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THE ECONOMIC BASE AND ROLE

OF THE

PRIVATE INVESTOR IN MICRONESIA

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In a scientific discussion, I believe that the writer or speaker should make clear his fundamental concepts and the standards by which he measures his facts, calculations and conclusions.

Economics and politics are social sciences.

My fundamental measurement standard for social science is the greatest good for the greatest number. I believe in one man one vote democracy as the form of government which best supports this. Even with some faults and abuses, it is better in every way and in every country than any other form of government. Special rights, influences, or powers based on social class, origin, wealth, education, race, or membership in political parties, organizations or churches, are economically and socially counter-productive and restrict or diminish the welfare of the total community and all its people. I know this sounds elementary, but it is not inappropriate. There are writers, speakers, and political leaders in the world who advocate special rights of leadership and decision-making based on social class, origin, wealth, race, education, membership in a political party, or status as an "intellectual", as being proper and beneficial to the community. This seldom involves such a crude principle as the ancient minimum property qualification for voting. But, the contention that leadership is a proper privilege of one or more groups, such as that only college graduates are qualified to be candidates for office or that decisions should be left to men only or to certain families -- all such concepts are restrictive of the full, free franchise. I need hardly add that most of those who advocate special privileges belong to one of these special groups or aspire to belong.

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In the field of Micronesian social and economic development, I consider the greatest good for the greatest number to be those economic and social policies and institutions which provide good present and future living conditions and educational opportunities for every Micronesian, present and future. This requires economic institutions, private or public, which provide reasonably full employment of the labor force, freedom to enter or leave an occupation, and flexibility in the adaptation of traditional subsistence economy labor to conditions of wage and salary labor. It requires ample school and work opportunities for acquisition of skills and knowledge for Micronesians to be qualified for more exacting and more rewarding work. These goals are primary. Political structures, executive, legislative and judicial authority, customs, land ownership and utilization all should be adapted to support these goals in order to achieve the greatest good for the greatest number.

Educational opportunities in Micronesia at present are widespread and good, by comparison with other "less developed countries" of the world. Education is free through high school. There are schools for every child. There is a community college, a vocational school and a broad program for scholarships to colleges outside Micronesia. Any child who enjoys school, wants to get the most out of it and performs well in his studies has an opportunity to go on through college. Furthermore, Micronesian parents are eager to see their children educated. The result is already visible in college graduates and trained professionals from Micronesia. However, education, while vital and essential is only part of social development. Social progress is largely dependent on economic progress and both are dependent on economic activity which provides employment for those who wish to and can work.

The employment picture is not as promising as the educational, although it has its favorable aspects. There is an imbalance in sources of money which is inevitable in the historical situation. About ninety percent of the total money income received by Micronesians comes directly or indirectly from government spending. The Trust Territory government is now spending \$60,000,000 to \$65,000,000 a year and other US government agencies, the Coast Guard, Post Office, Weather Bureau, US Army and Navy are probably spending another \$5,000,000 a year in Micronesia. A minority of this, (in the neighborhood of \$16,000,000) is capital spending for school buildings, hospitals, power plants and roads, etc.; all of which are necessary to provide the "infra-structure" for future economic growth. The majority of the government spending goes for wages, salaries and current expenses. The largest part of this is paid in salaries to Micronesians. Of the non-government income, copra is earning about \$2,000,000 a year and fishing about \$500,000. Handicraft \$100,000; vegetables and meat products \$100,000. Tourism is growing rapidly but direct tourist expenditures in Micronesia for hotels, services, transportation probably do not exceed \$4,000,000 a year. There is little other basic economic activity in the Territory. Thus, it can be seen that the necessarily somewhat rigid structure of government employment provides the vast majority of the income earned by Micronesians.

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The government employment is an economically useful activity but, except for the minor part used for capital investment in power plants, water systems, harbor improvements, etc., it does not contribute to creation of new jobs in the future. Nor is there a prospect of reduction in administrative costs to free money for investment. Very few, if any, of the administrative functions now financed and administered by the government are temporary or likely to be terminated by technological advances.

It is true that some government functions in the Trust Territory are private elsewhere. These include electric power and water supply, telephone, telegraph and radio communication, medical care and even education. The geography of the Trust Territory, with a small population spread thinly over hundreds of the islands makes it unlikely that the government will be able to transfer any of these functions to private enterprise. Thus, the roughly \$65,000,000 being spent by the US government is likely to continue to be used as at present and probably none can be considered to be available for additional job-creating capital investment above the present level.

