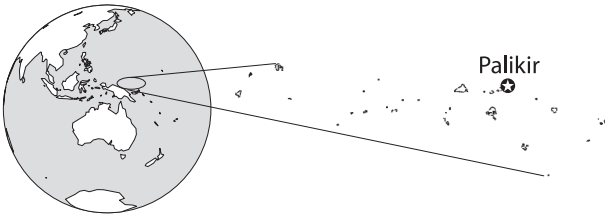


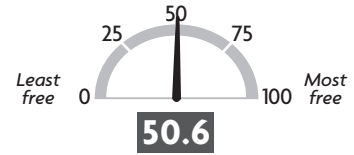
# MICRONESIA



World Rank: **142**

Regional Rank: **32**

## Economic Freedom Score



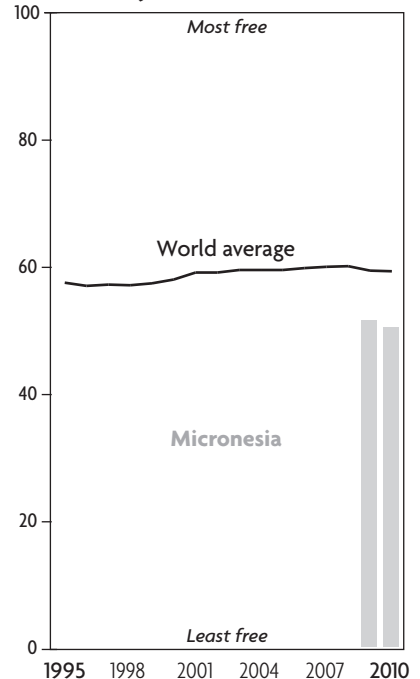
**M**icronesia's economic freedom score is 50.6, making its economy the 142nd freest in the 2010 *Index*. Its score has decreased by 1.1 points since last year. Micronesia is ranked 32nd out of 41 countries in the Asia-Pacific region, and its overall score is lower than the world and regional averages.

The Micronesian economy is heavily dependent on foreign aid, much of which comes as a result of a long-term compact with the United States. A substantial portion of economic activity is still concentrated in an outsized public sector, which is the largest source of employment. Government dominance reduces opportunities for private investment, and the state is not providing the institutional or physical infrastructure that is needed for an effective and efficient private sector. Fuelling corruption, Micronesia's legal framework remains inefficient and lacks transparency. Reform of the country's poorly performing tax regime has been delayed.

There are, however, a few bright spots. Average tariffs are low, and the economy is open to most imports. Inflation is well contained by the use of the U.S. dollar as the official currency, and tax rates are very low. Labor regulations do not constrain job growth.

**BACKGROUND:** Micronesia's population of approximately 100,000 is spread across a South Pacific archipelago containing more than 600 islands. Formerly administered by the United States as a U.N. Trust Territory, it became independent in 1986 and in that same year signed a Compact of Free Association with the United States. Under an amended compact, Micronesia receives \$100 million annually from the U.S. in addition to \$35 million in other U.S. government grants. As a result, the government sector employs more than half of Micronesia's workforce.

## Country's Score Over Time



## Quick Facts

**Population:** 0.1 million

**GDP (PPP):** \$0.3 billion

-1.0% growth in 2008

-1.7% 5-year compound annual growth

\$2,830 per capita

**Unemployment:** estimated to be over 10%

**Inflation (CPI):** 5.0%

**FDI Inflow:** n/a

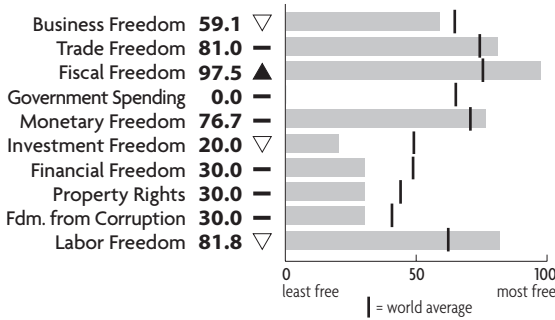
2008 data unless otherwise noted

Data compiled as of September 2009

## How Do We Measure Economic Freedom?

See page 457 for an explanation of the methodology or visit the *Index* Web site at [heritage.org/index](http://heritage.org/index).

