outlying islands are limited to bare essentials such as small docks, individual power generators, water catchments systems and small airport runways.

Each of the four urban centers has an international airport able to accommodate medium sized jet aircrafts. The international services are provided by Continental Micronesia's fleet of 737 aircraft, with routes to Hawaii, Marshall Islands and Guam with connecting flights in Guam to the rest of the world. The inter-island routes are serviced by Caroline Island Air.

The country's ports facilities are capable of handling commercial shipping needs and its port depths range from 30 to 160 feet and can provide containerized cargo handling, some warehousing, and transshipment. All its ports offer cold storage facilities.

Monthly ocean shipping is provided by Matson servicing the West Coast of the USA to the FSM through Guam and also to Asia. Other shipping lines include Kyowa Lines providing services to and from Japan and Southeast Asian regions.

Freight rates are reasonable given that these are monitored by the Micronesian Shipping Commission.

International telecommunications – telephone, cell phone services, facsimile and internet – are available in all four states and provided by the FSM Telecom Corporation.

Electricity (110-220 volt, 60 hertz) is generated by Diesel-powered generators, fueled by imported petroleum products and is used extensively in all major centres.

A full range of commercial banking services are provided by the Bank of the Federated States of Micronesia and the Bank of Guam. The Federated States of Micronesia also operates the FSM Development Bank.

There are also smaller financial institutions that provide loan guarantees and smaller secured loans.

Investment Policy and Regulations

The Federated States of Micronesia welcomes foreign investments given its importance to the country's development in terms of foreign capital, management, and technology.

The government actively encourages investments and activities that; earn foreign exchange; offer both training and increased employment; use sustainable and efficient use of local raw materials; prospects for future expansion; stimulates technological development, develops new and modern industries; and protects the environment.

Businesses may operate in whatever form (sole proprietorships, partnerships, corporations, etc) and laws do not require local citizens to share ownership. However the government encourages joint ventures with local partners.

Foreign investment permits are required and applications should be submitted either to the Department of Economic Affairs or to the State government authorities in each state that the proposed investment is to take place.

The following license fees apply:

- Importer; USD$100
- Exporter; USD$10
- Securities dealers; USD$250
- Insurance companies; USD$1,000
- Insurance brokers; USD$200
- Insurance agents; USD$100

Application forms may be obtained from the FSM Department of Resources and Development and filed with the same office.

Business activities other than banking, telecommunications, and insurance, fishing in the country's EEZ, international and interstate transport, and international shipping are processed by each of the four states with small fees.

Trade Relations

The Federated States of Micronesia has no quota restrictions to the USA markets for domestic or value-added products and it enjoys non-reciprocal market access to Australia and New Zealand under the South Pacific Regional Trade Economic Cooperation Agreement (SPARTECA).

Potential for duty-free access to Japan and other Asian markets also exists.

Land

Special importance is attached to land in Micronesia both because of its short supply and because of its traditional importance. Land ownership is limited by the Constitution to citizens of FSM and property is held in family trusts with its rights passed down from generation to generation.

Both the national government and the respective state governments will assist interested investors in identifying local partners as well as land owners interested in leasing their land to investors.

The initial point of contact with respect to access of land should be the Secretary of the FSM Department of Resources and Development.

Taxation and Other Regulations

There are three taxes imposed by the national government through its Customs and Tax Administration, this includes import tax, tax based on gross revenues of all businesses, and income tax.

The various states and municipalities also enforce other taxes where businesses are encouraged to seek their advice on what taxes apply to their business activity.

All imported goods must be cleared within 15 days of arrival or a penalty of 10% plus an additional 10% for each month the tax is not paid. Taxes on imports are assessed on the free on board (FOB) value of the goods.

Gross revenue taxes are based on $80 on the first $10,000 of gross revenues and 3% on amounts acceding that figure. Those with less then $2,000 annual gross revenues are eligible for a refund of the taxes. Payments for taxes should be made on or before the last day of the month following the close of each quarter and penalties apply for late payments.

Income tax rate is 6% of the first $11,000 and 10% on amounts exceding this, whilst those earning less than $5,000 a year are entitle to a $1,000 deduction before the taxes are computed.

Non-case wages and salaries are also taxable.

To support its social security system, employers and employees contribute 6% each of wages and salaries not in excess of $5,000 per quarter.

Special US tax credits exist for USA corporations operating in the FSM.

Investment Opportunities

Although the domestic market may seem quite limited, there exists rewarding opportunities for the serious investor:

- ***Agriculture:*** Traditionally this sector has been small-scale and on a subsistence level. The country boasts lush vegetation, abundant rainfall and varying soil quality in the different regions.

