

2012 Investment Climate Statement
The Federated States of Micronesia
U.S. Embassy Kolonia

Openness to, and Restrictions upon, Foreign Investment

The FSM is ranked among the lowest countries in the world in its friendliness to foreign investment by a variety of different organizations. Creating and implementing FSM foreign investment law is done by both the National Government and each of the four State Governments. This process can be long, expensive, confusing, and subject to changes on a case by case basis. Although the national law provides some general guidelines, the laws for the states vary widely in the sectors in which they allow foreign investment, the process through which a foreign investment permit is granted, in rules of ownership, and even the categories of persons permitted for expatriate employment. Any investor must acquire a permit for each state in which he or she intends to do business. An investor would only need a permit at the national level if the business fell into the category of national regulation (such as insurance or intra-state air transport).

FSM National Government

The national law establishes three categories (Red, Amber, and Green) to distinguish between prohibited business, restricted business, and unrestricted business. Businesses that fall into the Red category are arms manufacture, the minting of currency, and any business dealing in nuclear power or radioactive goods. The Amber category businesses, although not prohibited, face extra criteria for review before a foreign investment permit can be granted. These are banking services that fall outside of Title 29 of the FSM Code (essentially any non-traditional banking service) and insurance. The Green category includes those businesses for which no special criteria need to be met for a foreign investment permit to be granted. Banking (according to the definitions described in Title 29), fishing in FSM's Exclusive Economic Zone, international and interstate air transport, and international shipping are all Green category businesses. As noted above, businesses such as those outlined in the National Amber and Green categories that are subject to national regulation may be operated under a national foreign investment permit in any of the four states of the FSM without need for state-level permits.

Foreign ownership of land is not permitted and lease terms are controlled exclusively at the state level. Kosrae law allows for a 55 year lease renewable for an additional 55 years, Chuuk for up to 99 years, Pohnpei for 55 years renewable up to 99 years, Yap no more than 100 years, and the FSM National Government up to 99 years. In many locales, squatters, long-standing and multiple disputes over land ownership, lack of title certainty, poor surveying capabilities, and the absence of property records make leasing specific plots of land extremely difficult and costly. There have been reports of U.S. businesses that were successful in obtaining a foreign

investment permit, but who gave up on specific projects in the FSM due to the difficulty of obtaining a secure lease for land on which the project would have been placed. Restrictions on land sales among citizens from other FSM states also have the effect of driving transactions underground, which makes accurate pricing information difficult to obtain. There is no system for land title insurance in any of the four states of the FSM.

At present, there is little new net foreign private investment on an annual basis in the FSM. With few exceptions, recent foreign private investment in the FSM has been concentrated in small scale businesses located in population centers on the nation’s four main islands. The FSM does maintain a website for the promotion of foreign investment in each of the four states. The website lists some available projects and also provides some basic information on the application process. The address of the website is <http://www.fsminvest.fm/>. There is also an “Investment Guide” located on the website of the Department of Resources and Development which can be found at <http://www.fsmrd.fm>. No foreign investment incentives were reported.

Courts generally support contractual agreements, but enforcement of judicial decisions has been historically weak. Foreign firms doing business in the FSM have had difficulty in collecting debts owed by FSM companies and individuals, even after obtaining favorable judgments. U.S. companies and individuals considering dealing with buyers in the FSM should exercise due diligence and negotiate minimal credit and payment arrangements that fully protect their interests.

State Laws

Kosrae, Chuuk, and Yap laws remain unchanged from the 2011 Investment Climate Statement. Each has its own Red (Prohibited), Amber (Restricted), and Green (Open) categories in addition to those outlined by the national government. Pohnpei foreign investment law was re-written in 2011 with a variety of significant changes. A summary of the types of business and the corresponding investment category from each state’s law is provided in Table 1.

