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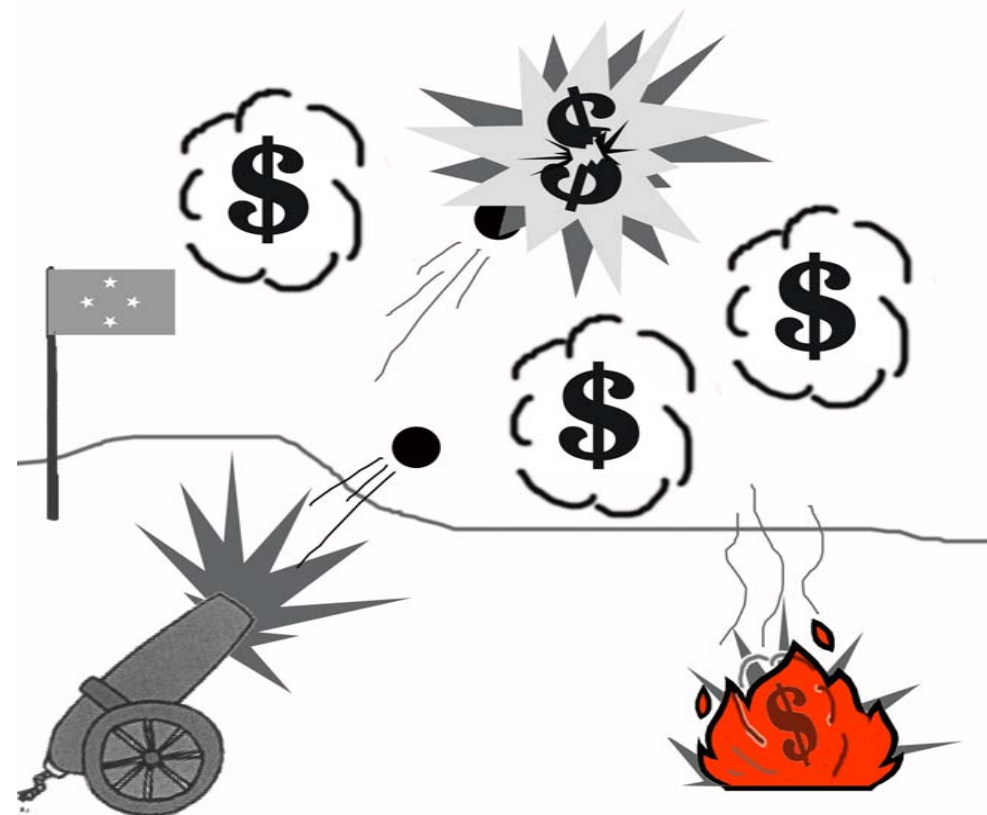
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Issue 59

Myths of the FSM Economy

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Myths abound in struggling Pacific nations, as they do in other parts of the globe. For a while, the chants ring true to us, but gradually we begin to realize that these self-evident truths are not borne out by our experience. Economists, international financial institutions, rich nations (like the US) and less wealthy ones (like FSM) may echo these for a time. But if genuine development is ever to occur, we would all do well to lay aside these fantasies and get on with the work of building a durable economy in a more realistic way while making good use of all the resources at hand.

The years of rapid population growth, extending from the end of the war through the 1980s, are decidedly over. The yearly growth rate then was well above 3 percent; between 1994 and 2000 it plummeted to 0.2 percent.

The two authors were recruited by Asian Development Bank to give a series of presentations on the report on the FSM economy completed by a bank-sponsored team earlier in the year. Rather than bombard participants with a series of detailed graphs and tables illustrating various aspects of the economy, we decide to focus on a few commonly held beliefs on economic development in the islands and examine these in the light of the data. In doing so, we cast ourselves as myth-busters. We present these myths and our comments on them here in the hope that they will stimulate serious reflection on FSM's economic growth, past and future.

Myth #1: Population Growth is a Problem

Even these days any number of consultants and other visitors will mention what they regard as the population problem in Micronesia. When this happens, I explain to them that they're 15 or 20 years behind times, because we haven't had what could be called a population problem since the 1980s when the growth rate for FSM was above three percent a year. The years of rapid population growth, extending from the end of the war through the 1980s, are decidedly over. The yearly growth rate then was well above 3 percent; between 1994 and

Fourth, fishing and tourism might show some modest growth in the years ahead, but it is unlikely that either will become a very lucrative industry. The governments would be well advised to be rid of their fantasies of rapid growth in these sectors and to resist the temptation to invest in either one. Fishing license fees, however, will continue to provide a significant but highly variable amount of revenue each year.

