

Chapter 4. Government Structures and Implications for Economic Development

4.1 National and State Governments' Role in the Federal Structure

The national constitution created three levels of government in the Federated States of Micronesia: national, state, and local. A state, however, is not required to establish a new local government if none existed prior to the effective date of the constitution. Under this federal system of government, the areas of responsibility between the national and the state governments are separated. The constitution delegated to the national government two types of power:

- *powers expressly delegated to the national governments;*
- *powers that are indisputably national in character as to be beyond the powers of the states to control.*

The powers granted to the state governments are:

- *powers not expressly delegated to the national government;*
- *powers not prohibited to the state.*

The constitution does not grant any authority to the local governments. The powers granted to the state are residual, i.e., the states exercise the remaining powers. The FSM Constitution does not seem to make any use of the doctrine of pre-emption on the part of the national government to encroach on state power.

The powers delegated to the national government are legislative and enumerated in Article IX. Among these legislative powers are:

- *to regulate banking, foreign and interstate commerce, insurance, the issuance and use of commercial paper and securities, bankruptcy and insolvency, and patents and copyright;*
- *to impose taxes, duties, and tariffs based on imports;*
- *to impose taxes on income;*
- *to establish usury limit on major loans;*
- *to regulate navigation and shipping except within lagoons, lakes, and rivers;*

- *to regulate the ownership, exploration, and exploitation of natural resources within the marine space of the Federated States of Micronesia beyond 12 miles from island baselines.*

In addition, the national government has the power to establish and administer post-secondary institutions and provide legal assistance. Pursuant to these powers, the national government established the College of Micronesia-FSM and the Public Defender's Office, and provided funding for the Micronesian Legal Services Corporation.

Among the residual powers exercised by the state governments are to:

- *establish and administer elementary and secondary schools;*
- *establish and administer health services;*
- *establish local government units;*
- *borrow money on state credit;*
- *establish and maintain public safety;*
- *regulate intrastate commerce;*
- *regulate navigation and shipping within lagoons and rivers;*
- *regulate the sale and use of land;*
- *regulate fishing within the twelve-mile territorial sea;*
- *levy sales tax.*

Despite the fact that the states control their area of jurisdiction, the FSM Constitution is the supreme law of the land and any state constitution and laws in conflict with it are invalid to the extent of conflict. However, some of the states have enacted laws that may be in breach of the equal protection clause of the national constitution. The legality of these laws has not been challenged in national courts so the states continue to enforce them regardless of their discriminatory nature.

4.1.1 The National, States, and Local Governments

The national government of the FSM is one of the four successors to the government of the Trust Territory of the Pacific Islands and the newest level of government in the federation. Two states, Chuuk and Yap, inherited their boundaries from the former administrative districts of the Trust Territory. The other two states, Kosrae and Pohnpei, were administered as one unit under the UN Trusteeship. Prior to the referendum on the national constitution, Kosrae became a separate and distinct state. With the exception of Chuuk, the

municipalities in the other three states maintained the boundaries that existed during pre-colonial times. In Chuuk, the Japanese consolidated the villages on each high island into local governmental units. Consequently, the boundary of each municipality in Chuuk transcended the borders of the autonomous pre-colonial local villages. So with the exception of Chuuk, the municipalities in the other three states are the oldest political units in the Federated States of Micronesia.

4.1.2 The Hot Spot: Center versus the Periphery

Despite the clear allocation of powers to each level of government, there is often conflict between the national and state governments which usually involve political power, money, and land.

One recurring issue, which started surfacing very early after the national government was installed, is which government – state or national – has the power to issue foreign investment permits. This power is not specifically allocated to the national government, but it could assert jurisdiction to regulate foreign and interstate commerce. In addition, foreign investment is linked to foreign affairs making it national in character. But in the journal of the 1975 Micronesian Constitutional Convention, the authority to regulate the issuance of foreign investment permits was listed as an example of a power a state may exercise. This conflict over jurisdiction prompted state and national leaders to call for leadership conferences to sort out the issue. The conferences decided on a compromise that resulted in both state and national governments having the authority to issue foreign investment permits. This political solution did not please the states.

In 1997, the national congress enacted a foreign investment law which set up national categories of economic sectors to be regulated by the national government and their state counterparts. It is unlikely that the states will readily embrace this new foreign investment law because it essentially dictates to the states what they can and cannot do. The states will view the new foreign investment law as a national government attempt to further control economic development activities. This issue should be revisited by national and states leaders to decide on where to draw the jurisdictional line between the national and state governments.

