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DEPARTMENT OF STATE

Washington, D.C. 20520

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October 24, 1973

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TO: DOD/OSD/ISA - Capt. Whelan  
 DOD/JCS - Col. Kenty  
 INTERIOR/OMSN - Mr. Loftus  
 INTERIOR/DOIA - Mr. Berg

FROM: STATE/EA-ANP - John C. Dorrance *J*

SUBJECT: Micronesia: Foreign Investment Policy

Attached for your review and comment is a third revision of the draft paper on foreign investment policy in Micronesia. The revisions are intended to take into account DOD and Interior views on the subject.

Also attached is a suggested memorandum to the Chairman, NSC Under Secretaries Committee, which would cover the foreign investment policy review and interagency recommendations. OMSN's views are not expressed in that draft memo since they are not known at this time.

Attachments:

Draft revision on foreign investment.

Suggested memo to Chairman, NSC Under Secretaries Committee.

cc: EA - Mr. Hummel  
 EA - Mr. Snodgrass  
 EA - Mr. Berg

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 STATE/EA-ANP: [unclear]  
 1/24/73 [unclear]

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REVIEWED BY B. H. BAAS DATE 4/23/87

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TS AUTH. [signature] REASON(S) E.O. 12356

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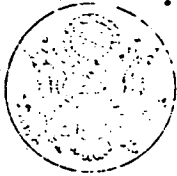
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 EA - Mr. Snodden  
 EA - Mr. Bangert

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REVIEWED BY B.H. BAAS DATE 8/19/86

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TS AUTH. S. BURKE REASON(S) CDC MEMO

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TO: Chairman, NSC Under Secretaries Committee.  
FROM: Chairman, Interagency Group on Micronesian Status  
SUBJECT: Micronesia: Foreign Investment Policy

By memorandum dated your predecessor, Mr. Irwin, directed that the Interagency Group on Micronesian Status prepare a study and recommendations on various aspects of US policy and operations in Micronesia. US foreign investment policy in Micronesia was cited as a specific issue for review.

The full study remains incomplete and may not be ready for submission for several more months. However, the review of our foreign investment policy has been completed, including the outlining of alternative future policies with appropriate recommendations. That review, concurred in by the Departments of Defense, Interior, and State, is attached.

The key conclusion of the review is that the existing US policy of excluding foreign investment no longer serves either US or Micronesian interests and in fact is detrimental to those interests. It is thus recommended that Micronesia be opened to foreign investment, but with appropriate safeguards to protect basic US and Micronesian interests.

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To achieve the latter goal, however, the foreign investment policy review portion of the basic study referred to in the first paragraph above must be considered immediately and separately by the NSC Under Secretaries Committee, and a decision taken on the review recommendations by November 10.

The Interagency Group on Micronesian Status therefore recommends:

(a) that the NSC Under Secretaries Committee consider separately from the basic US/Micronesian relationships study the attached foreign investment policy review and recommendations; and,

(b) that the NSC Under Secretaries Committee approve the recommendations contained in that review on pages \_\_\_\_\_.

EA/ANP:JCDorrance:rlw

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Foreign Investment in Micronesia

I. Present Situation

Acting under Articles 3 and 8 of the Trusteeship Agreement, the United States denies legal access to investment in Micronesia by all UN member states other than the US. (Article \_\_\_ of that agreement requires "most-favored nation" treatment of all UN member states other than the US.)

Despite the resulting monopoly conditions, US firms have not found Micronesia a particularly attractive field of investment. US investment presently is limited to minor fisheries operations, air and sea transport services, and to a few tourist-oriented hotels.

Micronesia is short of private capital and <sup>is filling</sup> ~~at least part of this need~~ <sup>being filled by</sup> with sub-rosa Japanese investment. These investments normally are through individual Micronesian fronts and are usually disguised as loans or lines of credit. Such activity is greatest in the Marianas and Palau, but exists in varying degree in all other districts. Because of the mode of operation of the Japanese investors and

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their fronts, it is virtually impossible to prevent or control their activities. Complicating "exclusion policy" enforcement efforts is the fact that the Micronesian fronts usually are prominent community leaders. However, while the Japanese subrosa economic presence is widespread and very evident, for the most part individual operations are small, e.g. small trading companies, smaller hotels, smaller construction firms, and the like. Thus far Japanese businessmen have not found it practicable to invest in large-scale ventures, ~~through fronts~~, although the groundwork for such ventures is undoubtedly being laid in anticipation of termination of the trusteeship agreement. Larger-scale activities which will hold particular interest for the Japanese include large tourist hotels and related infrastructure activities, development of shore base operations to support fisheries development in the area, and possibly some food-processing.