Table 1

State	Prohibited	Restricted	Open
Kosrae	Manufacturing of toxic and bio-hazardous material, gambling and casino establishments, fishing activities using sodium/cyanide compressed air.	Real property brokering, tourism other than eco-tourism, reef fish trade, coral harvesting.	Eco-tourism, professional services, exportation of local products.
Pohnpei	None are presently	Businesses that	Except for businesses falling in the

	identified. As the DRP-FIP evaluates applications under the “Restricted” category, decisions will be made to add a particular business type to the “Prohibited” category.	do not meet the criteria for the “Open” category can apply to DRP-FIP for a foreign investment permit if the business will be a significant benefit to the economy of Pohnpei.	“Prohibited” category, any business with a 60 percent or greater share held by citizens of the FSM; businesses with an initial capitalization of \$250,000 or more (or \$50,000 in the case of a professional service); or businesses that have a minimum of 51 percent FSM Citizen ownership and fall under the “Special Investment Sector” category which includes service industries (except professional or tourism services), retail trade, and exploration, development and extraction of land/marine-based mineral or naturally occurring timber resources.
Chuuk	Director designated – none listed in law.	Casinos and lotteries, businesses that create a high degree of environmental pollution, destroy the ecological balance, local culture or tradition, or deplete any natural resources.	Eco-tourism, professional services, intra-state airline services, exportation of local producers.
Yap	Manufacturing of toxic materials and waste, weapons and ammunitions, commercial export of reef fish, any other activity injurious to the health and welfare of the citizens of Yap.	None.	Investment in all other economic sectors is allowed.

Kosrae, Chuuk, and Yap

For Kosrae, Chuuk and Yap a foreign investment permit application is submitted to the Director of the state’s Department of Commerce and Industry. The application fee for a foreign investment permit in Kosrae is \$150. In Chuuk the application fee is \$250 followed by an annual fee of \$150. In Kosrae and Chuuk, a permit is automatically renewed each year for permit

holders who have complied with all the relevant terms. The initial application cost for Yap is \$250, with an additional annual renewal fee of \$100. In Yap, a foreign investor must submit an annual report along with the fee to renew the permit for the following year. The Director in each corresponding state reviews an application and is responsible to make sure that the proposed business does not conflict with either the state or national foreign investment law. Once an application is complete, the permit is issued and the business can begin its operations. In Kosrae and Chuuk, the permit is not transferable between investments or investors. However in Yap, any foreign citizen who holds a foreign investment permit for one business may engage in any lawful business activity within the State as long as it is not included in one of the prohibited economic sectors of the Yap law. Chuuk law prohibits the repatriation of capital over \$50,000 without prior consent of the Director.

Pohnpei

Pohnpei's amended Foreign Investment law was signed by the Governor in March, 2011. The new law does away with the old Pohnpei Foreign Investment Board, replacing it with a "Registrar of Corporations." The system is intended to improve transparency and streamline the process of granting a foreign investment permit with a single director appointed by the Governor. The Registrar of Corporations does have the power to approve foreign investment permits. However, the Registrar does not function independently. It is instead overseen by the Discretionary Review Panel on Foreign Investment Permits (DRP-FIP). The DRP-FIP will have seven members including two representatives of the business community, two representatives of consumers, Director of the Department of Land and Natural Resources, Administrator of the Office of Transportation and Infrastructure, and Administrator of the Office of Economic Affairs. The State Legislature has yet to confirm the members of the newly created DRP-FIP. In limbo status, all current foreign investment permit holders were granted a one year extension until the new law can be implemented. The office reports that any potential investors should wait until the board is officially established. At the time of this report, no timeline for the establishment of the DRP-FIP was available. When functional, the filing fee for an application for a foreign investment permit will be \$250, except when applying for a permit under the Preferred Joint Venture Sector or for any "alternate energy" business in which case the fee is reduced to \$50.

