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MAINSTREAMING TRADE IN MICRONESIA

Turning bilateral dependency into regional competitiveness

Abstract

As the Congress of the Federated States of Micronesia (FSM) prepares to debate a draft trade policy (the first in the young nation's history) in the next few months, this is as good a time as any to review the broader economic development context in which this policy was framed and to reviews its adequacy given the rapidly developing landscape of trading arrangements and economic integration emerging throughout the region.

As this paper will show, the 2004 Amended Compact of Free Association with the United States and the unprecedented amount of monetary transfers it involves from the US to the Federated States of Micronesia provides an ongoing source of budgetary support which has created a bloated public sector, stifled the development of a thriving private sector, and provided a long-term safety cushion until at least 2023 and quite possibly beyond. The result has been a culture of dependency, complacency and no real sense of urgency on the part of policy makers to make the painful political-economy choices that will inevitably have to be made if the economy is to move towards anything resembling competitiveness and economic-self sufficiency.

Whereas some of Micronesia's problems are certainly not of its own making (large distances to world markets, small population, narrow resource base), it is equally true that the vast majority of impediments standing in the way of greater economic efficiency and a business environment in which the private sector can flourish, are solely the cause of poor policies, ill-functioning decision-making structures and the over-fragmentation of sovereignty between the National and State governments. The draft trade policy soon to be debated before Congress cannot be expected to change anything unless it is accompanied by steps to tackle and remove many of these domestic impediments, the political will for which will only be found if the US unambiguously adopts a policy of bilateral engagement with FSM that involves less carrot and more stick.

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I. Introduction and Acknowledgements

The present paper emerged as an unintended consequence of an EU-funded technical assistance project¹ to support Micronesia in redrafting and amending some of its trade-related laws, which the author had the privilege of being the team leader on from May to August of 2010. It was intended to provide some context for those implementing the project and serve as a resource for them to quickly get up to speed on the trade policy context in which they would be operating.

As the project unfolded and as this paper emerged, the author was surprised to learn of the complex relationship that exists between the FSM and the United States and of some of the negative externalities which have emerged from this relationship. It seems that the age-old adage about there being nothing more dangerous than good intentions is true after all. Nowhere is this more in evidence than in the Federated States of Micronesia, into which the United States injects an incredible amount of money every year in what is ostensibly intended to be an effort to move the small island nation to a situation of long-term economic self sustainability. In fact, the approach taken by the United States is having exactly the opposite effect. Given the spiraling deficit in the US and calls from all sides of the political spectrum to return the government budget to a surplus, it is surprising that no one has so far called for a review and rethink of this particular policy.

This paper does not seek to question the rationale behind the US's policy in the FSM and in the Pacific as a whole, but only wishes to raise the question of whether the stated objective (creating a commercially viable economy that is not dependent on overseas development aid in order to even govern itself) could be pursued by means that don't actually achieve the exact opposite effect.

This paper would not have been possible without the help and advice of a number of colleagues in the FSM, who provided invaluable assistance and advice. These include the hardworking officials at the Department of Resources and Development, namely the Secretary Marion White, Assistant Secretary Ernest Weirlangt, Trade Policy Advisor Jean-Bertrand Azampo and Camille Movick. Sam Brazys of the Office of Statistics, Budget and Economic Management, Overseas Development Assistance and Compact Management (SBOC) was extremely helpful. Despite the support of the above mentioned individuals, any omissions or mistakes in the paper remain entirely my own. It should also be stated for the record that the views expressed in this paper are mine and mine alone and in no way reflect the official stance of the European Union, BKP, the government of the FSM, or anyone else for that matter.

This paper is not intended to malign or cast negative aspersions on the friendly and good natured people of the FSM who have endured so much since they were first "discovered" in the 16th century. Rather, it is a call to action by policy makers, elected officials and other stakeholders in the FSM to rethink the status quo and start debating, taking and implementing the difficult political-economy choices that are absolutely imperative if the country is to survive as an independent political entity beyond the next 50 to 100 years.

¹ Project 9.ACP.RPR.140 – Ref: 006-09: Legal drafting support and capacity building in trade-related laws and regulations –Federated States of Micronesia, under the auspices of the ACP MTS Program, implemented by BKP Development Research & Consulting GmbH.

II. The Federated States of Micronesia

1. Geography, Population and Sovereignty

a) Location and Size

The Federated States of Micronesia (FSM) consists of some 607 islands situated across a massive stretch of open ocean in the northern Pacific, approximately 2000 kilometers northwest of Papua New Guinea. Only some 65 of these 607 islands are reported as being inhabited. Together, the aggregate landmass of FSM is 702 km², and thus about 1.5 times the size of Andorra or 4 times the size of Washington DC. Despite its small size in terms of geographic landmass, the different island states that constitute FSM stretch across more than one and a half million square kilometers of the Pacific Ocean.²

b) Population and Work Force

The most heavily populated islands in this Federation are (in descending order) Chuuk (which, with 53'500 accounts for about half the total population), Pohnpei (34'500), Yap (11'200) and Kosrae (7'700). The total population of FSM, according to the latest census (2000), was 107'434, roughly the same size as South Bend Indiana, or twice the population of Siena in Italy. Of these, some 16'360 are estimated to make up the total labor force.

c) Sovereignty

The Federated States of Micronesia is a very young country, only having achieved nationhood in 1986. Prior to this, it had been a part of the United Nations Trusteeship, with the United States acting as Trustee. It is now governed by a President, currently President Emanuel Mori (since 11 May 2007, once-renewable, 4-year term), who is both the chief of state and the head of government. The President appoints a cabinet which includes the vice president (currently Alik L. Alik) and the heads of the 8 executive departments.

The move towards independence took a significant step forward in 1978, after a Constitutional Convention, with the people of four of the former Districts of the Trust Territory, Truk (now Chuuk), Yap, Ponape (now Pohnpei) and Kusaie (now Kosrae) holding a referendum in which they voted to form a Federation under the Constitution of the Federated States of Micronesia. The FSM Constitution was ratified on 10 May 1979. Negotiations with the United States ensued regarding the transfer of sovereignty. These negotiations resulted in the Compact of Free Association between FSM and the United States³, which was signed on 1 October 1982 and approved by a referendum in the FSM the following year (see immediately below). After ratification by the US Congress, the Compact entered into force on 3 November 1986. The FSM's long road to independence and territorial sovereignty culminated with the FSM being admitted to the United Nations on 17 September 1991.

III. Relationship with the United States

2. Previous Outside Interests and FSM

a) Initial Discovery

It is the Portuguese explorer Diego DeRocha who is credited with having first "discovered" Yap and Ulithi in 1526, while navigating the area in search of the Spice Islands (Indonesia). The remaining Caroline Islands were then discovered by the Spanish who set up a colonial administration on the island of Yap and claimed territorial sovereignty over the Caroline Islands until 1899, at which time the Spanish sold its interests in the region to Germany⁴, the exception being Guam which became a US insular area⁵.

² For a map of FSM and its relative position in the Pacific, see, among the many possible sources:

<http://www.adb.org/Micronesia/images/FSM-map.jpg> (19 May 2010)

³ At the same time, the US was negotiating similar arrangements with the other countries, islands and territories under the Trusteeship.

⁴ German possessions in the Pacific included the following: German New Guinea, Kaiser-Wilhelmsland, Bismarck Archipelago, German Solomon Islands, Bougainville Island, Nauru, Marshall Islands, Mariana Islands, Caroline Islands (Federated States of Micronesia), Palau and German Samoa. Most of these possessions were lost under the Treaty of Versailles in 1919, with some already being ceded to Japan as early as 1914 (German New Guinea and German Samoa). The German Solomon Islands were only in German hands from 1885 – 1899, after which they passed to Great Britain under the Treaty of Berlin).

⁵ Guam was captured by the United States in 1898 during the Spanish-American War. It was officially ceded to the US by Spain under the Treaty of Paris which formally ended this conflict.

b) German and Japanese Control

German administration is said to have encouraged the development of trade and the production of copra, but effectively came to an end when the Imperial Japanese Navy occupied the Marshall, Caroline and Northern Mariana islands in 1914. Japan received a League of Nations mandate over these territories in 1920. It was during the period of Imperial Japanese administration that large-scale inward migration had a far-reaching impact on the demographic make-up of the Islands, with over 100,000 Japanese coming to populate the region, whose indigenous population at the time was estimated to be only about 40'000. In terms of economic activity, sugarcane, extractive industries, marine fishing and the cultivation of tropical agricultural products were the main industrial staples.

c) The Second World War and Aftermath

The Second World War saw a rapid reversal in the socio-economic fortunes of the Islands as Imperial Japan and its possessions moved onto a war footing and all economic activity essentially became a matter of supporting the increasingly struggling war effort. World War II saw an "end to the relative prosperity experienced during Japanese civil administration"⁶, with most of the civilian populations of the Islands suffering from exploitation by the Imperial Japanese military forces and, as a result, succumbing to wide-scale poverty. By the end of hostilities in 1945, much of the Islands' infrastructure had been damaged or destroyed as a result of the relentless bombing campaign of the US Navy's Pacific advance.

In the aftermath of the Second World War, the newly created United Nations established the Trust Territory of the Pacific Islands (TTPI), which was formally set up in 1947. The TTPI was constituted by the islands of Pohnpei, Kosrae (at the time formally part of Pohnpei), Chuuk, Yap, Palau, the Marshall Island, as well as the Northern Mariana Islands. The US was appointed as and accepted the position of Trustee of the TTPI. As Trustee, the US was responsible for the security of the islands and assumed the responsibility of promoting "the economic advancement and self-sufficiency of the inhabitants."⁷ The US Navy first assumed responsibility for the civil administration of the TTPI, until this was taken over by the Department of the Interior in 1951.

