



FEDERATED STATES OF MICRONESIA
INVESTMENT CLIMATE STATEMENT
2015

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Executive Summary

The Federated States of Micronesia (FSM) is a lower middle income island nation of 102,000 people on 607 islands with a total land area of 271 square miles and an exclusive economic zone (EEZ) of over one million square miles (2.6 million km²) in a remote area of the western Pacific Ocean.

The FSM is part of the former United Nations Trust Territory of the United States that gained independence in 1986. Since then it has operated under a Compact of Free Association (Compact) with the United States, receiving more than \$100 million per year in development funding administered mainly by the Department of the Interior (DOI). The World Bank estimates Gross Domestic Income (GDI 2014) to be \$3,430 per person, showing no growth over the previous 10 years.

The FSM GDP for 2013 was USD314.6 million, a four percent decline from 2012. The FSM recorded a trade deficit of USD153 million in the same year, or USD41.3 million higher than the USD111.7 in Compact assistance.

The FSM currently has no major exports or domestic industry. Its largest sources of income are the sale of fishing rights (approximately USD50 million in 2014) and taxes on offshore captive insurance companies for Japanese industry (USD20 million in 2014). It is largely a subsistence economy except in larger towns where the economy is centered on government employment and a small commercial sector. The cash economy is primarily fueled by government salaries paid by Compact funds (66% of employed adults work for the government), and to a much lesser degree by family remittances. Cronyism is common in state and federal employment practices. The cost of doing business is high due to the region's remoteness and dependence on imported goods and services.

Transportation and shipping are difficult, limited, and expensive, not just because of the large distances involved. Pohnpei and Chuuk are serviced four times a week in each direction by the island hopper service of United Airlines linking Hawaii and Guam. Kosrae has only two flights per week in each direction, and Yap has two flights a week to/from Guam. Matson and Showa provide a weekly transport ship based in Guam.

Most political power of the nation is delegated to the individual states by the constitution, including regulation of foreign investment, restrictions on leases, distribution of federal tax revenue, and access to compact funds. There are no political parties. National legislators (senators) are directly elected, and the president and vice-president are selected by the senators from among the four at-large senators. At the state level, all offices are directly elected by the people. Most observers agree that state governors are generally more powerful than the president.

1. Openness To, and Restrictions Upon, Foreign Investment

Attitude toward Foreign Direct Investment

While the government of the Federated States of Micronesia (FSM) expresses public interest in finding ways to increase foreign investment, there are many structural impediments to foreign investment and economic progress in general that would require constitutional change, which is unlikely in the foreseeable future. Many political leaders at both the state and national level are owners of the largest businesses on the islands, and strongly oppose the needed structural changes that would increase competition to their own interests. The FSM scores in the lowest quintile in almost all measures of economic activity and the climate for doing business.

The most important impediments derive from land and contract issues. Foreign ownership of land is prohibited; most land is owned and passed on within the clan structure, leading to conflicting title claims, the need to negotiate leases with multiple parties, and the possibility of dramatic changes when the original senior lessor dies. There is no system for land title insurance in any of the four states. The combination of these factors placed the FSM at 189 out of 189 in registering property in the World Bank Doing Business report.

Courts nominally support contractual agreements, but enforcement of judicial decisions has been historically weak. Foreign firms doing business in the FSM have had difficulty in collecting debts owed by FSM governments, companies, and individuals, even after obtaining favorable judgments. For these reasons, the World Bank ranks the FSM very low in protecting minority investors (186) and enforcing contracts (162). U.S. companies and individuals considering doing business with parties in the FSM should exercise due diligence and negotiate minimal credit and payment arrangements that fully protect their interests.

Other Investment Policy Reviews

There has been no investment policy review conducted by United Nations Conference on Trade and Development (UNCTAD), World Trade Organization (WTO), or Organization of Economic Cooperation and Development (OECD).

Laws/Regulations of Foreign Direct Investment

The individual states directly regulate all foreign investment, except in the areas of deep ocean fishing, banking, insurance, air travel, and international shipping, which are regulated at the federal level. FSM national and state governments use a traffic light system to regulate businesses, with red for prohibited, amber for restricted, and green for unrestricted. Industry classifications in this system vary from state to state. Thus, a venture planning to operate in more than one state must obtain separate permits in each state, and often follow different regulations as well.

