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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 _____.

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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 ^{is filling} ~~at least part of this need~~ 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 ^{EVER MATCH} ~~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.

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.

[That policy (of which foreign investment exclusion was only one feature) was prompted by a belief that the Micronesians should be shielded and protected from influences they were ^{not believed} (culturally ill-adapted) to cope with; [REDACTED]

[REDACTED]

[REDACTED] The other side of this coin was the belief that it would be difficult to prevent, under the "most favored nation" clause of the Trusteeship Agreement, Soviet economic and thus political penetration should any other UN member state be permitted to invest or otherwise do business in the Territory. [These restraints on foreign influences were reinforced by rigid TPI 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. Article 8 of the Trusteeship Agreement

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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 ^{area of increasing interest for the} ~~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 investment 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 trustee-ship 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

¹²²
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.

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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.

[In terms of Micronesia, this broad policy translates into Japanese support for a ^{continuing} lasting association between the United States and Micronesia on the one hand, and on the other, a Japanese desire to be able to exploit the limited economic opportunities they see in Micronesia. GOJ support for our political objectives rests not only in its wish to be accommodating to its close ally, but also on the fact that our basic interest in the area--its strategic importance serves to reassure Japan in terms of the credibility of our security guarantee.]
Japan ^{our Government} has shown no irredentist desire

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[toward Micronesia and its economic interest in Micronesia appears at this time to be only a natural reflection of Japan's basic economic drive in an area of natural interest and potential to certain Japanese investors.]

[V. Attitudes in the UN Trusteeship Council

Although all of the eleven original trusteeship agreements contained similar "most-favored nation" clauses regarding trade and investment, no other administrative authority has interpreted the applicable clause in the ~~way~~ ^{particular manner} that we have.

Even our closest allies and friends on the UN Trusteeship Council have been critical of our exclusion of foreign investment, and have privately pressed the view that the existing policy is doing damage to our political position in Micronesia. They base this observation on reporting from their representatives who have been to Micronesia with UN Visiting Missions. Micronesian representatives at UN Trusteeship Council sessions also have effectively used our investment exclusion policy in criticizing US administration of the TTPI.

The US is on public record in the UN as having the present policy "under active review."]

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

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.

[Since the US in recent years has been unable to explain in acceptable political or economic terms the rationale for existing policy, the Micronesians ascribe to the US a variety of ulterior motives:

-- They argue that US policy is designed to maintain Micronesia as a private investment preserve for US capital.

-- They argue that, given the disinterest of US capital, the policy also is designed to assure a continuing and maximum degree of Micronesian financial dependence on the US Government.

-- As a corollary to the foregoing, they assume that the policy is designed to minimize non-US influence in Micronesia for US security purposes.

-- Based on these alleged US motives, the Micronesians argue that our declared concern for Micronesia's economic development cannot be considered as credible.]

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 ^{foreign} ~~Japanese~~ 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} 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. [The Department of State's Office of the Legal Advisor has examined our rights and obligations under the Articles 3 and 8 of the Trusteeship Agreement and has concluded:

- That our present policy of uniform exclusion is legally (if not politically) defensible;
- That we could allow foreign investment in the area;
- That exceptions to the requirements of equal treatment could be made on the grounds of security^(though not capricious) ~~e.g. prohibit investment from the USSR or the PRC--and the need to promote the advancement of the inhabitants,~~

first instance

- [-- That we could delegate our authority for regulatory control to the Micronesians, but that we would retain responsibility for our obligations under the Agreement;
- That our obligation to promote their advancement and welfare would allow considerable discretion, which also could be delegated, in deciding on investment opportunities;
- That we could delegate such authority and still retain our right of exclusion on security grounds; and
- That we could provide economic access in certain sectors of the economy or geographic areas while excluding others completely.]

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 applica-

tions 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 misunderstanding.) Finally, by providing for decisions on a district-by-district basis, the Act insures that divergent attitudes on investment ^{can} ~~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.)