3. Compact of Free Association

The most important relationship the FSM has with any other single country is with the United States, from whom it essentially gained a large degree of sovereignty through the Compact process in 1986. Despite being an independent nation, important areas of national policy making, such as monetary policy, and defense are still wholly controlled by the US, with little to no direct input from the FSM.⁸ The Compact is thus an important starting point to understand the relationship between the FSM and the United States, and the constraints placed on FSM in its foreign economic policies, including trade.⁹

a) Foreign Affairs and Foreign Economic Relations

Section 121 of the Compact governs FSM's sovereignty in foreign affairs and confirms the Island Federation's power to regulate the "conduct of foreign affairs relating to law of the sea and marine resource matters".¹⁰ Also important in the context of the present examination, is Section 121 (b) (2) which confirms the authority of FSM to manage the "conduct of its commercial, diplomatic, consular, economic, trade, banking, postal, civil aviation, communications, and cultural relations". Finally, in Section 121 (c) The United States government recognizes "that the Government of the Federated States of Micronesia has the capacity to enter into, in its own name and right, treaties and other international agreements with governments and regional and international organizations". These provisions, together with the general principles of State sovereignty under public international law, clearly and unambiguously grant Micronesia the discretion to exercise broad-ranging sovereignty in shaping its foreign economic policies, including entering into trade and investment agreements, as well as engaging in closer economic integration and cooperation agreements.

6 See: <http://www.visit-fsm.org/visitors/history.html> (20 May 2010).

7 Ibid.

8 I.e. FSM interests are not directly represented say, at the meetings of the Board of Governors of the Federal Reserve, or the US National Security Council, although FSM citizens are allowed to serve in the US Armed Forces and many in fact choose to do so.

9 For a copy of the full text of the Compact (last amended as per 17 December 2003), see: <http://www.rmiembassyus.org/Compact/Compact%20Public%20Law%20108-188.pdf> (19 May 2010).

10 Section 121 (b) (1).

b) Support in Joining International Organizations

Section 122 contains some loosely formulated obligations on the part of the United States to "support applications by the Government of the Federated States of Micronesia for membership or other participation in regional or international organizations" which might be availed of, and indeed could prove very useful in the event that it should come to an application by FSM to join the WTO.

c) Communications

Section 131 confirms the FSM's sovereignty over its own communications, whereby Section 132 contains the caveat that the FSM shall permit the US "to operate telecommunications services in the Federated States of Micronesia to the extent necessary to fulfill the obligations of the Government of the United States under this Compact". This clause might give rise to some "grandfathering" issues in future negotiations on liberalization of communications services, especially telecoms liberalization, if US interests are in any way represented in the telecoms sector.

d) Reciprocal Access to Labor Markets

Section 142 gives US citizens free access to the FSM labor market (this right is also accorded freely to FSM nationals for the US labor market) which, given the reciprocal nature of this obligation, should not give rise to any problems should the FSM seek to "grandfather" this access when negotiating the liberalization of its services markets and corresponding provisions on access to its labor market (under mode 4 or in the form of other commitments).

e) Grant Assistance

One of the most important aspects of the Compact is the grant assistance provided hereunder, which involves direct monetary transfers from the US to FSM from 2004 thru to 2023. The amount set aside is the same every year, namely USD 92.7 million, with this amount being divided between direct payments to the government of FSM and payments into a specially established Trust Fund. As time goes by, direct payments to the government gradually decrease, whereas payments to the Trust Fund gradually increase (although the aggregate amount of USD 92.7 million stays the same). The amount by which direct payments are reduced each year is known in local policy parlance as the "decrement" and it figures strongly in discussions on options for boosting the revenue raising capabilities of the FSM government. FSM also makes contributions to the Trust Fund, with the idea being that in 2023, when grant assistance ceases, the Trust Fund will be big enough to ensure that revenues from the fund will be enough to meet the public-purse needs of the FSM in the areas of education, health care, private sector development, the environment, public sector capacity building, and public infrastructure.

These transfers easily make the US the largest foreign donor in terms of economic assistance¹¹ to the FSM, but they also raise questions of accountability as to how those funds are being dispersed every year to improve the lives of FSM citizens in the areas mentioned above. For example, apart from the audit mandated by the Compact, there does not seem to be any direct reporting on the part of the FSM government to its citizens on how these funds are dispersed and what steps are taken to ensure they are dispersed transparently and efficiently.

The existence of the Trust Fund itself gives rise to a number of important questions, such as who administers these funds and where? How are they invested? What safeguards are in place against their misappropriation? Is the buildup of Trust Fund monies taking place at a rate which will allow the FSM to no longer have to rely on the Grant Assistance funds it currently enjoys under the Compact when it expires in 2023?

f) Trade under the Compact

Sections 241 to 244 contain the provisions most directly applicable and relevant to FSM's trade relations, both with the US and with third countries. Section 241 merely states that FSM is not part of the customs territory of the United States, thereby clarifying that despite a great deal of economic integration, the Compact does not create a customs union between FSM and the United States. Section 242 sets out some provisions for duty-free access to products from FSM under the US Generalized System of Preferences, but limits the amount of

¹¹ There is a widely held and often expressed view here that the direct monetary transfers are not aid or development assistance but rather consideration for FSM ceding significant areas of sovereignty (particularly over defense) to US control.

tuna that can be imported under this scheme as well as exempting some other products (watches, clocks, textile and apparel articles, footwear, handbags, luggage etc.). Section 243 provides for MFN treatment of all other imports from FSM into the customs territory of the US. Finally, Section 244 provides for MFN treatment to US imports into FSM but exempts the preferential market access provided to imports of signatories of the Pacific Island Countries Trade Agreement (PICTA, see below)¹², thereby releasing FSM from the obligation to extend such preferential access to the US under the MFN clause.

Section 243 (c) of the Compact contains probably the most important constraint or qualifier with regard to FSM's trade relations, in that it requires FSM to consult with the US when it enters into consultation or negotiations with governments that were not PICTA signatories at the time the Compact was signed. This clause is potentially significant, because it could result in any future preferential market access FSM extends under a free trade agreement, customs union or economic integration agreement, being automatically extended to the US under the Compact's MFN clause, depending on the outcome of FSM's consultations with the US on this issue as mandated under Section 243 (c).¹³ This potentially reduces the attractiveness of FSM as a free-trade partner, since any concessions extended to future FTA or closer economic integration partners, might automatically have to be extended to the US under Section 243 (c) of the Compact, thereby potentially undermining the commercial value of those preferences.

4. Beyond 2023

a) *Achieving Self Sufficiency and Breaking the Cycle of Dependency*

The fact that Grant Assistance funds will, in principle, stop flowing as of 2023 should, in theory, slowly start to create a sense of urgency among citizens and policy makers that this date is the deadline subject to which the FSM economy must have become self-sufficient and must be able to compete on its own strengths and merits in the global economy.

However, the cycle of dependency in the FSM runs deep, since there is no one alive and active in policy-making circles who can recall the days when the Islands were not under some sort of mandate or trusteeship. Being a young nation, FSM has taken on the mantle of independence and sovereignty in many policy areas, but it is still some distance from assuming the full burden of responsibility for its own economic destiny.

b) *Seeing the Problems but Recognizing that Solutions also Exist*

The Draft Trade Policy document (see below under Section 6), begins rather tellingly with a very poignant summary of the systemic difficulties faced by FSM in its attempts to move towards economic self-sufficiency:

"FSM is a very small economy with a small population, small landmass, narrow resource base, limited economic opportunities, weak institutional capacities, lacks adequate and cheap financial capital, suffers from diseconomies of scale, faces severe transportation problems and is far away from major commercial markets. The island is also very vulnerable to external (global) shocks and natural disasters."¹⁴

Nevertheless, given that we live in an era of human history where we have succeeded in putting mankind on the moon and overcoming a whole range of challenges once thought to be impossible, and given that the path from third world to first has been successfully trodden by an ever increasing number of countries both big and small, there is a relatively solid understanding among development economists today as to the kind of policies that need to be pursued in order to meet the development challenged faced by FSM in its pursuit of greater economic self sufficiency and increased competitiveness. The only questions now are: i) which policies will work best in the uniquely difficult situation FSM finds itself in; and ii) how can the political will be mustered and maintained in order to implement these policies in spite of the short-run difficulties and challenges that these policies will inevitably entail.

12 These are: Cook Islands, Fiji, Kiribati, Micronesia, Nauru, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu. For a copy of the agreement, see:

<http://www.forumsec.org/fi/resources/uploads/attachments/documents/PICTA.pdf> (19 May 2010).

13 A similar obligation exists under PICTA, see section 4.1 which covers this agreement.

14 See *Draft National Trade Policy* (Final Draft), authored by Division of Trade and Investment Department of Resources and Development FSM National Government, hereinafter cited as the "Draft Trade Policy Document" (see Appendix for details).

c) Avoiding Complacency in the Face of the Prevailing Realities

Another problem, entirely of its own making, is that there seems to be a broadly shared, and often expressed sentiment that even after 2023, the US can be relied upon not to walk away from its long-standing commitment to the region. This sentiment, although probably correct in light of the geopolitical and military significance of the region to the US (and the budding contest for dominance thereof between an emergent China and a long-established United States¹⁵), is hardly conducive to engendering an atmosphere where policy makers and economic operators in the FSM feel a genuine need to make far-reaching economic reforms and increase the overall competitiveness of the economy. This is especially the case when the road to doing so is almost certainly paved with short-term sacrifices and redistributive hardship, at least for many elements of a small and homogenous population with deep and close ties to one another.