Although there is some interest in investment in Micronesia by nationals of countries other than Japan (mainly Australians, Koreans and Taiwanese) such investment is unlikely <sup>EVER</sup> <sup>HATCH</sup> even to Japanese levels. As non-members of the UN, the Taiwanese and Koreans are already outside the bounds of our exclusion policy, as are the Nauruans who are investing on a small scale in Micronesia.

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II. Reasons for Investment Exclusion Policy

The decision to exclude all but US investment from Micronesia apparently was taken early in the US administration of Micronesia for a combination of altruistic and security motives. Until the mid-1960's the US maintained a policy of excluding all foreign influences from Micronesia.

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These restraints on foreign influences were reinforced by rigid TTPI entry controls which made it difficult for anyone other than US Government sanctioned visitors to enter Micronesia. The reasons why blanket exclusion of foreign investment was deemed necessary to protect US security interests in Micronesia are unclear. It is the purpose of the Trusteeship Agreement

provides adequate protection in that any threatening foreign business activity can be excluded on security grounds.

All elements of that policy (except foreign investment exclusion) have been discarded, and Micronesia is now being encouraged to play a role in regional affairs through participation in international organizations such as the South Pacific Commission and ECAFE, and through anticipated participation in UNDP programs. Travel restrictions have been lifted and Micronesia is now a <sup>area of increasing interest for the</sup> ~~tourist target~~ for Japanese while Micronesians in increasing numbers travel and are educated abroad.

### III. The Issues

The principal issue is not whether to open the door to legitimate foreign investment, but when to do so. The present restrictive policies can continue only so long as the trusteeship agreement remains in effect. Under a free association arrangement, a Micronesian Government would

have full authority to determine foreign investment policy.

*(although such could not conflict with US foreign affairs and defense)*  
Under any future Commonwealth arrangement with the Mariana

Islands, the latter would be an integral part of the US;

the only restrictions likely to apply to foreign invest-

ment would be those applied universally to the US and its

territories, plus such local regulatory devices as may be

consistent with national policy and law.



Assuming that our policy is changed under the trusteeship agreement, two subissues remain: (a) whether foreign investment will be permitted without restriction or on a selective basis; and (b) when such a policy change would take effect.

The basic question at hand, then, is whether it is in the US and Micronesian interest to permit legitimate foreign investment sooner rather than later.

IV. Japan's Role in the Area

<sup>(22)</sup>  
NSSM on "Policy Toward Japan" stated that "a pivotal factor in determining the state of the entire Pacific area in the 1970's and beyond will be the evolution of the relationship between the United States and Japan." The NSSM noted that we have considered Japan as our major ally in Asia and that we have "a major stake in preserving this relationship, including broad interests we would not wish to endanger to achieve other goals." We recognize the stabilizing role Japan has played and will continue to play in the area as a counterpoint to the Communist countries through the economic development of the non-Communist states of the region.

*A recent NSC study*  
The NSC notes the Japanese have based their foreign

policy on the central tenet that a close relationship with the United States is essential. Japan's trade with the United States accounts for a third of her total international trade. The only military pact Japan maintains is with the U.S. Her foreign policy has closely paralleled that of the U.S. We expect that Japan will maintain that position for at least the next decade so long as certain basic premises remain valid--the credibility of our security guarantee, an opportunity for political and economic growth, and a reciprocal U.S. attitude about the importance of the relationship.

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VI. Micronesian Attitudes

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Micronesia's traditional and political leadership has been highly critical of the US exclusion of foreign investment. Most of the six district legislatures at one time or

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another have adopted resolutions calling for a reversal of present policy, as has the Congress of Micronesia most recently earlier this year. Micronesian representatives at the annual UN Trusteeship Council sessions, and to UN Visiting Missions, have been most vocal in articulating their unhappiness with our present policy. The TTPI administration, including the High Commissioner, has also called for a change in that policy.

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Micronesian attitudes toward Japanese investment are ambivalent. On the one hand there is the natural attraction to forbidden fruit - encouraged by Japanese businessmen.