FSM National

Red: Arms manufacture, minting of currency, nuclear power, radioactive goods.

Amber: Increased scrutiny before approval for non-traditional banking services and insurance.

Green: Banking, fishing, air transport, international shipping.

Kosrae State

Red: manufacture of toxic, biohazard materials, gambling, casinos, fishing using sodium/cyanide or compressed air. (Note: There is also currently a ban on all business transactions on Sundays in the capital town.)

Amber: Real estate brokerage, non-ecology-based tourism, trade in reef fish, coral harvesting

Green: Eco-tourism, export of local goods, professional services.

Pohnpei State

Red: None presently defined, determined by board from amber candidates.

Amber: Everything not classified as green.

Green: Businesses with greater than 60% share owned by FSM citizens, initial capitalization of USD250,000 or more, professional services with capitalization of USD50,000 or more, and Special Investment Sector businesses with 51% FSM ownership in retail, trade, exploration, development, and extraction of land or marine based mineral resources or timber.

Chuuk State

Red: Determined by Director, none codified in law.

Amber: Casinos, lotteries, industries that pollute the environment, destroy local culture and tradition, or deplete natural resources.

Green: Eco-tourism, professional services, intra-state airline services, exports of local goods.

Yap State

Red: Manufacture of toxic materials, weapons, ammunition, commercial export of reef fish, activities injurious to the health and welfare of the citizens of Yap.

Amber: None at present

Green: All others

Industrial Promotion

There is no government agency tasked with developing an industrial strategy; however the 2023 Planning Committee, organized by the president, made recommendations for growth in all sectors without substantive measures to realize those goals. The largest company owned by the government, the FSM Petroleum Corporation (FSMPC), organized to fill the gasoline and diesel supply gap when Exxon/Mobil left the local market in 2007, is planning to expand into renewable energy technologies like solar power. It is also now responsible for the copra trade.

Politicians call for expansion of the tourism sector, but have created no tax or licensing incentives to encourage investment. Considering the remoteness of the FSM, land ownership prohibitions, business ownership restrictions, and the current lack of hotel facilities and tourism services, tourism is not likely to grow, and has actually fallen in the areas of scuba diving, boating, and fishing. In Pohnpei, land issues block development of a significant archaeological site, and caused the closure in 2013 of the most successful hotel on the island.

Limits on Foreign Control

All of the states have limits on foreign ownership of small- and medium-size businesses. Large projects are assessed on a case-by-case basis. The states require separate applications for foreign

investment permits. Foreign investment is strictly limited by local ownership (51%-60%) or a residency requirement of more than five years. Local small- and medium-size businesses are protected from foreign competition, and larger projects in a business sector already owned by public figures will face strong political opposition. The World Bank ranks the FSM low (151) for starting a business. Large and unrealistic development proposals have been received enthusiastically by politicians, but have not moved forward primarily due to land issues.

Privatization Program

There is no privatization program currently in the FSM.

Screening of FDI

FDI is screened at both the state and federal level. See the above explanation on FDI regulation. Procedures exist for appeals, but have not been used.

Competition Law

There is no law or agency governing competition in the FSM.

Investment Trends

At present, there is almost no new foreign private investment in the FSM except for refurbishing of existing operations. Recent foreign private investment in the FSM has been limited to very small-scale family businesses funded by remittances from overseas family members, or by expatriates marrying locals and registering the business in the names of FSM family members.

The FSM maintains a website for the promotion of foreign investment that provides some basic information on the application process: <http://www.fsmgov.org/info/fi.html>. An investment guide is planned by the Department of Resources and Development for print and on its website at <http://www.fsmrd.fm>. At last check the website was not yet operational. No foreign investment incentives were reported. Individual states also maintain varying information online about doing business in their state.