Fifth, the development of small niche industries could make an important contribution to the nation's economy. Whether in agriculture, fishing, tourism or other sectors, such industries should be encouraged.

* * *

NEW PHOTO ALBUM



70s: Revival of Towns

If development began in the 60s, it accelerated in the 70s. US subsidies continued to increase, with most of the money going into public building projects and new federal programs. Mom-and-pop stores evolved into supermarkets, and new hotels went up to accommodate the growing number of visitors. As business flourished, the towns took on a new look. To some older people it looked like a revival of the boom towns in the 1930s. Meanwhile, hundreds of young people were going off to college in the US. Their lives were being reshaped there, just as were their islands back home. Island social life was being transformed in big ways and small throughout the decade.

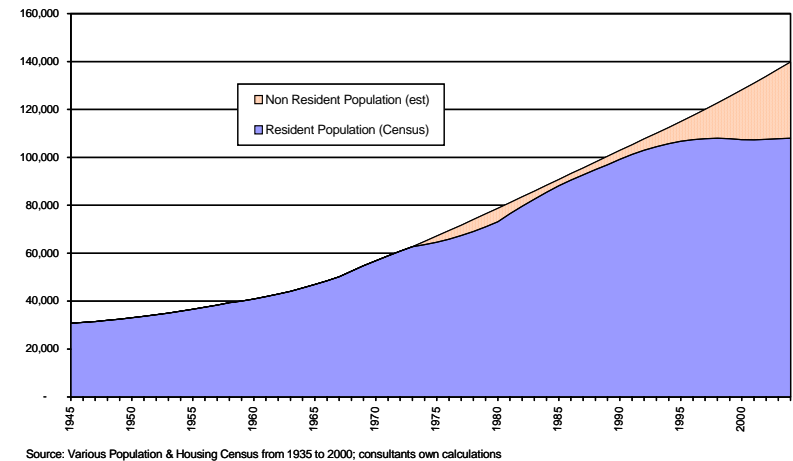
Even if these people are not dying in the streets (or on the village paths), they are in danger of being seriously neglected by their government. Attention should be given to providing these people with the basic social services: public education, health services, and transportation to and from the population centers as required.

Conclusion

What does the future hold for the FSM economy?

- First, with the migrant population growing by 2,000 each year, remittances could become a major source of income if ways are found to retain strong ties with those who have departed for the US. Tonga, Samoa and the Cook Islands seem to have been successful in maintaining their social ties with emigrants. FSM should consider strategies for doing the same.
- Second, Compact funds will continue to underwrite many of the government services during this 20-year period, while the Trust Fund will theoretically pick up the slack at the end of this time. If there is to be a smooth transition at the end of this period, FSM will have to monitor the Compact Trust Fund and ensure that it achieves its potential earnings.
- Third, household production anchored in the subsistence sector together with agricultural cash crops being sold in the islands and abroad, should continue to provide a viable option for those who, even without advanced education and any hope of full-time employment, would prefer to live at home rather than migrate to the US.
- Fourth, fishing and tourism might show some modest growth in the years ahead, but it is unlikely that either will become a very lucrative industry. The governments would be well advised to be rid of their fantasies of rapid growth in these sectors and to resist the temptation to invest in either one. Fishing license fees, however, will continue to provide a significant but highly variable amount of revenue each year.

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Graph 1: FSM Population growth, 1945-2005

What's happened to change things? In the first place, fertility rates have dropped. The average Micronesian woman in the early 1970s was having eight children throughout her childbearing years; twenty years later she was only having four or five. Even more important as a brake on the population growth has been the enormous emigration since the late 1980s, when the Compact was officially implemented. Graph #1 shows how the population of FSM has flattened since the mid-1990s. In the past ten years, between 1995 and 2005, about 2,000 Micronesians each year have been leaving the islands and moving overseas to live and work. Added to these 20,000 recent emigrants are the 10,000 or so who left the islands during the early years of the Compact or even before that. Hence, there are now an estimated 30,000 FSM citizens living overseas—this number represents nearly 25 percent of all FSM citizens. Meanwhile, the resident population in FSM has hit a plateau and may even dip in the future as FSM citizens spill over into the US, where public services are good, salaries are relatively high, and entry-level jobs are easily found. There is no indication that this trend will change in the future.