## MICRONESIA'S TEN ECONOMIC FREEDOMS



### BUSINESS FREEDOM — 59.1

The overall freedom to start, operate, and close a business is constrained by Micronesia's regulatory environment. Starting a business takes about half the world average of 35 days, but the entry cost is high. Closing a business is time-consuming and costly.

### TRADE FREEDOM — 81

Micronesia's simple average tariff rate was 4.5 percent in 2007. Some high tariffs, import restrictions, inadequate infrastructure, and underdeveloped markets add to the cost of trade. Ten points were deducted from Micronesia's trade freedom score to account for non-tariff barriers.

### FISCAL FREEDOM — 97.5

Micronesia's tax regime is poorly documented, and collection rates are low. National taxes include a wages and salary tax (10 percent at the highest level); a 3 percent gross revenue tax on businesses with turnover that exceeds \$10,000 a year; and an excise tax on alcohol and tobacco products. Sales taxes are set and collected separately at the state level. In the most recent year, overall tax revenue as a percentage of GDP was only 11.7 percent.

### GOVERNMENT SPENDING — 0

Total government expenditures, including consumption and transfer payments, are extremely high. In the most recent year, government spending equaled 64.3 percent of GDP. Government and public enterprises account for nearly 40 percent of GDP and over 50 percent of paid employment.

### MONETARY FREEDOM — 76.7

Inflation has been moderate, averaging 4.4 percent between 2006 and 2008. The U.S. dollar is the official currency, and the government has few policy tools with which to affect inflation or interest rates. Ten points were deducted from Micronesia's monetary freedom score to adjust for measures that distort domestic prices.

### INVESTMENT FREEDOM — 20

The Foreign Investment Act of 1997 provides for non-discriminatory treatment of foreign investment, indicates the sectors in which foreign investment is not allowed, notes

additional regulation for certain sectors, and sets out guarantees regarding expropriation. All foreign investment is prescreened. The states license and regulate all other sectors and may impose additional restrictions. Each of Micronesia's four states has a unique foreign investment regime and can counter national policy. Regulations are non-transparent and applied inconsistently, and enforcement of contracts is weak. There are no limitations on currency or capital transactions. Foreign investors may not own land but may lease it for short periods.

### FINANCIAL FREEDOM — 30

Micronesia's small financial system is hindered by a large government presence and is not developed enough to generate and support dynamic entrepreneurial activity. The formal private sector is small and constrained by ineffective regulation, high credit costs, and scarce access to financing. Much of the population remains outside of the formal banking sector. The financial sector is dominated by banking, which includes one state-owned development bank and two commercial banks, one of which is majority government-owned. State influence in allocating credit is substantial, and government-controlled or government-owned banks make a majority of all loans. Bank lending has been concentrated on state-owned enterprises in recent years.

### PROPERTY RIGHTS — 30

Foreign ownership of land is not permitted. Lease terms for real property are controlled at the state level and often limited to relatively short periods. Squatters, long-standing and multiple disputes over land ownership, and the absence of property records make leasing land extremely difficult, costly, and uncertain in some locales. Transfer of title sometimes occurs informally, and this causes a lack of accurate public pricing information. Most original land records in Chuuk State were destroyed in a fire; the other three states have functioning land offices. Copyrights are protected by statute, but there are no trademark, patent, or other intellectual property rights regulations in effect.

### FREEDOM FROM CORRUPTION — 30

Corruption in Micronesia is perceived as widespread. The level of corruption varies in each island state, with Chuuk perceived as the worst. Micronesia has laws prohibiting corruption, and there are penalties for corrupt acts. Bribery is punishable by imprisonment for not more than 10 years and disqualification from holding any government position. Micronesia has not signed or ratified the U.N. Convention on Corruption. Many government officials also own businesses.

### LABOR FREEDOM — 81.8

Micronesia's labor regulations are relatively flexible, but its formal labor market is not well developed. The non-salary cost of employing a worker is low, and dismissing an employee is fairly easy.