15 See: Statement of Admiral Robert F. Willard, U.S. Navy Commander U.S. Pacific Command Before the House Armed Services Committee on U.S. Pacific Command Posture March 23, 2010, available at: http://armedservices.house.gov/pdfs/FC032510/Willard_Testimony032510.pdf (30 July 2010)

IV. Other Economic Integration Efforts

1. Pacific Island Countries Forum

a) *Establishment and Mandate of the Forum*

Founded in 1971, the stated goals of the inter-governmental organization are to "enhance cooperation between the independent countries of the Pacific Ocean and represent their interests".¹⁶ Forum member States include Australia, the Cook Islands, the Federated States of Micronesia, Fiji (suspended on 2 May 2009), Kiribati, the Marshall Islands, Nauru, New Zealand, Niue, Palau, Papua New Guinea, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu. In 2006, New Caledonia and French Polynesia joined as associate members.¹⁷

Forum members cooperate under three broad headings, namely i) Economic Governance; ii) Political Governance and Security; and finally iii) Strategic Partnership and Coordination. Each of these three headings comprise various subcategories of cooperation, whereby the most important for the purposes of the present examination include (under Economic Governance): i) Economic Reform and Infrastructure; ii) Transport; iii) ICT; iv) Energy; v) Regional Trade; vi) International Trade; vii) Pacific Regional Economic Integration Programme (PACREIP); viii) Private Sector Development and ix) Traditional Knowledge. Under the Political Governance and Security heading, areas of cooperation or interest to the present study include: i) Regional Cooperation in the Legal Sector (under the subheading Legal Matters) and; ii) Legislative Drafting. Finally, under the heading Strategic Partnership and Coordination, the area of cooperation of greatest interest to the present examination are: i) the so-called Pacific Plan, which envisages "a new and innovative approach to the unique challenges that Pacific Island Countries face through a framework of greater regional cooperation and integration."¹⁸; ii) Pacific Principles on Aid Effectiveness and perhaps iii) Climate Change, to the extent it is rapidly become a trade issue, with or without the "explicit consensus" of WTO members to negotiate an agreement on trade and environment.¹⁹

Perhaps the most notable thing about this organization, at least at first glance, is the glaring absence of the United States, despite its considerable interests in the region, and despite the fact that other developed nations, arguably at odds with the otherwise homogenous socio-economic conditions of the majority of member States (I am of course referring to Australia and New Zealand) are themselves members. This naturally begs the question whether the organization was originally set up to serve as a kind of counterweight to US dominance in the region, as well as casting a rather large question mark over what the US's stance towards the organization might be.

b) *The Pacific Islands Forum Secretariat*

The Forum is served by a Secretariat (known as PIFS), which is based in Fiji, despite the fact that this country was suspended from the organization in 2009.²⁰ PIFS is an international organization set up by the Agreement Establishing the Pacific Islands Forum Secretariat, done at Tarawa on 30 October 2000 (last amended in 2005). The Secretariat has legal personality under public international law. The Forum Secretariat has Trade Offices in Auckland, Beijing, Sydney, and Tokyo, and maintains desk officers in some of its smaller members, including Cook Islands, Kiribati, the Marshall Islands, Nauru, Niue, Palau, and Tuvalu.

c) *The Pacific Island Countries Trade Agreement (PICTA)*

Done at Nauru on 18 August 2001, between some 14 Pacific Island Forum Countries²¹, PICTA²² sets out a number of objectives²³, including the expansion and diversification of trade between signatories through the

16 See: <http://www.forumsec.org.fj/> (20 May 2010).

17 See: http://en.wikipedia.org/wiki/Pacific_Islands_Forum (20 May 2010).

18 See <http://www.forumsec.org.fj/pages.cfm/strategic-partnerships-coordination/pacific-plan/> (20 May 2010).

19 See: WTO and UNEP, *Trade and Climate Change*, 2009, available at:

http://www.wto.org/english/res_e/booksp_e/trade_climate_change_e.pdf (20 May 2010).

20 See: <http://www.forumsec.org.fj/pages.cfm/newsroom/press-statements/2009/forum-chair-on-suspension-of-fiji-military-regime-from-pif.html> (20 May 2010).

21 These are the Cook Islands, FSM, Fiji, Kiribati, RMI, Nauru, Niue, Palau, PNG, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. To date, only 7 countries are trading under PICTA, namely Cook Islands, Fiji, Niue, Samoa, Solomon Islands and Vanuatu, with Tuvalu having announced last month (April) that it intends to join these countries this year. See: <http://www.vox.co.nz/business/tuvalu-ready-trade-under-picta/548902> (21 May 2010).

22 See <http://www.forumsec.org.fj/resources/uploads/attachments/documents/PICTA.pdf> (20 May 2010).

elimination of tariff and non-tariff barriers; the promotion and facilitation of commercial, industrial, agricultural and technical cooperation; to further the development and use of the resources of the Pacific with a view to the eventual creation of a single market; and finally to contribute to the harmonious development and expansion of world trade in goods and services and the removal of trade barriers.

The Agreement provides for the gradual establishment of a free trade area among the signatory countries,²⁴ covering trade in goods originating in one signatory to another.²⁵ In addition, the Agreement contains MFN obligations, set out in detailed terms,²⁶ but which contain a built-in exemption in the case of advantages granted in the context of frontier-traffic, preferences granted under an FTA or customs union, or measures adopted in the context of a commodity agreement.²⁷

The Agreement also sets out some relatively detailed provisions on preferential rules of origin, which are further fleshed out in Annex I to the Agreement.

Significantly, Art. 6.3 contains a similar obligation to that contained in Section 243 (c) of the Compact (discussed above at page 8), requiring parties to PICTA who enter into free trade negotiations with non PICTA signatories, to "notify the Forum Secretariat and be prepared to undertake consultations with the other Parties to this Agreement as soon as practicable.". This obligation, although at first sight similar to Section 243 (c) of the Compact (discussed above at page 8), actually goes less far than the Compact, since it involves mere notification and consultation obligations, rather than what the Compact potentially foresees, which is extending to the US any preferential access agreed with a third country in the context of future trade liberalization.

Article 7 of PICTA, which relates to tariffs, requires signatories to "identify which goods are not ordinarily produced or obtained in its own territory" and to "eliminate tariffs on such goods as soon as possible". The implications of this provision are far-reaching, in that given its narrow base of self-produced agricultural and industrial goods, this will require FSM (and indeed most if not all signatories) to remove tariffs on well over 90 percent of their tariff lines, although the trade effects of this provision will be minimal, since the signatories' economies are all relatively similar in terms of natural economic endowment and production capacity. The concrete economic implications of this provision will likely be limited to trade-diversionary effects, as possibilities for arbitrage arise, depending on the different speed with which signatory countries implement the tariff elimination foreseen under this clause.

Article 8 allows PICTA signatories to exempt, subject to certain conditions, imports from their tariff elimination obligations, although market access must still be granted on an MFN basis for such exempted products. Each signatory had the opportunity, on signing PICTA, to submit a list of products so exempted, and these lists are scheduled, on a country-by-country basis, in Annex 3 of the Agreement. Extensive use of this right was made by Papua New Guinea (which exempted some 89 tariff-product lines in this manner), followed by Vanuatu (18 tariff-product lines) and Solomon Islands (16 tariff-product lines).

Other noteworthy elements of the Agreement include a tariffication obligation formulated in very similar terms to that contained in Article 4.2 of the WTO Agreement in Agriculture. Like Article 11.2 of the WTO Agreement on Safeguards, PICTA also explicitly bans voluntary export restraints and orderly marketing arrangements and other so-called grey-area measures²⁸ against imports originating in signatory states.²⁹ The Agreement also contains National Treatment language framed in similar terms as that found in Article III of GATT '94.

The Agreement also has contingency protection clauses on safeguard actions, antidumping measures and countervailing duties which closely resemble those applicable under the corresponding WTO agreements and even contains a reference to these provisions in the case of dumping. However, the Agreement also provides for emergency action against imports (in the form of tariff increases) in the event of balance of payments difficulties, which are much more loosely formulated than those allowed under WTO (GATT '94) rules. The Agreement also sets out provisions for tariff protection on infant industry grounds, which are more easily available than is the case under WTO (GATT '94) rules.

23 Art. 2.

24 Art. 3.

25 Art. 4.

26 Art. 6.

27 Paragraphs a), b) and c) of Art. 6.2 respectively.

28 Originally labeled as such since their legality under the GATT was questionable.

29 Art. 9.2.

Another noteworthy element of the Agreement, particularly given the fact that it was concluded among developing nations, is the inclusion of a series of best endeavors obligations on the liberalization of government procurement markets.³⁰ Although the relevant provisions provide that concrete steps towards establishing such rules would be taken within 2 years of signing PICTA, steps to do so are still very much in the planning and analysis stage, with a report on the feasibility of these efforts just having been completed this year.

The Agreement contains the same general and security exceptions contained in Articles XX and XXI respectively of GATT '94.³¹ It also sets out transparency obligations in much the same terms as contained in Art. X of GATT '94.³²

The Agreements' consultation and dispute settlement clauses represent something of a novelty, although they build, to a certain extent on the *acquis* of the GATT/WTO, including the nullification and impairment language so central to the GATT/WTO rules.³³ Thus, Art. 21 sets out a number of grounds for requesting consultations, including a breach of obligations, denial of benefits, frustration of an objective, all of which are quite familiar (although not identical) to the rules developed under the GATT/WTO system. However, two additional reasons are provided, for requesting consultations, namely "a case of difficulty"³⁴ and "a change in circumstances"³⁵ which necessitates or may necessitate an amendment to the Agreement.

The dispute settlement provisions provide for various stages of escalation in a dispute, from the consultations discussed above, to mediation, to arbitration, with the authority to suspend equivalent concessions extended under the Agreement against the defaulting party in the event of non-compliance with the arbitration award.³⁶ Annex V to the Agreement contains 13 paragraphs which govern the arbitration procedure. These provisions provide for a sole arbitrator³⁷, appointed in the absence of agreement between the parties by the Forum Secretary General. The arbitrator must hand down a ruling within 180 days from the date of his or her appointment (with the possibility of seeking an extension for another 180 days)³⁸, and such ruling shall be final and binding.³⁹

To date, recourse has never been had to these provisions by any signatory of the Agreement.

d) *The Pacific Agreement on Closer Economic Relations (PACER)*

PACER⁴⁰ was negotiated and concluded in parallel with PICTA, and like PICTA, was done at Nauru on 18 August 2001. PACER was concluded between 16 Pacific Island Forum nations, namely the same 14 nations that concluded PICTA as well as Australia and New Zealand. The objectives⁴¹ of the Agreement include providing a framework for cooperation which, over time is intended to lead to the development of a single regional market; to foster increased economic integration and competitiveness; to minimize disruptive effects and adjustment costs of increased integration into the international economy for developing Forum Island Countries; to provide economic and technical assistance to Forum Island Countries so as to assist them in implementing trade liberalization and economic integration.

