The Trade Policy for the Republic of the Marshall Islands

BY

THE MINISTRY OF RESOURCES AND DEVELOPMENT

DIVISION OF TRADE AND INVESTMENT

MAY 2012
# LIST OF ACRONYMS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>ACP:</td>
<td>African, Caribbean and Pacific</td>
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<tr>
<td>Compact:</td>
<td>Compact of Free Association</td>
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<td>R&amp;D:</td>
<td>Ministry of Resources and Development</td>
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<td>T&amp;C</td>
<td>Ministry of Transportation and Communication</td>
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<td>EPA:</td>
<td>Economic Partnership Agreement</td>
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<td>EC:</td>
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<td>European Development Fund</td>
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<td>EEZ:</td>
<td>Exclusive Economic Zone</td>
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<td>FFA:</td>
<td>Pacific Islands Forum Fisheries Agency</td>
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<td>FTA:</td>
<td>Free Trade Agreement</td>
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<td>FAS:</td>
<td>Freely Associated States</td>
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<td>FDI:</td>
<td>Foreign Direct Investment</td>
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<td>GDP:</td>
<td>Gross Domestic Product</td>
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<td>GSP:</td>
<td>Generalised System of Preferences</td>
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<td>IPR:</td>
<td>Intellectual Property Rights</td>
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<td>LDCs:</td>
<td>Least Developed Countries</td>
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<td>MFN:</td>
<td>Most Favoured Nation</td>
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<td>NTFC:</td>
<td>National Trade Facilitation Committee</td>
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<td>MIMRA:</td>
<td>Marshall Islands Marine Resources Authority</td>
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<td>MIVA:</td>
<td>Marshall Islands Visitors Authority</td>
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<td>NSA:</td>
<td>Non State Actors</td>
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<td>OCO:</td>
<td>Oceania Customs Organization</td>
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<td>PIFS</td>
<td>Pacific Islands Forum Secretariat</td>
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<td>PACP</td>
<td>Pacific ACP</td>
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<td>SPC:</td>
<td>Secretariat of the Pacific Community</td>
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<td>SPS:</td>
<td>Sanitary and Phytosanitary Measures</td>
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<td>SPARTECA:</td>
<td>South Pacific Regional Trade and Economic Cooperation Agreement</td>
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<td>SPTO:</td>
<td>South Pacific Tourism Organisation</td>
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<td>TBT:</td>
<td>Technical Barriers to Trade</td>
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<td>UNCTAD:</td>
<td>United Nations Conference on Trade and Development</td>
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<tr>
<td>WTO:</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
# Table of Contents

1. Background and Introduction ................................................................. 1
   1.1 The Rationale for a Trade Policy Framework ................................... 2
   1.2 The Objectives of the Trade Policy .................................................... 3
2. Economic Growth and Development ......................................................... 4
3. Trade Policy by Sector .................................................................................. 7
   3.1 Agriculture ......................................................................................... 7
   3.2 Fisheries .............................................................................................. 8
   3.3 Tourism .............................................................................................. 10
4. Merchandise Trade ..................................................................................... 12
5. RMI Investment Regime ........................................................................... 13
6. Trade in Services ....................................................................................... 13
7. Trade Related Issues ................................................................................. 14
8. Market Access and Trade Negotiations .................................................. 14
   8.1 The Pacific Island Countries Trade Agreement (PICTA) .................. 14
   8.2 The Compact Trade Provisions (US) .................................................. 16
   8.3 PACER Plus ....................................................................................... 18
   8.4 Japan .................................................................................................. 19
   8.5 The Economic Partnership Agreement (EPA) .................................. 20
   8.6 The Micronesian Trade Committee .................................................... 22
   8.7 The World Trade Organisation .......................................................... 22
   8.8 Guidelines for Trade Negotiations ...................................................... 22
9. Aid for Trade ............................................................................................ 23
10. Implementation ......................................................................................... 24
FOREWORD

The Republic of Marshall Islands (RMI) requested for assistance from the Pacific Islands Forum Secretariat to formulate its National Trade Policy Framework. In November 2009, the Ministry of Resources and Development (R&D) convened a National Trade Policy Consultative Meeting, where all the stakeholders from the National Government, private sector and non-state actors were invited. The purpose of the meeting was to brainstorm and consider the key elements and priorities of a Trade Policy Framework. This meeting was followed by one-on-one consultations with the various Government Ministries, the private sector, non-governmental organizations and academia.

The recommendations from the consultative meeting and one-on-one consultations were used as a basis for formulating the first draft Trade Policy Framework. The draft Trade Policy Framework was circulated to all the stakeholders for further comments before it was presented at the Second National Trade Policy Consultative Meeting that was held in May 2010. The meeting endorsed the draft Trade Policy Framework and agreed that the draft be finalized and submitted to Cabinet for consideration. The Second National Trade Policy Consultative Meeting also agreed to revive the National Trade Facilitation Committee (NTFC) and the NTFC was formally established by Cabinet in 2010. The Trade Policy Framework was endorsed by the NTFC on 3 May 2012 and submitted to Cabinet for endorsement.

The key objective of the Trade Policy Framework is to enhance the participation of the private sector in the economy and promote export-led sustainable economic growth and self-reliance with the ultimate objective of creating employment, alleviating hardship and raising the living standards of Marshallese citizens.

The Trade Policy Framework is divided into ten chapters. Chapter one gives the background including the rationale for a Trade Policy Framework, its vision and sets the context in which the Trade Policy Framework is being formulated.

Chapter two details how the RMI economy has been performing and what needs to be done to ensure that trade is fully mainstreamed into the national development plan to promote sustainable and inclusive economic growth and development. In particular, the Trade Policy Framework provides some recommendations on what needs to be done to promote private sector development and export-led economic growth. This is very important in light of the fact that economic growth is primarily driven by a large public sector, which depends heavily on declining Compact grants. The Trade Policy Framework will also assist RMI to cope with changes in the global economy.

Chapter three deals with trade policy by sector and examines how the three priority sectors (agriculture, fisheries and tourism) have been performing and what needs to be done to improve trade in these sectors. It is clear that the fisheries sector as well as the tourism sector have potential for further growth, while the agricultural sector has a number of well-known challenges that need to be addressed. If these challenges are addressed, RMI will be able to increase production of agricultural products for the local
market and export a few niche agricultural products such as value added coconut products, nin and pandanus products.

Chapter four deals with RMI’s participation in international trade. According to available statistics, it is clear that RMI has a huge trade deficit and imports continue to increase while exports are still very small. The Trade Policy Framework recommends a number of measures that could be taken to promote exports of goods and services. As discussed in chapter three, fisheries and tourism have potential to boost exports and should be prioritized and supported. RMI also needs to improve its human resources, including vocational skills that are required to promote trade and turn the economy around. Improving vocational skills could also help RMI to fully utilize the preferential arrangement it has with the U.S. on labour mobility and to improve the flow of remittances to RMI.

Chapter five deals with the investment climate in RMI. Investment has been identified as a key sector that needs comprehensive reform in order for RMI to be able to produce goods and services that can be traded competitively. The Trade Policy Framework makes it clear that without some bold reforms on relevant laws governing investment including immigration, labour, land and taxation laws, it will be very difficult for RMI to participate meaningfully and benefit from international trade and foreign direct investment. The key issues that have been identified in the World Bank’s report on the ease of doing business need to be reviewed carefully and implemented accordingly to improve the investment climate in RMI.

Chapter six highlights the importance of trade in services and what needs to be done for RMI to participate actively in trade in services. It also recommends RMI to take urgent measures to improve the efficiency and quality of services provided as this is critical to ensure competitiveness in the global economy. Services such as transportation, communications, education, business services, financial services, energy and health play a vital role in the production of goods and services for the local as well as the export market. The Government will work with all the stakeholders to provide the key infrastructure and undertake the necessary reforms in the services sector to enhance the capacity of the private sector to participate in trade in services. This will also contribute to reducing the cost of doing business in RMI and enable the private sector to produce goods and services that can be traded in a competitive manner. To this end, policies and laws dealing with services reforms including liberalization of trade in goods and services will be addressed simultaneously in order to maximize the benefits of reform and trade liberalization.

Chapter seven identifies some of the trade-related issues such as taxation, competition, government procurement, intellectual property rights (especially traditional knowledge and biodiversity), corporate governance that need to be addressed in order to create a good business environment for trade and investment. The chapter also focuses on the need for RMI to ensure that trade is undertaken in a manner that does not undermine the environment. The issues pertaining to trade and environment, including climate change will also be taken into account. There is also a need for RMI to ensure that trade benefits
the Marshallese people, including the vulnerable and disadvantaged groups such as women and unemployed youths.

Chapter eight is one of the most important sections dealing with ongoing trade negotiations and market access. It provides some recommendations and guidelines on what needs to be done in the various trade negotiations. In particular, RMI is urged to participate in regional integration through the Pacific Island Countries Trade Agreement (PICTA), which is now being extended to trade in services and labor mobility as directed by the Leaders under the Pacific Plan. The Trade Policy Framework also recommends RMI to participate actively in the Economic Partnership Agreement (EPA) negotiations with the European Union (EU) and consider signing the comprehensive EPA to promote its fisheries exports to the EU. However, assistance will be required from the Government as well as the EU to enable RMI to establish a Competent Authority and to comply with other export requirements including the EU Illegal Unreported and Unregulated (IUU) regulation that entered into force in 2010.

The Trade Policy Framework also recommends that RMI should ensure that its trade interests are also included in PACER Plus negotiations with Australia and New Zealand. RMI must work with all the national and regional stakeholders to ensure that EPA does not set a bad precedent for PACER Plus or any future trade negotiations.