There will probably be some increases in US government spending in the next two years while the negotiation of political status is continuing and while certain continuing construction programs initiated or authorized by the present Trust Territory administration reach periods of higher cash demands. The High Commissioner has announced that he will ask for \$70,000,000 next year. However, there are also some negative forces at work. Unsympathetic observers (and there are some) divide the present expenditure figure by the population and come up with roughly \$650 for each man, woman and child in Micronesia, a higher per capita expenditure than is spent per capita on the residents of any state in the U.S. Admittedly, this calculation is inappropriate and an inaccurate reflection of the need for and the purpose of expenditures either in Micronesia or in a state of the U.S. It is also imprecise as the U.S. federal programs in a state with many state-financed government activities can not be compared with the Trust Territory with virtually total federal funding. Yet, the comparison is made and it impresses some people, and it is an influence against increased U.S. spending in Micronesia.

A second factor which will inhibit future increases is the obvious progress in negotiations on future political status, and the certainty of a new political status in the next few years. This is not a matter of reprisal for wanting and securing autonomy. It is simply a fact that no nation gives substantially more money to a new country, which was once a territory, than it spent when that country was still a territory. Thus, as a matter of practical international affairs, I think we can assume that the level of U.S. spending in Micronesia when the treaty is signed between the United States and Micronesia will be the rough ceiling level on U.S. contributions thereafter. Reinforcing

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this are three major economic and social influences in the United States today:

- (1) Continued massive deficits in the U.S. federal budget:
- (2) Increasingly strong and successful demands for heavily increased expenditures in the United States itself on social welfare and on protection of the environment.
- (3) An increasingly isolationist attitude of the United States people, reflected, among other things, in their reaction to the Vietnam war.

A most significant, balanced and objective account of the current economic situation of the United States has just been released. It is "The United States in the Changing World Economy." by Peter G. Peterson, Assistant to the President for International Economic Affairs, and Executive Director, Council on International Economic Policy. It explains, with great clarity, the forces leading to the drastic re-direction of U.S. international economic policy last August with the devaluation of the U.S. dollar and the demand for concessions from foreign trading partners. The two significant elements that affect our problems today are the study of balance of payments showing that even on the current account, not taking into account investments overseas, there was a \$1,000,000,000 balance of payments deficit in 1971 and that the U.S. government support to less developed countries is dropping. The formal U.S. Foreign Aid Program this year is less than \$3,000,000,000 and no observer expects it to increase.

Mr. Peterson asks "Can we assume, as we have done in the past, that our resources are relatively limitless and that the room for maneuver in meeting the negotiating desires of our partners is wide?"

Therefore, it seems logical to conclude that the level of funding to be reached by the Trust Territory government in the next year or two of roughly \$70,000,000 will remain the maximum figure of direct U.S. financial help with, possible but not certain, small percentage increases annually or periodically to take care of inflation, emergencies, etc. The expenditures by agencies other than the Trust Territory government will vary with U.S. programs, but are not likely to increase.

Another important factor is that Micronesia will not escape the present world-wide inflation which makes everything from outside cost more each year. Its government will have to face demands from government employees for periodic wage increases, probably justified, but expensive. One more socio-economic influence is the fact that in a growth economy, even an under-developed one, prosperity brings more demands for government services. Take the simple problems of roads and electricity. With a steady government job, the head of the family buys a car and he wants a good road to his house. His children now

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go to school through high school, at the minimum, and he wants electricity so they can study their lessons, which are now more demanding.

Of the population of roughly 100,000 in the Trust Territory, more than half are under 21. The Nathan report in 1966 estimated the potential labor force then at 33,000. This included students and outer island residents. The Nathan report estimated a total labor force of 46,500 in 1972. In the next ten (10) years, on the basis of the Nathan report, I estimate it will become 76,500. The question now posed is how to expand the total income -- the "Gross Micronesian Product" -- to provide good present and future living conditions and educational opportunities for every Micronesian, when the labor force has added 30,000 potential workers and the educational facilities have been effectively producing educated workers for a generation.

In 1965, according to the Nathan report, there were 26,000 students enrolled in school. Ten years from now, it can be assumed that all of these will have been graduated and that perhaps double the number will then be in school.

