

# THE FEDERATED STATES OF MICRONESIA

## TRADE POLICY



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Division of Trade and Investment  
FSM Department of Resources and Development

## **FOREWORD**

The Strategic Development Plan (SDP) called for FSM to adopt trade and tax policies to enhance the competitiveness of producers. In 2005, the Economic Policy and Implementation Council (EPIC) passed a resolution calling for the establishment of a National Trade Facilitation Committee (NTFC) to formulate a Trade Policy for the nation. This was further reiterated by the Chief Executive Council (CEC) in June 2006.

Accordingly in October 2006, the Department of Resources and Development (R&D) convened a National Trade Policy Consultative Meeting, where all the stakeholders from the National Government, the states, private sector and non-state actors (NSA) were invited.

To facilitate the formulation and implementation of the Trade Policy, the National Trade Facilitation Committee (NTFC) was established by Executive Order on the 14<sup>th</sup> of January 2008. The NTFC convened its meeting in June 2008 to consider the final technical draft of the Trade Policy.

The ultimate objective of the Trade Policy is to promote export-led sustainable economic growth and self reliance, with the ultimate objective of creating employment, alleviating hardship and raising the living standards of FSM citizens. The Trade Policy provides clear recommendations on what needs to be done in order to promote private sector development and export-led economic growth.

I would like to take this opportunity to thank the Vice President, who is the Chairman of the NTFC, the Commonwealth Secretariat (Hub and Spoke Project) and the Pacific Islands Forum Secretariat (PIFS) for providing technical and financial assistance, the States, NSA, the National Government and the members of the NTFC who have participated actively in the formulation of the Trade Policy. I would also like to thank the many citizens of the FSM who participated in the Trade Policy formulation and the private sector for their valuable input in the process. Lastly, my gratitude goes to the Department of R&D, which was primarily responsible for managing this consultation process and developing this Trade Policy.

I am confident that the Trade Policy will help in putting the necessary measures in place to address supply-side constraints and help our nation to produce goods and services that can be traded competitively on the international market and help us to achieve our shared goals of economic growth, employment creation, poverty alleviation, and sustainable development.

Emmanuel Mori  
President

## **VISION**

The FSM Trade Policy shall promote and facilitate private sector development and foreign direct investment in priority sectors in order to achieve export-led economic growth and sustainable development, creating employment, improving services, alleviating poverty with the ultimate objective of raising the standards of living in the FSM.

## **The Trade Policy Statement**

The Federated States of Micronesia (FSM) consists of about 607 small islands with a total land area of about 701.8 square kilometers and an exclusive economic zone of over 1 million square miles (2 589 988 square kilometers). The country is divided into four States namely; Chuuk, Kosrae, Pohnpei and Yap with an estimate population of about 110, 000 people.

2. The FSM economy is mainly an import based aid dependent economy (mainly from the Compact). In 2005, grants contributed about 63% to total revenue compared to 66% in 1995 and the bulk of the money (\$131.4 million) in 2005 was spent on current expenditure and very little (\$11.4 million) was used on capital expenditure. The overall economic performance from FY 1995 to FY 2006 was very weak and the annual average percent growth was -0, 7%, GDP and real income have actually fallen. The Government has the largest contribution to GDP, followed by wholesale and retail, and subsistence. Trade in agriculture, fisheries and tourism contributes very little to GDP. In order to promote trade and investment, FSM needs to create a conducive environment for investment and private sector development.

3. The main sectors that were identified in the SDP as priority sectors and which will be targeted by the Trade Policy to promote economic growth include agriculture, fisheries and tourism.

4. FSM's performance in trade has also been very weak. In 2007, the value of merchandise exports from FSM constituted about \$16.2 million and imports were about \$142.7 million. Food and beverages dominate the import bill representing about \$40.1 million of imports in 2007 (30% of total imports). The main import markets are the US, Japan, Guam and Australia. Fish is the major export commodity and it accounted for about 69 % of total exports in 2007. Other products, which used to do well in the export market, include copra, bananas and citrus and recently kava and betel nuts are the main exports. The main export markets are Japan, US, Guam, Commonwealth of Northern Mariana Islands (CNMI), the Republic of the Marshall Islands (RMI) and Hawaii.

5. Services contribute about 77% to GDP but exports of services are very low. The main services export is tourism, but it is still underdeveloped. Another potential source of 'exports' is the temporary movement of natural persons abroad. Technical and financial assistance is needed to upgrade the training institutions to develop skills that are needed to turn around the economy and export the surplus skills.

6. FSM will liberalize and upgrade the key service sectors such as telecommunication, financial and transport services amongst other sectors to promote efficiency and reduce the cost of doing business. However, diagnostic studies need to be undertaken prior to liberalization and some regulations need to be put in place to protect public interest.

7. FSM has various trade-related laws regulating trade and investment at the National and State level. FSM will review and introduce new laws relating to taxation, trade facilitation, corporate governance, government procurement, competition, intellectual property, traditional knowledge and genetic resources, environmental laws in order to create a good business environment, which is conducive for promoting sustainable economic growth and development.

Tax reform must be prioritised in order to ease the tax burden on the business community and also to minimize revenue loss from participating in trade agreements.

8. The Trade Policy seeks to assist FSM exporters to consolidate existing markets and identify new ones. It will promote inter-state trade, trade with the Freely Associated States (FAS), and nearby markets such as Guam, Saipan, Hawaii and the US mainland.