The amended law follows the National Government as well as the other three FSM State laws in implementing a color system (Green, Amber, and Red), but continues to define the categories differently. Included in the Green category is a *Preferred Joint Venture Sector* which requires at least a 60% investment held by citizens of the FSM; an *Initial Capitalization Sector* which requires an initial capitalization of \$250,000 or more, or \$50,000 in the case of a professional service; and a *Special Investment Sector* to include service industries (except professional or tourist services), retail trade, exploration and development of land or marine based mineral resources, and exploration, cutting and milling of naturally occurring timber resources. The

Special Investment Sector requires at least a 51% stake by FSM citizens. Should anyone want to apply for an investment permit that does not comply with the regulations in the Green category (for example, a retail store with less than 51% ownership by an FSM citizen), the permit is considered to move to the Amber category. Any permit issued under the Amber category must have concurrence from the DRP-FIP before approval. The DRP-FIP may also include additional written stipulations before approving such a permit. The Red category includes those businesses in which foreign investment is prohibited and will be defined as the DRP-FIP makes decisions for business applying under the Amber category.

The Duration of Permits depends on the type of business: ten years for businesses providing professional services; 55 years for those businesses that meet certain capital investment criteria; and 25 years for everyone else. Businesses are required to submit an annual report to ensure they are in compliance with the law. This aspect has not changed from the previous investment law.

The amended investment law does provide for a “Compact Exemption.” A U.S. citizen who has maintained the FSM as their primary place of residence for five years or more is eligible to apply for a certificate of exemption. This certificate frees them from all the provisions of the Foreign Investment Law, effectively allowing the investor to operate and own a business under the same terms as an FSM Citizen.

FSM Rankings

Below are rankings and evaluations for the FSM from a variety of indexes used to measure the ease (or difficulty) of doing business in a country. For the U.S. Millennium Challenge Corporation (MCC) measures, the score is listed first followed by the percentile ranking in the lower middle income peer group in parentheses.

Measure	Year	Index/ Ranking
TI Corruption Index	Not available	
Heritage Economic Freedom	2012	143rd (of 179 ranked)
World Bank Doing Business	2012	140th (of 183 ranked)
MCC Government Effectiveness	2012	-0.33 (24th percentile)
MCC Rule of Law	2012	0.40 (76th percentile)
MCC Control of Corruption	2012	0.35 (79th percentile)
MCC Fiscal Policy	2012	N/A
MCC Trade Policy	2012	81.00 (80th percentile)
MCC Regulatory Quality	2012	-0.36 (31st percentile)
MCC Business Start Up	2012	0.860 (11th percentile)
MCC Land Rights Access	2012	N/A
MCC Natural Resources Mgt	2012	60.8 (12th percentile)

Sources: <http://www.heritage.org/index/ranking>

www.doingbusiness.org/data/exploreeconomies/micronesia
<http://www.mcc.gov/documents/scorecards/score-fy12-old-micronesia.pdf>

Conversion and Transfer Policies

The U.S. dollar is the FSM's official currency. The limitation on the repatriation of funds for business operations working under a National Government foreign investment permit was repealed in 2005. As noted above, the State of Chuuk has a provision requiring approval for repatriation of capital in an amount greater than \$50,000.

Expropriation and Compensation

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

The Act states that the FSM National Government shall not take any action or permit any state action that has the effect of expropriation. If this occurs, the FSM National Government is responsible for prompt and adequate compensation. In practice, however, this may not happen with indirect interferences of business. There have been reports of cases of government intervention in markets, prices, and even in the creation of public enterprises for the specific purpose of interfering with business. There was one case, adjudicated in the FSM Supreme Court, in which a substantial judgment was made in favor of a foreign investor in Pohnpei State after a finding that state-level action had, indeed, negatively affected the business operations of the foreign investor.

Dispute Settlement

Disputes concerning contractual rights are handled through the FSM court system. A decision by the Secretary of Resources and Development regarding an application for a Foreign Investment Permit may be appealed by the applicant to the Supreme Court of the FSM. There are no provisions under FSM Federal law for alternative dispute resolution. This is also true of the states, with the exception of Kosrae where an alternative dispute resolution system has taken the place of a small claims court. A bankruptcy law came into effect in January 2005. Judgments from foreign jurisdictions are not enforceable in the FSM courts. The FSM has signed the Convention on the Settlement of Investment Disputes and Nationals of Other States; however the FSM has taken no legislative measures to make the Convention effective or to designate any competent courts or other authorities for enforcing or recognizing the Convention. A resolution to accede to the New York Convention on the Recognition and Enforcement of

Foreign Arbitral Awards was presented before the FSM Congress. The resolution was not adopted.