Most importantly, RMI is required to consult with the U.S. under the most favored nation clause in its Compact with the U.S. before it concludes a free trade agreement with non-PICTA parties (e.g. EU, Australia and New Zealand). The consultations should be undertaken as a matter of urgency under the Micronesian Trade Committee. RMI should also use this opportunity to improve its trade and investment relations with the U.S. including the removal of tariffs that are being levied on its fisheries exports to the U.S.

Chapter nine deals with Aid for Trade. The Trade Policy Framework identifies RMI’s national Aid for Trade needs and priorities that should be supported by the Government, donors and trading partners in order to ensure that trade promotes sustainable development in RMI. RMI will improve its coordination of donor funds and ensure that all the Aid for Trade into RMI is coordinated effectively and channeled towards the priorities identified in the Implementation Matrix.

Chapter ten provides key recommendations on how the Trade Policy Framework should be implemented. The Government is urged to allocate funding to priority sectors identified in the Trade Policy Framework, undertake the necessary reforms and work with trade and development partners to secure Aid for Trade to implement its Trade Policy Framework. This section identifies the agencies that are responsible for implementing the Trade Policy Framework, the timeframe involved, the funding required and the annual progress reports for the Government to be able to assess whether the objectives of the Trade Policy Framework are being achieved and what needs to be done to improve the implementation of the Trade Policy Framework.

The ten chapters cover the key issues that need to be addressed in order to promote trade and sustainable development in RMI. It is clear that a lot of work was done to produce
the National Trade Policy Framework and in this context, I would like to take this opportunity to thank the Minister for Resources and Development, the Chairman of the NTFC, non-state actors, the National Government and the members of the NTFC who have participated actively in the formulation of the Trade Policy Framework. I would like to thank the many citizens of the RMI who participated in formulating the Trade Policy Framework and the business community for their valuable input in the process.

I would also like to thank the Ministry of Resources and Development, especially, the Division of Trade and Investment which worked very hard with all the stakeholders to produce our first National Trade Policy Framework. Lastly, I would like to express my appreciation to the Forum Secretariat, especially the Hub and Spokes Project, which is jointly funded by the EU and the Commonwealth Secretariat, for providing the technical and financial assistance which enabled us to formulate our first National Trade Policy Framework.

The Trade Policy Framework will help us to identify our trade priorities and focus our attention on addressing the supply-side constraints that are inhibiting us from producing goods and services that RMI has the potential to export competitively on the global market. The ultimate objective is to ensure that trade is fully mainstreamed into our national development plans and used as an engine to promote inclusive and sustainable economic growth and development, with the ultimate objective of raising the living standards of our people.

The adoption of this Trade Policy Framework shows the importance that the Government places on private sector development. I strongly believe that trade is the engine for sustainable economic growth and development and the role of the Government should be to facilitate the participation of the private sector in trade. I am fully committed to working with all of you, especially the private sector and our trading partners and donors to ensure that the Trade Policy is fully implemented for the benefit of the Marshallese people.

H.E. (Christopher J. Loeak)
(President)
VISION

To mainstream trade into the national development plan, create an environment conducive for trade and investment, secure Aid for Trade to build capacity on trade and address supply-side constraints and improve infrastructural services to enable the private sector to produce quality and competitive goods and services that can be traded locally and globally, thereby enhancing the capacity of RMI to participate effectively in, and benefit from trade, and use trade as an engine to drive inclusive and sustainable economic growth and development; with the ultimate objective of achieving fiscal sustainability, creating employment, alleviating poverty and raising the standards of living for the Marshallese people.
1 Background and Introduction

The Republic of the Marshall Islands (RMI) consists of two groups of 29 atolls and five raised coral islands extending 750 miles (1,200 km) north-south and 800 miles (1,300 km) east-west, with the capital Majuro located 2,000 miles (3,200 km) from both Honolulu and Tokyo. The land area is about 181 km² but the Exclusive Economic Zone (EEZ) covers about 2 million square kilometers. According to the 1999 census, the total population in RMI was 50,840. The current population is estimated at 53,291 and about 51% of the inhabitants live in Majuro, while 20% live in Ebeye (Kwajalein atoll). The estimated annual population growth rate from 2006-2010 is around 1.3%.

2. The RMI became independent in 1986 but maintained a special relationship with the US under the Compact of Free Association (Compact) from 1986 to 2001. The Compact was amended and renewed in 2004 but Compact grant funding is expected to end in 2023. Under the Compact, the US was given the right of strategic denial, while RMI benefits from annual payments as well as the right for its citizens to live and work in the US. The US has exclusive military access into RMI and in return RMI benefits from a guarantee of defence against third parties. The Compact also allows the US to lease most parts of Kwajalein for military and defence purposes through to 2066 with an option to extend to 2086. The US and RMI agreed to make annual contributions into a Trust Fund and this is expected to be the main source of funding for RMI from 2024 onwards.

3. The RMI is a Small Island State (SIS), which is largely dependent on foreign aid, foreign goods (imports) and foreign investment. Between 2000 and 2010, on average, RMI received $58 million in annual grants, which is equivalent to 43% of Gross Domestic Product (GDP). In 2010 total grants were $68.9 million and Compact grants contributed $55.8 while other grants contributed $13.1 million.

4. In 1999, the Human Development Index (HDI) was 0.563 and RMI was ranked number 10 out of 15 Pacific Island Forum members. Palau was ranked number 1 with a HDI of 0.86, while PNG was number 15 with an index of 0.314. These criteria are based on life expectancy, level of literacy and average GDP. In terms of Human Poverty Index (HPI), - which measures the number of people who die before the age of 40, the number of underweight children who are less than 5 years, the number of people who do not have access to safe drinking water and health services - RMI was ranked number 11 out of 15 with an index of 19.5. Niue was ranked number 1 with an index of 4.8 and PNG was number 15 with an index of 52.2. In terms of the Vulnerability Index (VI) - which provides a quantitative measure on external environmental and economic shocks - RMI is considered to be vulnerable to coastal flooding, moderate cyclones, droughts and rise in sea level.

5. However, despite the lack of recent data, anecdotal evidence suggests that many children suffer from malnutrition while adults suffer from obesity and overweight. There are challenges in terms of the quality of education at all levels and the health system. All these services need to be improved for RMI to able have a healthy and educated workforce, which can contribute effectively to trade and sustainable economic development.
Like many other small islands, RMI is a very small economy, with a small population and landmass, narrow resource base, limited economic opportunities, weak institutional capacity, lacks adequate and cheap financial capital, lacks economies of scale, faces severe transportation problems and is far away from major commercial markets. The island is also vulnerable to external (global) shocks and natural disasters.

1.1 The Rationale for a Trade Policy Framework

Since 1986, when RMI attained independence, it did not formulate a comprehensive Trade Policy Framework to guide the nation on trade matters. Trade issues have been approached in a piecemeal fashion through various sectors and agencies.

The first and main rationale of having a Trade Policy Framework is to mainstream trade into the national development plan. The Strategic Development Plan Framework (SDPF) makes some references to trade issues but there are no direct linkages between the SDPF and trade; in particular, how trade will contribute towards development goals. The R&D Strategy and Action Plan attempts to address some trade-related issues, but since it was never designed as a Trade Policy Framework, it is not surprising that it does not address trade issues in a comprehensive manner.

The second rationale is to improve coordination and consultation between the Government, the private sector and civil society. One of the issues hampering RMI’s effective participation in regional and international trade is that there is poor coordination between government departments, the private sector and the civil society. The institutional support for trade is very weak. This hinders the capacity of RMI to participate in the formulation, negotiation and implementation of trade agreements. Therefore, RMI needs a comprehensive Trade Policy Framework and an effective institutional mechanism to guide the nation on regional and international trade matters. It is in this context that the NTFC has been established, comprising representatives from the government, the private sector and civil society, to assist the nation on trade matters.

The third rational of having a Trade Policy Framework is to create a transparent, consistent, coherent and predictable trading environment. A trading environment where rules are unclear, where sectoral policies are conflicting with each other will discourage trade and investment. The Trade Policy Framework will therefore help to address these issues and avoid *ad-hoc* decision making and sometimes conflicting rules and policies. In order for RMI to create a good trade and investment climate, it needs a comprehensive Trade Policy Framework, which is applied consistently to ensure certainty, predictability and credibility among its trading partners. Frequent Trade Policy changes or reversals are inimical to free and fair trade and hampers development.

The fourth rationale is to articulate a clear negotiating strategy that would be applied consistently in trade negotiations to promote and protect RMI’s offensive and defensive interests. The global trading system is undergoing enormous changes and RMI needs to formulate a Trade Policy Framework to protect its interests in trade in this evolving world economy. In this respect, the RMI needs to develop clear positions and
strategies with regard to the Pacific Island Countries Trade Agreement (PICTA), the Pacific Agreement on Closer Economic Relations (PACER) Plus, the Economic Partnership Agreements (EPA), Micronesian Trade Committee (MTC), the US and the World Trade Organization (WTO). A Trade Policy Framework will, in this context, help the country to be proactive in international trade negotiations rather than being reactive.

12. The fifth rationale is to develop holistic solutions to trade problems. Most of the products that are produced by RMI require the services of various agencies, therefore, there is a need to coordinate the activities of these agencies to ensure that they provide supporting services that are needed to develop production capacity and export competitiveness. There is a need for a clear Trade Policy Framework that ‘connects all the dots’ and identify strength, weaknesses and opportunities along the ‘trade policy chain’ (production, processing, handling, transportation, marketing, exporting and distribution) to ensure that all the trade-related problems are addressed in a holistic manner. The Government needs to have a comprehensive document which covers all the aspects from trade policy formulation, negotiations, implementation and exploitation of market access opportunities.