Unlike PICTA, which provides a classical and relatively rigorous regime for the reduction of tariffs and other trade barriers, PACER is short on hard commitments, and long on best endeavors and consultation obligations, intended mostly to preserve the market access rights of Australia and New Zealand should any of the signatories to the Agreement conclude free trade arrangements with a developed third party States (see next paragraph). PACER explicitly states that it is not an agreement which requires notification to the WTO Committee on Regional Trade Agreements under GATT Art. XXIV or Art. V of the GATS.⁴²

30 Art. 15.

31 Art. 16.

32 Art. 17.

33 The notion of nullification and impairment is mentioned in the context of retaliation for non-compliance with a ruling (award) handed down in application of the dispute settlement procedures (last sentence of Art. 22.6).

34 Art. 21.1 (d)

35 Art. 21.1 (e)

36 Art. 22.

37 Annex V, para. 3.

38 Annex V, para. 11.

39 Annex V, para. 12.

40 See: <http://www.forumsec.org.fj/resources/uploads/attachments/documents/PACER.pdf> (21 May 2010).

41 Art. 2.

42 Art. 3.7 (a) and (b).

The language requiring PACER signatories to consult with Australia and New Zealand in the event that they conclude free trade arrangements with a developed non-PACER signatory, and to potentially begin free trade talks with these two countries is curious and seems intended to ensure some sort of pre-emptive right against encroachment in the region by another developed country seeking free trade partners among Pacific Island Forum States (PIFS).⁴³ It also could potentially make PACER signatories less attractive to a future free trade partners since any preferential market access it may extract might eventually have to be accorded in equal measure to Australia and New Zealand, thereby eroding any competitive advantage it might have hoped to gain from the free trade arrangement in question. This is indeed a similar obligation to that discussed above in the context of FSM's Compact of Free Association with the United States.⁴⁴ Indeed, it was the EPA negotiations entered into between the EU and all 14 FICS (see below at Section 4.2) which launched the PACER Plus process (see directly below) in application of this clause.

Perhaps the most important outcome of the PACER Agreement is the Regional Trade Facilitation Program (RTFP), which covers cooperation in a range of areas including customs, quarantine, standards and conformity assessment. Action under this program is mandated in Art. 9.2 of the Agreement.

PACER also includes a provision (Art. 11) on financial and technical assistance, arguably the most important provision from the perspective of developing Forum countries. Such assistance is to be provided under corresponding work plans to be managed by the Forum Secretariat and Australia and New Zealand shall provide "an adequate level of funding".

e) *The PACER Plus Process*⁴⁵

PACER Plus negotiations are very much a work in progress, with Australia and New Zealand pushing fairly hard, under the guise of the Pacific Island Forum, for negotiations to move expediently, and to maintain a certain degree of momentum, without which it is almost certainly assumed that the negotiations will languish and go nowhere (probably not a bad assessment if one looks at how sluggishly PICTA has been implemented).

In August 2009, at the fortieth Pacific Islands Forum Leaders meeting in Cairns Australia, negotiations were launched for a new regional trade and economic agreement, to be known as PACER Plus. In another meeting of Pacific Island Forum Trade Ministers in Brisbane from 23 - 24 October 2009, an outcomes document was adopted in which a Chief Trade Advisor was appointed⁴⁶, and an Office of the Chief Trade Advisor was established with Australian and New Zealand funding in Port Vila Vanuatu. In addition, consensus was achieved on a number of issues including that within the first 12 months of the process, Forum members would focus on i) consolidating the Office of the Chief Trade Advisor; ii) intensifying national consultations, iii) undertaking meetings at officials level to deepen understanding on common priority issues including, but not limited to:

- Rules of origin;
- Regional labour mobility (beyond Mode 4);
- Development assistance, focusing on physical infrastructure for trade, trade development and promotion; and
- Trade facilitation, including sanitary and phytosanitary measures, technical barriers to trade, standards and customs procedures.

During the Brisbane meeting, Forum Trade Ministers also identified a number of priority issues for discussion, namely: services, including health, education, telecommunications, shipping and aviation; investment; economic cooperation; and environment, including renewable energy.⁴⁷

Since the October 2009 meeting, not much has happened, whereby in April 2010, a meeting of Forum Trade Ministers held on Pohnpei ended with a few procedural decisions on enhancing awareness of the issues

43 Australia and New Zealand are the largest source of imports in 10 of the 14 PIFS; see: Pacific Island Forum Secretariat, *Pacific Regional Trade and Economic Cooperation Joint Baseline and Gap Analysis*, 2007, at p. iv, available at: http://www.forumsec.org/fi/resources/uploads/attachments/documents/Pacific%20Regional%20Trade%20and%20Economic%20Cooperation_FINAL%20REPORT_December%202007.pdf (21 May 2010).

44 See comments on Section 243 (c) of the Compact on page 5 above.

45 See: <http://www.dfat.gov.au/geo/spacific/pacer/index.html> (21 May 2010).

46 Dr. Chris Noonan, Deputy Head of Department of Commercial Law of the University of Auckland, see: <http://www.law.auckland.ac.nz/uoa/chris-noonan> (21 May 2010).

47 See: http://www.trademinister.gov.au/releases/2009/sc_091024-outcomes.html (21 May 2010).

among trade officials and other stakeholders and furthering the process of national consultations. It's still anyone's guess as to when substantive negotiations might begin, namely with the tabling of a draft legal text or the initiation of an offers and request process. When this does happen, it will almost certainly be driven by Australia and/or New Zealand.

Australia has posted the submissions received from the public on PACER Plus, and they make interesting reading. A summary of the views expressed in these submissions was prepared by DFAT for Parliament.⁴⁸ Although some references are made to the development implications of PACER Plus in official Australian statements on the negotiations, the summary of the submissions made and the assessment provided thereof, do tend to favour the impression that, more than anything else, it will be the Australian national economic interest, and the desire to find potential new markets for Australian exports of goods and services that will be the driving dynamic behind the negotiations (as is usually the case in talks such as these). However, the website of the New Zealand Ministry of Foreign Affairs seems to indicate that the New Zealand government is taking a more nuanced approach, by stating from the outset that "PACER Plus will not be a traditional trade negotiation in which commercial interests alone define New Zealand's approach". The emphasis is instead, to be shared with the broader development objectives pursued by New Zealand towards the region.

It can be expected that PACER will most likely languish in national consultations, impact studies and capacity building efforts for at least another six to twelve months, before Australia and/or New Zealand will be able to credibly make the case that it is time to move towards substantive negotiations and the tabling of concrete draft treaty texts.

2. Economic Partnership Agreement with the EU

All 14 developing country members of the Pacific Forum are also signatories of the Cotonou Agreement and thus also ACP countries. As a result, all 14 were supposed to have concluded Economic Partnership Agreements with the European Union before the end of 2007, when the WTO Cotonou waiver expired.

However, negotiations over EPAs proved difficult in the Pacific amid persistent resistance to what was perceived as the EU's inflexible negotiating positions on a whole range of issues. As it stands today, only Fiji and Papua New Guinea have initialed interim EPA agreements, and then only covering trade in goods. Whether or not a final, region-wide EPA with all Forum members will be concluded is very much in doubt. Some observers claim that the only reason Fiji and PNG initialed the interim EPA agreement was in order to protect existing export opportunities to the EU market.

3. Other Initiatives

Other regional trade agreements worth noting in the context of this study are the 1981 South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) between the FICs, Australia and New Zealand, as well as the 1994 Melanesian Spearhead Group (MSG) Trade Agreement.

However, PACER, and in particular PACER Plus, is largely perceived as having supplanted SPARTECA, since PACER Plus negotiations hold the prospect of a broader, deeper and more comprehensive framework for trade and economic cooperation between Forum member States.

⁴⁸ See: http://www.dfat.gov.au/geo/spacific/pacer/pacer_views.html (21 May 2010).

V. The Strategic Development Plan

1. Underlying Realities and Driving Dynamics

a) *The Compact with the US and the 2023 Deadline*

The introductions to the various documents that together constitute the Strategic Development Plan⁴⁹ provide a certain degree of insight into how the Plan was conceived. It essentially evolved at the insistence of the US, as part of the Amended Compact process, and is intended to give a measurable degree of credibility to the Compact's underlying thesis, namely that at the end of the Amended Compact's term (in 2023), FSM will be self-reliant and there will no longer be any need for direct financial transfers.

b) *The Strategic Development Plan as Consensus Document*

The Strategic Development Plan is a comprehensive policy document and blueprint for achieving economic growth and self-reliance. It was adopted following the 3rd National Economic Summit which took place over four days in 2003, a meeting which was reportedly attended by over 400 people, representing a broad cross-segment of stakeholders from the national and state governments, the business community, civil-society organizations, and the international donor community. The Strategic Development Plan was subsequently adopted by the FSM Congress and can thus said to be a largely representative consensus document whose recommendations enjoy broad support from citizens and policymakers throughout FSM.

The Plan does not seem to pull any punches when it comes to describing existing constraints and future needs. The main tenants of the Plan consist of dividing priorities among nine policy areas⁵⁰ which are then further fleshed out by means of mission statements, strategic goals, necessary policies, activities, outcomes and objectives.