  Identified as amongst the country's high growth strategy sectors, the government is encouraging production cooperatives, to ensure a sustainable and consistent supply in both the local and overseas markets.

  Potential products include bananas, breadfruit, pepper corn, kava, noni and other niche agricultural products.

- ***Aquaculture:*** The country's extensive reefs and lagoons offer several promising opportunities for aquaculture ventures for both export and domestic consumption.

  Activities currently underway include cultivation of giant clams, black pearls, mangrove crab, sponges, live cultured coral, ornamental fish, sea cucumber and trochus shells.

- ***Fisheries:*** Marine Resources offer FSM their largest resource with value of near-shore and coaster fisheries estimated at around USD$24.5 million (subsistence and commercial).

  There are opportunities in the longer term development of tuna fisheries and further potential for line tuna and purse seine transshipment. Reports by the Asian Development Bank state that tuna processing and servicing sector offers the greatest opportunity for the FSM.

- ***Manufacture:*** This sector is focused primarily on small-scale production and draws mainly from the natural resources available. Recent developments in this sector include recycling of aluminum cans, water bottling plant and a coconut processing plant.

  The FSM is seeking investors in assembly line manufacturing, beer breweries and coconut products to name a few.

- ***Tourism:*** This is perhaps the largest growth opportunity for the islands with its clear blue waters, traditional island lifestyle and a unique and distinctive heritage in each of the four states.

  An anticipated move of 30,000 or so military and dependents from Okinawa to Guam, offers an added bonus where distinct tourist attractions can be accessible to accommodate this much closer and emergent market.

  The national government is also promoting the expansion of eco-tourism activities and services thus promoting low-impact and culturally-sensitive tourism. There are opportunities in the eco-tourism, hotels, cultural tours, dive operators, cruise operators and conference facilities.

- ***Other opportunities:*** The FSM offers opportunities in the following sectors as well - Telecommunications submarine cable, waste management, entertainment facilities (bowling alley), and inter island transport.

Business Development Assistance

Small Business Development Centre (SBDC), Chuuk

There are Small Business Development Centres (SBDC) in all of the states. The centres in Chuuk, Yap and Kosrae are a strategic alliance between the State Governments, the US Small Business Administration and the University of Guam. The Pohnpei Business Development Centre is a collaboration between the State Government and the College of Micronesia- FSM. They all aim to foster sustainable business development by providing quality management and technical training assistance to businesses throughout the State.

The Centre provides the following programmes:

- Business counselling; Pre-venture feasibility assessments, business plan development, local and international marketing advice, book keeping, financial planning, human resource management and preparation of funding proposals;
- business training;
- business referrals;
- business information; and

- training workshops;

All prospective or established business enterprises throughout the state are entitled to this assistance.

Financial Services

Bank of Guam

The Bank of Guam is a publicly owned company with its headquarters in Guam, USA. It started operations in the Federated States of Micronesia in the 1990s and currently has branches in Pohnpei and Chuuk. The Bank provides a full range of personal and commercial banking services.

Bank of the Federated States of Micronesia

The Bank of the Federated States of Micronesia is 80% jointly owned by the Federal and State Government of the Federated States of Micronesia and 20% by local investors. It has four branches, one in each of the four states. The Bank provides a full range of commercial banking services to all the states in the Federated States of Micronesia and has a clearing office in Honolulu.

The Federated States of Micronesia Development Bank

The Federated States of Micronesia Development Bank is owned and operated by the Government of the Federated States of Micronesia. The bank's head office is located in Pohnpei and their branch offices in all four states. The bank also provides client training courses on business development and business advisory services. The Development Bank of FSM makes concessionary long-term loans, mainly to local investors.

- Commercial loans: up to maximum of 25 years for large projects and depending on sector
- Smaller project loans: up to 5 years and up to value of USD$200,000
- Real estate finance secured by mortgages;
- Loan guarantees

Bank focuses on businesses involved in the government's priority sectors of marine, tourism, agriculture, manufacturing and real estate.

Small Business Guarantee and Finance Corporation

The Small Business Guarantee and Finance Corporation is owned and operated by the Government of Pohnpei State. The Corporation was established in Pohnpei in 2000. The Corporation provides loan guarantees in lieu of equity to small and medium-sized enterprises (SMEs) in Pohnpei State.