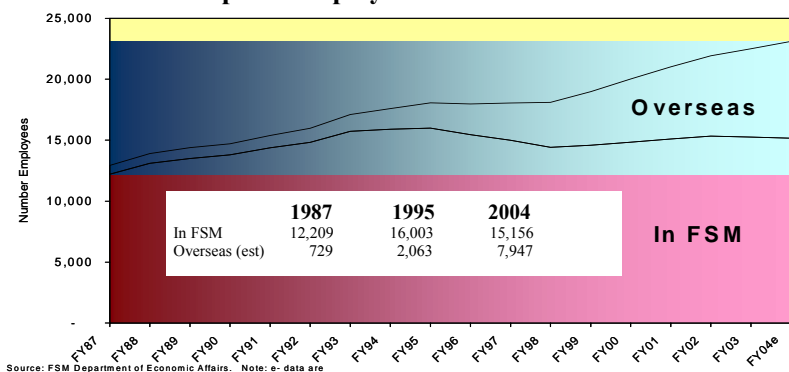
There are now an estimated 30,000 FSM citizens living overseas—this number represents nearly 25 percent of all FSM citizens.

Should this loss of population be considered a problem? Probably not, especially from an economic point of view. With the ever declining operational funds from Compact assistance, employment opportunities have been extremely limited in FSM over the past ten years. An estimated 60 new jobs open each year, many of them replacement positions for employees who have died or retired. If we accept the results of a survey done of the migrant population in Hawaii in 1998, we can assume that 30 percent of those 2,000 emigrants each year are finding employment. This would mean that 600 FSM citizens each year are finding jobs abroad, while only about 60 or so are being hired in the islands. Thus, for every job that a Micronesian gets in FSM, citizens are finding ten others outside the country.

Emigration is offering a cash income to many Micronesians who would not otherwise have had good prospects for employment. Without emigration a much larger population would have to get along on the income derived from far fewer full-time jobs. (See graph #2) Thanks to the nearly 8,000 jobs held by FSM citizens overseas, each employee must support an average of six other persons, not the nine he or she would have had to support if everyone were required to remain at home.

For every job that a Micronesian gets in FSM, citizens are finding ten others outside the country.

Graph 2: Employment in FSM and Abroad



- Functioning markets
- Transparent and consistent governance
- Secure, transferable property rights
- Straightforward investment procedures

The features of this formula are all praiseworthy; they will certainly improve economic opportunities for local citizens and improve the life of everyone. It would be a mistake, however, to think that fulfilling the formula will necessarily guarantee that foreign investors will be opening briefcases filled with cash on the table to buy into development in the islands. The limitations that FSM faces will remain in force: its limited resources, its remoteness from markets, and its relatively small population. The only way to overcome these is to think globally, beyond the national boundaries of the FSM.

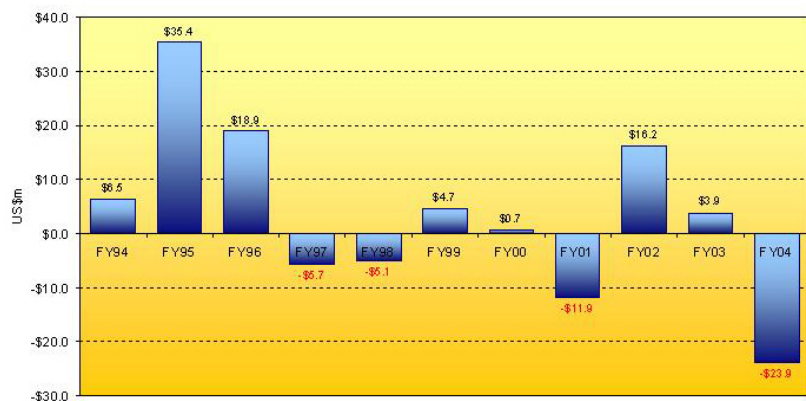
With a per capita GDP of less than \$2,000, FSM ranks well below the countries of the developed world, although it is far from the lowest in the Pacific.