2. Trade Policy

a) *Trade-Related Policies*

In the National Development Plan, trade policy or issues bound to be of relevance in the context of closer economic integration with future trading partners or a potential WTO accession bid, are most directly addressed under the policy area Private Sector Development. Here Volume 1 of the Plan discusses a number of constraints that will need to be addressed, such as bringing more land into productive use by reforming land tenure systems; increasing the efficiency of the banking sector; improving the regime faced by foreign investors; creating an enabling business environment.

b) *Membership in Trade Agreements and Accession to the WTO*

The National Development Plan recognizes that given the fact that tariff rates are already generally quite low in FSM, any tariff concessions that might necessarily have to be made as part of any decision to ratify PICTA, enter into closer economic integration under PACER Plus, or accede to the WTO, would not automatically involve critical revenue losses for the public purse. It is quite well known that this was one of the main reasons why Vanuatu was so reluctant to ratify the WTO accession package its negotiators concluded on its behalf almost ten years ago.⁵¹

The Plan seems to concede that trading under PICTA (and PACER, which would have few direct policy implications for its trade regime) is largely just a matter of time. It makes no such concession on WTO membership, which would seem to indicate that policy makers are unsure of the desirability of this option. The implications of acceding to the global trading body are discussed (positively) only in terms of its relatively limited implications on tax revenues. The report does not seem to recognize the sweeping changes to all aspects of economic regulation that WTO membership would inevitably entail.

49 There are three volumes, together comprising some 866 pages of text, matrices and appendices.

50 These are: Private Sector Development, Public Sector Management, Education, Health, Agriculture, Fisheries, Tourism, Environment, Gender.

51 See Roman Grynberg and Roy Mickey Joy, *The Accession of Vanuatu to the WTO Lessons for the Multilateral Trading System*, published in: *Journal of World Trade* 34(6), 2000 Kluwer Law International, at pp. 159–173.

c) *Strategic Goals and Necessary Policies*

As outlined above, the nine policy areas are each defined by a separate mission statement and implemented by means of a set of strategic goals. The focus of the present review is largely confined to the first of these (Private Sector Development,) whereby some degree of overlap also exist in the areas Agriculture and Tourism.

d) *Private Sector Development*

For the policy area Private Sector Development, the Mission Statement is "to facilitate the development of an environment supportive of a competitive and growing private sector". In support of this Mission Statement, five Strategic Goals have been agreed upon, whereby for the purpose of this project, the most important would be:

- Strategic Goal 1 Create a sound economic policy making environment, in full consultation with the private sector, to support export-oriented, private sector-led growth;
- Strategic Goal 2 Improve the competitiveness of the factors of production to promote private sector development;
- Strategic Goal 3 Improve the environment for direct investment and expand entrepreneurial and business development support services.

Strategic Goal 1 lists a number of required policies which the government must pursue in order to successfully achieve this goal, the most important for the purpose of the present review being "to adopt trade and tax policies consistent with improving the international competitiveness of FSM-based producers".

Strategic Goal 2 lists a number of required policies which are of relevance to the present study, including;

- Expand access to bank financial services and products to a broader range of enterprises.
- Give priority to Micronesian products, Micronesian owned businesses and Micronesian labour in government procurement and public contracting.
- Consult with the private sector on the selection of foreign aid and other outside funded projects.
- Continuing subsidies to achieve desired social outcomes are provided in economically efficient and cost-effective manner (e.g. outer-island transport).

A number of activities specifically envisaged in the pursuit of these policies and of immediate importance in the policy area which forms the focus of the present review include:

- Improve the functioning of the financial sector.
- Review existing laws and regulations to determine consistency with granting priorities to Micronesian products, Micronesian owned business and Micronesian labour in government procurement and public contracting.
- Consult with the private sector on the selection of foreign aid and other outside funded projects
- Improve subsidy policies

Strategic Goal 3 also sets out a number of required policies of direct significance to the present study, including the following:

- Improve the corporate regulatory environment;
- Revise, if necessary, foreign investment laws and regulations to improve attractiveness;
- Support for entrepreneurial development and export promotion should be provided to new entrepreneurs or to small and microenterprises;
- Seek country to country and international agreements to promote foreign investment within the FSM

e) *Agricultural Sector*

The Mission Statement set out under this policy area provides that "the agriculture sector, including forestry, shall provide: (i) food security, cash incomes and healthy livelihoods; and (ii) opportunities for domestic and export markets, while promoting environmentally sustainable production within a stable and consistent policy framework."

This is to be achieved by means of several Strategic Goals of interest in the present context, including:

- Strategic Goal 1 A well resourced and properly focused agriculture sector operating within a stable and consistent policy framework;
- Strategic Goal 2 Increase production of traditional farming systems for home nutritional and traditional needs and cash incomes;
- Strategic Goal 3 Increased volumes of saleable surpluses to be marketed by the private sector into local and regional markets.

Under Strategic Goal 1, a number of necessary policies are set out which touch upon the subject matter of the present study, including: i) allocation of an equitable government budget share to agriculture; ii) invest in border protection and agricultural quarantine. Under Strategic Goal 2, the necessary policy of the greatest significance to the present project is to "replace some imported foods with local product". Finally, under Strategic Goal 3, the required policy of "encouragement of niche commercial crops for import substitution and export" is one which will be of potential significance in designing policies and drafting laws that do not run afoul of recognized trade policy constraints.

f) Tourism Sector

The Mission Statement guiding the entirety of any policy choices under this sector is ambitious and seeks to "progressively develop the tourism sector to become the leading sustainable economic activity in the nation, and establish the FSM as a top quality, premium-priced international tourism destination by 2020".

This target is to be achieved by pursuing some eleven Strategic Goals, the most important of which in terms of the present study would have to include:

- Strategic Goal 3 Create an attractive and supportive environment for private sector tourism industry investors;
- Strategic Goal 6 Promote inter-sectoral linkages and maximize use of local produce and services

Under Strategic Goal 3, the activities which are of the greatest relevance in the context of the present project include i) FSM establishes a signposting function for the tourism industry by 2007 to assist private sector businesses to access all appropriate forms of assistance from existing institutions in and outside the FSM; and a support function to work with State and national legislative bodies on issues of land tenure, immigration, licensing and tax or fiscal incentives; ii) FSM introduces by 2008 a function to identify and promote new tourism projects, working directly with the State tourism offices, and in association with national and/or international development finance institutions".

Under Strategic Goal 6, the activities foreseen which are of the greatest relevance in the present context include: "each State's agricultural and fishing authorities to identify reliable local sources and suppliers of fish, meat, vegetables, and fruit in 2006; ii) develop a plan in each state for use of local construction techniques and materials in hotels, other tourism infrastructure and in cultural and other tourism related events by 2007.

Many of the policy objectives and activities foreseen under the Strategic Development Plan have obviously been prepared in the absence of the kind of binding disciplines that WTO membership would entail, or membership in any other trade and investment agreement with national treatment obligations (it should be recalled that FSM does not [yet] trade under PICTA).

VI. The Draft Trade Policy

1. Background to Drafting the Trade Policy

The National Trade Policy, which has yet to be ratified by the Congress, was drafted in reaction to FSM increasingly being asked to take positions in the context of different initiatives (PICTA, EPA, PACER Plus), without itself having a great deal of coherence about what its objectives in this important area of policy might actually be.

Thus it was that in 2005, the Economic Planning and Implementation Council (EPIC) mandated the establishment of a National Trade Facilitation Committee with representation from the Government (National and State governments), the private sector, NGOs and other stakeholders. The NTFC was instructed to formulate a trade policy, educate leaders and policy makers in States about trade agreements and develop a coherent trade strategy for FSM.

The draft National Trade Policy recognizes that a trade policy is merely a means to an end, and not an end in itself. It sets out the vision of Trade Policy in the following terms:

"Encourage and facilitate local and foreign direct investment in agriculture, fisheries, tourism, human resources development and other supporting services to enable the private sector to produce value added, quality and competitive goods and services both for the local and the export market, in order to promote export-led economic growth, self reliance and sustainable development, with the ultimate objective of creating employment, alleviating hardship and raising the living standards of FSM citizens."

The National Trade Policy is thus framed very much in terms of achieving economic growth, alleviating poverty, reducing unemployment, and helping the FSM economy as a whole to become more competitive. It is thus to be considered in the broader context of the Strategic Development Plan discussed above.

The National Trade Policy is divided into six sections, each of which discusses a different aspect of the current state of policies in a given area and where the FSM should ideally be headed. It is essential reading for anyone taking an interest in how the FSM intends to steer its way through the various regional and multilateral trade liberalization initiatives.

Below is a brief discussion of some of the more important findings and policy statements contained in the draft document.

2. Institutional Framework

a) *The National Trade Facilitation Committee*

The National Trade Facilitation Committee (NTFC) was established by Presidential decree in January 2008. It is chaired by the Vice President, who reports on the Committee's activities to the President, Congress and several high-ranking economic policy committees. Its membership is made up of Secretaries (i.e. Ministers) and Directors (senior civil servants) of a number of departments and offices at the national government level. The draft National Trade Policy lists the following departments and offices as being members, *ex officio*, of the NTFC:

- Department of Foreign Affairs (DFA);
- Resources and Development (DR&D);
- Finance and Administration;
- Justice (DOJ);
- Transportation, Communication and Infrastructure (TC&I);
- Health and Social Affairs (HSA);
- Education (DOE);
- National Oceanic Resources Management Authority (NORMA);
- Office of Statistics, Budget and Economic Planning;

- Overseas Development Assistance and Compact Management (SBOC);
- Office of Environment and Emergency Management (OEEM); and
- One Non-Governmental Organization (NGO) representing the collective interests of this sector in the FSM.

b) Representation at the State Level and Key Line Agency

Representation at the State level is less broad, and consists solely of the Chairman of the State Trade Facilitation Committee and one private sector representative, who is tasked with representing the collective interests of the business community from each State.

The key line agency and also the drafter of the National Trade Policy is the Department of Resources and Development, formerly known as the Department of Economic Affairs. It can be expected that once the Policy has been adopted, and the NTFC is formally established, it will, for all intents and purposes, be convened and serviced by DR&D.

c) Proposed Subcommittee Structure and Current State of Play

The draft National Trade Policy proposes the establishment of six sub committees which incidentally shows where the strategic emphasis of the National Trade Policy's priorities will be. The six proposed sub-committees are fisheries, agriculture, tourism/services/investment, market access, trade-related issues and aid for trade.