13. The Trade Policy will also help with identifying production constraints in key sectors of the economy (agriculture, fisheries, tourism, manufacturing and handicraft), including labor mobility and all other services. The pre-eminent objective of a Trade Policy Framework is to create an environment that is conducive for private sector development, and to identify and address supply and demand-side constraints inhibiting trade in goods and services. The long-term focus of the Trade Policy Framework is value addition, diversification of the export basket, addressing product standards, consolidation of the existing markets, finding new markets and assisting exporters to access these markets.

14. The Trade Policy Framework also takes into account other social, cultural and environmental goals of the nation. Trade is not an end in itself, but a means to achieve export-led economic growth, which in turn should lead to employment, increased standards of living and poverty alleviation.

15. The Trade Policy Framework encourages private sector development. It advocates that the government should not compete with the private sector, but facilitate and promote private sector development and investment. The Trade Policy Framework will guide the RMI in exploiting its full potential in trade and to participate effectively in the global trading system.

1.2 The Objectives of the Trade Policy

16. The objectives of a Trade Policy Framework include:

- To build institutional capacity on trade by strengthening the Trade and Investment Division and the NTFC
• To create an environment which is conducive for trade, investment and private sector development and use trade to promote sustainable economic growth and development
• To address production and supply-side constraints (structural challenges hindering trade)
• To reform the investment laws so as to facilitate investment in fisheries and tourism, and develop competitiveness in the production and export of value-added fisheries products as well as high end tourism services
• To develop the necessary human capital that is required to produce goods and services in RMI and also to fully utilize labor opportunities in the US and increase remittances
• To increase production and consumption of local foods, ensure food security and reduce the trade deficit
• To mobilise all the support required to facilitate trade including cheap and quick access to finance, efficient customs services, modern and business-friendly tax system, business support services, assistance to meet export requirements including sanitary and phytosanitary measures and technical barriers to trade.
• To improve trade-related infrastructure, strengthen the legal and institutional services and liberalize trade in services to promote competitiveness and efficiency, and reduce the cost of doing business
• To assist farmers/producers/manufactures to secure the best market for their products and to guide the nation in negotiating and implementing trade agreements, including US (Compact), PICTA, EPA, MTC and PACER Plus.
• To mainstream trade into the national development strategy and use the Trade Policy Framework to secure Aid for Trade from RMI’s trade and development partners.

2 Economic Growth and Development

17. The RMI economy is mainly an import-based and Compact dependent economy. The RMI adopted the SDPF 2003-2018, which is commonly known as Vision 2018, in order to stimulate sustainable economic growth and development. The SDPF is complemented by master plans, which focus on major policy areas as well as Action Plans of Ministries and statutory agencies, featuring the relevant projects and costs. Of particular relevance is the Ministry of Resources and Development (R&D) Strategy and Action Plan 2005-2010, which provides strategies and an action plan on how to implement some of the activities that fall under the R&D, including those falling under the Division of Trade and Investment. However, the SDPF needs to be supplemented by a comprehensive national development plan, which sets clear priorities and measurable indicators. The R&D Strategy expired in 2010 and needs to be revised. In the process of renewing or revising the SDPF and the R&D Strategy, it is important to ensure that trade is fully mainstreamed into the national development plans and policies.

18. RMI still faces significant challenges in meeting the Millennium Development Goals. Goal 8, which deals with a global partnership for development, recognises the role that trade plays in promoting economic growth and development. In general, economic
growth in RMI has been very slow. GDP increased from $110.9 million in 2000 to $162.9 million in 2010. Average economic growth from 2003 to 2007 was 1.9%; however RMI experienced negative growth in 2008 and 2009 mainly because of the global economic crisis. The economy grew by 5.2% in 2010 mainly as a result of a drop in inflation as well as an expansion in the fisheries sector.

19. Real GDP per capita increased from about $2,350 in 2000 to about $2,750 in 2010. From 2006-2010, the private sector contributed on average about 27.3% to GDP but the Government and public enterprises contributed about 42%. Out of the three priority sectors, fisheries have the highest contribution to GDP followed by tourism and agriculture. With the exception of fisheries, exports from these sectors are still very small.

20. The balance of payment situation is also not sustainable. In 2009, the current account balance was -$26.4 million and the trade deficit for trade in goods and services was -$127.3 million. 2010 figures are even worse, showing a current account balance of -$40.7 million and a goods and services trade deficit of -$136.2 million. The large trade account deficit is matched by substantial inflows on the primary and secondary income accounts. The imports of goods and services are financed mainly by earnings of Marshallese workers at the Kwajalein U.S. base, rental of the base and Compact current transfers. The private sector is very weak and highly dependent on the government and the civil servants, and produces very few foreign exchange earning goods and services. At this stage, RMI does not have sufficient capacity to generate its own foreign exchange to pay for imports.

21. With regard to fiscal policy, the United States contributes $57 million to the RMI, partially adjusted for inflation, over a 20 year period. The annual sector grants started at $35 million in 2004, but will be reduced annually by $0.5 million. The difference between the total contribution and the annual sector grant levels is deposited in the Trust Fund to accumulate over the 20-year Compact period. In addition to the sector grants and Trust Fund, the United States will contribute $15 million a year, for Kwajalein impact, to the Kwajalein landowners. The United States agreed to contribute a further $5 million to the RMI in FY2014, $2 million of which would be added to the annual sector grants; the remaining $3 million would be used for Kwajalein impact.

22. The bulk of Compact funding is allocated to education, infrastructure and health. However, it is interesting to note that very little funding is allocated to private sector development, yet the private sector is supposed to play a vital role in promoting economic growth in light of the expiry of Compact funds in 2023.

23. At the end of FY2007, the balance on the A account stood at $83.9 million, after a bullish year on the U.S. stock market. However, RMI lost about $20.5 million due to the financial crisis. The delay in investments during the early years and the financial crisis raise doubts over whether the Compact Trust Fund would meet the target for FY2024, at which time withdrawals from the Fund are to replace the use of the annual sector grants. RMI needs to take urgent measures to create an environment which is conducive for
trade, investment and private sector development to minimise the impact of the expiration of Compact grants.

24. RMI has also been receiving grants from the Republic of China, and generating its own local revenue. However, the local revenue alone will not be adequate to support the current levels of expenditure. As aforementioned, a major portion of revenue comes from the US through the Compact funding. In 2010, total revenue was $109.2 and expenditure was $101.7 million and grants accounted for about 63% of total revenues and 43% of GDP. The total tax revenue was only $25.2 million, which is approximately 23% of total revenue or about 15.4% of GDP. This means that RMI will also not be able to support the current level of expenditure, including government subsidies that are given to public enterprises.

25. In 2010, the total subsidies that were given to public sector enterprises were $8.1 million. Most of these subsidies went to Air Marshall Islands, Marshall Islands Energy Company, the National Telecommunication Authority (NTA), Kwajalein Atoll Joint Utilities Resources, Majuro Water and Sewer Company, Tobolar and Marshall Islands Shipping Corporation. RMI needs to review its subsidy policy to ensure that subsidies do not distort the allocation of resources or stifle private sector development. Subsidies must also be reviewed to ensure that they are targeted, effective and time-bound to enable RMI to prepare for the post 2023 era.

26. In 1996, RMI’s debt was $138 million, which represented about 115% of GDP. However, by FY2002, RMI had already paid the bond debt, and the debt declined to $78.9 million. In FY2008, outstanding external debt was about $99.1 million and increased to 106.8 in 2010. With this situation, the expiration of grace periods will put a lot of pressure on RMI’s debt obligations.

27. The RMI uses the US dollar, so its economy is vulnerable to fluctuations in the US dollar - and also to inflation - because of its dependence on imports. In 2004, inflation was as low as 2.7% but increased to 14.8% in 2008.

28. Another challenge to economic growth is that the RMI’s population is relatively young and has been affected by emigration to the US. Between 1990 to 2007, over 15,000 Marshallese are estimated to have emigrated to the US. The labor force is estimated to be between 14,000 - 15,000 persons. In 2009, about 10,216 people were formally employed and this means that more than 5,000 people are either informally employed or not employed whatsoever. The RMI’s official unemployment rate based on the 1999 census stood at 30.9%. However, about 30% of adults in the RMI have completed high school and about 5% have completed college level (bachelor level degree). These rates are very low compared to other Pacific Islands.

29. Employment increased from 7,940 in FY1997 to 10,709 in 2011. After the downsizing in the public sector in late 90s, public sector employment had decreased to about 3,672 in FY1999. However, by 2011, it had increased to 4,730 and the RMI Government contributed a lot to this expansion.
30. In 2011, the total number of people employed in the private sector was 4,440 and the wholesale and retail sector had the largest contribution to employment. This was followed by fisheries, then construction, transport, storage and communications, real estate, renting and business activities and hotels and restaurants. The employment in the fisheries sector increased mainly as a result of the opening of the processing facility by Pan Pacific Foods in 2008. Very few people are employed in manufacturing and agriculture.

31. It is clear that the fisheries industry has the potential to create more jobs. There is also an opportunity for growth in the tourism sector; however, for the tourism industry to expand, the government needs to provide the necessary support. Agriculture, on its part, contributes very little in terms of formal employment. However, subsistence farming in outer islands plays a vital role in the economy and should not be neglected. The Government should use the Trade Policy Framework to develop trade and investment in fisheries, tourism and agriculture, to increase the contribution of these sectors to employment.