Myth #7: Poverty is Everywhere or Nowhere

What you see in FSM today depends on where you stand. To those who are reading the economic reports, FSM might appear to be mired in poverty. With a per capita GDP of less than \$2,000, FSM ranks well below the countries of the developed world, although it is far from the lowest in the Pacific. Poverty alleviation is now the battle cry of the international donor community, with FSM one of its targets. While the efforts of other countries are appreciated, outsiders looking in may fail to take into account the “subsistence, affluence,” or abundance of local food and building materials that afford even rural dwellers a decent livelihood. The degrading poverty of some parts of Asia and Africa is nowhere to be found in the Pacific.

Many islanders, on the other hand, argue that poverty is a term should not be applied to FSM. Generally speaking, this may be true. Yet, it is undeniable that some people suffer real hardship, have very limited cash incomes, and live in remote and poorly serviced places.

Graph 8: FSM Current Account Balance



Although FSM has very little industry to speak of, the national income is in reasonably good shape thanks to those transfers from overseas. Compact funding has been renewed for an additional 20-year period, with a trust fund set up to generate a stream of revenue even at the end of Compact 2. Fishing license fees are likely to continue to generate money each year, even if the amount might fluctuate depending on the tuna market. Remittances, although negligible now, could well become a considerable source of money in the future. This should not lull people here into complacency and neglect of local development opportunities. But as we work to strengthen the local economy, we should also understand that the future of the nation depends on global ties, with emigrants and with foreign governments, as much as on what is produced in the islands themselves.

Consultants and the international financial institutions that support them sometimes assume that any nation, no matter how small or resource-poor, can become another Switzerland or Singapore if only its government will follow the formula. The formula, which is aimed at creating an environment conducive to investment, includes these items:

- Rule of law enforced
- Stable government

Emigration on the scale we have seen during the last twenty years represents a real resource for the nation, providing we continue to think of those who have left as part of our own community rather than fugitives from FSM. Other countries in the South Pacific depend heavily on the remittances emigrants send home to support their families, churches or other institutions. Tonga derives 45 percent of its total income (GDP) from this source, while Samoa obtains 25 percent from remittances. If each of the 8,000 FSM citizens working abroad were to send back \$1,500 to family and friends in the island, the sum of remittances would total \$12 million, or about the same amount that the nation is now obtaining each year from fishing license fees.

If other Pacific Island nations benefit so much from remittances, why not FSM as well? Admittedly, the money flow back into the islands from emigrants seems to be no more than a trickle right now (although none of us are entirely sure since we have never measured remittances). The tide of resources could reverse in time, however, with much more money and goods flowing back to the islands to support relatives who have remained at home than outward to assist new emigrants in getting established abroad. FSM government leaders might consider what steps they could take to encourage this—not by mandating remittances by law, but by offering emigrants other incentives to remain linked to their home islands. FSM citizenship, the right to vote, and retention of land rights in the islands might be a place to start. Sponsoring periodical events to which emigrants are invited to return home and join the celebration, as is done on Christmas every fourth year on Kosrae, is also a good strategy to keep links strong.

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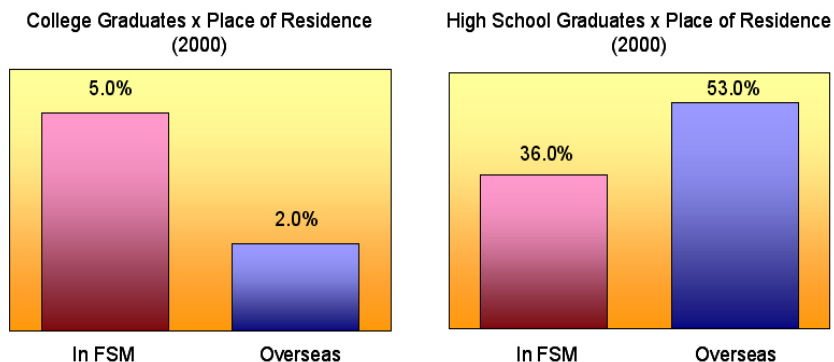
Myth #2: Emigration is Causing a Brain Drain

As emigration in FSM soars, most observers assume that the nation is sending off its best and brightest to make their fortune abroad. Isn't it always the most ambitious and the most highly trained that have the



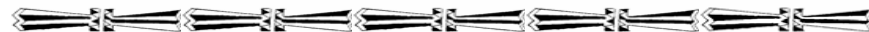
confidence and resourcefulness to leave home and clear new trails overseas?