Table 1

Measure	Year	Index or Rank	Website Address
TI Corruption Perceptions index	2014	Not ranked	transparency.org/cpi2014/results
World Bank’s Doing Business Report “Ease of Doing Business”	2015	145 of 189	doingbusiness.org/rankings
Global Innovation Index	2014	Not ranked	globalinnovationindex.org/content.aspx?page=data-analysis
World Bank GNI per capita	2013	\$3430	data.worldbank.org/indicator/NY.GNP.PCAP.CD

Millennium Challenge Corporation Country Scorecard

The Millennium Challenge Corporation, a U.S. Government entity charged with delivering development grants to countries that have demonstrated a commitment to reform, produced scorecards for countries with a per capita gross national income (GNI) or USD4,125 or less. A list of countries/economies with MCC scorecards and links to those scorecards is available here: <http://www.mcc.gov/pages/selection/scorecards>. Details on each of the MCC’s indicators and a guide to reading the scorecards are available here: <http://www.mcc.gov/pages/docs/doc/report-guide-to-the-indicators-and-the-selection-process-fy-2015>.

The FSM has never qualified for MCC assistance due to lack of reporting to international agencies on several of the indicators. The U.S. Embassy has encouraged the government to complete its reporting obligations.

2. Conversion and Transfer Policies**Foreign Exchange**

The currency of the Federated States of Micronesia is the U.S. dollar. The only two banks operating in the country at present are the Bank of Guam and the Bank of the FSM, both of which are FDIC insured.

Remittance Policies

There are no specific restrictions on repatriating profits from a business, except in Chuuk, where an amount greater than USD50,000 requires approval by the state.

Statistics on family level remittances are difficult to obtain, with various studies reporting from USD3 to USD14 million per year entering the FSM. However, remittances travel freely into and out of the country. Micronesians in US territories send money to their families in the FSM, while Filipino professionals and laborers send money to their families in the Philippines.

3. Expropriation and Compensation

There has been no history of expropriation. The FSM Foreign Investment Act of 1997 guarantees that there will be no compulsory acquisition or expropriation of property of any foreign investment for which a Foreign Investment Permit has been issued, except for violation of laws and regulations and in certain extraordinary circumstances. Those extraordinary circumstances include cases in which such action would be consistent with existing FSM eminent domain law, cases in which such action is necessary to serve overriding national interests, or cases in which either the FSM Congress or the FSM Secretary of Resources and Development has initiated expropriation.

4. Dispute Settlement

Legal System, Specialized Courts, Judicial Independence, Judgments of Foreign Courts

The FSM follows the U.S. common law system. The judiciary is independent, but weak, and lacks the ability to properly enforce judgments.

Bankruptcy

A bankruptcy law has been in existence since 2005, and has been used by a local service provider to evade collection of social security payments for his employees by the national government.

Investment Disputes

There are no provisions under FSM Federal law for alternative dispute resolution. This is also true of the states, with the exception of Kosrae where an alternative dispute resolution system has taken the place of a small claims court.

International Arbitration

Judgments from foreign jurisdictions are not enforceable in FSM courts.

ICSID Convention and New York Convention

Since 1993, FSM has been a member state to the International Centre for Settlement of Investment Disputes (ICSID Convention). To this date they have not had cases brought against them.

Duration of Dispute Resolution

Disputes take years to resolve and still may not produce concrete results. Some cases have been on the docket, with no or little movement, for thirty years or more.

5. Performance Requirements and Investment Incentives

WTO/TRIMS

The FSM is not a member nor does it have observer status in the World Trade Organization (WTO). It also does not adhere to TRIMS.

Investment Incentives

There are currently no government programs or incentives to attract foreign investment.

Research and Development

Information not available

Performance Requirements

There are currently no defined performance requirements for investments.

Data Storage

Information not available

6. Right to Private Ownership and Establishment

The rights of private property and establishment are protected for FSM citizens and to a much lesser degree for foreign nationals who have more than five year's residence in the country. The legal system has tended to favor local partners in joint ventures. Under the Compact of Free Association, U.S. citizens do not require visas, residence permits, or work permits to live or work in the FSM, but are severely limited in their ability to register businesses.

7. Protection of Property Rights

Real Property

Foreign nationals cannot own real property.

