

SECTION A

**ECONOMIC ASSESSMENT
TECHNICAL REPORT**

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EXECUTIVE SUMMARY

Overview of Economy

Driven mainly by tourism, the CNMI economy has experienced rapid growth since 1980 and particularly since 1984 as indicated by constant dollar Gross Island Product (GIP) which has increased at an average annual rate of 15.3 percent per annum. Garment manufacturing and U.S. financial assistance under the Commonwealth Covenant and other regular Federal grant programs also have been significant contributors to growth of the CNMI economy. Private sector employment increased 112 percent between 1984 and 1987, from 7,560 to 16,040, while that of government increased by less than 400 to 2,7%. Nearly all of the private sector employment gain occurred as a result of the importation of nonresident foreign labor. While official employment statistics are unavailable for 1988, there were 15,088 registered alien workers in the CNMI in 1988. Total employment in 1988 has been unofficially estimated at about 23,000. One of the consequences of the large increase in nonresident alien workers has been to depress wage rates. In 1984, the average private sector annual wage was \$5,184, higher than the \$4,648 average earned in 1987.

Since 1985, visitor arrivals in the CNMI have more than doubled, increasing from 142,300 to 301,800 in 1989; this represents an average annual growth rate of almost 21 percent since 1985. During this same period (1985-1989) the number of hotel rooms has risen from about 980 to almost 2,000. The Japanese market accounts for about 75 percent of the visitor arrivals, and a strong yen together with government policy encouraging overseas travel have been major factors contributing to the strong growth in CNMI's tourism sector. Foreign investment, mainly from Japan, has financed a major share of the increase in hotel rooms and other tourism-related facilities. To accommodate the influx of visitors and large increase in alien workers, the construction industry has had to expand tremendously as well. In addition to constructing hotel and other tourism-related facilities, construction related to infrastructure expansion and garment manufacturing plants also has been undertaken.

The overall pace of economic activity has placed a strain on the Commonwealth's power, water, sewerage, road and other infrastructure systems. As a consequence, utility service has not been satisfactory. To bring utilities and other infrastructure up to conventional service standards is expected to cost nearly \$250 million. Approximately \$153 million of this cost is anticipated to be funded by identified Covenant and other U.S. Government capital assistance programs. The remainder will have to be funded from future, as yet undetermined, U.S. Federal assistance, private developer impact fees, and the CNMI Government (through domestic tax and nontax revenues).

In accordance with the Special Representatives Agreement under the Covenant, the U.S. has committed \$126 million in capital funding for infrastructure and economic development during the 1986-1992 period. Receipt of these funds (in annual installments) was made contingent on the CNMI Government meeting prescribed performance standards, including reducing the size of government (operating budget as a percent of GIP), setting utility rates which pay the full cost of services, and demonstrating a decreasing reliance on Covenant financial assistance for government operations. The amount of future Covenant capital funding (in the post-1992 period) is likely to depend both on CNMI needs and progress in meeting the current performance standards.

The CNMI economy is heavily dependent on imports, both to meet the demands of the tourism industry, but also to meet the consumption standards of the resident population. Commodity imports in 1988 amounted to about \$220 million, 129 percent of personal consumption and 49 percent of GIP in 1988.

Impact of Tourism Expenditures

In FY-88 tourism expenditures were estimated at \$237.5 million, some \$192.9 million of this amount (81 percent) from Japanese visitors. Since visitor spending accounts for a large proportion of the Commonwealth's gross business revenue (46 percent in 1988), it obviously generates a large share of the economy's total employment and income. An interindustry model constructed by the University of Hawaii's School of Travel Industry Management in 1986 enables the measurement of the impact of visitor spending in the CNMI, through the computation of income and employment multipliers. The magnitude of the impact multipliers depends upon the interindustry structure of the economy (i.e., strength of linkages among industries), import and factor payment leakages (e.g., loss of income through necessity to pay overseas suppliers for imports, and the repatriation of profits and wages by foreign investors and workers in the CNMI), and the pattern or distribution of visitor expenditures by category of goods and services purchased. Taking into account 1988 data on the pattern of visitor expenditures and inflation, the interindustry model was updated and used to determine the impact of visitor expenditures in 1988.

In 1988, for each dollar of visitor spending, on average, \$.583 in household income was generated through both direct and indirect multiplier effects. Income multipliers differ among the principal market segments: Japan, U.S. and Other Foreign visitors. For the Japanese market, the largest, each \$1.00 of spending generates \$.570, and for U.S. visitors, the income multiplier is \$.640. Similar to other small island economies, the CNMI income multipliers are less than 1.0 because of large import requirements and consequent leakages. Total 1988 visitor expenditures of \$237.5 million generated about \$139 million in income, about 31 percent of Commonwealth GIP. With respect to employment, for each \$1.0 million in visitor spending, on average, an estimated 45.4 jobs are created, either directly (in enterprises directly serving visitors), or indirectly (in enterprises which supply the visitor industry). In 1988, direct and indirect employment created by the \$237.5 million in visitor spending was about 10,800, or about 47 percent of estimated total employment in the CNMI.

