

B. Country Chapter: Federated States of Micronesia

Table 13. Country Summary

Country:	Federated States of Micronesia
Prime Minister	President Joseph J. URUSEMAL (since May 11, 2003); the president is both the head of state and government.
Head of State	President Joseph J. URUSEMAL (since May 11, 2003)
Independence	3 November 1986 (from the US-administered UN Trusteeship)
Government	Unicameral Congress (14 seats; one elected from each of the four states to serve 4-year terms and ten elected from single-member districts delineated by population to serve 2-year terms; members elected by popular vote.)
Land area	702 sq km
Population	126,766 (2004 est.). Population growth is 1.8% (2004 est.).
Cities	Capital: Palikir
Provinces	Four states: Chuuk (formerly Truk), Kosrae , Pohnpei , and Yap.
Languages	English (official and common language), Trukese, Pohnpeian, Yapese, Kosrean, Ulithian, Woleaian, Nukuoro, and Kapingamarangi.
Natural Hazards	Typhoons (June to December)
Natural Resources	marine products, deep-seabed minerals.
Major Products	Economic activity consists primarily of subsistence farming and fishing, with fish as the main export.

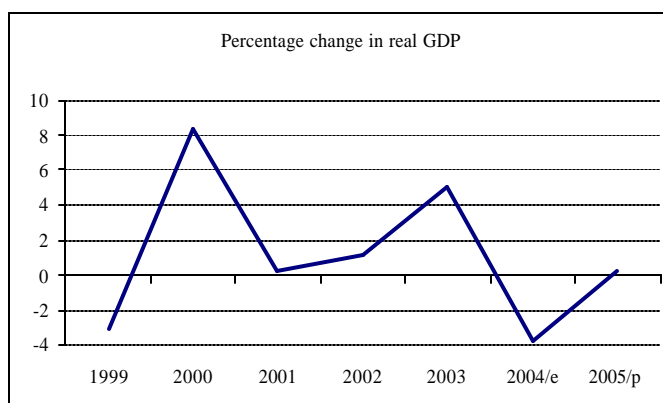
1. Economic Overview

88. The Federated States of Micronesia (FSM) consists of four states—Chuuk, Kosrae, Pohnpei, and Yap—which enjoy a high degree of political and economic autonomy (to date the latter states, particularly Yap, have enjoyed a higher degree of economic success). The FSM receives substantial levels of external assistance (aid per capita averaging US\$963 over 1999-2002), particularly from the United States through the Compact of Free Association. Compact I (1987-2001), provided the FSM with grants of about half of GDP. Compact II (2004-23) includes lower U.S. grant assistance and the creation of a Compact Trust Fund to promote economic self-reliance.

89. Real GDP fluctuated extensively over the period 1999-2004 (see Figure 5), growing at an average of 2 percent. The reduction in Compact transfers to the government budget and the delayed availability of infrastructure grants, contributed to the estimated contraction of 3.8 percent in 2004. However, the latter funds will become available in 2005 and with a slight expansion in private sector activity, growth in real GDP is projected to be 0.3 percent in 2005.

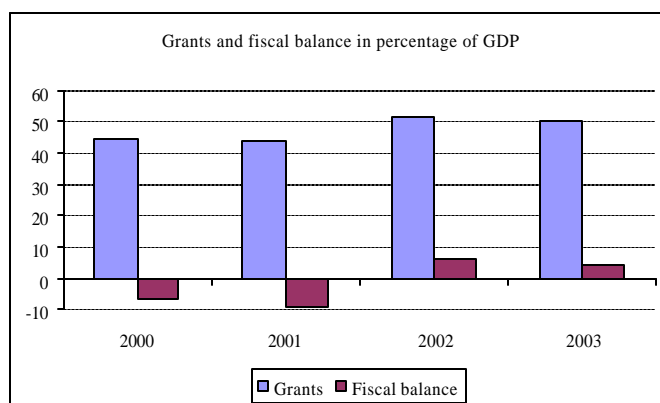
90. A low inflation of 2 percent is projected for 2005, reflecting the use of the U.S. dollar as the domestic currency. Owing to an unfavorable trade balance the current account deficit rose above 10 percent of GDP in 2004.

Figure 5. Growth in the FSM's Real GDP during 1999-2005.



91. Central government finances vary considerably with variations in grant disbursements (see Figure 6). Public debt stood at 26 percent of GDP in 2004.

Figure 6. Compact Grants and Fiscal Balance of the FSM during 2000-03.



92. Economic activity in the FSM is dominated by the public sector. Government expenditure accounted for about 70 percent of GDP in 2000-03. The private sector is steadily increasing in importance, but currently remains mainly a provider of services to the public sector. The latest available official data indicate that commercial agriculture, fisheries, and tourism totaled only 5 percent of GDP in 1996.