Intellectual Property Rights

Intellectual property is nominally protected, the FSM is a member state of the World Intellectual Property Organization (WIPO), and the country is not listed on the USTR Special 301 Report for 2015. The Embassy has not received complaints from U.S. firms, but there are currently none active in the country except United Airlines and Matson Shipping. The only three U.S. chains present (Ace Hardware, True Value Hardware, and NAPA auto parts) are 100% locally owned franchises. However, a small CD/DVD pirating market exists that the government has taken no action against. U.S. corporations have taken out legal ads in the local paper to protect their trademarks, but the enforcement of IP has not been tested yet.

For additional information about FSM treaty obligations and points of contact at local IP offices, please see WIPO's country profiles at <http://www.wipo.int/directory/en/>.

Resources for Rights Holders

Contact at Mission:
William Cook
Economic Officer
+691-320-2187
cookwr@state.gov

A list of local attorneys is available at: <http://kolonia.usembassy.gov/lawyers.html>

8. Transparency of the Regulatory System

The FSM is not a signatory to any convention on transparency in international investment. Transparency of government actions is typically based more on personalities than on the law. Regulatory bodies sometimes involve themselves in issues beyond their jurisdiction. Conversely, other regulations are not uniformly enforced. It is often difficult to obtain public records, although some states and government organizations do require open meetings. In addition, government audits and statistical reports are not prepared promptly and current data is often not available.

Two websites provide relatively recent (if not comprehensive) data and reports: <http://www.sboc.fm/> and <http://www.fsmopa.fm>. Similarly, it has been reported that obtaining licenses and permits in a timely manner may depend more on the relationship of the investor (or local legal counsel) with the official in charge than any clear procedure or timeline.

9. Efficient Capital Markets and Portfolio Investment

There is no stock or commodities exchange.

Money and Banking System, Hostile Takeovers

Little credit is available locally. Banks make relatively small and short-term local loans because of the prohibition of using land as collateral for mortgages or any other type of loan, difficulties inherent in collecting debts, and identifying collateral that could be attached and sold in the event of default. The Bank of FSM is prohibited by its charter from investing in any securities that are not insured by the U.S. government, so more than 90% of its investment is in U.S. Treasury bonds. The Bank of Guam operates as a deposit collector in the FSM, with most of its loans made in Guam.

Since most businesses are family owned, there are no shares that could be acquired for mergers, acquisitions, or hostile takeovers. A secured transaction law was signed by the FSM President in November 2005 and a filing office has been in operation since October 2006 primarily to serve the captive insurance market.

10. Competition from State-Owned Enterprises

The FSM established state monopolies in the areas of fuel distribution, telecommunications, and copra production. These companies are the FSM Petroleum Corporation (FSMPC), the FSM Telecommunications Corporation, and the FSM Coconut Development Authority, which was folded into the FSMPC in 2014. Recent legislation somewhat liberalized the telecom market in order to qualify for World Bank funding for a submarine fiber optic cable to Yap and Palau.

OECD Guidelines on Corporate Governance of SOEs

FSM does not currently adhere to the convention on the Organization of Economic Cooperation and Development guidelines on corporate governance of State Owned Enterprises (SOE's)

Sovereign Wealth Funds

Information not available

11. Corporate Social Responsibility

There is little awareness of corporate social responsibility (CSR) in the FSM, however most local businesses are small and generally responsible in the community in which they operate. There are only a few multi-national companies operating in the FSM and all are foreign-owned. U.S.-based companies in the FSM generally follow CSR principles.

OECD Guidelines for Multinational Enterprises

FSM does not currently adhere to the convention on the Organization of Economic Cooperation and Development guidelines for Multinational Enterprises.

12. Political Violence

The Federated States of Micronesia enjoys a stable, democratic form of government. Under the Amended Compact of Free Association, the U.S. Government guarantees the FSM's external security. There is no history of political violence in the FSM.

13. Corruption

The FSM has laws prohibiting corruption and there are penalties for corrupt acts. The National Office of the Public Auditor, with support from the FSM Department of Justice, has been the entity most active in anti-corruption activities. A number of senior ex-FSM Government officials have been convicted of corruption under the FSM Financial Management Act, usually involving procurement fraud. Two current officials are now under indictment. Corruption is not a predicate offense under the money laundering statute. Bribery is punishable by imprisonment for not more than ten years and disqualification from holding any position in government.