Project viability is the major criterion for any assistance and must be reflected in proposals. Focus is on reef fishing, small textile, clothing and footwear industries, retail expansion and working capital for existing businesses;

- Corporation provides guarantees to commercial and development banks for loan applications within the range of US$2,000 to US$250,000
- It also provides advice to SMEs and assists in the preparation of funding proposals and business plans.
- Direct lending to entrepreneurs with viable business proposals

Useful Contacts

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The Pacific Islands Trade & Investment Commission, Sydney

Who We Are and What We Do

We are one of four overseas agencies of the Suva-based Pacific Islands Forum Secretariat (PIFS). PIFS has other overseas offices located in Japan, New Zealand, and the People's Republic of China.

We work closely with a network of government and private sector agencies in the 14 Pacific Islands who are members of Pacific Islands Forum.

Our aim is to improve the capabilities of their private sector; in particular in enterprise, export and tourism development.

Our Functions

1. To assist Pacific Island enterprises develop sustainable business and trade activities.
2. To assist Pacific Island governments and private sector service providers develop their tourism potential.
3. To support private sector growth in the Pacific Islands, including promoting intra-regional investment.
4. To support business linkages between government and enterprises in the Pacific Islands and Australia through efficient and effective dissemination of market information.

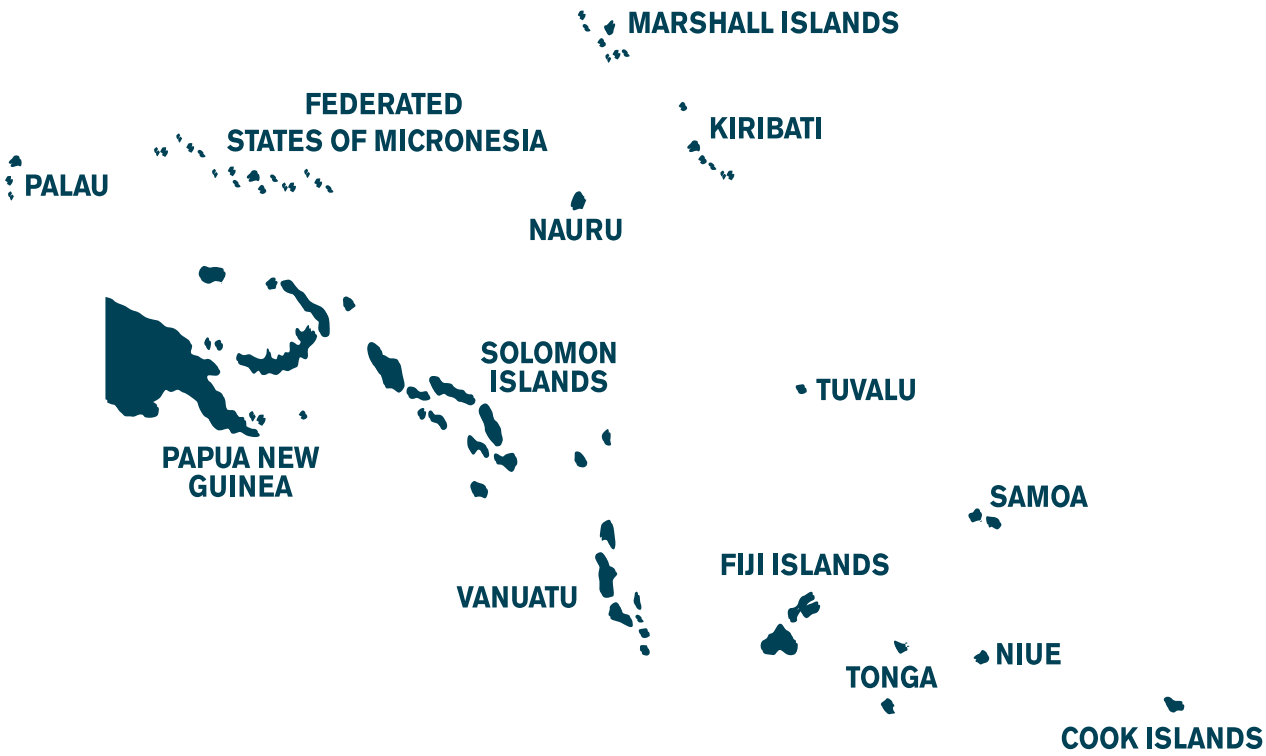
Out Special Projects Unit

- Supports private sector development in 14 Pacific Islands Countries.
- Promotes intra-regional investment development.
- Supports the business development programs of Small Island States (SIS).
- Supports skills development, including through capacity building initiatives.

Our Newsletters

Our newsletter provides practical information about trade, tourism and investment trends in the Pacific Islands and Australia. Pacific Outlook also contains up-to-date information on developments on regulatory changes and requirements for trade and industry in the region.

Our newsletters are published on a bi-monthly basis. Register online at www.pitic.org.au for your free subscription.



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