3 Trade Policy by Sector

3.1 Agriculture

32. The contribution of agriculture to GDP decreased from 4.5% in 1997 to 3.5% in 2010, while the contribution of fisheries increased from 4.5% to 10.8% over the same period. The contribution of tourism to GDP decreased from 5.4% in 2001 to 1.6% in 2010.

33. With regard to agriculture, and especially the copra industry, it is clear that Tobolar, the only copra processing company has not been operating efficiently and profitably. Its returns have not been able to support reasonable prices for copra. The company depends heavily on government subsidies both for the price of copra and transportation. The price of copra in the outer islands in 2010 was 15 cents per pound and 16.5 cents per pound in Majuro. In the past, the price used to be as high as 22 cents per pound and 26 cents respectively, but it has been affected by a global decline in oil prices. A copra price of at least 20-22 cents per lb would be needed to double copra production in the outer islands.

34. However, it is important to note that copra trade is essentially a commodity trade that is vulnerable to the fluctuations in the global market. RMI has very small production of copra and does not have economies of scale as regards the copra business. The biggest copra production was recorded in 2000 and 2008 and a total of 6,500 and 7,100 mt were produced respectively. Tobolar has the capacity to process 13,728 tons per year but has been operating below its capacity because of shortage of copra mainly as a result of low production coupled with random and unreliable shipping. About 60% of the copra that is supplied to Tobolar is converted into crude oil, 33% is converted into copra cake, and
about 1% is distilled into bio-fuel while about 1% is turned into soap. Tobolar also lacks new technology and has not been able to innovate and add value.

35. The Government should consider restructuring and/or privatising Tobolar and find other ways of supporting people in the outer islands. The Government should also facilitate the participation of the private sector in the coconut industry and encourage the sector’s actors to add value to coconut products. Some of these activities can be done in the outer islands. The Government can facilitate private sector participation through a pilot project. Interested individuals in the private sector can use their own machines to produce oil and use it to run their boats. The Government needs to look for a grant to undertake a pilot project on coconut value addition and once it is successful; it can be run on a commercial basis and be used as a model in other outer islands.

36. There is also room to produce a number of agricultural products, in particular fruits and vegetables for the local market and a few niche products such as noni, pandanus and unique handicraft products for the export market. The Government needs to increase its support to agriculture, especially other agricultural products aside from copra.

### 3.2 Fisheries

37. The fisheries sector has the greatest potential to contribute to sustainable economic development. The marine resources of RMI are contained within an EEZ covering around 2 million square kilometers. The Marshall Islands Marine Resources Authority (MIMRA) is responsible for the management and development of the tuna fishery in RMI. The fishing activities in RMI’s EEZ range from long line, purse seine, and pole-and line vessels fishing under various access arrangements. The RMI is a party to regional and international fisheries management arrangements.

38. The Parties to the Nauru Agreement (PNA) Members established their Secretariat in Majuro in 2010, and issued a declaration which aims to develop innovative ways to maximize economic gains from sustainable management of their tuna resources. The introduction of the Vessel Day Scheme (VDS) has led to a significant increase in access fees. The PNA also secured eco-label certification from the Marine Stewardship Council (MSC) for skipjack tuna. This will help to increase the value of the purse seine fishery and PNA Members may be able to derive more economic benefits by promoting their skipjack as being sustainably managed.

39. The major challenge for RMI to maximise the benefits from its tuna resources is its lack of capacity to fish in its EEZ and add value to its tuna resources. The majority of the fish in its EEZ is caught by licensed distant water fishing nations; mainly China, the Federated States of Micronesia (FSM), Japan, Korea, Chinese Taipei, Belize, Kiribati, New Zealand, Vanuatu, Solomon Islands and the US. Only a tiny portion of the fish are processed in RMI, while the rest are shipped overseas as unprocessed products. The bulk
of the returns are going to the distant fishing nations and to the wholesale and retail industries where the fish is sold.

40. The total catch by purse seine fleets operating in the RMI EEZ declined from 36,324 mt in 2001 to 15,600 mt in 2009. Skipjack was the main target species and it is mainly used for canning. The total catch from domestically-based long-line vessels increased from 2,056 mt in 2010, and skipjack was the main target species.

41. The total annual catch and effort estimates for the Marshall Islands purse seine fleet in the Western and Central Pacific Fisheries Commission (WCPFC) Convention area increased from 37,875 mt in 2003 to 59,485 mt in 2007.

42. The value of fish caught by foreign based vessels licensed to fish in RMI waters increased from $28.3 million in 2001 to $84.6 million in 2010. Aside from access fees, RMI is getting very little benefits from the activities of foreign based fishing vessels that are licensed to fish in RMI. According to official statistics, access fees declined from $2,750 million in 2000 to about $1 million in 2010. However, access fees are estimated to have improved significantly as a result of the implementation of the VDS in 2011. Total exports of fish increased from $0.4 million in 2000 to $8.8 million in 2010. This shows that onshore-processing activities play a vital role in economic growth as opposed to relying purely on access fees. RMI should promote investment in the fisheries sector and encourage the private sector to establish on-shore processing facilities and add value to fisheries products.

43. Currently, RMI has three fishing companies, all based in Majuro. The Marshall Islands Fishing Venture (MIFV) was established in 2001 and its main activities are fishing and processing. It operates the long-line fish base with about 33 domestically-based foreign long-line vessels as well as a national long-line fleet (about four of which are RMI flagged). MIFV exports mainly fresh chilled tuna species to the US, Canada and China. Fresh tuna is also processed into fillets or loins and the whole fish is exported to Canada, US, and Japan. Frozen steak goes to the US, Philippines or China and frozen mahi-mahi goes to China. MIFV has a sales branch in the US which receives products from RMI every week. However, frozen products do not fetch much money because the prices are very low.

44. MIMRA has a Joint venture with Koo’s Fishing Company (KFC). In May 2008, Marshall Islands Fishing Company (MIFCO) formally opened its permanent offices within KFC’s new office building adjacent to MIMRA. KFC has 5 purse seine vessels but one is owned under a joint venture with the Government through MIMRA (51%/49%). In 2007, Koo’s vessels caught about 53,916 mt of skipjack in the WCPFC Convention area. KFC catch is mainly for canneries in Bangkok, Philippines, Pago Pago, Japan and China. They also sell to local processors such as Pan Pacific Foods (PPF) but Japan is their key market. The company is also planning to have a small market to process by-catch.
In 2006, Shanghai Deep Sea Fisheries Co Ltd signed an MOU with MIMRA to reactivate the loin plant, with the endorsement to add four purse seine vessels to associate with the plant to secure the supply of raw fish. PPF was registered in 2006, started constructing the plant in January 2007 and completed the construction in December 2007. However, according to the evaluation that was done in commissioning, PPF suspended processing from January to June 2009 to install new machinery and equipment to fully support production. PPF resumed production in June 2009 and has 1,600 local workers, but only about 400 show up regularly. Since the resumption of production on June 22, 2009, PPF has increased the daily production and its day-shift is fully operational.

PPF is the biggest exporter of processed fish and about 80% of PPF production is tuna loins for the US market, while a few loins are exported to Bangkok. For the year 2010, PPF’s aim was to process over 15,000 mt fish and export 5,000 mt of loins and 800 mt of fish meal provided that it could get more workers and space. These challenges need to be addressed to enable the factory to expand.

All the fisheries companies indicated interest in exporting fish to the EU market and urged the Government to sign the EPA and establish a Competent Authority to ensure that all the export health requirements are complied with. It was also noted that at this stage, canning will be costly because most of the raw materials will have to be imported. This is worsened by the lack of space in Majuro.

There are also opportunities on aquaculture and the Government needs to support this sector to develop export competitiveness.

### 3.3 Tourism

The RMI is geographically, culturally and historically unique. It is one of just a few coral atoll nations in the world and the vast majority of its land and sea environment is still pristine. This includes an abundance of uninhabited coral atolls, islands and their terrestrial and marine areas and resources. If managed properly, tourism has the potential to spur developments in other sectors.

The National Tourism Development Plan (NTDP) outlines a number of goals and objectives that, if fully implemented, can help the RMI develop into a truly successful and sustainable tourism destination. However, for this to occur, RMI needs to improve the basic services and infrastructure, education, health, enhance skills, preserve the environment and culture for the benefit of the local people as well as the tourism industry.

Tourism plays a vital role in the Pacific region and many countries in the region are taking measures to benefit from the global tourism market. The Pacific Islands can be divided into four major clusters based on the size of their visitor markets. At the top, destinations like Guam, the Commonwealth of Northern Mariana Islands (CNMI) and Fiji have more than half a million visitors per annum. The next group which consists of French Polynesia, Samoa, New Caledonia receive about 100,000 to 200,000 visitors.
Cook Islands, Palau and Vanuatu have between 50,000 to 100,000 visitors a year. The other remaining countries, including the RMI, receive less than 50,000 visitors a year.

52. RMI has seen a steady but slow growth in the tourism industry. In the 80s, annual tourists were around 4,000 a year. However, the number of visitors increased to 9,173 in 2005 mainly because of the entry of Continental Air Micronesia, which began servicing RMI in 1968, and the establishment of major hotels. The numbers also increased because of Japanese tourists who came in through Japan Air Line (JAL) charter flights. In 2007, visitor arrivals were about 7,000, about 2000 of whom were brought in through 6 JAL flights. However, in 2008, the number of visitors decreased to 6,022 mainly because there were no JAL flights that year. The number of visitors arrivals decreased further to 4563 in 2010 respectively. The Government need to provide more funding to support the tourism sector. Such funding should be seen as an investment and not a loss. It is estimated that about 10,000 visitors could contribute about $ 7-8 million to GDP per year.