Another flash point has to do with the power of the national court to hear cases arising in areas of jurisdiction constitutionally delegated to the states. These cases deal with land, and foreign boats illegally fishing in the territorial sea. The national court has introduced the legal fiction of concurrent jurisdiction

to hear these cases. The state courts consider this claim as another example of national government's encroachment on state jurisdiction.

An issue that has caused many political problems and dissension in the states, mainly in Pohnpei, is land. All the states incorporate in their constitutions some form of restriction against the sale of land. In Yap, any transaction must be in accordance with local custom and tradition. In Pohnpei, the restriction against sale of land applies to foreigners as well as non-Pohnpeian citizens. In spite of this restriction, Pohnpeian landowners have found a lawful way to transfer title to their land to FSM citizens from the other states by treating the transfers as gifts and accepting payment as a private loan. This problem exemplifies the difficulty in regulating the use of private land.

The constraint on the sale of land discourages foreign investors from establishing business ventures. Pohnpei, under pressure from donor agencies, has enacted a land-use law which allows fifty-five year-leases, but it attaches so many conditions that no investor would want to obtain such a lease. The effect of this law is disappointing to donor agencies that have encouraged FSM governments to promote private sector development. The states need to enact new land-use laws that will allow long-term leases to attract investment in the private sector. The states must do their part to demonstrate to donor agencies and countries that they are serious about private sector development.

There also exists a conflict about money which has to do with revenue derived from two sources: tax on wages and gross business receipts, and fishing permit fees.

The national government collects wages and salaries tax, and gross receipts tax then pays each state its share of 50% as mandated by law. The dispute centers around the share of each state. The states wanted a split of eighty-twenty: 80% of the taxes collected going to the state, and 20% to the national government. Each state government was able to collect enough signatures to force the national government to subject the eighty-twenty formula to a nationwide referendum. The new formula failed to gain the constitutionally mandated prerequisite of at least two thirds of the votes cast in three of the four states. After the referendum, the national congress enacted a new revenue sharing formula of seventy-thirty. The national congress also mandated that the states should use the revenue received under the new formula only for education and health. The states argued that even though they would be getting a bigger share of the revenue, the attached condition made the law incapable of meeting their needs. But with the defeat of the eighty-twenty formula at the hands of the voters, the states shied away from risking another showdown with the national government over revenue sharing. So the seventy-thirty formula remained until 2004 when the national congress amended the revenue sharing law to restore the original fifty-fifty split.

A second money problem deals with the fishing permit fees. The national government, through the National Oceanic Resources and Management Agency (NORMA), issues licenses to foreign vessels to fish within the exclusive economic zone (EEZ). When the Micronesian Constitutional Convention met in 1975, the delegates did not foresee the revenue that would derive from issuance of permits to foreign fishing vessels.

The proposal to allow the national government to regulate the use of living and non-living resources in the EEZ was adopted without any attempt to require the national government to share the revenue with the states. To the delegates, the constitutionally mandated creation of the EEZ was a political statement intended to strengthen the hands of the Micronesian negotiators at the Compact negotiation.

In just a few years after the national constitution took effect, the revenue derived from the issuance of fishing permits to foreign fishing boats became a major source of funds for the national government, and the states had started to express interest in receiving a share of the fishing permit fees. There was no response from the national government so the states circulated a proposed constitutional amendment that would declare the states as the owners of the exclusive economic zone (The National Union, 1998). The amendment was greatly flawed, but the states were determined to push it in a nationwide referendum. The proposed constitutional amendment failed in the four states, but this issue continues to be a potential source of conflict in the relationship between the national government and the states.

Pohnpei has been the most vocal critic of the national government. In 1991, the Pohnpei State Legislature created a special committee to look into areas of state concern vis-à-vis the national government. The committee reported that Pohnpei was actually worse off at the beginning of Compact I because it was receiving less funding than under the Trusteeship. The committee also indicated that with the impending step-downs and termination of Compact I, the state would face a drastic cut in operating revenues. One way to increase revenue is to liberalize foreign investment law. The only way the state could manage this is to have the power to make decisions without interference from national government.