Graph 3: Educational Level of FSM Residents and Emigrant

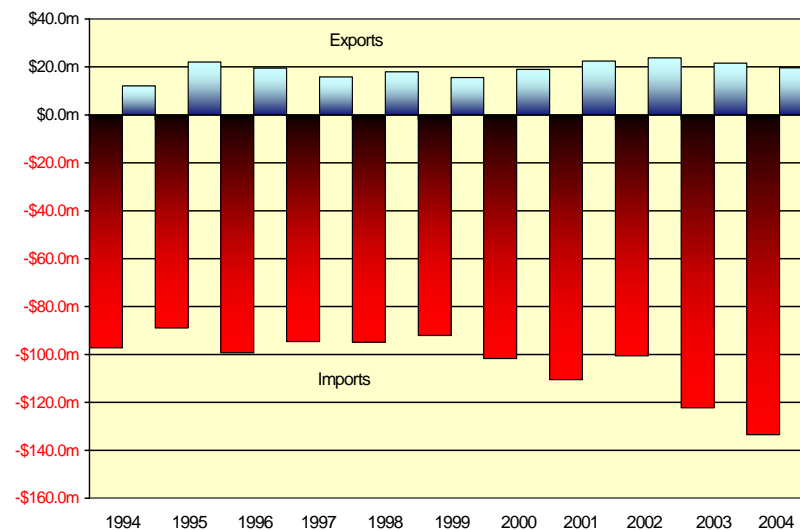


Whatever the case might have been in other countries, this does not seem to be true in FSM. Data from the migrant FSM community in Hawaii in 1998 reveals that the percentage of those with a high school diploma is high (53%), considerably higher than the percentage of those who stayed home (36%). (See Graph #3) When we look at the comparative percentages of those who hold a four-year college degree, however, we find that percentage of college graduates at home (5%) is more than double what it is among the migrants in Hawaii (2%). This suggests that the best educated Micronesians, the ones who are reasonably sure of finding a job in the islands, will return home by and large. On the other hand, young people who may have finished high school but are unable or unwilling to continue their education—that is, those with poor job prospects in the limited job market at home—are forced to look for employment abroad. This merely confirms the impression many of us have had for years that most Micronesians would prefer to live and work in FSM, other things being equal.

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Graph 7: FSM Imports and Exports



Over the past 11 years, FSM's exports have amounted to no more than a small fraction of its imports. Graph 7 shows that imports over this period have averaged about \$100 million annually, while total exports amount to barely \$20 million a year. The imbalance of exports and imports in the islands is an old story, a constant reminder of the long distance to go before this imbalance is redressed and the islands are domestically self-reliant. Yet, when we look at the current account balance for those same years, we find that more often than not there was a positive balance. Between 1994 and 1996, for instance, Graph 8 indicates that there was positive balance for each of those years even though FSM's exports were dwarfed by its imports. In other words, the national income exceeded national expenditure during this time. Clearly, only part of this income is derived from exports. The rest comes from financial transfers that include funds received through the Compact, foreign aid from other governments, revenue from fishing license fees, and possibly even remittances.

We should also understand that the future of the nation depends on global ties, with emigrants and with foreign governments, as much as on what is produced in the islands themselves.

Agriculture, then, appears to be serving a two-fold purpose in FSM today: it is providing food (and shelter) for a considerable segment of the local population, while also offering a number of cash crop opportunities for people who might otherwise have no cash income. Although it has produced no one miracle crop, agriculture accounts for a variety of exports with a total worth of nearly \$2 million yearly. Hence, agriculture can be considered a mainstay of the economy, with every household relying on at least some household production to support their livelihood.

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Myth #6: FSM Must be Domestically Self-Reliant

The lesson hammered home repeatedly even when FSM was still a part of the Trust Territory was that an independent nation must pay its own way in the modern world. Most of us assumed that this meant that the islands would have to produce as much as they consumed if they were to have any future as an independent country. This was reinforced by a generation or two of economists and planners who drilled home the point that nations, new or old, are built on productive economies that export as much as they import. Self-reliance was an indispensable platform for political independence. What some termed a MIRAB economy, based on migration and remittances, aid and bureaucracy, was somehow a deformed mutant.