53. The US and Japan are RMI’s major source markets for tourism. The US has been the number one market for visitors to the RMI and about 2,000 visitors were received on an annual basis. However, the holiday visitors from the US declined from 506 in 2002 to 200 in 2007. This was mainly because of the problems with Air Marshall Islands, which have especially hurt Bikini Atoll dive tourism. The economic crisis and the poor marketing strategy have also contributed to this decline. However, the arrival numbers from Japan have been steady.

54. The RMI has about 300 rooms available for tourists and there are about 20 to 30 units to be added with new resorts currently under construction. It should also be noted that even though RMI has very few rooms, it has been struggling to fill the existing capacity. For both 2006 and 2007, the estimated annual occupancy rate for RMI stood at around 23 percent.

55. The hotel and restaurant industry (excluding dive operators, airlines, and other tourism related industries) currently employs around 300 people. Total wages paid to about 250 hotel and restaurant workers in FY2010 was around $1.5 million dollars, or an average of around $6,000 per annum per worker. Hotel tax is about 8% plus local tax of about $3 per night, and 10% of this goes to the Marshall Islands Visitors Authority (MIVA).

56. The tourism marketing strategy focuses on North American and Asian markets as primary source markets; and Australia, New Zealand and EU markets as secondary markets. Aside from the fisheries sector, tourism is another sector that has potential and the Government should allocate more resources to the industry.

57. Since RMI became a Member of the South Pacific Tourism Organisation (SPTO) in 2008, it should also work with SPTO to develop and market its tourism industry. SPTO is also the implementing agency for the “Pacific Regional Tourism Capacity Building Programme (PRTCBP)”, which is funded by the European Union under the 10th European Development Fund and will be carried out over 36 months from January 2012 to December 2014. The PRTCBP will focus on the development of sustainable tourism.
by supporting a more conducive enabling environment for regional tourism growth through enhanced policy and capacity development as well as increased productive capacity and improved market access.

4 Merchandise Trade

58. The RMI’s performance on merchandise trade has been very poor. Its balance of trade for goods has always been in the negative (deficit). In 2010, the value of merchandise exports from RMI was $32.3 million and that for imports was $125.5 million (f.o.b). There was a deficit of $93.2 million. However, $21.1 million was not actual exports but mainly re-exports of fuel. If re-exports are excluded, the actual exports will decline to $11.2 million.

59. The US is RMI’s major trading partner. According to US mirror data, the US exported goods worth about $77 million to RMI and imported goods worth about $13.7 million from RMI in 2009. However, according to RMI Customs’ data 2009 imports from the US was worth about $50 million. Notwithstanding the discrepancy, it is clear that the bulk of RMI imports come from the US, with which it has a huge trade deficit.

60. According to recent data from RMI Customs, the major import markets are the US Mainland, Guam, Japan, Hong Kong, Australia, Korea, China, Philippines, Taiwan and New Zealand. The RMI has a very simple tariff structure. Foodstuffs are levied at 5% and non-food products at 8%. However, there are specific duties and different rates for luxury products, alcohol and tobacco, fuel, mixed drinks, soft drinks and vehicles. Cigarettes have the highest tariff, which is 151%, while mixed drinks are levied at 26%, and public transport attracts a duty of 5%. Non-carbonated and artificially flavored beverages are levied at 10%. In addition to the above tariffs, the College of Marshall Islands (CMI) is entitled to certain percentages and amounts deducted from import duties.

61. The Minister of Finance is entitled to issue about 30 licenses per year for the importation of alcohol and tobacco for re-sale. The Secretary of Finance solicits applications for a license through an invitation for bids.

62. The Marshall Islands Energy Company (MEC) and Kwajalein Atoll Joint Utility Resource, Inc. (KAJUR) are exempted from paying import duties on lubricating oil and diesel fuel oil imported by, for, or on behalf of, or sold to them solely for the purpose of power generation. However, they pay duties for fuel sold to fishing vessels. Duties have also been removed on a few food items.

63. The main merchandise exports of RMI include re-exports, fish, coconut oil, copra cake and handicrafts. However, there is no disaggregated data on exports. In 2010, re-exports constituted about $21 million, exports of copra/ coconut oil about $2.4 million and fish about $8.8 million. Under international statistical guidelines, fish caught and sold to non-residents by vessels incorporated in the RMI are considered to be exports. However, the fishing vessels incorporated in RMI operate effectively as offshore units, thus the sales are not included in the RMI's 'official' exports. The value of fish ‘exported’
by foreign-based offshore fishing vessels increased from $28.3 million in 2001 to $84.8 in 2010.

64. The Government will focus on promoting exports, especially in the fisheries sector, coconut by-products and a few niche agricultural products such as noni and handicraft. It will also support the production, post harvest handling, transportation and marketing of these products to encourage the consumption of healthy local foods.

5 RMI Investment Regime

65. The National Investment Policy encourages private sector development in fisheries, tourism, manufacturing and agriculture in order to meet RMI’s development goals. However, fisheries and tourism have the greatest potential. RMI allows investment in almost all the sectors except a few sectors that are in the reserve list. The other laws relating to investment including immigration, labor, and taxation would need to be reviewed to ensure that they are investment friendly.

66. RMI was ranked number 106 out of 183 countries in the 2012 Report on the Ease of Doing Business. In the Eastern and Asian region, RMI was ranked number 16 out of 24.

67. The major areas that need improvement include the number of procedures involved when starting a business, registering property (RMI is the worst out of 183 countries), getting credit, protecting investors, paying taxes, trading across borders and enforcing contracts. The RMI will use the World Bank Report as well as the lessons from other island countries that have undertaken major reforms to improve its investment environment.

6 Trade in Services

68. Services play a vital role in the production of goods, and for any industry to be competitive in the production of goods all the necessary services including transportation, finance, education, energy, water, telecommunication, ports and distribution and business services must be improved. Infrastructural services as well as the regulatory reforms need to be improved in order to enhance competitiveness of industries, reduce the cost of doing business in RMI and create an environment that is conducive for private sector development.

69. The value for imports of services increased from $39.9 million in 2000 to $54.1 million in 2010 and the major services imported by RMI are transportation, passenger services (mainly airline), freight and postal services, travel and business services. The total exports of services were around $11.3 million in 2010. The major exports of services include fish processing, transport related services, travel and
telecommunications. The balance of trade in services deteriorated from a negative $30.4 million in 2000 to $-42.8 million in 2010.

70. With regard to labor mobility and remittances, it is important to note that RMI is actually sending out more remittances than what it is receiving. Even though RMI has the best access into the US labor market, it does not have the relevant skills to fully utilise this opportunity. In order to benefit from the labor mobility schemes and remittances, RMI needs technical and financial assistance to upgrade its educational services including vocational training institutions to be able to produce the required skills that are needed locally and abroad.

7 Trade Related Issues.

71. The RMI has some laws on public procurement, consumer protection and unfair business practices. However, RMI will focus on building its capacity to strengthen or introduce laws on competition, government procurement, intellectual property, biodiversity, traditional knowledge and cultural expressions. It will also take the necessary measures to protect the environment and ensure that the interest of women and other disadvantaged groups are represented in the Trade Policy Framework and trade agreements.

72. RMI will also reform its tax laws to broaden the tax base in preparation for the expiry of the Compact funding and also to allow RMI to participate in trade agreements. In FY 2010, income tax was a major source of local revenue for the Government, estimated at around $10.8 million, while import duties contributed about $7.7 million and gross revenue tax contributed about $6.2 million. The level of tax compliance in RMI especially for import duties is very low (40-60%). If RMI enters into trade agreements without reforming its tax system, it may lose a huge portion of import revenue. However, if RMI adopts a consumption tax, this may neutralise the revenues loss.

8 Market Access and Trade Negotiations

8.1 The Pacific Island Countries Trade Agreement (PICTA)

73. The main objective of PICTA is to promote regional integration among the fourteen Forum Island Countries (FICs). It serves as a stepping stone for FICs to participate in the increasingly liberalized global economy. Forum Leaders adopted the Pacific Plan, which seeks to promote deeper and broader integration in the Pacific as a strategy for pursuing the main goals of economic growth, sustainable development, good governance and security.

74. PICTA requires developing countries that are parties to the agreement to reduce their import duties (ad-valorem tariffs) to zero by the year 2015, while Least Developed
Countries (LDCs) and Small Island States (SIS) are required to reduce their import duties by 2017. Import duties that are not expressed as a percentage of the value of goods (non-advalorem) will be eliminated by 2020 for developing countries and 2021 for LDCs and SIS. Those products that are sensitive from a revenue or development point of view can be put in the negative list and, tariffs will be reduced to zero by 2020 for developing countries and 2021 for LDCs and SIS. However, non-tariff barriers must be eliminated immediately.

According to studies that were conducted in 2007, PICTA will have minimum negative impact on RMI. The indicative revenue loss for RMI under PICTA is estimated to be close to 0% of total tax revenue. This is mainly because RMI has very little trade with FICs. If RMI adopts consumption tax under the current proposal, the revenue loss may be neutral. The RMI has also been granted a waiver on PICTA and this allows it to accede to the Agreement without being obliged to offer the same trade preferences to U.S.

Cook Islands, Fiji, Samoa, Vanuatu and Niue have been trading under PICTA since 01 January 2007. In April 2010, Tuvalu also announced its readiness to trade under PICTA. Kiribati, Nauru, PNG, Solomon Islands and Tonga have completed notification, but yet to announce readiness to trade under PICTA. The RMI and Palau did not sign PICTA. FSM signed but has not yet ratified the agreement.