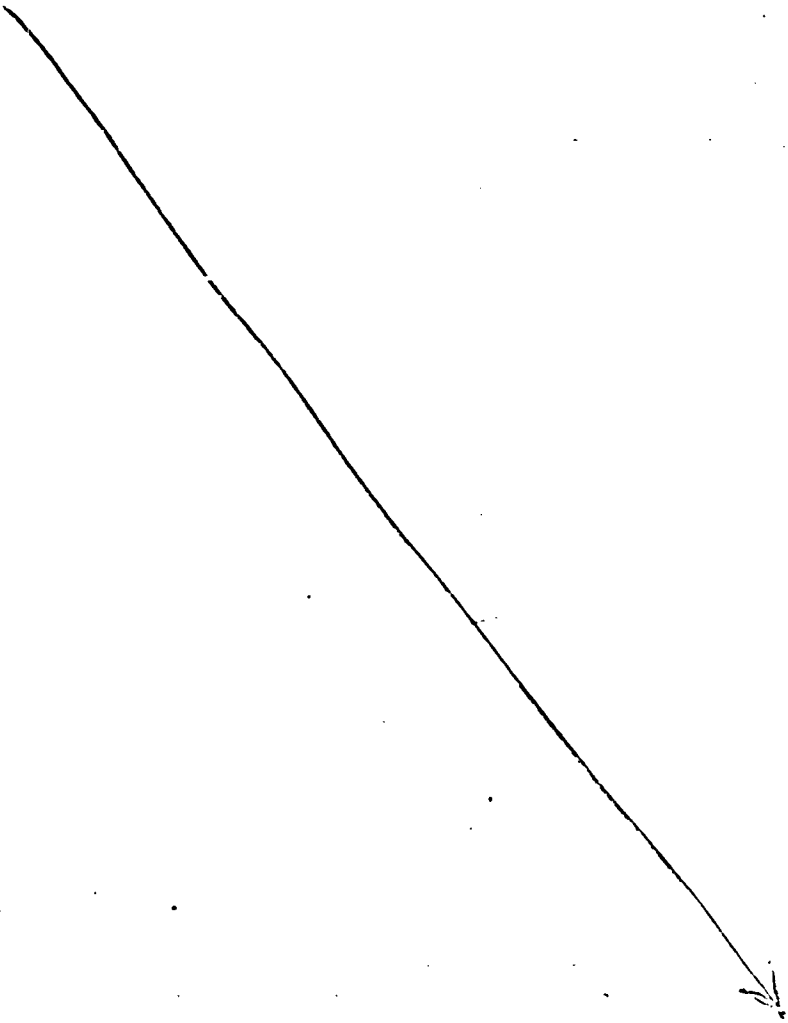


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-- would perpetuate major irritant to US/Micronesian relationships.

[-- ~~would reinforce~~ ^{would continue to ext} Micronesian view that the existing policy is designed to serve only US interests, thus weakening the case for association with US.]



[-- would encourage continuing and even increasing
 subrosa foreign investment while also feeding
 unrealistic expectations ^{as to} the character and levels
 of Japanese economic assistance in the post-trusteeship
 period; all to the detriment of our position in the status
 negotiations.

-- would not ^{be} allow for, ~~(in remaining years of trustee-~~
~~ship period of adjustment to foreign investment pressures.~~ B, AS

[REDACTED]

[REDACTED]

-- would delay the inevitable at considerable
 political costs to us unmatched by significant
 advantages to US interests.

-- 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.

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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:

-- foreign investment projects would not be permitted on TTPI land areas required for US defense purposes (e.g. Tinian Island, certain parts of Babeldaob Island, and Kwajalein Atoll);

-- 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.

PROS

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

-- could importantly enhance the credibility of our negotiating position by demonstrating our responsiveness to Micronesian desires, and by weakening the argument that we seek continued ties with Micronesia for essentially selfish purposes.

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[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

-- would contribute to Micronesian development, but without reducing the need for association with US.