Other important measures of tourism impact provided by the model include government revenue, import and total leakages multipliers. The government revenue multiplier for all visitors is .087, which means that for each \$1.00 of visitor spending, on average, 8.7 cents in tax and nontax revenues are received by the CNMI Government. Given 1988 visitor expenditures of \$237.5 million, about \$20.7 million in government revenue was generated. In regard to imports, each dollar of visitor spending, on average, leads to \$.388 worth of import purchases. However, for the Japanese, who spend proportionately more on gifts, each dollar of visitor spending generates \$.412 in imports. Total visitor spending in 1988 generated an estimated \$92.2 million in imported goods and services. The total leakages multiplier takes into account factor payment leakages, such as repatriated profits and wages, in addition to import purchases. For all visitor spending, the total leakages multiplier was .522, which means that for each \$1.00 in visitor spending, 52.2 cents leaks out of the economy, and 47.8 cents of net export earnings remains in the economy. Based on the \$237.5 million in visitor expenditures, net export earnings amounted to about \$113 million in 1988.

To increase economic benefits per dollar of visitor spending, the CNMI needs to reduce

leakages, thus boosting net export earnings and income and employment multipliers. This can be done by strengthening intersectoral linkages, i.e. promoting the establishment and expansion of enterprises which supply goods and services to the tourism sector, using local labor and other domestic resources. In strengthening intersectoral linkages, emphasis also should be placed on encouraging greater participation of residents in the management and ownership of enterprises. Increased participation, both in enterprises directly serving tourists (e.g., hotels and restaurants) and in those which supply the tourism sector, would promote a wider distribution of economic benefits to residents, and would tend to reduce the leakage of profits and other forms of income from tourism.

Continued growth of tourism will depend on sustaining the rate of capital investment, both in tourism facilities and in infrastructure. Although accurate data are currently unavailable, tourism foreign investment has been a major contributor to the present construction boom and overall strong economic growth in the CNMI. Since foreign investment generates income and employment in the same way that visitor spending does, besides enabling the visitor industry to accommodate an increased volume of arrivals, it directly results in the creation of employment, household income and government revenue.

For this reason foreign investment should continue to be encouraged, but at the same time it is important for the CNMI to be able to monitor the magnitude and nature of investments, and to promote, to the maximum extent possible, the participation of residents through joint ventures. Some forms of foreign investment, such as smaller scale investment in accommodations, retail and wholesale trade, eating and drinking places, and transportation services, may displace comparable investments by residents, and therefore should be subject to screening and control. With respect to domestic investment, the CNMI Government in conjunction with private lenders, needs to promote a greater flow of investment in tourism-related enterprises. Through the Commonwealth Development Authority (CDA), both economic development loan funding (from Covenant monies) and management/technical assistance can be provided to resident entrepreneurs. Increasing the capacity of resident investors to absorb and more effectively utilize capital to start or expand tourism-related enterprises also needs to be given higher priority, through the allocation of increased resources to entrepreneurial and management development programs.

Economic Strategies and Policies

This section summarizes the strategies and policies judged amenable to CNMI government intervention to enhance and more equitably distribute the benefits of tourism, and to sustain growth at a pace compatible with a desired level of public services and maintenance of the environment.

Development impact Fees

To help defray the anticipated large cost of infrastructure needed to sustain tourism growth and meet acceptable public service standards, it is recommended that the CNMI implement a system for collecting impact fees from private developers. The impact fee system would have to be integrated with comprehensive land use and infrastructure planning.

Foreign Investment

1. While continuing to encourage foreign investment, it is recommended that the CNMI Government enact a foreign investment law which enables the monitoring and screening of investments. The law should include provisions for hiring and training citizens, promotion of citizens to management positions, and

for increased participation in the ownership of tourism enterprises.

2. Foreign investment law should contain specific incentives to encourage joint ventures, such as fiscal benefits, availability of loans to local partners, and access to government sponsored training.

Minimum Wage

The present minimum wage covering the private sector is too low to attract citizens, who rather than accept private jobs, typically seek government employment which pays much higher wages and salaries. It is recommended that the CNMI Government increase the minimum wage incrementally, and eliminate existing gaps in coverage of the law.

Visitor Expenditure Survey

To obtain more accurate data, it is recommended that the CNMI Government implement a regular periodic survey of visitors, utilizing a method whereby sampled visitors maintain an expenditure log or diary during their stay in the CNMI.

Interindustry Linkages

Strengthening interindustry linkages by promoting the establishment and expansion of businesses which supply tourist enterprises reduces the need to rely upon imports, and therefore cuts leakages. Reduced leakages, in turn, result in increased employment and income benefits per dollar of visitor spending. It is recommended that the CNMI Government through its Economic Advisory Task Force review promising business activities identified previously by the Saipan Chamber of Commerce, and to make recommendations with respect to industry and government action.

Domestic Investment

To increase the rate of new business formation and participation of CNMI citizens in the ownership of tourism enterprises, several factors need to be addressed. These include: availability of capital, entrepreneurial and management training, and technical assistance. It is recommended that the CNMI Government:

1. Encourage the Commonwealth Development Authority (CDA) to allocate more Covenant funds for economic development purposes and to accord higher priority to financial assistance for tourism-related projects.
2. In coordination with the intersectoral linkages task force and the Northern Marianas College, implement short-term technical assistance and training for entrepreneurs and managers of tourism-related businesses.
3. Establish specific programs aimed at providing financial and technical assistance to joint ventures.
4. Consider the feasibility of CDA taking equity positions in wholly-owned and joint venture projects as a means of facilitating increased participation of citizens in tourism sector ownership.

Business Establishment Survey

The current interindustry model is largely based on data obtained in 1985. A new survey of business establishments should be undertaken for the purpose of reconstructing the model. With the 1990 Census data expected to be available in 1992, undertaking the business survey and reconstructing the model would be facilitated. It is recommended that the CNMI Government undertake a business establishment survey for the purpose of updating the interindustry model, thereby enabling a more accurate determination of the impact of visitor spending on the CNMI economy.