The FIC Trade Ministers agreed that PICTA be extended to trade in services. According to studies that were commissioned by PIFS, FICs were recommended to initially to liberalize a minimum of four out of seven sectors that were identified for liberalization. The seven sectors are financial services, telecommunication, transport (air and maritime), tourism & travel, educational service, health services and professional services. Trade Ministers also urged FICs to ensure that the liberalization commitments that they enter into with third countries do not supersede the commitments they give to PICTA parties.

The Forum Countries also agreed to extend PICTA to include Temporary Movement of Natural Persons (TMNP). The objective of the TMNP scheme is to draw from labor surpluses within the region to meet national skill shortages and stimulate skills development. In 2008, Pacific ACP (PACP) Trade Ministers agreed to develop a framework for a TMNP scheme that considers using a two tier approach, whereby recognized professionals could move freely amongst FICs, and semi-skilled or trades professionals would be subject to a mechanism based on minimum quotas. They also agreed that the benefits should extend to FIC nationals and persons with the right of permanent residence in a FIC, irrespective of their place of residency.

The report that was concluded in 2009 defines Tier 1 as professionals who have acquired a minimum of a bachelor’s degree from a recognized university with three years work experience and if required, a license to practice. Tier 2 is defined as semi-skilled/trades professionals with a minimum qualification of a diploma with three years of experience or certificate with five years experience and a license to practice, if required.
Part III of PICTA, provides that a Protocol on Government Procurement must be developed and included as part of PICTA within two years of the latter coming into force. PICTA came into force on 13 April 2003 and as mentioned above, trading under the agreement commenced on July 1, 2007 for some countries. In 2007, a PICTA Parties meeting agreed that a comprehensive study be conducted to provide information on ways FIC Governments may undertake liberalization of their current procurement systems. This was endorsed by the Pacific ACP Trade Ministers in 2007. RMI will review the 2010 Report on Public Procurement and participate in the negotiations to ensure that its interests are reflected.

8.2 The Compact Trade Provisions (US)

The RMI has preferential market access to the US under the Compact of Free Association with the US and most of its goods enter the US market duty free. However, there are exceptions and restrictions on a number of products. For products from RMI to qualify for duty free treatment, they must comply with the US rules of origin. This means that exporters in RMI must ensure that the value of the local content that is included in any products that are exported to the US must be 35%. In order to meet this 35% requirement, RMI is allowed to use about 15% of the value of materials from the US. However, for RMI to be able to fully utilise these preferences, the tolerance rule must also apply to other developing countries including Asian countries. The requirement for local content should be reduced from 35% to 10-15% to enable RMI to fully utilise the preferential market access. In addition to that, a change in tariff classification rule could be considered at the six digit level of the Harmonised System for a number of products.

According to the Compact, the following products do not qualify for duty free:
- textile and apparel articles which are subject to textile agreements
- footwear, handbags, luggage, flat goods, work gloves and leather wearing apparel, the foregoing which were not eligible articles for purposes of the Generalized System of Preferences on April 1, 1984
- watches, clocks and timing apparatus of chapter 91 (except such articles incorporating an optoelectronic display and no other type of display)
- buttons of subheading 9606.21.40 or 9606.29.20
- any agricultural product of chapters 2 through 52, inclusive, that is subject to a tariff-rate quota, if entered in a quantity in excess of the in-quota quantity for such product

It is important to note that the US has not offered 100% duty free and quota free access to the FAS. This position can be compared with the EU which has offered 100% duty and quota free access and improved rules of origin under the EPA.

The US Tariff Act also imposes a graduation criteria, which is not explicitly stated in the Compact. The Compact states that duty free may be limited by section 503 (b) of title v of the Trade Act of 1974 (19 U.S.C. 2463 (b)). This section sets out the articles that may be considered import sensitive and they are similar to those enumerated
in section 242 (c) of the Compact. However, the 2010 US Tariff Schedule imposes further restrictions which are not stipulated in the Compact.

85. In a nutshell, section 2463(c) provides for withdrawal of duty free status when a country becomes competitive in producing a particular product. A country is deemed to be competitive if its exports exceed a certain value threshold stipulated in the US Customs legislation or 50% of the value of the total imports of such article into the US. The special treatment may be reinstated if the product does not exceed the limit imposed. However, these provisions can be waived under the de minimis rule.

86. The fisheries sector is one of the sectors that have the greatest potential when it comes to economic growth and development. In general, RMI has better market access into US fisheries market. However, the US imposes some restrictions on rules of origin, and import duty of about 35% on canned tuna in oil. Furthermore, only tunas and skipjack, prepared or preserved, not in oil, in airtight containers (1604.14.22) weighing with their contents not over 7 kilograms each, in an aggregate quantity entered in any calendar year from the Freely Associated States not exceeding 10 percent of United States consumption of canned tuna during the immediately preceding calendar year will enter the US duty free. Any tuna in excess of this amount do not qualify for duty free. The consumption level will be determined by National Marine Fisheries Service.

87. The US is also a major market for tuna loins that are to be processed into cans. This is mainly because Bumble Bee and Chicken of the Sea no longer process whole fish in their US plants but import tuna loins. The US market for fresh and frozen tuna is more stable but generally lower in value than the Japanese market. The US has a commercially significant (although niche) market for tuna fillets and steaks and the US market for fresh-chilled tuna is of considerable economic importance to RMI.

88. The US imports of seafood increased from about $10 billion in 2000 to about $14.2 billion in 2008. Exports were slightly above $2.5 billion in 2000 but increased to about $4.3 billion in 2008. The top species imported (by volume) include shrimp, tuna, salmon, ground fish, freshwater fish, crab and squid. About 60% of imports of seafood into the US come from Asia, followed by North America, South America, Europe and Oceania. The major exporters of seafood to the US are China, Thailand, Canada, Chile and Ecuador. The US imports most of its canned tuna from Thailand, Philippines, Ecuador and Indonesia. Any canning industry in the RMI is likely to face stiff competition from these countries that already have access to cheap labor, raw materials, economies of scale as well as good transportation links to the US which RMI does not have.

89. It is recommended that RMI producers should move away from mass consumer/mass market and shift to boutique production. Investors should stay focused and be less greedy, and look at quality issues and niche markets. Despite competition from Ecuador, industries based in RMI have the potential to produce tuna in pouches and export them to the US. However, RMI needs to request the US to provide it with duty free status to be competitive.
Another equally important issue is the need for RMI to discuss the most favored nation (MFN) treatment provision in the Compact and assess its impact on RMI if it decides to sign a trade in goods agreement with the EU or with Australia and New Zealand. According to a study that was conducted by Watergall in 2007, the indicative revenue loss as a result of the MFN obligation with the US is expected to be about $4,961 million. However, if RMI moves towards a consumption tax based system and eliminate import duties, it will not lose much revenue when it signs trade agreements. It should be noted that this figure does not take into account any dynamic gains that RMI may get from participating in trade agreements.

It is also important to note that RMI had negotiated favourable tax and trade preferences in its original Compact. However, these benefits were abolished in 1986, when the U.S. Congress passed enabling legislation to put into effect the Compact of Free Association between the U.S. and RMI. The first Compact Agreement had incorporated a number of provisions that would have given RMI special tax and trade concessions, meant to serve as an engine for economic growth and stimulate private sector development. Unfortunately, the U.S. Congress, in the process of authorizing programs and funding levels that were part of the agreed Compact, deleted or modified a number of those provisions. In this process, Section 254 of the original Compact agreement which, would have provided American taxpayers an exemption of all U.S. income taxes if they resided in the RMI for 183 days per year and paid RMI taxes was modified. This provision would have provided a powerful instrument for economic growth as some US citizens would have moved to the RMI to enjoy its beautiful environment while benefiting from a tax “holiday” in the U.S.

Equally important is the deletion of section 936 of the US Internal Revenue Services Act, which provides for tax credit to US companies. This is the main provision that enabled the canneries in American Samoa to survive. By changing the RMI from the status of a US possession to a FAS, RMI also lost some of the trade benefits which are enjoyed by US possessions such as American Samoa, and was never fully compensated for this loss.

It is patently clear that RMI suffered major losses as a result of the deletion or modification of trade and tax provisions. The US has provided only $10 million to the Investment Development Fund (IDF) to compensate for the loss, as well as a few Federal programs. However, the US indicated that upon a showing of additional adverse financial and economic impact, an additional $20 million could be provided. RMI needs to work with FSM under the Micronesian Trade Committee to ensure that this issue is addressed.

8.3 PACER Plus

The South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA) which was signed on 14 July 1980 and entered into force in 1982 provides duty and quota free access to the Australian and New Zealand markets for all the products originating in FICs. It is a non-reciprocal agreement, which means that the FICs are not required to provide duty free access to Australia and New Zealand.
95. The Pacific Agreement on Closer Economic Relations (PACER) is an arrangement between the FICs on one hand and Australia and New Zealand on the other. It is not a free trade agreement, but provided for technical and financial assistance under the Regional Trade Facilitation Programme (RTFP). The RTFP provided assistance on customs, standards and conformance and quarantine. The RMI has signed PACER but has not yet ratified the Agreement.

96. PACER also contains provisions for future trade negotiations between FICs and Australia and New Zealand including economic and technical assistance to help FICs implement trade liberalisation measures and facilitate "adjustment". The overall goal of PACER is to facilitate sustainable development in FICs. The parties seek to gradually and progressively establish a single regional market, which includes Australia and New Zealand. This will assist the FICs to integrate into the global economy. PACER envisaged the negotiation of Forum-wide trade arrangements 8 years after PICTA enters into force (2011). However, it also provides that if FICs enter into free trade negotiations with developed countries (e.g. EU) they are required to enter into consultations or free trade negotiations with Australia and New Zealand.