Obviously, not all the potential labor force, described by Nathan as males and females, 14 to 65, is at work, or available with skills at a point where employment is feasible.

However, the rising standard of living, the increased availability of consumption objects of all kinds, coupled with the increased levels of education, make the need for and the desire to work much stronger, therefore making the active job-seeking force constantly closer to the potential.

From where will the new enterprise come to provide employment and expanded total income to provide good present and future living conditions and educational opportunities for Micronesians? It seems inescapable that it must come from capital investment. There is just not a reasonable or even faint possibility that the Micronesian government can find large additional sums of money for this purpose, or can terminate any large section of present government services to free some of the money it is now receiving. Barring any remarkable and fortuitous circumstances, such as an oil strike in one or more of the islands, it will have to come from development of the natural resources now known.

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These seem to be, at present:

- Fisheries - tuna, langousta and possibly other species.
- Agriculture - coconuts, vegetables and meat for the tourist industry, local consumption, export to Guam, and Kwajalein and possible other markets.
- Tourism - hotels, resorts, restaurants, fishing and sight-seeing boats, guides, rental cars, etc.
- Handicraft - carvings, woven products, black coral jewelry, etc.
- Minerals - possibly bauxite in Babelthaup.

All of these, except handicraft, require substantial capital investment. Fisheries will produce no jobs if Micronesia merely collects taxes from foreign boats fishing in Micronesian waters. There must be shore installations for freezing, canning or both. These cost \$1,000,000 or more each. A modern fishing boat costs \$250,000 to \$2,500,000. Agriculture requires powered cultivators, fertilizer spreaders, sheds, machinery for picking and processing and packaging to protect the product to market. While the large scale farming of the U.S. is not transplantable to the islands, relatively expensive machinery is necessary for efficiency.

One hundred room hotels to modern tourist standards cost \$1,500,000 or more. Even a very simple, island style, 25-room hotel costs \$75,000 to \$125,000. Sightseeing boats and buses, rental car fleets, etc., all require substantial capital investment.

A mining venture, if one is ever justified, requires millions of dollars in machinery and more in docks and loading equipment.

All of these capital investments, made either by a government or by private investment, will, of course, create jobs. But, we have examined the government's capacity to generate extra money for this type of capital investment and found it wanting.

Before we talk of how this capital can be found and invested in Micronesia on a socially desirable basis, let us examine the types of employment created by these investments in these resources.

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The tuna fish canneries in Samoa employ 300 to 400 women. Miscellaneous services to the boats, icing, haul-out, repair, provisioning, probably make use of 100 men. The boats themselves are manned by Asian personnel. The asiatic type of fishing boat, with cramped quarters, remaining at sea 30 to 60 days, has not been successful in holding Polynesians or Micronesians as crews.

However, there is a well-developed fishery in Truk and Ponape using smaller boats that go out for 24 hours or less. With a well organized buying, boat outfitting, freezing, canning and marketing program, this could be greatly expanded and improved. The present tuna freezing facility in Koror employs 50 to 100 persons, directly and indirectly. There are islands, principally in the Marshalls, where langousta abound. There have to be collecting vessels, making regular trips, and paying fishermen immediately on the spot. Perhaps a 1,000 or more fishermen could be employed in a fishing industry if there were large shore installations and perhaps 500 to 1,000 men and women ashore.

Vegetables and meat can be absorbed by the Guam market in very large quantities. Rota vegetables and Tinian meat are now being marketed there on a steady basis. Investments in machinery and stock can greatly increase the return to the farmers and draw in many who now farm a little for themselves. Probably 1,000 to 2,000 persons could be engaged in this activity.

Handicraft is well-organized in several districts. It can increase modestly. Prices are high compared with other Pacific Island regions, but in general, quality is excellent. Investment here is not important, except perhaps in training. The nature of the work is such that it will continue to come from the outer islands where it is part of the non-wage economy and adds to income but does not create wage-jobs.