93. FSM controls a large ocean area in the Pacific region with significant fish stocks. Most commercial fishing activity is licensed out to foreign vessels. License fees declined by 45 percentage points to 5 percent of GDP in 2004 from the 1994 level, owing to unfavorable weather conditions and restrictive policies faced by foreign vessels.

2. Outlook

94. In the near term, the FSM economy should recover from the initial shock of the lower Compact grant disbursement in 2004, and the fiscal deficit should narrow. Beyond that, however, some significant challenges suggest the need for decisive action. Considering that more than 60 percent of total government revenue consists of external grants, of which more than half are Compact funds, the progressive declines in Compact grants imply that the combination of a large public sector and undersized private sector is unsustainable. There is pressing need to address the fiscal and structural problems that contribute to budgetary strains and slow growth.

95. To maximize the potential of agriculture, fishing, and tourism, structural reforms are required in land tenure, human capital investment, the public enterprise sector, and the legal and institutional framework to foster private sector activity. The relative success of Yap and Pohnpei in comparison to the other states shows that the right directions can produce the desired results.

3. Key Issues Shaping the World Bank's Involvement

96. The FSM became a World Bank member in 1993. Since that time the Bank's involvement in the FSM consisted of a range of regional initiatives and focused technical assistance, particularly in the fisheries sector. With GNI per capita of US\$2,090 in 2003, the FSM is an IBRD-eligible country.

97. The Bank stands ready to build its relationship with the FSM over 2005-08. The Bank recognizes that the FSM has access to substantial grant assistance from other development partners, particularly the US and Japan. Any potential Bank involvement will hinge on our ability to effectively leverage the key donor resources and build local capacity.

98. The Bank has held initial consultations with the government on areas of possible support and expects an agreement on these to be concluded in the near future. Tentatively, the discussions encompass two broad areas: (a) to assist in encouraging the growth of the private sector through targeted interventions (for example through support for tax, public enterprise or regulatory reforms), and (b) to progress the public expenditure management reform agenda, such as enhancing the government's ability to maintain key assets, particularly as the FSM strives to adapt to scheduled reductions in direct U.S. Compact funding.

4. Donor Coordination

99. Table 14 describes the nature of the assistance provided by the FSM's other development partners.

Table 14. Activities of Other Development Partners

<i>Development partner</i>	<i>Primary Activities</i>
ADB	The Country Strategy and Program Paper 2005-2006 (Updated, August 2004) identifies three areas of strategic priority for ADB activities in the Federated States of Micronesia: support for good governance; inclusive social development; and, pro-poor economic growth. An indicative ADF allocation of US\$8 million has been set for FSM over the coming 2-3 year period. ADB has two active lending operations in FSM totaling US\$33.8 in ADF credits (Basic Social Services Project, US\$9.2 million, closing 30/06/2007 and Private Sector Development Program) the second of which is a program loan. To date, no further lending operations have been identified for 2005 or 2006.
Australia	Australia is expected to provide about approximately A\$1.9 million in bilateral assistance over 2003-04 concentrated in education, training, and support to policy and management reform. In addition, a small grants scheme supports the work of community organizations and some government initiatives.
European Union	FSM has been allocated, Euro 4.8 million under the A-envelope for financial and technical co-operation and Euro 1.4 million under the B-envelope for the period 2002-2007 (the 9 th EDF). The program aims to contribute to outer island development through the identification and use of new and renewable sources of energy, and support to the work of non-state actors in the areas of conservation and environmental protection.
Japan	JICA supports volunteer-led programs in the areas of primary and secondary education, industrial development, development planning, environment, and regional health. In addition, the Ministry of Foreign Affairs provided US\$3.62 million in grant funding. The Government of Japan has no active lending operations in the Federated States of Micronesia at this time.
New Zealand	Support to the FSM is included within NZAID's program to other Micronesian states, with an allocation of NZ\$835,000 in 2003-04. The focus is on education and with limited grant funds for self-standing community development initiatives.
United States	A revision to the original Compact of Free Association (1986) was passed into law in December 2003. This compact is structured in terms of a sector grant (providing approximately US\$76 million per annum, decreasing by US\$0.8 million per annum) and a Trust Fund (providing approximately US\$16 million per annum, rising by US\$0.8 million per annum). Funds provided under the sector grants are allocated to activities in six priority sectors: infrastructure, education; health care; private sector development; environment, and; capacity building. The gradual increase in trust fund contributions are offset by a corresponding annual reduction in the sector grants. Trust funds contributions will not be utilized until the compact concludes in 2023, by which time it is intended that accrued trust funds would replace the annual sector grants.
Other	The following UN agencies have activities: ICAD, ITU, UNCTAD, UNESCO, WHO, WMO, UNEP, ITC, FAO, UNFPA, UNICEF, UNDP