Given that many FSM National, State, and Municipal Government officials also own businesses, there exists significant potential for conflicts of interest. One local NGO, Micronesian Seminar,

has prepared an anti-corruption video that has received wide play. The U.S. Embassy is not aware of any other significant anti-corruption efforts. The degree to which government officials accept direct bribes is unknown, however misuse and misappropriation of government funds is widespread.

UN Anticorruption Convention, OECD Convention on Combatting Bribery

The FSM has not signed or ratified the UN Convention on Corruption.

Resources to Report Corruption

Information not available.

14. Bilateral Investment Agreements

No bilateral investment agreement exists between the United States and the FSM. The 2003 Amended Compact of Free Association is the only applicable guidance (www.uscompact.org). Under this treaty, articles from the United States imported into the FSM are guaranteed to receive treatment that is no less favorable than any other foreign country. Articles exported from the FSM to the U.S. are duty exempt, with a number of exceptions as listed in Article IV, Section 242.

Bilateral Taxation Treaties

FSM does not have a bilateral taxation treaty with the United States.

15. OPIC and Other Investment Insurance Programs

In 1988, FSM signed a bilateral agreement with Overseas Private Investment Cooperation (OPIC), but since FSM law does not allow foreign corporations to operate independently in its territory, there are currently no OPIC financing projects listed for Micronesia on their website: www.opic.gov.

16. Labor

Wages are very low, with minimum wage laws for government employees in all states and the federal government. Only Pohnpei has a minimum wage for the private sector at USD1.75 per hour. Employment in the public sector is preferred because the wages are significantly higher. The minimum hourly wage for employment with the national government is USD2.34. The minimum hourly wage for government workers in the individual states is: Pohnpei USD2.00, Chuuk USD1.25, Kosrae USD1.42, and Yap USD1.60.

There is no law regulating hours of work (although a 40-hour work week is standard practice), nor are there enforceable standards of occupational safety and health. One federal regulation requires that employers provide a safe workplace. Neither the Department of Health nor the Environmental Protection Agency has enforcement capability, and working conditions vary in

practice. There is no law for either the public or private sector that permits workers to remove themselves from dangerous work situations without jeopardy to their continued employment.

There are few FSM citizens with skills to perform tasks of any technical nature. Foreign workers are typically hired to fulfill these roles. The vast majority of doctors, nurses, accountants, lawyers, engineers, construction foremen, or even construction machine operators are foreign workers.

17. Foreign Trade Zones/Free Ports/Trade Facilitation

There are no Foreign Trade Zones, Free Trade Zones, or Free Ports in the FSM.

18. Foreign Direct Investment and Foreign Portfolio Investment Statistics

Table 2: Key Macroeconomic Data, U.S. FDI in Host Country/Economy

Economic Data	Host Country Statistical source*		USG or international statistical source		USG or International Source of Data: BEA; IMF; Eurostat; UNCTAD, Other
	Year	Amount	Year	Amount	
Host Country Gross Domestic Product (GDP) (\$M USD)	2013	USD314	2013	USD316	www.worldbank.org/en/country
Foreign Direct Investment	Host Country Statistical source*		USG or international statistical source		USG or international Source of data: BEA; IMF; Eurostat; UNCTAD, Other
U.S. FDI in partner country (\$M USD, stock positions)	n/a	n/a	2013	32	http://bea.gov/international/factsheet/factsheet.cfm
Host country's FDI in the United States (\$M USD, stock positions)	n/a	n/a	2013	n/a	http://bea.gov/international/factsheet/factsheet.cfm
Total inbound stock of FDI as % host GDP	n/a	n/a	n/a	n/a	

Note: Figures for GDP vary greatly, due to poor collection of statistics. PITI at the Graduate School USA provides economic analysis for the DOI, which oversees the Compact development funding. PITI includes Compact funding from the US of \$111 million per year in its calculations of Gross National Disposable Income (GNDI) of USD453 million.

Table 3: Sources and Destination of FDI

There is no IMF data on foreign direct investment entering or leaving the FSM.

Table 4: Sources of Portfolio Investment

There is no IMF data on portfolio investment entering or leaving the FSM.

19. Contact for More Information

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