Tourism appears to be the principal economic activity capable of substantial expansion to create employment. Tourism generates large-scale direct and indirect employment, in construction and operation of new installations plus additional income for existing stores, boats, restaurants, etc. This is done at all skill levels and also creates a large amount of purely local enterprise, including management and labor in such auxiliary activities as rental cars, charter boats, sightseeing buses, local restaurants, fishing guides, etc. and the enterprises they patronize. An hotel can be assumed to have one employee for each guest. Thus, 10 -- 150-room hotels would directly employ 1500 persons. The smaller, islands-type hotels, will employ the same or more per guest. Twenty -- 25-room hotels would employ 500 directly. The indirect employment from tourism is in the neighborhood of four indirect employees to one direct. Thus, these 2,000 jobs are supplemented by another 8,000.

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Hotels buy from local suppliers, use local taxis and utilize many other enterprises. Hotels, necessarily, use indigenous labor. The guests want to be part of the community and be exposed to local residents. Also, it is expensive to recruit expatriates and rotate them, vacation them, etc.

Currently, there are approximately twenty (20) hotels of ten rooms or more operating in Micronesia, employing an estimated 750 persons directly - and probably giving full or partial, indirect employment to another 3,000. Micronesians function as owners, managers, chefs, bartenders, accountants, waiters, waitresses, laundresses, cleaners and desk clerks. They operate rental car agencies, charter boats, fishing boats, sightseeing buses, handicraft stores, movies and tours. All these activities patronize further local enterprise, existing restaurants, gasoline stations, garages, night clubs, bakeries, laundries, boat repair, etc. The smaller installations can, in general, be expanded with small investment of cash and labor by the owners or partners. A large hotel will cost \$1,500,000 to \$3,000,000, as detailed previously.

All studies of Pacific Island countries have concluded that tourism is a major resource of the country, a major source of employment and income for the people and the most likely foundation for a stable island economy. Fiji, Cook Islands, American and Western Samoa, Tahiti and the rest of French Polynesia and even the sparse and remote Gilbert and Ellice Islands and nickel-rich New Caledonia have reached this conclusion.

Many times they would like it without problems. This is wishful thinking embodied in the recognizably humorous statement that, "We would like the tourism without the tourists!". That is difficult. In any case, there are substantial tourism resources in Micronesia, far more than in many other Pacific Islands. They can be developed to provide employment and a stable economy which in turn provides a basis for a stable government. However, they will require substantial capital investment for satisfactory development.

I think it is reasonable to conclude that U.S. government funding will not expand sufficiently either to employ the increased work force or to provide the capital investment necessary to create such employment. While we need not accept the Nathan report of 1966 as the authoritative guide for future economic development, we can make use of its research and analysis. It is the only comprehensive study available to us. In 1966, the Nathan report estimated that there was need for \$150,000,000 of capital investment in the next five years -- that is until this year. Obviously, nothing like that has been invested. To approach it from another point of view, it has been estimated roughly that it takes investment of a minimum of \$5,000 in a less developed country to provide one job. Thus, if we are looking at employment for another 30,000 workers at the end of ten years, we are again talking about investment of \$150,000,000.

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This problem is not unique to Micronesia. It exists in every developing country and to a lesser extent in every developed country. Capital is needed to create employment. Because there is not the enterprise to provide full employment, it is difficult to save to create capital.

What are the ways in which such capital funds can be secured? Obviously, they are:

- (1) External aid from one or more governments.
- (2) Internal government resources -- local taxation.
- (3) Local investment of funds saved by Micronesians; and
- (4) Foreign investment.

We have already reviewed the possibilities of major increases in U.S. government funding and found it unlikely. Grants or gifts from other governments are possible. However, the record is clear that such grants in the past have been far smaller than the U.S. grants and have always had a requirement for a political or an economic commitment.

Micronesia, which is now in the process of taking control of its own government and resources would have to yield major political and economic concessions, greater than those held or exercised by the United States during the period of trusteeship. Specifically, I am of the opinion that even a small grant from Japan would require complete access for Japanese fishing vessels in Micronesian waters, with no requirement for shore facilities.

International loans have been a source for some developing countries to create agricultural and industrial job-providing activities. While a few loans of limited size may be possible for international political purposes, Micronesia does not presently have the proven natural resources necessary for a pay-back program, similar to cocoa in Ghana, or sugar, gold and large-scale tourism in Fiji, etc. I believe this source (large international loans) can be considered minimal to non-existent.

It should be noted that President Nixon has just signed a law raising the ceiling on the Economic Development Loan Fund to \$5,000,000 and that appropriations to reach this are indicated. This is valuable but, by the nature of the fund and policies that govern its disbursements, it will clearly not be available in large amounts for establishment of substantial enterprises. It will benefit the small entrepreneur and this is very healthy since it will allow expansion of many small auxiliary businesses.