-- would permit [REDACTED] B1, A5

[REDACTED] curtailment of subrosa activities which would be relatively less attractive to the Micronesians and the Japanese.

(Legitimizing of foreign investment would be an incentive for formalization of existing subrosa arrangements, while incentives for future subrosa investment would be slight. From the Japanese investors' point of view, subrosa arrangements are extremely risky in that the investor has no recourse under law against his Micronesian fronts or partners in the event the latter misuse the foreign investor's funds.)

CONS

-- could, at least theoretically, remove an inducement to achievement and early implementation of status agreements.]

-- 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.

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-- would, if restrictions on foreign investment limited tightly 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.

X. Discussion

A. US Interests -- It is clear that there ~~are~~ ^{EXIST ALREADY} 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.)

A major argument against relaxation of our investment policy is that massive Japanese investment would follow, and that this could be followed by Japanese political influences inimical to US interests. It is also argued that massive Japanese investment would lessen Micronesian dependence on the US, and thus would result in lessened Micronesian interest in association with the US. We believe these arguments ignore realities.

-- It is unlikely that ~~in any circumstances~~ a Japanese economic presence would expand so rapidly in the ~~few~~ remaining years of the trusteeship that status attitudes would be significantly altered vis-a-vis the US during that time-frame.

-- There is no evidence to support the thesis that the Japanese Government has political ambitions in Micronesia; in fact, the Japanese Government has made clear that it favors a close political relationship between the US and Micronesia, but with opportunities for Japanese investment.

... These arguments exaggerate the likely character of Japanese investment in Micronesia. Some minor Japanese companies

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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.

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

[-- Many Micronesians have exaggerated expectations as to the manner in which Japanese economic activity might contribute to a lessened dependence on US grant aid, and therefore on association with the US. Practical experience with Japanese investment, and in particular, the character of Japanese control of their foreign investments, could have a salutary and sobering impact on those who hold the view that there is a "Japanese alternative" to the US. In fact, it is probable that an opportunity to compare concrete Japanese investment proposals against US proposals they are already familiar with may operate to the advantage of US investors.]

[-- Since Japanese investment is in any event inevitable with termination of the trusteeship, it is very much to our advantage to permit such investment during the remaining transition period. A relaxation of existing policy, while we continue to administer Micronesia, will permit us to channel or encourage Japanese investments in areas which will best serve Micronesian and US interests.]

[[REDACTED]

[[REDACTED]

[[REDACTED]

[[REDACTED]

[[REDACTED]

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On the other hand, it would appear that an early change in policy could impact favorably on the negotiations by removing a major irritant in our relations with Micronesia's leaders. For maximum impact, it would be desirable to accomplish any change in policy at the earliest possible date, after consultations with Micronesia's leadership.

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. If such restrictions are significant, much if not all of the positive political impact of the policy change will be lost. If they are limited to a narrow range of areas related directly to our security interests, the practical effect will be no different than Option II, but there would be the disadvantage of highlighting the character of our security interests, ~~to no useful end.~~

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.

D. Possible Offsets to an Expanded Japanese Economic Presence

Although it is unlikely that US or any other foreign investor interest will in the foreseeable future equal that of the Japanese, some actions can be taken to offset the potential Japanese presence and minimize the possibilities for Japanese domination of any given sector of the Micronesian economy.

These could include the following:

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.

[REDACTED]

[REDACTED]

[REDACTED]

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

More specifically, the following actions might be taken immediately:

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

4) The possibility of Micronesian^(AS AGAINST US GOVERNANCE) restrictions on the character and level of foreign investment can be explored with the Congress of Micronesia.

[REDACTED]

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E. Timing and Methodology of a Change in Policy

If our investment policy is to be changed to permit foreign investment, it is logical to time and manage the change in a manner politically most advantageous to the US.

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. Consultations at that time will serve a twofold purpose: (a) to improve the atmosphere surrounding the talks by advising the Micronesians of an anticipated change of policy they have long sought; and, (b) to commence the consultations process necessary to successful implementation of a new policy. 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.

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-- 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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