Some Micronesian leaders are being encouraged to anticipate both a high level of personal return from potential ~~Japanese~~ <sup>foreign</sup> investment, as well as expectations that somehow most of the Territory's economic ills, and dependence on the US, will disappear once the Japanese are permitted to "develop" the territory. On the other hand, most subrosa Japanese investment has been through individual Micronesian fronts. In those few instances where Micronesian leaders in the districts have had an opportunity to make a collective decision on ~~Japanese~~ investment proposals, the latter have been turned down. Micronesians in general are very cautious regarding (and even antagonistic toward) outside interference or control from any source. In these circumstances, given the opportunity, they have treated Japanese investment proposals in the same manner as they have handled most US investment proposals -- rejection based on a Micronesian unwillingness to concede to any foreign firm control of new economic ventures within the territory. Although there may in time be a more receptive attitude toward foreign investment proposals, it would seem that in the main the Micronesians will continue to be cautious about Japanese control of major ventures.

VII. Available Foreign Investment Controls

A change in policy permitting foreign investment would not mean uncontrolled Japanese or other foreign economic penetration. Three broad and highly effective means of control or regulation of investment already exist and would be fully applicable under any relaxation of existing policy.

1) Existing law provides that no land in Micronesia can be sold or otherwise permanently alienated to non-Micronesians. Land can be leased to non-Micronesians, but only with the approval of the TTPI administration.

2) Under Article 8 of the Trusteeship Agreement, the US can exclude any foreign nation or venture from any part of the Territory for security reasons.

3) Existing territorial law provides that all potential foreign investors (including US) must apply to district economic development boards for business permits. Thus far these district boards have taken an extremely negative attitude toward all applications, and, in any event, the TTPI High Commissioner has final authority. All applications are submitted to him for review and final approval or disapproval.

VIII Legal Position and Exercise of Necessary Control

Legally we have a substantial degree of flexibility.

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As for actually implementing these various legal options available to us, the Foreign Investor's Business Permit Act offers a reasonable and defensible basis

for reviewing applications for investment, and for discriminating between applicants. In practical terms, it also provides the necessary review procedure--every application approved at the district level is subject to final approval by the High Commissioner--both for exercising our UN obligations and for maintaining our rights to security denial. (It would be necessary to give the High Commissioner some specific guidelines to apply in his review of each case--e.g. how to deal with USSR and PRC investment proposals--and to provide for automatic referral to Washington for review in certain defined areas. These guidelines could also be made known in

general terms to the Micronesians to avoid unnecessary mis-  
 understanding.) Finally, by providing for decisions on a  
 district-by-district basis, the Act insures that divergent  
 attitudes on investment <sup>can</sup> ~~will~~ be reflected, ~~and, that tight~~  
~~control could be maintained throughout the Territory.~~

IX. Policy Options

In light of the above considerations, we see three possible options for future US policy on foreign investment in Micronesia. These, with pros and cons, are discussed below.

A. Option I: Retain Status Quo Restrictions -- We would continue to deny foreign investment by UN member states (other than the US).

PRO

-- would maintain favored position for present and potential US investors for the few remaining years of trusteeship.

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-- would minimize the prospects for foreign control or domination of various sectors (e.g. tourism) of the Micronesian economy during the remaining few years of the trusteeship.

(This pro is offset by the fact that such a prospect could be prevented in any case by investment controls existing under a relaxation of our exclusion policy.)