It has become quite apparent from meetings and discussions that the National Trade Facilitation Committee currently exists more on paper than it does in the real world. This is not to say that consultations between the above listed stakeholders has not already taken place and was indeed a key process requirement for the formulation of the draft policy, but it is the view of most observers that only once the draft policy has been adopted by Congress, and some level of prioritization has taken place will it be possible to formally schedule regular meetings of the NTFC and to constitute some, albeit perhaps not all, of the proposed sub-committees.

3. Participation of FSM in International Trade

Section 3 of the draft policy discusses this topic. What follows below, is a brief summary of the key findings the draft policy makes on this issue, followed by another summary of some of the goals the draft policy sets. Finally I have added some of my own commentary and an evaluation of these findings and goals.

a) Key Findings and Factual Statements

The Draft Trade Policy Document describes FSM's performance in merchandise trade as "disappointing"⁵², having consistently run a trade deficit. Foodstuffs, mostly from the US, seem to dominate the import bill, which are for domestic consumption, and are channelled through locally owned and operated wholesale and retail distributors (see below when the discussion turns to trade in services). In addition to the US, the main sources of imports are Singapore⁵³, Japan, Hong Kong, Australia, Korea, China, Philippines, Taiwan, Thailand, and New Zealand. Europe is almost entirely absent as a source of imports (as well as exports, see below).

The tariff structure in FSM is relatively simple. There are five tariff bands, with the highest tariff rate of 50%, which is however only levied on a very limited number of products (alcoholic beverages and tobacco). Most food items are in the lowest tariff band, namely 3%. Tariff revenue is not a significant factor in terms of the total government budget (this would be grant aid under the Compact) and this fact is alluded to in several instances as being potentially favourable to reducing the costs of trade liberalization.

FSM's export performance is described as "very poor"⁵⁴, with fish being the major export commodity. Textiles previously played a role but this ended in or around 2004, due largely to the phasing out of quota arrangements (MFA) under Art. 9 of the WTO Agreement on Textiles and Clothing, as well as a change in US rules of origin requirements, presumably adopted at the behest of the US textile industry, which at the time was itself scrambling to adapt to the end of the MFA. Betel nut and kava are also significant sources of export revenue.

⁵² Draft Trade Policy Document, p. 54.

⁵³ Almost certainly as a mere point of loading, but not necessarily as the source or origin of the imports in question.

⁵⁴ Ibid, p. 58.

A number of factors are blamed for the lack of export performance, including distance to world markets; poor logistical supply chains even to regional markets; lack of scale capacity in domestic production, considering that the FSM is itself fragmented demographically and geographically between the 4 island states that constitute it; lack of access to capital for investment; highly restrictive investment regimes in the four States which have a dampening effect on prospective investment; weak legal system for the enforcement of contracts; poor regulatory environment that increases uncertainty for local and foreign investors; insufficiently skilled local labour market; excessive restrictions on inward migration which could otherwise mitigate local labour market constraints.

Many of the factors listed above which act as constraints to the development of FSM's exports also impede other economic development efforts, and will be repeated when discussing other economic sectors. Apart from the distance to regional and global markets, many of the underlying unfavourable conditions which impede the development of different export sectors are largely of the FSM's own making, another theme that will be discussed later.

The document points out that in FSM, international trade falls within the purview of the National Government whereas investment is regulated by both the National Government and the four States. Some general legislative instruments regulating trade in services in FSM include:

- The National Foreign Investment Act of 1997 and the Regulations (1998),
- The Chuuk Investment Act (1998);
- The Kosrae Investment Act;
- The Pohnpei State Foreign Investment Act (2006);
- The Yap Investment Act;
- The Immigration Act [Title 50 Chap 1];
- The Protection of Resident Workers Act [Title 51 Chap 1]; and
- The Constitution of the Federated States of Micronesia.

In addition to these laws, a number of sector-specific laws and other regulations are enacted on a continual basis by the respective competent authorities.

The laws on investment, of which there are five (see above list), operate a traffic-light system (green, amber and red, similar to the WTO Agreement on Subsidies and Countervailing Measures) to regulate investments. Sectors falling in the red category are deemed prohibited to foreign investors. Those in the amber category are open to foreign investors but only subject to certain specified criteria as set out in the regulations. Finally those in the green category are deemed open to foreign investors, subject of course to all applicable laws, whereby there are no specific conditions investors must meet before being granted a license to operate in this sector.

Several key service sectors such as telecommunications, retail banking, international maritime and domestic air transport fall within the competence of the national government and are in the green light category, although the Telecommunications Corporation Act (1981) establishes the fully-government owned Telecommunications Corporation of the Federated States of Micronesia (FSMTC) as the 'sole provider' of all telecommunications services, except radio and television broadcasting. In fact, FSMTC provides all telecommunications services in FSM, including internet and mobile telephony and is thus the monopoly incumbent.

The document also discusses the banking sector, and states that there are only two commercial banks operating in the FSM (Bank of FSM and Bank of Guam), admitting that the Bank of Hawaii withdrew from the market in 2002. The banking sector in FSM is supervised by the US Federal Deposit Insurance Corporation (FDIC), something that has gone a long way to ensuring the stability and viability of the domestic financial system, which is also regulated by the FSM Banking Board, currently building its own capacity to exercise banking supervision. The competencies of the Board include licensing of domestic and foreign banks, on-site and off-site supervision of all banks, consumer protection and consultation with the FDIC.

Foreign banks wishing to establish in FSM must first obtain a license from the Department of Resources and Development and are subject to higher minimum capital requirements than local banks under the Bank Act

(1980). The national government is well aware of the inefficiencies plaguing the banking sector, and is rumoured to be contemplating talks with the Australian government to discuss the possibility of "inviting" an Australian bank to establish itself in FSM. For its part, ANZ Bank has itself expressed a very tangible interest in the PACER Plus progress, and has made a corresponding submission to the Australian government who invited submissions from the public prior to initiating negotiations.⁵⁵ ANZ already has retail and commercial banking in 11 Pacific countries including Papua New Guinea, Fiji, Solomon Islands, American Samoa, Samoa, Cook Islands, Tonga, Vanuatu, Kiribati, Timor Leste and Guam as well as operating a representative office in New Caledonia. It would presumably view such an "invitation" in a favourable light.

The draft document discusses the transportation sector briefly. International maritime transport is under the purview of the Micronesian Shipping Commission (MSC) which has the competence to grant license routes, manage competition and administer entry into international shipping services of FSM, Palau and the Republic of the Marshall Islands. Licences valid for a period of 5 years are issued, but subject to annual review. In terms of air transport, FSM maintains an open-sky policy. Under the Compact of Free Association, the US guarantees air services to the Compact States. Priority in air transportation is required to be given to a US airline under the Compact (currently Continental Micronesia), but no formal monopoly exists. The national government is also aware of the limitations it suffers by the fact that FSM is serviced by one airline and airline alone and is working hard to tackle this problem. It compares its situation to that of Palau (a similarly-sized island), which is serviced by no less than five international airlines.⁵⁶ Of course, Continental Micronesia, which operates out of Guam, would be most reluctant to relinquish its monopoly, and would no doubt lobby the US government against any perceived encroachment against its privileged position. But the requirement that any visitor to FSM must transit through Guam and thus obtain a US visa, is a significant and detrimental hindrance to the movement of persons (and airfreight) between FSM and the majority of its partners in the region. The length of the runway at Pohnpei's airport is currently in the process of being extended with the help of funding from Japan. This will make it possible for Pohnpei to be serviced by larger aircraft operating out of Japan, but does not offer a solution to the air-transport bottlenecks suffered by the other island States that constitute FSM.

b) Strategic Objectives of the Trade Policy

The strategic objectives which the Draft Trade Policy Document discusses in terms of import policy extend across a range of proposals from excluding high revenue-generating imports from liberalization (alcohol and tobacco) to beginning any tariff-cutting measures on those imports already in the lower tariff-rate bands. It also suggests that in future, higher tariffs may be needed in order to protect agriculture, fisheries, textiles and some other products. The document alludes to the need to "maintain policy space" but also recognizes the reality that "it is difficult to identify products that may need protection in future because of constant global changes"⁵⁷.

The document discusses the need to establish a National Export Strategy which could identify key products (and services) that might possibly be the focus of development and promotion efforts. The document also admits that what is needed is more infrastructure investment and what it describes as a "liberal regulatory environment"⁵⁸.

The document recognizes the many downsides to the monopoly enjoyed by FSMTC in telecommunications, and discusses the potential benefits which could be enjoyed if this sector were to be liberalized. At the time of the document's drafting (2007), there was legislation before congress which sought to remove the monopoly status of the FSMTC, something that was being pushed for especially hard by some of the States. However, this initiative failed to pass, and current legislative and institutional efforts are focused on establishing and equipping a regulator to oversee the telecoms sector.

The document recognizes that foreign operators are clustered in a number of sectors, including wholesale, retail, construction, hotels, restaurants, and real estate rental services. Foreign investors are also most prevalent in these sectors, as well as agriculture and fisheries, although the presence of foreign interests in almost all of these sectors began declining some ten years ago and has yet to recover. The document admits that in manufacturing, financial services, transport and telecommunications there is very little foreign activity.

⁵⁵ See: <http://www.dfat.gov.au/geo/spacific/pacer/submissions/ANZ.pdf> (8 August 2010).

⁵⁶ Pacific Flyer of Australia, began operating 2 flights per week from Brisbane; Continental operates daily flights from Guam; Japan Airlines operates seventy charter flights per year from Tokyo, Nagoya and Osaka; China Airlines operates four flights via Taipei per week; and Asiana airlines also operates two flights per week from Seoul Incheon.