No one would deny the ideal of self-reliance, but experience has taught us that it is difficult for many Pacific nations, with their scant resources, to achieve this goal. They are hard pressed to pay their own way in the modern world since their productive capacity is often limited unless they are blessed with an abundance of minerals like gold or copper or phosphate. On the other hand, they do not have the option of returning to a traditional lifestyle inasmuch as they depend on the outside world for imports like petroleum that are fundamental to their way of life today. While there is no turning back, neither is there a resource base on which to build the sort of economy that many developed nations enjoy. The US might urge FSM to build a self-reliant economy as expeditiously as possible, but it is not clear on just what the economy will be built.

The limited number of jobs available in FSM combined with the prohibitive costs of college education today guarantee that increased numbers of young people will be seeking employment abroad in the future. These include a large percentage of the recent graduates from PATS, who have received the benefit of a very good vocational education but seem to find no market for their skills in the islands. If even PATS graduates were forced to emigrate to find jobs, and then were obliged to take the ordinary entry-level positions rather than technical jobs in their fields, a strong case can not be made that vocational education will prepare the young to find jobs either at home or abroad.

A corollary of these emigration trends relates to the type of vocational education that is truly need today to assure young Micronesians jobs in the future. Since most of the people we are training will find jobs abroad—ten jobs abroad for every one in FSM—the best “vocational education” will be one that prepares these young people with the survival skills they will need anywhere. In other words, a basic academic education that stresses functional literacy and numeracy.

A strong case can not be made that vocational education will prepare the young to find jobs either at home or abroad.

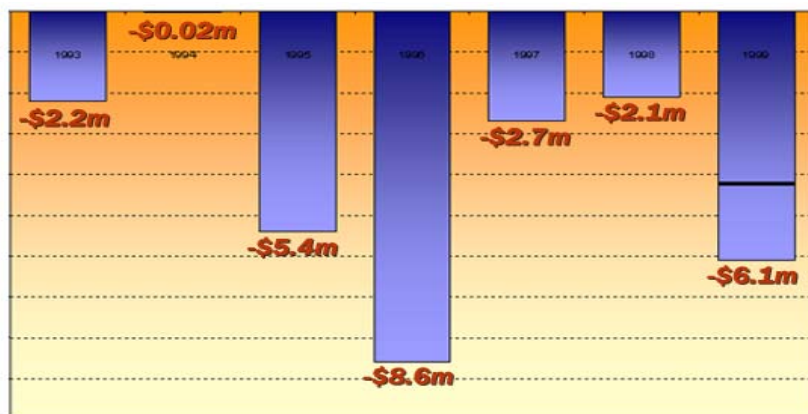
Myth #3: Fisheries Can Provide Hundreds of Millions for the Taking

Even before the implementation of the Compact, tuna fishing was presented as one of the three pillars of the FSM national economy. With its extensive EEZ embracing one of the finest tuna fishing areas in the world, planners and politicians alike were enthusiastic at the economic possibilities that tuna fisheries offered FSM. The lucrative market value of sashimi tuna in Tokyo inspired visions of a tremendous fishing industry in these waters.

Naturally, FSM aggressively pursued this vision with its Compact development funds during the 1990s. No fewer than 11 government-financed fishing ventures were established at a total funding of \$56 million. During a seven-year span, as Graph #4 shows, the fishing ventures made a net profit only in a single year (1994) and the profit was no more than \$20,000. Overall, the ventures showed a total loss of over \$27 million during that same span. Hence, FSM investment in the fishing indus-

try and payment of the debt incurred ate up over \$80 million during the last decade.

Graph 4: Profit and Loss in Public Owned Fishing Enterprises



Source: Matthew Jacobs, (2002) Micronesian Counsellor, Issue 40.

Although we might regret such ill-fated efforts, most of the investments were made on the strength of what appeared to be sound advice from international experts in the field. The information on hand at that time seemed to suggest that tuna fisheries could generate a substantial profit for the nation. The fishing ventures in FSM were subject to the vicissitudes of the market and the influence of many factors that could not be seen clearly at the time. We recognize more clearly now that tuna is an international commodity and that the fishing industry is highly competitive and high-risk. It operates on small margins of profit and requires large economies of scale; the fishing fleets must be flexible and mobile, always ready to move when circumstances demand. Furthermore, we can not assume that island people will be willing to serve on fishing boats inasmuch as fishermen are poorly paid, subject to cramped and even squalid conditions on the boat, and expected to spend nearly all their time fishing even if this means neglecting other social and cultural obligations.