Performance Requirements and Incentives

Although there are no specific performance requirements, each of the states does require an annual report from any foreign investor, which is also associated with an annual fee. The states' respective investment board or director reviews these reports to make sure the business' activity falls within their issued investment permit and/or the laws of that State. Under the Compact of Free Association, U.S. citizens do not require visas, residence permits, or work permits to live or work in the FSM. The FSM does not provide any special incentives for foreign investors.

Right to Private Ownership and Establishment

FSM national and state laws do not currently require local citizens to share in the ownership of the business. However, since foreigners are not allowed to own land in the FSM, foreign investors often choose to work with local partners. The law states that once approved and established, a foreign-owned business will be treated the same as a locally owned business. In practice, however, this is not consistently followed in the FSM. Foreign investors often face extra roadblocks, criticism, and outright interference in their business operations if local citizens disagree with business practice. The difficulty or ease of running a business in the FSM has been reported to be based more on personal relationships than legal code.

Protection of Property Rights

Because foreign ownership of land in the FSM is forbidden, mortgages are generally not available to foreigners, but a leasehold interest may be used as security for a mortgage in some cases. Each state has different issues regarding the use, sale, and titling of land. In Pohnpei, for example, the state has blocked any sale of land since the early 1980's. The market persists, but underground, making a determination on current ownership or leasing rights complicated and unreliable. One court case, which involved squatters occupying government land leased to another party, took over a decade to resolve. In Chuuk, the land records office was destroyed in a fire, wreaking havoc on determination of land ownership for many potential commercial plots of land. U.S. Embassy Kolonia has not received land dispute complaints for Yap or Kosrae.

Copyrights are protected under FSM Code, Title 35 for those cases where one or more of the authors are a national or domiciliary to the FSM or to a country that is party to a copyright treaty with the FSM. The FSM is a contracting party to the Berne Convention, with accession in July, 2003 and entry in force in October, 2003. There is no trademark, patent or other intellectual property rights regulation currently in effect.

Transparency of the Regulatory System

The FSM is not a signatory to any convention on transparency in international investment. Transparency of government actions is typically based more on personalities than on the law. Regulatory bodies sometimes involve themselves in issues beyond their jurisdiction. Conversely, other regulations are not uniformly enforced. It is often difficult to obtain public records, as there is no Freedom of Information or Sunshine Laws in the FSM although some states and government organizations do require open meetings. In addition, government audits and statistical reports are not prepared promptly and current data is often not available. Two websites provide relatively recent (if not comprehensive) data and reports: <http://www.sbcoc.fm/> and <http://www.fsmopa.fm>. Similarly, it has been reported that obtaining licenses and permits in a timely manner may depend more on the relationship of the investor (or local legal counsel) with the official in charge than any clear procedure or timeline.

Efficient Capital Markets and Portfolio Investment

The Bank of Guam and the Bank of the FSM are the only full-service financial institutions presently operating in the FSM. Both are regulated by the U.S. FDIC. There is no stock or commodities exchange. Little credit is available locally. Banks make relatively small and short-term local loans because of the difficulties inherent in collecting debts and obtaining collateral that could be attached and sold in the event of default. As a result, banks move a large share of deposits to U.S. financial markets. As of their 2010 annual report, the Bank of Guam had total assets of about \$990.5 million (most of which were located outside of the FSM) and the Bank of the FSM reported total assets to be \$93.0 million. Both banks are considered sound. Because most businesses are family owned, there are no shares that could be acquired for mergers, acquisitions, or hostile takeovers. A secured transaction law was signed by the FSM President in November 2005 and a filing office in operations since October 2006.

According to its annual report, the FSM Development Bank (FSMDB) “actively promotes the growth of micro, small and medium enterprises in the FSM.” The bank has historically provided loans for a number of joint venture operations between a foreign investor and a local FSM citizen. These joint ventures can be approved as long as a minimum of 25% of the business belongs to the FSM citizen.