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We should look briefly at the possibility of raising sums for capital investment from local taxes. Assuming the total value of goods and services from all sources to be not more than \$125,000,000 per annum, (using a multiplying factor on direct payments and earnings) there would have to be an average 10 percent income tax to earn even \$12,500,000 a year, less than half the annual requirement suggested by the Nathan report. But, assuming that Congress would take the unpopular step of collecting another \$12,500,000 in taxes, it is difficult to see how the government could channel it all into investment in economic, job-creating activities. The result is more likely to be to use it for general government costs, largely, social development programs. Actually, education and health and government social services will probably absorb any and all increased taxes for a long time to come.

I conclude that the government will not be able, either by taxes or by borrowing, to provide the funds for capital investment in quantities sufficient to provide assurance of jobs for the increasing work force. It should be understood that this means ten percent of all incomes and profits, even the income of a laborer making \$1,000 a year. If exemptions are granted, there must be compensatory collections from others, so that with any exemptions, the relatively more affluent would be paying at rates well over 50%. The certain resistance to this and the cost of administration make it an unlikely possibility. The sum might be collected indirectly in sales and import duties. The result of this would be a very large increase in the cost of living, probably not less than 50%. Also, such levies are socially undesirable.

So, next we must look at the possibility for capital formation in the private Micronesian economy. In no less developed country has it been possible, simultaneously, to provide rapid social and educational advancement and to save funds for major capital investment. To return to the figure of \$12,500,000 a year, this would mean \$125 of savings for every man, woman and child in Micronesia.

Assuming a family of eight (children, parents, etc.), this would mean an average of \$1,000 per family per year. In a country with rapidly advancing social and educational standards (with fathers and mothers ambitious for their children to be equipped to compete in the modern world, with a well-developed desire for some of the comforts and advantages of the modern world), the likelihood of voluntary savings of this size seems remote. There are still many families, in the outer islands particularly, who do not have this cash income per year. Their needs for housing and other necessities of life are great. They are not likely to be able to put aside \$1,000 a year for ten years. There is also a "hen and egg" situation here in which without employment the capital cannot be saved and without the capital there is no employment. As with the taxation, that is possible, but it would require such rigid controls that I doubt if the Micronesian government could achieve it and still retain its democratic form.

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The nations with rigid and authoritarian political regimes are able to allocate resources and restrict personal consumption and the people accept, because they must. In a representative, democratic government such as Micronesia has, and will have, the restrictions necessary for mandatory large scale capital formation are most unlikely.

So, we come to the fourth possibility of funds for capital investment-- foreign investment. This has been a problem for all less developed countries --both in granting concessions for foreign investment which have been exploitative and have not helped the country or its people, or alternatively, in absence of foreign investment which has left the less-developed country stagnating and prevented advancement of its people.

Today, I think it fair to say that all the less-developed countries want economic growth and development of their resources. In general, they have neither the capital nor the experience and skills to start and operate sophisticated modern industries. Yet, they do not wish to give the exclusive right of resource to the foreigners. When this has been done in the past, frequently there has been subsequent bitter criticism of foreign exploitation, accusations of economic colonialism, etc. If it was not done in the past, governments frequently now are eager to give out concessions in order to develop employment and to receive badly-needed royalties and tax revenues.

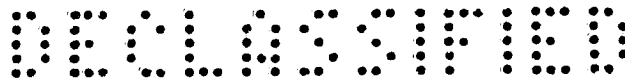
In passing, it should be noted that foreign investment is not restricted to developing countries. There is very large foreign investment in every developed country. For example, in the United States, foreign direct investment in 1970 was over \$1,000,000,000, and the trend is increasing. The British Lever Brothers are in the soap, detergent and cosmetic business; the French Pechiney interests are in mines and smelters. Various German, French and Dutch firms manufacture patented products. Royal Dutch Shell and British Petroleum have oil marketing facilities, British, French, Japanese and Canadian banks operate branches and the Italian Olivetti Company makes and sells typewriters and office machines.

A discussion of the problems inherent in multi-national enterprise would go far beyond our problem here. It is important to note that foreign investment is found everywhere in the world, and is welcomed almost everywhere. Even the Russians, with 200,000,000 people, and a highly developed technology in many fields, such as space rockets and military hardware, are looking for foreign investment in particular types of manufacturing.