The committee report also leveled the following complaints against the national government:

- *Pohnpei needs more liberalized investment policies than the FSM is willing to provide.*
- *The FSM government is encroaching on the authority of the state by making payments to local governments and handing out Congress money to other institutions over the heads of state officials.*

- *FSM government is not compensating Pohnpei for its government services to non-Pohnpeian FSM citizens.*
- *Pohnpei is obligated to honor those FSM laws that may be against its best interest; e.g., open immigration policy.*
- *Land on Pohnpei is being lost to other FSM citizens, even though purchase of land by non-Pohnpeians is illegal.*
- *The presence of the national government on Pohnpei only intensifies negative social change as exemplified in the increased rate in crime and family breakdown.*
- *There are too many levels of government (national, state, municipal) for effective and decisive action.*
- *Pohnpei is ready for full independence, as opposed to being a part of the FSM's Compact of Free Association with the US.*

A glance at the list shows that only one has to do with the federal relationship with the national government. The first complaint has to do with foreign investment policies which the state shares with the national government. The other complaints are misleading. An example is the accusation made against the national government for failure to compensate the state for services (presumably education, health, and utilities) provided to non-Pohnpeian FSM citizens. In fact, employees from other FSM states who reside in Pohnpei pay taxes to the Pohnpei State treasury, but their children are not eligible to receive scholarships from Pohnpei. In addition, most of the national government employees from other FSM states enroll their children in private schools and join the health insurance program. When they are sick they utilize the services of the various medical clinics in Kolonia. These employees pay their utility bills, too. The committee report did not discuss the benefits Pohnpei receives from the presence of the national government and the College of Micronesia in the state. The committee also attributed the rise in crime rates and family breakdown to the presence of non-Pohnpeian FSM citizens. This claim is potentially divisive.

The problems articulated in the report of the special committee have little to do with the nature of the federal system of government. These tensions are political. Since the inception of the Federated States of Micronesia, Pohnpei has attempted several times to secede. This breakaway movement flares up from time to time, especially during economic hardship such as the Compact funding step-downs in the 1990s.

The criticism against the national congress for directly providing funds to the municipalities is valid, but this is not unconstitutional. The funds are used to build secondary roads, repair municipal offices, and extend power in the villages.

A possible incentive for the national government is that providing funds for infrastructure development in the villages make the national senators more influential with the local leaders and voters.

The complaint that FSM has too many levels of government is valid, but the national government is not responsible for creating municipal governments. The state could choose to utilize the traditional political structure already in existence. This arrangement will actually be less expensive for the states.

Despite being home to the government for 24 years, Pohnpei is still uncomfortable with this role. Although the discomfort of Pohnpei does very little harm, the picture of political instability it portrays is not conducive to economic development.

The ongoing Yap State Constitutional Convention is considering a proposal that would ask the voters, at ten-year intervals, whether the state should remain a part of the Federated States of Micronesia. At present Yap is considered as the most politically stable state in the federation. However, the fact that this proposal is being discussed in the state constitutional convention would mark Yap State as politically unstable and discourage potential investors in the local economy.

The structure of the federal system of government in the Federated States of Micronesia is not an insurmountable barrier to a good working relationship between the center and the periphery. To maintain political unity in Micronesia, a federal system is more acceptable than a unitary one. The resentment directed towards the national government is due to the division of national resources and the perceived co-optation of state powers. It will take an innovative approach and commitment to national viability and economic self-sufficiency on the part of the national and state leaders to reach an acceptable division of national resources and to solve the nuances of the federal relationship that exist in the Federated States of Micronesia.

4.2 Role of the Legislature vis-à-vis the Executive

The FSM Congress is given the power to elect the President and Vice President from among its four at-large members who represent the four states. These members serve a longer term of four years. The other ten members of Congress, who represent single-election districts, serve two-year terms. The National Congress has no term limit.

A quick glance at the lists of powers delegated to the three branches of the national government indicates where the power in the national government lies. The powers assigned to the National Congress fill more than four pages while the

ones entrusted to the Executive Branch fill only two. Aside from the power to elect the President and Vice President, the National Congress possesses three other important powers:

- *to impose taxes;*
- *to appropriate public funds;*
- *to override presidential veto.*

The power to elect the President and the Vice president gives the National Congress undue influence over the executive branch. If the president wants to run for reelection, he must act upon requests from members of Congress. Perhaps what impacts the president's decision the most is the knowledge that any use of his power might alienate the people who handed him the presidency.

The power to impose taxes gives the national congress the authority to control the financial policy of the nation. For instance, earlier this year congress altered the revenue sharing formula despite strong protest from state leaders. In addition, the power to appropriate public funds enables Congress to have influence over decisions that could result in conflicts of interest, such as projects in their election districts. The president is almost powerless to guide such decisions. Since 1992, the Congress has developed a practice of overriding presidential veto of appropriations for projects in their election districts. This year Congress overrode a presidential veto of an appropriation of \$2 million for public projects in the states, an act which put the nation in deficit.