97. The Forum Leaders agreed to launch negotiations in August 2009 and several meetings have been held to progress PACER Plus negotiations. Currently, RMI does not have much trade with Australia and New Zealand. According to mirror data from Australia, Australian exports to the RMI in 2007-08 totalled AUD10.2 million. These included telecommunications equipment, rotating electric plant and parts and ships and boats. Re-exports from RMI totalled $952,000 and these consisted of insecticides, herbicides and disinfectants, plastic plates, sheets and film. RMI also exported copra cake to Australia. Exports from New Zealand in 2009 (July) were NZ$3.95 million and the main exports were wood and aluminium windows. There were no exports from RMI to New Zealand.

98. According to the study that was conducted by Watergall in 2007, RMI may lose about 1,272 million dollars from the PACER Plus agreement. RMI needs to conduct a study on the costs and benefits of participating in PACER Plus.

8.4 Japan

99. The Japanese market is a good market for fisheries, tourism and agricultural products. However, with regard to fisheries, it is important to note that the Japanese tuna fleet has been declining, though it remains the most important in the Western and Central Pacific Ocean (WCPO) and catches more tuna in the WCPO than any other country. The best market is the sashimi market and the average price for fresh big eye and yellow fin since 2003 have been good.

100. The top ten suppliers of fresh or chilled yellow-fin tuna to Japan in 2005 were Indonesia, Sri-Lanka, Palau, Thailand, Taiwan, Maldives, Philippines, Vietnam and Fiji. The total value of fresh/chilled yellow fin tuna imported by Japan decreased from $158
million in 2005 to $128 million in 2007 mainly due to decline in catch levels. In 2007, the major suppliers were Indonesia, Palau, Thailand, Sri-Lanka, Taiwan, PNG, Guam, Maldives, Philippines and Fiji.

101. The value of fresh or chilled bigeye tuna imported in Japan decreased from $134 million in 2005 to $117 million in 2007. The major suppliers in 2007 were Indonesia, Palau, Guam, Thailand, Australia, Sri-lanka, Maldives, Fiji, Vietnam and FSM.

102. In 2005, RMI was the number one ‘exporter’ of strip-bellied bonito frozen fish to Japan. It supplied fish worth about $14 million. In 2007, RMI was number four and the other competitors were Indonesia, Taiwan, Philippines, Thailand, FSM, Kiribati, Belize, Vietnam and South Korea.

103. Based on statistics from the Pacific Islands Center, RMI has significant trade with Japan. The ‘exports’ of fish from RMI to Japan increased from $3.5 million to a peak of $26.5 million in 2004 before declining to about $8 million in 2007. The major ‘exports’ were frozen strip-bellied bonito (skipjack), frozen yellow-fin and fresh or chilled big-eye tuna and a little contribution from fresh or chilled yellow-fin.

104. The RMI imports from Japan increased from $127,000 in 2003 to $594,000 in 2007. The major imports include manufactured products and foodstuffs. RMI needs to work with Japan to maximise its returns from its fisheries products.

8.5 The Economic Partnership Agreement (EPA)

105. The Cotonou Partnership Agreement which was signed in 2000 and revised in 2005 and 2010 is an international agreement between 27 members of the EU and 79 Members of the African, Caribbean and Pacific (ACP) Group of States. The agreement covers development cooperation, trade and political relations between the EU and ACP States. The relationship between the EU and ACP States dates back to 1963, however, the ACP Group was formalised in 1975 and this relationship was governed by a series of Lome Conventions. The Lome Conventions provided non-reciprocal trade preferences to ACP States and were ruled to be inconsistent with WTO rules because they discriminated against other non-ACP developing countries.

106. In order to maintain the non-reciprocal trade preferences, the EU and ACP countries secured a WTO waiver, which expired on 31 December 2007. The Cotonou Agreement seeks to usher in a new trade relationship based on reciprocity and WTO compatibility, while giving the desired flexibilities to ACP countries. The new trade arrangement is the Economic Partnership Agreement that is currently being negotiated. At the all-ACP level, negotiations on EPAs started in September 2002 and the Agreement was expected to enter into force on 01 January 2008.

107. The first objective of EPAs is to foster smooth and gradual integration of ACP States into the world economy, taking into account their development priorities. The ultimate goal is to promote sustainable development and eradicate poverty.
one is to enable ACP States to play a full part in international trade, especially in multilateral negotiations and to help them manage the challenges of globalization thereby facilitating their transition to the liberalized global economy. The third objective is to enhance the production, supply and trading capacity of ACP States and their capacity to attract investment thereby creating new trading dynamics, strengthening trade and investment policies and the capacity of these countries to deal with trade-related issues. The fourth one is to ensure that the economic and trade cooperation is implemented in full conformity with WTO rules, including special and differential treatment taking into account the different levels of economic development. The Cotonou Agreement also makes it clear that EPAs must promote regional integration.

108. At the beginning of the negotiations, the PACPS wanted the EPA to cover trade in goods, services, investment, fisheries and development. The EU wanted other trade-related issues such as competition policy, intellectual property rights, government procurement to be included in the agreement. The PACPS agreed that these trade-related issues are important; however, since the region has not yet developed rules in these areas, PACPS wanted the EU to focus on providing technical and financial assistance to enable them to build their regulatory and institutional capacity on these issues first before they undertake legally binding commitments. The PACPS also did not want binding rules on these trade-related issues because they may pose enormous administrative costs. Furthermore, some of the rules that are being proposed by the EU go beyond WTO rules and they will constrain policy space and limit development options in PACPS.

109. The PACPS also see very little benefits in signing a trade in services agreement if the EU does not agree to the comprehensive PACP proposal on Temporary Movement of Natural Persons and the related technical and financial assistance required to assist the PACPS to fully utilise opportunities arising from such a scheme. The PACPS also wanted assistance to upgrade their vocational schools.

110. With regards to fisheries, the most important change in the rules of origin is the one on global sourcing or change in tariff classification. Regardless of where the fish is caught or the status of a vessel’s flag, registration or ownership, the fish is deemed originating as long as it is transformed from being fresh or frozen (HS chapter 3) into being a pre-cooked, packaged or canned product (HS 1604 and 1605). The PACPS also want the global sourcing rule to also apply to fresh and frozen fish under heading 0304 and 0305 but the EU has not accepted this yet. The EU now wants the PACPS to sign onto a fisheries chapter which includes some onerous rules on conservation and a guarantee of five percent access to the PACP fisheries resources. RMI needs to look at this issue and ensure that its efforts to maximize its returns from its fisheries resources are not undermined.

111. There is also a growing (albeit niche) market in the EU for tuna fillets and steaks for direct human consumption, partial reprocessing or even simple repackaging under tariff headings other than heading 1604 (i.e. tuna imported as frozen or fresh fillets under tariff heading 0304).
It should be noted that the canneries in the EU survive mainly because of tariff protection. The tariff for fresh/chilled fish fillets (0304) is 15% (GSP 14.5%) and frozen fish fillets is 18% (GSP 14.5%). For prepared and preserved tuna in oil (1604), not in oil, in pouches, tuna loins for use under 1604, the MFN tariff is 24% whilst the GSP rate is 20.5%. These tariffs offer huge preferential margins for ACP countries that are party to the EPA. The current negotiations at the WTO as well as free trade agreements that are being negotiated by the EU with non-ACP countries threaten to erode such preferences. However, if the RMI wants to benefit from these preferences whilst they last, it should consider signing in the EPA trade in goods agreement.

### 8.6 The Micronesian Trade Committee

The MTC was established in Pohnpei in 2008 by the Trade Ministers from FSM, RMI and Palau following the recommendations from the Micronesian President’s Summit in 2007. The MTC provides a platform for the FAS to discuss trade issues of common interest including those arising from the Compact agreement and trade among the three countries - and to develop common positions on other trade negotiations.

Some of the issues that are currently being addressed by the MTC include the compensation for lost trade and tax preferences as a result of the amendment of the original Compact by the U.S Congress, the MFN issue and how to improve the trade relations with the U.S. The MTC is also working on formalising the MTC Secretariat and is, in addition, discussing other issues on how to promote trade among the three countries.

The FAS need to build institutional capacity at the sub-regional level to be able to pool resources required to address common trade issues.

### 8.7 The World Trade Organisation

RMI is not a WTO member; however other FICs such as Fiji, Papua New Guinea, Solomon Islands and Tonga and Vanuatu are WTO members. Samoa (since 1998) is in the process of acceding to the WTO. RMI as well as other FICs are represented at the WTO through the Forum Secretariat’s Geneva Office and RMI has been participating in WTO regional workshops. Some of the issues of interest to RMI include the proposed disciplines on fisheries subsidies, preference erosion through the non-agricultural market access negotiations and non-tariff barriers. At the moment, RMI should continue participating in the WTO related activities through the Forum Secretariat.