Competition from State-Owned Enterprises (SOEs)

The FSM has a number of SOEs, some functioning moderately well and others virtually defunct. The FSM Petroleum Corporation is responsible for all of the fuel in the country and FSM Telecom runs phone (both land and cell), internet, and television operations. Both are providing acceptable levels of service and appear to be commercially viable. The government has attempted to set up public businesses in an effort to promote job creation and boost economic output. However, none have proven successful over an extended period of time. Although virtually defunct, there remains a National Fisheries Corporation as well as the Coconut Development Authority. There is a National Aquaculture Center in Kosrae which primarily

grows giant clams for export which is functioning, but is very small, employing just a few people. During the early period of the Compact of Free Association, the power generation and water companies were heavily subsidized. To this day, the power and water systems continue to charge rates that do not allow the enterprises to run on a commercially sustainable level due to political interference.

Corporate Social Responsibility (CSR)

There is little awareness of corporate responsibility in the FSM, however most local businesses are small and generally responsible in the community in which they live. There are only a limited number of multi-national companies operating in the FSM and all are foreign-owned. Companies that are U.S.-based do generally follow CSR principals.

Political Violence

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

Corruption

The FSM has laws prohibiting corruption and there are penalties for corrupt acts. The National Office of the Public Auditor, with support from the FSM Department of Justice, has been the entity most active in the anti-corruption activities. A number of senior ex-FSM Government officials have been convicted of corruption under the FSM Financial Management Act, usually involving procurement fraud. Corruption is not a predicate offense under the money laundering statute. Bribery is punishable by imprisonment for not more than ten years and disqualification from holding any position in the FSM Government. The FSM has not signed or ratified the UN Convention on Corruption. Given that many FSM National, State, and Municipal Government officials also own businesses, there exists significant potential for conflicts of interest. One local NGO, Micronesian Seminar, has prepared an anti-corruption video that has received wide play. The U.S. Embassy is not aware of any other significant anti-corruption efforts. The degree to which government officials accept direct bribes is unknown, however misuse and misappropriation of government funds is widespread.

Bilateral Investment Agreements

No Bilateral Investment Agreement exists between the United States and the FSM. The *Compact of Free Association, As Amended*, between the two nations is the only applicable guidance. Under this treaty, articles from the United States imported into the FSM are guaranteed to receive treatment that is no less favorable than any other foreign country. Articles exported from the FSM to the U.S. are duty exempt, with a number of exceptions as listed in Article IV, Section 242.

OPIC and other Investment Insurance Programs

The U.S. Overseas Private Investment Corporation's (OPIC) investment coverage extends to projects in the FSM. Information concerning applying for OPIC assistance can be found at: www.opic.gov. Since the FSM uses the U.S. dollar as its currency, there are no currency exchange issues.

Labor

There are no laws regulating hours of work (although a 40 hour work week is standard practice) or prescribing standards of occupational safety and health. A federal regulation requires that employers provide a safe workplace. Neither the Department of Health nor the Environmental Protection Agency has enforcement capability, and working conditions vary in practice. There is no law for either the public or private sector that permits workers to remove themselves from dangerous work situations without jeopardy to their continued employment.

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

The minimum wage varies depending on the state. In Pohnpei the minimum wage for government workers is \$2.00 per hour and for workers in the private sector is \$1.35 per hour. The other three states have no set minimum wage for the private sector. For government workers in Kosrae the minimum wage is \$1.42 per hour, in Chuuk it is \$1.25 per hour, in Yap it is \$1.60 per hour, and for the national government it is \$2.65 per hour. As of 2010, about 50% of the labor force was employed by the public sector.

Foreign Trade Zones/Free Ports

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

Foreign Direct Investment Statistics

The FSM National Government Office of Statistics, Budget and Economic Management, Overseas Development Assistance, and Compact Management (SBOC) reported difficulty in obtaining Foreign Investment statistics. The FSM National Government Foreign Investment office had only recently agreed with the State Governments upon a matrix to provide such statistics for the purpose of reporting to the FSM Congress. In Pohnpei, the Foreign Investment office reported a total of 96 active foreign investment permits. The Embassy has been unable to obtain monetary value statistics in the FSM.