The cornerstone of the relationship between the national congress and the executive branch is the doctrine of checks and balances. For this relationship to work properly, the functions of the legislative and executive branches must be complementary.

In the FSM, the political culture is devoid of ideology; and political parties are yet to develop. Lacking these necessary political ingredients, politics in the FSM is driven mainly by the interests of the states, as represented by the individual politicians.

One political phenomenon unique to the FSM government system is the cohesiveness that exists among the members of the national congress. The only centrifugal force is state interest. The members have an informal understanding that each state congressional delegation has exclusive authority to determine the funding priority for its state public projects appropriations. The direct result of this unity among the members is the ability of congress to override presidential veto with ease. Political observers contend that there are too many checks and no balance between the Congress and the President. This problem will persist until the political infrastructure in the system becomes fully developed.

The president however is not completely powerless. He is bestowed with such constitutional powers as the nomination of the principal officials of the government; appointment and reception of ambassadors; the conduct of foreign affairs according to statute; and the veto of bills enacted by the congress. The president derives additional power from the respect and prestige of his office as the head of government and head of state. This accords the president the power to persuade. This means that the president must be fully immersed in politics with the national congress and the state governments. The presidential position is key to the system, and success depends on the political skill to persuade and to build political alliances that transcend regional, ethnic, and cultural divides.

At the state level, the executive and legislative branches work relatively well together. Yap is a model of cooperation in a government that espouses the doctrines of separation of power. Yap practices cannot be replicated in other states because the Yapese have lived under a traditional political system that practiced a similar type of checks and balances as that built into the modern government.

Three states have fulltime unicameral legislatures. Chuuk, on the other hand, chose a bicameral legislature, with a senate and a house of representatives. The advantage of a bicameral legislature lies in the internal checks and balances between the two chambers. But this system of government is expensive and Chuuk can hardly afford the expense.

4.3 Economic Implications

The economic implications of the political problems come down to one thing: if people perceive the FSM to be politically unstable, nobody will make any significant investment in the country. The national and state governments need to work out a more acceptable solution for the good of the entire FSM.

The delineation of power should be reviewed. In matters concerning economic development, the national government's role should be to support state efforts. The states need a clearly designated area of jurisdiction with respect to foreign investment. The national government can step in if, for example, the foreign investor is involved in export from FSM – then the national government may regulate such an activity through taxation.

The other issue has to do with the sharing of fishing permit revenues. Much tension can be alleviated if the national government shared this income with the states. The matter of revenue is particularly important to the states because it is at that level that the cost of education and health is shouldered.

Another fiscal measure that may be adapted to avoid conflict over domestic revenue is the application of VAT as a substitute for business gross tax and duties on imported goods. VAT has two major advantages. The first is that since it is spread across a broad base, it may be assessed at a lower rate. Second, since VAT is not assessed against investment goods and exports, it makes the economic environment more conducive to the development of the private sector.

The implementation of VAT, however, must come with an amendment to the FSM constitution granting both the national government and the states the concurrent power to levy value-added taxes. This is necessary because as a tax on goods and services, VAT comes within the taxation power of the state – but also falls under the authority of the national government as a tax on imported goods.

There are concerns over the checks and balances applicable to the national Congress. The recent indictments against several members of the national congress for criminal conspiracy and theft of public funds are the symptoms of a corrupt national political system. Similarly, there are concerns over the incomplete separation of powers. For example, the Chuukese national senators have created the Chuuk State Committee on Improvement Projects despite the national court ruling in *Udot v. FSM* that national senators' involvement in choosing and approving projects for funding by the Committee is in violation of the separation of powers embodied in the FSM constitution and that the existence of the Committee itself is constitutionally suspect. Protection of public confidence and trust in the national government requires that these matters be carefully examined.

Promotion of transparency in the three levels of government in the Federated States of Micronesia requires an interested public. The lack of media to report what is happening in government is a big factor in the lack of public interest. One option is to encourage non-governmental organizations to report on the happenings in government.

To reduce the cost of government, the states need to consider amending their constitutions so that members of their legislatures are only paid when they are actually performing official work.

For the Federated States of Micronesia to effectively promote an attractive political and business climate for investment and economic development, governance standards must be raised substantially, through implementation of initiatives to achieve transparency and accountability – and in the end, by removing the potential for corruption.