### 8.8 Guidelines for Trade Negotiations

During the consultations, it was clear that the trade negotiations should bring development benefits to RMI and assist the nation to address the key supply-side constraints and infrastructural services hindering trade and development. Some of the key
guidelines and recommendations that were raised by the participants as key principles that should be followed during trade negotiations include the following:

- RMI must be given the option to opt out of the trade in goods agreement, until the MFN issues with the US are addressed.
- In the event that RMI decides to participate in the trade in goods agreement, the agreement must be asymmetric and incorporate special and differential treatment, allowing RMI to liberalize not more than 80% of its trade value or tariff lines.
- Rules of origin must be improved and be based on change in tariff heading or on the value added approach with local content requirements of between 10-15%.
- RMI must be given maximum flexibilities and policy space in order to protect its infant industries and use trade defence measures.
- Trade Agreements must include a chapter on development cooperation providing predictable, adequate and legally binding Aid for Trade based on the five categories identified by the WTO Task Force on Aid for Trade.
- Technical and financial assistance must be provided to assist RMI to address the supply-side constraints, build production capacity, and address transportation and marketing issues. Assistance must be also be provided to address the sanitary and phytosanitary issues, the technical barriers to trade, customs issues, tax reform, adjustment costs amongst other things.
- RMI must use the GATS positive list when participating in trade in services negotiations.
- Assistance must be provided to assist RMI to develop its tourism sector and to improve transportation, energy, telecommunication and the financial services.
- Technical and financial assistance must be provided to enable RMI to introduce the necessary regulatory and institutional framework before opening up trade in services.
- Technical and financial assistance must also be provided to assist RMI to upgrade its education system including the vocational training institutions.
- Trade Agreements must provide predictable and legally binding access on labor market that is comparable to or better than what RMI has under the Compact.
- RMI must reform its tax policy in order to create a conducive business environment and neutralize revenue loss that may be incurred as a result of signing onto trade agreements.

9 Aid for Trade

In 2005, the Sixth Ministerial Conference that was held in Hong Kong highlighted the importance of Aid for Trade as essential in assisting developing countries to implement trade agreements and to exploit the market access arising from trade liberalisation. Paragraph 57 of the Hong Kong Ministerial Declaration provides that Aid for Trade should aim to help developing countries, particularly LDCs, to build the supply-side capacity and trade-related infrastructure that they need in order to implement and benefit from WTO Agreements and more broadly to expand their trade.
Furthermore, the Ministers recognised that Aid for Trade cannot be a substitute for the development benefits that will result from a successful conclusion to the Doha Development Agenda (DDA), particularly on market access. However, it can be a valuable complement to the DDA. They requested the Director-General of the WTO to create a Task Force that shall provide recommendations on how to operationalise Aid for Trade. The Task Force was requested to provide recommendations to the General Council by July 2006 on how Aid for Trade might contribute most effectively to the development dimension of the DDA. The Ministers also requested the Director-General to consult with Members as well as with the IMF and World Bank, relevant international organisations and the regional development banks with a view to reporting to the General Council on appropriate mechanisms to secure additional financial resources for Aid for Trade, where appropriate through grants and concessional loans.

The WTO Task Force concluded that Aid for Trade can be divided into the following five broad categories:

- Trade policy and regulations. This includes training of trade officials, technical support for trade policy formulation, negotiations and implementation of trade agreements
- Trade development. This includes investment promotion and business support services
- Trade-related infrastructure, including physical infrastructure
- Building productive capacity
- Trade-related adjustment. This includes assistance to introduce accompanying measures to assist countries to benefit from trade liberalisation and revenue loss suffered as a result of liberalisation
- Other trade-related needs

The PACP Trade Ministers in 2009 also adopted the Pacific Aid for Trade Strategy which identifies a list of regional and national needs. However, only about 35 million Euros was provided by the EU to implement the regional projects. Currently, the PACPS are working on refreshing and renewing the Aid for Trade Strategy and establishing the Pacific Trade and Development Facility that will be used to channel Aid for Trade resources to the region.

10 Implementation

In order to achieve the abovementioned objectives, multi-year project proposals which include measurable indicators will be prepared based on trade policies detailed in the implementation matrix. The Trade Policy Framework will be reviewed and monitored and the necessary changes will be made in order to ensure that these objectives are met. The key policies outlined in the table below will be pursued in order to promote trade and investment in the identified priority sectors.
124. This Trade Policy is supplemented by a full Trade Policy Framework (attached as Annex 1) which is mainly meant for technocrats, and the implementation matrix (attached as Annex 2), which will be used to guide the NTFC to implement the Trade Policy.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Trade Policy</th>
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<tbody>
<tr>
<td>Institutional Capacity Building</td>
<td><em>The Government shall establish the National Trade Facilitation Committee comprising representatives from the government, the private sector and civil society to assist the nation to formulate, negotiate and implement the Trade Policy Framework.</em></td>
</tr>
<tr>
<td>Trade and Investment Division</td>
<td><em>The Government must employ at least 3 qualified people in the trade and investment division and secure technical and financial assistance to build institutional capacity on trade. The Government must allocate a budget to run the NTFC including hiring a Long Term Trade Expert (at least 3 years contract) to assist the NTFC.</em></td>
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<tr>
<td>Economic Growth</td>
<td><em>RMI shall mainstream trade into the national development plan and provide the necessary support to enhance the capacity of the private sector to produce quality goods and services that can be exported competitively to promote sustainable, export-led economic growth, development and employment.</em></td>
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<td></td>
<td><em>RMI shall adopt measures that will stimulate trade and facilitate private sector development with a view to enhance sustainable economic growth and development.</em></td>
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<tr>
<td>Agriculture</td>
<td><em>The Government shall promote and facilitate investment in agriculture and enhance the capacity of the private sector to produce quality products in a consistent manner to supply the local market and export a few niche products such as noni, pandanus and coconut by-products.</em></td>
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<td></td>
<td><em>The Government shall take measures to increase production and value addition of agricultural products to ensure rural livelihood, food security and development.</em></td>
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<tr>
<td>Fisheries</td>
<td><em>The Government shall take measures to promote sustainable fishing, local participation, foreign investment in integrated catching and processing/value addition to maximise its returns from its tuna resources.</em></td>
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<td></td>
<td><em>The Government shall assist the private sector to establish a Competent Authority and secure preferential market access through trade negotiations with the EU and further consultations with the US and other countries.</em></td>
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<tr>
<td>Tourism</td>
<td><em>RMI shall provide adequate resources to tourism and improve all the infrastructure services that are required to enhance trade and investment in the tourism industry.</em></td>
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<td>Section</td>
<td>Description</td>
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<tr>
<td>Handicraft</td>
<td><strong>The Government shall promote planting and conservation of resources that are used for producing handicraft and provide all the necessary support to market handicraft products.</strong></td>
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<tr>
<td>Merchandise Trade</td>
<td><strong>RMI must provide the necessary support to address production and supply-side constraints to assist the private sector to produce quality goods in a consistent manner both for the local and export market.</strong></td>
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<tr>
<td></td>
<td><strong>The Government shall assist the producers/manufactures to secure the best markets and provide the necessary assistance on customs, sanitary and phytosanitary measures, technical barriers to trade, market research and intelligence to enable RMI to fully utilise its market access.</strong></td>
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<tr>
<td>Investment</td>
<td><strong>RMI must reform its investment laws to create a good business and investment climate.</strong></td>
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<tr>
<td>Trade in Services</td>
<td><strong>RMI must improve the basic services infrastructure required to produce competitive goods and services and liberalise those sectors where it does not have local capacity.</strong></td>
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<tr>
<td></td>
<td><strong>RMI should consider liberalising trade in services and making commitments on tourism, transportation including domestic air transportation, services provided by port authorities, telecommunication especially the mobile and internet sector, business services, and environmental services.</strong></td>
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<tr>
<td>Education and Human Resources Development</td>
<td><strong>RMI shall secure funds to strengthen and upgrade 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 US labor market.</strong></td>
</tr>
<tr>
<td>Trade-related Issues</td>
<td><strong>RMI shall build capacity and undertake reforms on trade-related laws including taxation, competition policy, government procurement, intellectual property, traditional knowledge and biodiversity, trade and environment, trade and gender to create an environment which is conducive for sustainable trade and investment.</strong></td>
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<tr>
<td>PICTA</td>
<td><strong>RMI shall accede to trade in goods, submit a trade in services market access offer and participate in labor mobility and government procurement under PICTA.</strong></td>
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<tr>
<td>The US</td>
<td><strong>RMI shall take measures to fully utilise the market access into the US market and enter into consultation with the US on compensation for lost tax and trade preferences, the most favoured nation and how to improve market access into the US market.</strong></td>
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<tr>
<td>PACER Plus</td>
<td><strong>RMI shall conduct a cost-benefit analysis on PACER Plus and identify it's offensive and defensive interests, opportunities, adjustment costs, technical and financial assistance as well as other measures that are</strong></td>
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</table>
required to address production and supply capacity to enable the private sector to produce quality goods and services which can be traded in a consistent manner. The study must be in line with RMI’s development plan and promote the objectives of RMI’s Trade Policy Framework.

<table>
<thead>
<tr>
<th>Region</th>
<th>Description</th>
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<tbody>
<tr>
<td>Asia</td>
<td>RMI shall consult with Japan, PRC and ROC to improve trade, investment, development cooperation including assisting RMI to maximise its returns from fisheries.</td>
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<tr>
<td>EPA</td>
<td>RMI shall sign the comprehensive EPA to allow the fisheries industry to benefit from the liberal rules of origin that have been offered by the EU.</td>
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<tr>
<td>MTC</td>
<td>RMI shall work with FSM and Palau to establish the MTC Secretariat to address trade issues that are of common interest including the Compact MFN as well as other trade issues.</td>
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<tr>
<td>Aid for Trade</td>
<td>RMI shall work with its trade and development partners to secure technical and financial assistance (Aid for Trade) that will be required to implement the Trade Policy Framework.</td>
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<tr>
<td>Implementation</td>
<td>The Trade Policy Framework shall be implemented over 15 years with a 5 year review and PIFS should play a vital role in mobilising the resources required for implementing the Trade Policy Framework.</td>
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