FSM investment in the fishing industry and payment of the debt incurred ate up over \$80 million during the last decade.

tant product some years ago, serving as a high-quality specialized product that was carefully marketed into a specialized niche. The regrettable demise of the pepper industry may have been accelerated by some rash government actions, but the emergence of a strong sakau market undoubtedly also played a part in the decline. As these earlier products have fallen off, others have replaced them. Sakau exports totaled almost one-quarter million dollars a year in 2002, while the export of betel nuts has climbed to close to a million dollars. Export of cooked food, which now brings in more money than copra, is another example of opportunistic response to new conditions. Chuukese pounded breadfruit (*kkon*) and Pohnpeian banana pudding (*pihlohlo*), among other island foods, are being distributed and marketed to the growing FSM emigrant population overseas.

Commercial exports are generally niche agricultural industries that pop up when occasion offers.

Table 1: Agricultural Exports

Commodity	1992	1993	1994	2000	2001	2002
Copra	222	0	390	186	201	211
Banana	278	754	456	72	33	26
Citrus	15	8	9	44	23	28
Kava	-	-	-	152	160	241
Betel Nuts	94	267	252	625	908	888
Black Pepper	32	36	95	-	-	-
Root Crops	11	85	91	30	17	4
Other Products						
Garments	2,045	2,055	2,161	3,010	4,391	3,591
Handicrafts & Souvenirs	35	85	240	9	11	11
Cooked Food	-	-	-	191	232	251

Graph 6: Subsistence Share of Total FSM Economy



and household production, activities in which an estimated 45 percent of the FSM population engage. Even in the towns a surprisingly large number of people depend on locally grown foods as a major part of their diet. Local food is also shared between members of the family and community, with these exchanges playing a critical role in strengthening social bonds and cultural ties. The monetary value of local production is estimated at about \$50 million a year, or one-fourth of the total value of the FSM economy. As Graph #6 indicates, the value of local agriculture increased, from 18 percent to 26 percent, over the period of Compact 1. This growing share in the total economy, which was due as much to the reduction of US Compact aid as to growth in subsistence agriculture production, clearly depicts the importance of local production as a fallback when external funding is cut back.

When we turn to commercial agriculture, we find that there is no single dominant export, such as sugar in Fiji, squash in Tonga, or pineapples on Hawaii. For one thing, large tracts of suitable agricultural land are not available on most of the islands. For another, small-scale production of cash crops fits better into the rhythm of island social life than extensive plantations requiring full-time employment. There are commercial exports, as Table 1 shows, but these are generally niche agricultural industries that pop up when occasion offers and which wax or wane according to market conditions and the cost of production and delivery. For a time in the early 1990s, for instance, bananas became a sizeable export but dropped off sharply in recent years. Pohnpei pepper, too, was an impor-

Given all the uncertainties in the tuna industry, a reasonable return is about 5 percent of the market value of the fish. This is, in fact, approximately what FSM has been receiving in the fishing license fees that it issues to foreign fleets to enable them to fish in FSM waters. The yearly total brought in by these fees has ranged from just over \$20 million to about \$12 million a year. Perhaps the FSM government, which has lost millions in failed ventures, might do better to recognize the limited potential of tuna fishing, withdraw from the operational side of the business, and continue to take what it can get from fishing license fees. This is not to say that private entrepreneurs should not be encouraged from trying to get their own businesses started, if they are willing to accept the risks of the industry. The government, however, should cut its losses, divest itself of unprofitable businesses, and concentrate on other things.