In the case of most developed countries, the foreign investment is a minority of total investment but, more important, it accepts the laws and control of the country in which it operates. In fact, it is no different than indigenous investment except that its owners live elsewhere. It obeys the same labor and social and tax laws and competes for services, supplies and customers.

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In the case of a less developed country, the principal problem is that the economy is so small that a few large expatriate investments can dominate the country or a major segment of it. Then, the citizens begin to feel that they are losing control of their country and their own destinies. The solution lies in two parts.

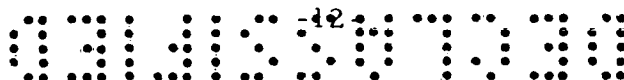
First, the country can and should adopt and enforce laws which ensure that all investors, local and foreign, are good citizens by local standards, pay the going wage scale, have fair employment standards, exercise no discrimination, avoid destruction of the environment, pay taxes and are assets to the community. The country can control every aspect of the expatriate industry except its right to go out of business. A fair balance is achieved which sees that the expatriate company observes all local standards, provides much needed employment and yet is able to survive and make a profit.

Second, if the country will encourage and facilitate partnerships between indigenous investors and expatriate investors, its resources will be developed with local participation. Local participation in ownership means local participation in management. The expatriate brings the capital and the sophisticated technical skills of the special industry and, frequently, access to markets so that product can be sold. The indigenous investors provide the local knowledge and the land, help to find the labor and advise on local custom. Over a period of years, it is very much to the economic benefit of the joint venture to train and employ the maximum local staff at all levels for the very reason that a simple man living in his own homeland is much less expensive to a company than an expatriate, even at the same salary. He doesn't have to be transported, provided with living quarters, sent home every year or two for vacation and his children transported to and from the expatriate's home country once or twice a year for schooling.

The way that I believe will provide the greatest good for the greatest number of Micronesians is to secure the capital investment necessary to develop the economy and secure it through an honest partnership in which Micronesians share in ownership, management and direction, as well as in employment.

No single formula for this can be prescribed. But, if outside or foreign capital is encouraged to seek local partners and thereby becomes an enterprise with Micronesian owners and directors, it will automatically become involved and interested in the welfare of Micronesia.

The partnership or joint venture will succeed only if it is fair to both sides and the investment is successful. The Micronesian government will have to treat the outside or foreign investment in the joint venture just as fairly as it would expect another country to treat the investment of Micronesians there.



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Thus, license conditions which require turning over all the expatriate stock to Micronesians in five or ten years are likely to induce dishonesty, or stifle investment. No Micronesian investor would invest in a business in, say Japan, or Taiwan or Honolulu, with the knowledge that in five years he must walk away and leave his investment to someone else. The result would be either to kill the investment and, thus, the economic activity, or to encourage duplicity with hidden ownerships.

To come back to the original problem, we are looking for the greatest good for the greatest number of Micronesians. That means good living and educational opportunity for all. That means jobs to support these two goals. Jobs require successful economic activity. Successful economic development requires capital investment. The government does not and will not have the funds for such capital investment. Micronesia is at a stage of economic development at which it cannot generate sufficient capital itself. Outside capital is essential. It should be invested under the best conditions for Micronesians. The fairest way with the best social results is the partnership or joint-venture of outside and Micronesian investment.

After all of this, possibly excessive, detail of the problem which I think faces Micronesia, it is important to note that the Pacific Island countries and territories with thriving economies have all arrived at this economic policy of encouraging foreign investment. Fiji and Tahiti are prime examples. But, Tonga, Western Samoa and the Cook Islands and the New Hebrides have also arrived at this policy. New Caledonia and Guam are special cases with special situations, but they two have successfully encouraged foreign investment under their laws.

I think there must be one further point made to throw light on the economic approach here presented. Many people properly see great values in the old way of life. Many do not want it to change. Sometimes they actively oppose change. I am not here advocating change. Change is coming to Micronesia and will come no matter what is done. The whole world is changing and all the countries of the world are linked, including Micronesia. The problem is to adapt the inevitable change to the needs of the people of Micronesia and make use of it for their benefit. This has been done elsewhere in the Pacific and can be accomplished in Micronesia too.

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