⁵⁷ Ibid.

⁵⁸ Ibid, p. 61.

The main impediments to growth in these sectors are indicated as being the existence of different foreign investment laws and regulations between the national government and the States, a poor regulatory environment, limited market size, the weak institutional and legal framework for the enforcement of contracts, legislatively mandated monopolies, strict laws on land transactions which essentially make land a commodity that cannot be traded commercially, lack of credit information, among various others.

c) Commentary and Analysis

The relatively simple structure and low tariffs which characterize FSM's import regime is probably to be welcomed in the context of future trade liberalization efforts, particularly given that the potential loss to public revenue from this source will be minimal. Nevertheless, initiatives are in place to raise tariffs on a number of goods, and one could argue that this runs contrary to the standstill obligation that would have come into effect when FSM began formal negotiations with the EU with a view to concluding an EPA (or even PACER plus).

Of much greater relevance at present in this context is the proposed adoption of a new VAT scheme, which would be imposed on goods as they enter the country, and which would present national treatment issues if no mechanism is found to similarly impose VAT on domestically produced goods (something that customs and revenue authority officials seem to be ill-equipped to deal with).

The proposal to establish a National Export Strategy is surely of great merit and has been fleshed out in some detail. But it will need corresponding institutional support and legislative backing if it is to go anywhere. Many of the impediments that businesses and economic operators face, and not just those looking to export, require concerted and determined action by a government agency that has the institutional and legal capabilities to identify, take on and remove existing impediments. This should be a very high priority of the FSM government and something that it should ideally have been doing for many years now.

The need to improve services markets and the various impediments that exist are relatively well documented in the draft trade policy, but strategies and roadmaps need to be developed and then implemented in order to remove them. It should be pointed out that almost all of these impediments are home-grown, and removing them should not require additional development assistance, at least not in the form of direct monetary transfers.⁵⁹ This is an area where the national government of the FSM and the States can work together to prove they are truly serious about taking the politically difficult steps required in order to improve the contestability of services markets and ultimately the competitiveness of the economy as a whole.

4. Trade Policy and Business Environment

This section of the document essentially examines a number of supply-side constraints, some of which were already identified and discussed above during the section on export promotion. It is divided up into a number of subsections, which cover i) domestic trade policies and instruments; ii) taxation; iii) competition policy; iv) government procurement; v) trade facilitation; vi) corporate governance; vii) intellectual property rights; and viii) trade and environment.

Here I limit my analysis domestic trade policies and instruments, competition policy, government procurement, trade facilitation and intellectual property rights.

a) Domestic Trade Policies and Instruments

This section of the document reiterates a few of the strategies already outlined, such as "promoting production and value addition in agriculture, fisheries, manufacturing, food processing and putting in place quality infrastructure and services needed to promote trade and investment, including promoting services trade, especially tourism".⁶⁰ In this context, the document calls for a comprehensive export promotion strategy.

It also suggests the launching of what it calls a Skills Development Initiative to improve the capacity of the local labour market to adapt and contribute to the planned growth of priority sectors. This initiative calls for

⁵⁹ This approach was taken some years ago by the ADB which offered a number of low-interest loans contingent upon the national government and the States reforming investment regimes, amending land-tenure rules, and downsizing its involvement in business. For more on this, see the unpublished draft report by Richard G. Caldwell, *ADB TA-4539 (FSM): Legislation for Private Sector Development (SSTA)*, 4 November 2005, available on request from SBOC.

⁶⁰ Ibid, p. 77.

"vocational training schools in tourism, fisheries and agriculture, construction, nursing, science and technology".⁶¹ Whereas the constraints and weaknesses of the local labour force are more than apparent to anyone who has spent any time in the FSM, this does not necessarily form part of trade policy *per se*, but is rather an economic development objective. This is a policy area that should be addressed under education policy, or an industrialization program, or a strategic sector development initiative.

The draft trade policy document also discusses the need to establish laws, institutions and procedures for contingency protection, particularly in tandem with any industrialization efforts (infant industry protection). Whereas it undoubtedly makes sense to set up such laws and procedures to impose safeguard measures, particularly if FSM is contemplating further liberalization of its import regime, it would probably be an inefficient use of very limited resources to focus on the establishment and development of a legal and institutional framework for the conduct of antidumping, countervailing duty or safeguards investigations. Then again, contemplating the opening of goods markets should ideally go hand-in-hand with the adoption and implementation of working trade defence measures (if these are not already in place) as well as a number of trade adjustment policies. Neither of these areas are contemplated in much depth in the draft trade policy document.

b) Competition Policy

The draft trade policy limits itself to making some broadly formulated and rather sweeping statements about the perceived benefits of enacting a competition policy.⁶² In terms of the discussion of existing impediments as outlined above, it is clear that rules on competition could be useful in increasing the contestability of certain markets like telecoms, banking, air transport, utilities, as well as contributing to breaking down a couple of already well established monopolies in these and other sectors.

Competition policy, and particularly consumer protection, will play an import role in protecting smaller and more vulnerable interests from potential market failures which may accompany future liberalization efforts. As competition increases in certain sectors, and given the relatively modest size of the domestic economy, the opportunities for collusive behaviour among a limited number of economic actors in any given sector, or the emergence of a dominant player who is easily capable of abusing the market power that comes with such a position will need to be carefully policed.

The enactment of an effective competition law, and the empowering and training of government regulators to identify, prosecute and punish offenders will be an import flanking policy that will need to accompany the opening of FSM's markets if its citizens are to derive the full benefits of liberalization. This is certainly an area where future technical assistance efforts could be considered. As it is, some limited competition rules could well be coming FSM's way the closer it gets to concluding an EPA with the EU or PACER Plus with Australia and New Zealand. This last statement rests on the fact that a number of the EPAs that the EU has concluded and published contain detailed provisions on collusive behaviour and abuse of dominant position. Likewise, a number of the free trade agreements concluded recently between Australian, New Zealand and their respective trading partners also contain provisions that seek to bring competition into the fray of trade policy.

c) Government Procurement

The Draft Trade Policy Document discusses this issue in slightly more detail than competition.⁶³ It notes that some States already have rules on government procurement, but that these laws need to be reviewed and updated to ensure that the procurement system is transparent.

It is difficult to overstate the importance of having properly drafted and properly enforced government procurement rules on the statute books in FSM. The public sector is without doubt the largest single sector in the economy and dwarfs the private sector on almost any indicator. Moreover, in FSM the public sector is largely in the business of spending other taxpayers' money, i.e. public funds of the US or other nations which extend development assistance to it. It owes its development partners some sort of systemic and embedded procedural and legal guarantees that those funds are spent in an economically efficient and transparent manner, especially when they are used to fund infrastructure or other large-scale public works projects. This is as much an issue of governance as it is one of economic efficiencies.

⁶¹ Ibid.

⁶² Ibid, p. 82.

⁶³ Ibid. pp. 82-83.

Finally, given that a number of export promotion and business development measures will address supply-side constraints that will require either large monetary transfers or infusions of state capital, it should be a matter of priority for policy makers in the FSM to have government procurement rules in place and in operation that leave no doubt that the funds are being dispersed in accordance with fair and transparent procedures on the basis of economic efficiency and value for taxpayers' money.

In a small economy where many people not only know each other but are more often than not bound together by family ties, the need to have such rules in place is no longer of any theoretical benefit but of the greatest urgency. This should be addressed as part of the government's efforts to improve the business environment, promote investment, and increase exports. The Draft Trade Policy Document correctly points out that there is some work already going on under the Forum Island Country Secretariat process, especially some reflection on whether government procurement rules should be enacted under the PICTA process. The FICS would undoubtedly be a useful source of technical cooperation for lawmakers and regulators in FSM, but rules on government procurement are probably coming FSM's way in the context of the PACER Plus process, where New Zealand at least has listed it as one of the areas it intends to hold negotiations on.

d) Trade Facilitation

The Draft Trade Policy Document lists a number of areas in the field of trade facilitation which, in its view, need to be part of an improved trade policy environment, including modernizing customs, and improving the capacity of customs officials in the areas of quarantine and IPRs. These are certainly areas where an upgrading of existing procedures will have to be part of comprehensive reform of the FSM trade policy regime.

For the purposes of the present project, a brief review of the Customs Code and an indication of where it deviates from the four WTO trade facilitation agreements⁶⁴ might be useful.

e) Intellectual Property Rights

Existing law in FSM only extends protection to copyright, although patents and trademarks are also mentioned in Title 35 of the FSM Code. Legislative drafting is required to provide protection to copyrights and related rights, trademarks, geographical indications, industrial designs, patents, and layout-designs of integrated circuits, as required under the WTO TRIPS Agreement. There will also need to be the establishment of institutional and enforcement measures, including the training of judges to enforce such rights. Although this last aspect goes beyond the TOR of the present project, some degree of legislative drafting and institutional recommendations can undoubtedly be achieved.

The draft trade policy document recognizes the need to establish a sui generis system to protect traditional knowledge, bio-diversity and genetic resources in FSM, and correctly points out that the Pacific Island Forum Secretariat is already running a pilot project that seeks to establish international rights to protect Traditional Knowledge and Cultural Expressions. Any initiatives launched will need to tap into the work already ongoing in the context of the Forum Secretariat.

f) Commentary and Summary

The policy urge to establish a comprehensive export strategy is certainly laudable and has been successfully pursued by a number of countries as a key component of export led growth strategies (Japan, Taiwan, Korea, China, and with more limited success in Malaysia). But it is the opinion of the present author that this should be subsumed to a broader and more widely-beneficial policy of improving the business environment in general, since what is good for business, will also be good for exports, and what benefits the domestic business environment is more likely to bring tangible benefits across broad sections of the FSM population as a whole than to a few narrowly defined and specifically targeted export interests. Making the economy competitive as a whole will have vastly greater and more widely impacting economic benefits than just focusing on improving export performance, and will also improve the potential and abilities of economic operators to produce for export. The specific impediments to exports, such as logistical constraints, port infrastructure limitations, costly transport networks, are issues that can be addressed in the context of a narrowly focused set of policies which should be implemented separate to but in rough chronological cohesion with a set of policies specifically aimed at improving regulatory frameworks and providing an enabling environment for business.