Myth #4: Tourism: Build It and They Will Come

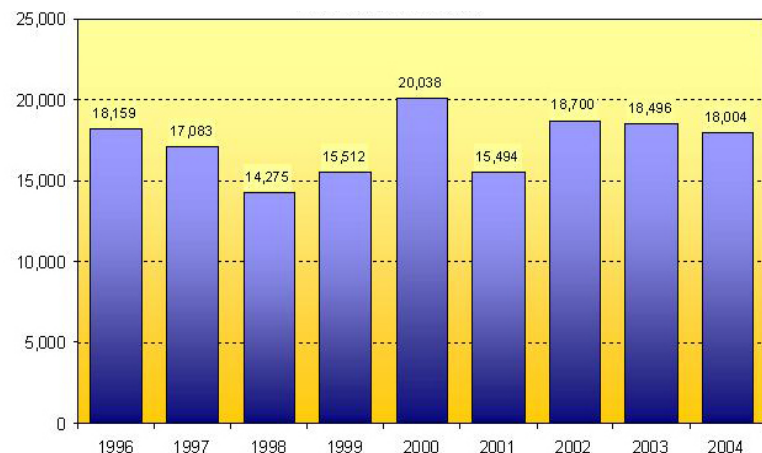
Tourism has long been billed as the second big hope of the FSM economy. This is entirely understandable in view of the islands' exotic environment, natural and social, and the appeal that the tropical Pacific has for the imagination of virtually all citizens of the planet. Moreover, several neighboring islands have struck it big with tourism. Palau, a relative newcomer to the tourist market, has nearly 100,000 visitors a year; the Northern Marianas have 500,000, and Guam has about 1.2 million. If these places, so close and seemingly so similar to FSM, can do it, surely FSM can cash in on the apparent tourist boom.

The number of visitors has been constant throughout the past 20 years despite attempts to stimulate the tourist industry in FSM.

But the tourist industry in these other islands, as in places such as the Maldives and Fiji, is partly the result of favorable economic conditions (like the growing prosperity of Japan), the relative advantages of location (Guam and CNMI are much closer to Japan than the rest of Micronesia), attractiveness to the market (eg, sheltered, sandy beaches on Guam) and a good measure of luck. Pohnpei's magnificent ruins at Nan Madol may be genuinely one of the man-made wonders of the world, but this does not guarantee that they will offset the island's other limitations (eg, its distance from major markets, lack of beaches, and rainfall) to make it a

premiere tourist destination. Chuuk and Yap may be world acclaimed scuba diving spots, but the paucity of visitors to both places reflects a small niche market.

Graph 5: Visitors to FSM, 1996-2004



Source: FSM Department of Economic Affairs

Visitor entries to FSM has remained stable, at 15,000 to 20,000 visitors a year, during the past decade, as Graph 5 shows. The number of visitors has been constant throughout the past 20 years despite attempts to stimulate the tourist industry in FSM. New hotels have been constructed, airports have been improved, and Visitors Bureaus put in place in each of the states, but all this appears to have had a negligible effect on the growth of tourism. Despite its natural beauty and marvelous cultural features, FSM still lies outside the charmed circle of high-profile tourist destinations.

There is no evidence that an attempt to buy an industry will work any better in tourism than it has in fishing.

The national and state governments seem to believe that if they become directly involved and spend enough money, they can kick-start the tourist industry. This sounds perilously close to the line of logic used to justify the ill-fated investment in the fishing industry. Some of the states

are considering lengthening their runways to permit large, wide-bodied planes to land; others talk of improving their air terminals to entice the tourists who are not coming in sufficient numbers. Construction of golf courses, opening shopping malls and creating boardwalks are other options that are periodically discussed. “Build it and they will come,” appears to be the prevailing myth. FSM seems disposed to believe that if it wants tourism badly enough and spends enough money to attract it, people will come in sufficient numbers to generate a bona fide industry in the islands.

Yet, there is no evidence that an attempt to buy an industry will work any better in tourism than it has in fishing. Before investing heavily in a tourist industry, we should have a clear understanding of why tourists choose to visit a particular destination and how that knowledge can be used to guide decisions in FSM. Some factors that may be responsible for tourism growth—like opportunistic publicity, proximity to a country with a rapidly expanding economy, and even good luck—have nothing to do with government initiatives. Attempts should be made to develop tourism, but without a large expenditure of government funds. Perhaps the strategy that Yap has employed in piggybacking off tourist industry of neighboring Palau presents a modest but viable option for the future.

Myth #5: Agriculture is Underperforming

Some of us were startled when agriculture was declared the third pillar of the new FSM economy back in pre-Compact days. Although we all acknowledged that land was an important commodity in the islands, there didn’t seem to be enough of it to allow agriculture to become a real force in the FSM economy. There were always people around who could visualize a lucrative fishing industry or a booming tourist industry, but it was difficult to imagine a commercial agriculture of any significance in the islands.

The monetary value of local production is estimated at about \$50 million a year, or one-fourth of the total value of the FSM economy.

Perhaps our first mistake was in thinking of agriculture as primarily commercial. We had ignored the importance of subsistence agriculture