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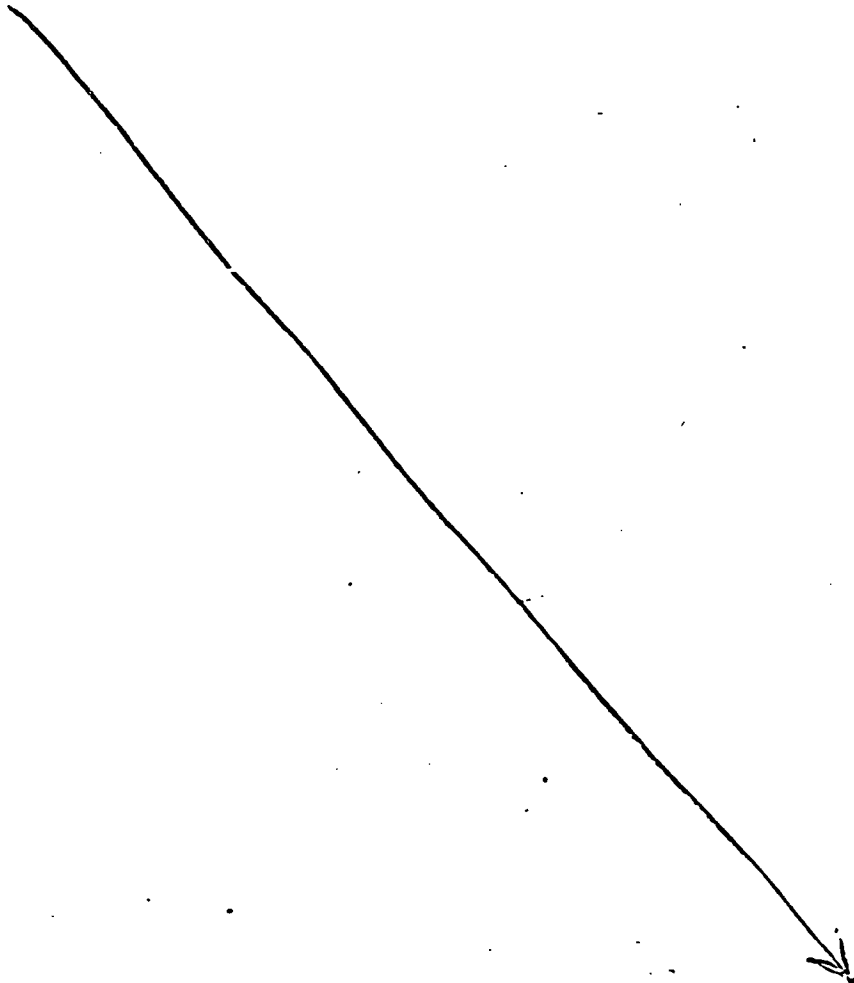
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-- would perpetuate major irritant to US/Micronesian relationships;

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-- would further delay some development which might in some degree permit reduction of US grants.

B. Option II: General Relaxation of Present "Exclusion" Policy --

We would open Micronesia to foreign investment with no basic conditions or controls, other than those provided by the Trusteeship Agreement and existing legislation. The latter would provide for a case-by-case review of investment ventures, and would permit exclusion on security grounds, or on the basis that the venture would not serve Micronesian interests. We would, in announcing our change of policy, alert the Micronesians to our UN responsibilities and to our intention to invoke the security provisions of the Trusteeship Agreement as necessary.

More specifically, we could provide guidelines for policy implementation to the High Commissioner designed to protect US and/or Micronesian interests under existing authority.

As examples:

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-- administrative measures could be taken to assure that no foreign nation, though investment by its nationals, obtains control of any sector of the Micronesian economy;

-- certain critical service areas could continue to be denied to foreign investors, e.g. communications and public utilities;

-- any ~~form~~ of investment, considered by the US to be prejudicial to the security of the US or Micronesia, could be prohibited in case-by-case reviews.

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-- would remove one of the major irritants in Micronesian/US relationships.

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-- would, to extent we veto individual investment ventures on security or other grounds, provide new friction points in our relationships with Micronesians.

C. Option III: Controlled Relaxation of Existing Investment Policy --

Investment would be allowed only in certain geographic areas and in carefully-defined economic activities, e.g., tourism and fisheries development.

PROS

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-- would, if restrictions on foreign investment tightly limited to areas affecting US security interests, offer PROS similar to those for Option II.

-- would, if restrictions are broad and relate to both geographic areas and major economic functions, offer PROS similar to those for Option I.

CONS

-- would, if restrictions are severe, suffer most of the disadvantages of Option I without balancing advantages of Option II.

-- would, if restrictions are limited and relate only to US security interests, differ from Option II only in that our security concerns would be highlighted to no practical advantage.

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X. Discussion

A. US Interests -- It is clear that there are adequate controls to prevent investment ventures that might ~~directly~~ threaten US security interests, (e.g., Soviet or PRC investment, an overwhelming foreign economic presence and therefore political influence, or the use of land in which the US has a defense interest.)

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... these arguments are based on the likely character of Japanese investment in Micronesia. ... Some minor Japanese compa

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are eager to invest in tourism and fisheries in Micronesia, especially in the Marianas, Palau, and Truk. But they will wish to do so on terms consistent with similar Japanese ventures elsewhere in Asia and the Pacific -- terms which thus far have proven to be unattractive to the Micronesians. In the circumstances, a relaxed investment policy probably would lead to a slow but expanding Japanese economic presence, and not to spectacular early growth. The overall Japanese economic presence would probably remain relatively ~~xx~~ insignificant as compared to the US economic presence (manifested by US programs and grants) in the few remaining years of the trusteeship.