9. Presently, the US Mainland, Hawaii, CNMI and Guam remain FSM's key trading partners both in terms of export and import. There will be a need to review existing trade and investment incentives in order to boost exports into those markets and enhance US investment in the FSM.

10. The sub regional market is also an area of interest with export opportunities in RMI and Palau, noting that they already constitute a destination for exports originating from the FSM. In this regard, the Micronesian Trade Committee (MTC) will need to be further strengthened, noting that it may also serve as institutional tool for negotiations with big trading partners.

11. FSM has signed and is in the process of ratifying the Pacific Island Countries Trade Agreement (PICTA). Currently, PICTA is being extended to include trade in services and temporary movement of natural persons and FSM will continue to participate in those negotiations.

12. FSM has access into the Australian and New Zealand market via the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA), which is a non-reciprocal Agreement. However, market access is hampered by transportation problems and onerous rules of origin, quarantine and phytosanitary requirements. Although FSM is not a signatory to the Pacific Agreement on Closer Economic Relations (PACER) between Forum Island Countries (FICs) and Australia and New Zealand, it is participating together with the other FICs in discussions for PACER Plus. National and State study and consultations are being undertaken to assist the FSM in developing its negotiating strategy and positions with the view to enhance its participation in those negotiations. In addition, FSM will need to consult with the US on whether and how the most favoured nation (MFN) clause in the Amended Compact will be applied.

13. Asia is an important market for FSM, with Japan being the major export market, especially for fish and tourism. FSM should continue to seek additional market access in other Asian countries.

14. FSM together with the other 13 Pacific ACP States is negotiating an Economic Partnership Agreement (EPA) with the European Commission (EC). The fisheries sector has indicated its interest in the EU market and there is merit to explore the potential cost for the FSM to signing the Interim EPA or comprehensive EPA to enable the private sector to benefit from the market access opportunity that has been offered by the EC. However, before signing the EPA, FSM will also need to consult with the US on whether and how the most favoured nation (MFN) clause in the Compact Agreement will be applied.

15. The key objectives of the Trade Policy include: creating an environment which is conducive for investment and private sector development; addressing the supply-side constraints and non-tariff barriers; promoting import substitution and exports of value added goods and services; guiding the nation in trade negotiations and in implementing trade agreements; using

the Trade Policy to secure Aid for Trade from FSM’s trading partners and donors; and promoting export-led sustainable economic growth, with the ultimate objective of raising the standards of living in the FSM.

16. In order to achieve the abovementioned objectives, multi-year project proposals, which include measurable indicators, will be prepared based on trade policies detailed in Annex 2. The Trade Policy will be reviewed and monitored annually and necessary changes made to ensure that the objectives are met.

17. This abridged version of the Trade Policy should be read together with Annex 1 which details the key trade policy issues, challenges and opportunities and Annex 2 which identifies the main stakeholders and entities responsible for the implementation, the time frame, and the sources of funding.

18. The key policies outlined in the table below will be pursued in order to promote trade and investment in the identified priority sectors.

<b>Sectors</b>	<b>Trade Policy</b>
<b>Agriculture</b>	Promoting import substitution, agricultural production, food security, value addition and exports.
<b>Fisheries</b>	Promoting sustainable fishing, local participation, foreign investment in catching and processing.
<b>Services</b>	
<i>Transport</i>	Liberalization of the transport sector (air, maritime) to improve efficiency, reliability and quality of service.
<i>Tourism</i>	Liberalization of the tourism sector to allow foreign investment and improve the quality of services offered to tourists.
<i>Financial Services</i>	Liberalization of the financial sector to improve the quality of services to the private sector including the small and medium enterprises.
<i>Education and Human Resources Development</i>	Strengthening and upgrading the education system/programs to improve the quality of education and produce work-ready graduates for the local market and export the surplus skills to the international labor market.
<i>Telecommunications</i>	Liberalization of the telecommunication sector to improve the quality of services and reduce the costs of business.
<i>Energy</i>	Liberalization of the petroleum sector and promotion of investment in renewable energy.
<b>Exports and Imports</b>	Development of an export strategy to promote exports and reduce the trade deficit.
<b>Tax &amp; Customs</b>	Introducing a VAT plus excise tax and maintain tariffs that are necessary to protect infant industries.
<b>Institutional and</b>	Adoption of institutional sound measures to promote private sector

<b>Government Support level</b>	development and foreign investment to enhance exports of value added goods and services.
<b>Investment</b>	Providing cheap capital to Small Medium Enterprises and reforming of existing investment laws in order to create a good business and investment climate.
<b>Trade-Related Laws</b>	Putting in place trade-related laws to create a good investment environment.
<b>International Trade</b>	
<b>Existing international markets</b>	Review existing trade and investment incentives in order to boost FSM export to the US mainland, Hawaii and Guam and to increase US investments in the FSM.
<b>Sub-regional trade network</b>	Enhance the sub-regional trade network through the consolidation of the Micronesian Trade Committee (MTC).
<b>Market Access and International Trade Agreements</b>	Diversification of international partners and entering into international trade Agreements including PICTA, EPA, China-Forum Island Countries Trade Agreement.
<b>Aid for Trade</b>	Using the Trade Policy to secure Aid for Trade in order to address the supply-side constraints inhibiting trade to enable FSM to utilize the opportunities that are offered by trade liberalization.