⁶⁴ Agreement on Customs Valuation, Agreement on Preshipment Inspection, Agreement on Rules of Origin, and Agreement on Import Licensing Procedures.

5. Trade Agreements and Market Access

This section of the Draft Trade Policy Document focuses on a number of areas, including PICTA, the extension of PICTA to include services, access to the US market, PACER, the Japanese market, the EPA process, WTO membership. For the purposes of the present report, I have selected those areas of immediate interest to the execution of the project.

a) US Market

The Draft Trade Policy Document recognizes the US as a potentially interesting market for services (tourism) and agricultural goods, but also notes that its importance in terms of fisheries exports is limited in light of the decline in the US canning industry. However, one fails to see why, if Vietnam can build a multi-million dollar export industry for frozen cat-fish filets to the US from nothing, as it did in the wake of its FTA with the USA in the early 2000s, why FSM would not be able to develop similar export opportunities for the US or other markets in a specific salt or fresh-water fisheries product, especially given its preferential market access.

The document lists some of the existing constraints which hamper exports to the US, but they are the same as those that have already been identified elsewhere in the document, and could all be overcome either with a concerted effort to improve the business environment and an export development strategy that is serious about addressing transport and logistical constraints.

The rest of the section on the US market discusses additional ways and justifications for extracting even more development assistance and aid from the US above and beyond what the FSM already receives under the Compact arrangements. This is only likely to win any measure of support in the US to the extent it can be sold as benefitting US export or investment interests, rather than just representing yet another hand-out.

b) The EPA Process

The Draft Trade Policy document discusses continued (or perhaps renewed) engagement in the EPA process in largely favourable terms, although it states the need to resist rules on competition policy, intellectual property rights, government procurement and trade facilitation, since it claims to have identified these areas for its own unilateral reform processes. Be that as it may, it is unlikely that the EU would be willing to conclude an EPA with FSM without these areas, since it has shown itself relatively unwilling to depart from these and other key areas of concern to it (investment, comprehensive access to services markets). Moreover, the best way to ensure that FSM's planned unilateral efforts to address competition, IPRs, government procurement and trade facilitation are actually locked in and that they are seen through to completion, is to bind them into a set of treaty commitments like those entered into in the course of negotiations on the EPA, an FTA or WTO accession.

The Draft Trade Policy Document also recognizes that the economic impact of the EPA would mostly likely be minor, since existing trade with the EU is almost non-existent, but it also notes that preferences into the EU market could help stimulate exports in some sectors, particularly fisheries.

The document also identifies the EU as a source of potential tourists in high-value eco tourism. In the course of its EPA negotiations FSM offered to open the tourism sector (hotels and restaurants), air transportation, financial services (banking and insurance) and selected business services. In addition, it was also prepared to offer additional market access opportunities in sectors such as, maritime transport, telecommunications (initially internet and mobile phones). In terms of requests made to the EU in the context of services negotiations, FSM requested that the EC provide technical and financial assistance to strengthen key infrastructure services sectors, and to upgrade its technical and vocational education training schools.

The other interests FSM typically asserts in the context of its EPA negotiations with the EU are almost all focused on receiving development assistance rather than market access, but the document correctly recognizes the difficulties FSM would face in getting such commitments enshrined in language that would be actionable under such an agreement.

c) WTO Membership

The document's discussion of WTO membership is brief and inconclusive, and policy makers seem to think that their already low tariffs would make WTO accession relatively fast and painless. Nothing could really be further from the truth, since the process of joining the WTO would inevitably involve FSM opening up all or most of its

services sectors to one degree or another, and to adopting and implementing new laws and policies in a whole range of areas that affect market access and the competitive environment in which foreign firms compete with local firms across almost all goods and services markets. WTO accession would also entail a complete overhaul of existing intellectual property laws and the institutions that enforce them. It would require the most fundamental and far-reaching process of legislative and policy reform ever embarked upon by this young nation. Although it is something policymakers do not quite realize the full implications of, and would almost certainly have little stomach for, it is also and with all likelihood the best chance the FSM has of truly embarking on and seeing through the kind of sweeping reforms that are necessary to make this economy competitive and able to determine its own economic destiny free from Compact grant aid or other sources of development aid.

6. Recommendations and Implementation

This section of the document is very focused on practical outcomes and suggests a three-pronged or three-track approach, dividing up implementation tasks in terms of immediate, short-term and medium to long-term objectives, and then further distinguishing outcomes in terms of either supply-side policies, market access and export policies, and finally trade-policy institution building.

a) Immediate Objectives (so-called "Fast Track")

The focus in the immediate aftermath of the adoption of the National Trade Policy would primarily be on establishing a trade adjustment facility with funding received in the course of the EPA process (supply-side policy), exploit existing market access opportunities by utilizing preferences, and finally trade-policy institution building.

The weaknesses of this approach are fairly self-evident, the main one being that the EPA process seems to have run out of steam and it is anyone's guess as to if and whether these negotiations will resume and under what terms. This puts the achievement of this immediate policy goal at the mercy of influencing factors that FSM has little control over.

Furthermore, the ability to exploit existing market access opportunities (through utilization of preferences) is something that FSM has consistently failed to do ever since it became established as a nation, and there are deep-rooted and systemically difficult to overcome reasons for this failure. To imagine this could be fixed in the immediate term misjudges the intractable nature of the problems, many of which have been perfectly well formulated during the course of the document.

b) Short-term Objectives

These objectives, to be implemented over a time-frame of 5 years, focus on supporting export oriented and import-substitution industries (supply-side policies), to improve market access and entry for key potential products and services through regional and multilateral negotiations, and finally to provide capacity building for trade policy formulation, negotiations and implementation.

The focus on improving market access through regional and multilateral negotiations would seem to be somewhat misplaced, since sufficient market access opportunities would seem to exist already, and the problem up to now for the FSM has been availing itself successfully of these opportunities. Only once FSM has managed to build up a fairly diverse export base, which constitutes significantly to the economy in terms of GDP and employment, will it really need to develop capacity and institutions that are capable of ensuring that market access opportunities are not arbitrarily denied FSM by trade policies and measures of its trading partners, and that market access opportunities are steadily increased by engaging in regional and multilateral trade negotiations.

These are probably to be best defined in terms of the medium or even the long term, rather than as short-term objectives. The priority for the short-term must be removing barriers to the development and operation of businesses, promoting inward foreign and domestic investment, and to creating an environment where production and exports can flourish.

c) Medium to Long-term Policy Objectives

On the supply-side, these are indicated as instituting an enabling policy environment for manufacturing and services, whereas the market access objectives are formulated in terms of increasing market access and entry

through positive measures (a very broadly-formulated policy objective). Finally, the institution and policy building objective in the medium to long term is stated as being sustaining capacity in trade policy formulation, negotiations and implementation.

These are all laudable goals but creating an enabling environment is probably the issue that needs to be tackled first, not last, and the other two objectives are formulated in terms that are completely non-actionable.

d) Comments and Critique of Recommendations and Implementation

This chapter of the document, which is arguably the most important, is also the weakest and fails to recommend concrete and specific objectives, the implementation of which can be quantified and measured.

This is an area where the present project can provide some much needed input and help to refocus the energies of policymakers on pursuing goals, and building institutions that will be dedicated to and capable of tackling the very real problems that FSM faces in reducing its dependence on imports, expanding its production base, and generating export income.

VII. Concluding Remarks

The record of economic performance in the history of this young nation is not something FSM policymakers can point to and be proud of. Declining living standards, falling life expectancy, a bloated and largely unaccountable public sector, overdependence on development assistance and a lack of strategic political thinking and implementation as to how to improve things all characterize the policy environment in FSM. There is an urgent need to tackle the declining competitiveness of the economy and the Strategic Development Plan and the National Trade Policy are two instruments for doing so.

The Terms of Reference of the present project are fairly limited in scope and focus on improving the trade-related laws, building institutional capacity (establishment of a trade policy unit) and bringing about a policy shift towards accession to the WTO, within the context of a three-day sensitization workshop on trade policy issues and the benefits of WTO accession.

The first of these tasks is relatively straightforward and a number of legislative instruments have already been identified in the course of this report. Here, the work of the Key Experts is well cut out for them.

The second objective will need to be relativized somewhat. Given the truly limited HR environment we are operating in here, and the overwhelming and largely home-grown nature of the barriers that stand in the way of FSM succeeding in achieving its economic policy and trade-led growth strategies, any institutional changes and capacity building efforts would be better focused on creating an economic policy unit that is dedicated to helping business people from the private sector, as well as investors and exporters, to overcome the numerous barriers they face from the prevailing regulatory and governance environment. The unit would also have to expend some of its energies researching and informing the public and policymakers as to what the costs of this poor regulatory environment are and what the hidden costs of protection are. This should largely be done on the basis of existing manpower, since the National Government is already a very bloated structure compared to the relative size of the population and uses a disproportionate amount of the public revenues available to FSM (mostly Compact funding).

The third objective will also need to be tweaked in order to be better adapted to local audiences. After consultations with the beneficiary, it is recommended to organize this event around two days. The first day would be a sensitization workshop to discuss the passage of the draft Trade Policy before Congress, tentatively scheduled for September. This would involve members of Congress, representatives from the States' foreign trade facilitation bodies, the States' attorney generals offices and NGOs, also from the States. The second day would be a practical workshop exercise on legislative drafting, addressed to representatives from the Department of Justice, the Attorney General's Office, the States' attorney general's offices.

There is a genuine need to impress upon policymakers and the broader public, the urgency and magnitude of the challenges FSM faces in turning itself into a competitive and self-sustaining economy. This project will make a modest albeit useful contribution to furthering FSM in the pursuit of these goals.

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