-- The arguments advanced against a change in policy also ignore the existing Japanese presence, and the fact that legitimizing foreign investment would make subrosa Japanese investment less attractive. Indeed, existing subrosa arrangements probably would be formalized and thereby brought under control.

A change of policy to permit foreign investment would, as indicated in the Pro and Con discussion of the Options, also directly serve US interests in a variety of ways. Perhaps the most important advantages to a relaxed foreign investment policy are as follows.

-- The credibility of our concern for Micronesia's development would be enhanced.

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C. Restrictions on Foreign Investment -- Since adequate controls exist to prevent any (undesirable) investment venture on a case-by-case basis, there would appear to be no point in broad restrictions as under Option III. [

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It is therefore concluded that Option II providing for general relaxation of our foreign investment policy, but with carefully developed "safeguard" guidelines, is the preferred course.

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1) Investment guidelines to the TPI administration

which would require that the High Commissioner review all investment applications not only on a case-by-case basis, but also on a "sector" and district basis. Should it become evident that investment from any one country is approaching the point that a particular sector or district of the economy will be effectively controlled by nationals of that country, then further investment in that sector or district could be rejected and reserved for other countries or for Micronesians.

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The potential for investment from these other countries may in fact be considerable.

More specifically, the following immediately:

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3) Means for improving local capitalization of major ventures, through "seed capital" and similar devices can be actively explored.

(AS AGAINST US GUIDELINE)

4) The possibility of Micronesian restrictions on the character and level of foreign investment can be explored with the Congress of Micronesia.

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E. Timing and Methodology of a Change in Policy

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It has already been concluded elsewhere in this study that the earlier the change in policy, the better. More specifically, it is also concluded that the forthcoming Micronesian status negotiations, scheduled for November 10 in Washington, provide an excellent opportunity for informal consultations with Micronesia's elected leadership on a policy change.

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The following timing and steps thus are considered desirable.

1) The Department of the Interior, coordinating with Defense, State, and OMSN, could informally advise the Micronesians during the course of the forthcoming status talks, of the US intention to change its present foreign investment policy and seek their views on new policy guidelines. In effect, Option II would be outlined to them.

2) In December, taking into account the above informal exchanges, the Department of the Interior, in coordination with the Office of the High Commissioner, State, Defense, and OMSN, would develop detailed US guidelines for the new policy.

3) In January, the High Commissioner would formally announce the new policy during his ~~XXXXX~~ "State of the Territory" address to the Congress of Micronesia, and solicit formal consultations with the Congress on the establishment of implementing administrative arrangements. The timing of full implementation of the new policy would be determined by the High Commissioner in consultation with the Congress, but with an outside target date of June 1, 1974.

#### XI. Conclusion and Recommendation

The Departments of \_\_\_\_\_ conclude that continuation of existing policy excluding foreign investment under the "MFN" clause of the trusteeship agreement serves ~~no~~ US interest and in fact is an unnecessary irritant in US/Micronesian relationships. As a practical matter, continuation of the policy merely postpones the inevitable by a matter of several years at most. On the other hand, relaxation of that policy, but with maintenance of existing legislative and executive controls, provides significant political advantages -- if only by recognizing and dealing with reality.

It is accordingly recommended that ~~the NSC Under Secretaries agree~~

-- ~~that~~ present policy will be terminated at the earliest possible date by acceptance of Option II which will permit foreign investment under the "most-favored nation" clause of the trusteeship agreement, while also permitting the US to continue to ~~prevent any investment venture~~ on security or other appropriate grounds.

-- that the Department of Interior, in consultation with the Departments of Defense and State, and with OMSN, establish appropriate guidelines under which the High Commissioner would administer the new policies consistent with US security interests and US international obligations, and in a manner which will take into account the considerations and suggestions outlined in the foregoing section X.D.

-- that the Department of the Interior and the High Commissioner of the Trust Territory be authorized to consult with key Micronesian leaders on the timing of announcement, the application of the new policy, and on guidelines for the implementation thereof.

-- that the timing and methodology of a policy change take into account the discussion in Section X.E. above.

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