

FEDERATED STATES OF MICRONESIA -
EUROPEAN COMMUNITY

COUNTRY STRATEGY PAPER
AND
NATIONAL INDICATIVE PROGRAMME
for the period 2002 – 2007

The Government of the Federated States of Micronesia and the European Commission hereby agree as follows:

- 1) The Government of the Federated States of Micronesia (FSM) (represented by <name and title>,) and the European Commission, (represented by <name and title>,) hereinafter referred to as the Parties, held discussions in Pohnpei fromtowith a view to determining the general orientations for co-operation for the period 2002–2007. *The European Investment Bank was represented at these discussions by <name and title>.*

During these discussions, the Country strategy paper and an Indicative Programme of Community Aid in favour of FSM were drawn up in accordance with the provisions of Articles 2 and 4 of Annex IV to the ACP-EC Partnership Agreement, signed in Cotonou on 23 June 2000. These discussions complete the programming process in FSM.

The Country Strategy and the Indicative Programme are annexed to the present document.

- 2) As regards the indicative programmable financial resources which the Community envisages to make available to FSM for the period 2002-2007, an amount of € **4.8 million** is foreseen for the allocation referred to in Article 3.2 (a) of Annex IV of the ACP-EC Partnership Agreement (A-allocation) and of € **1.4 million** for the allocation referred to in Article 3.2 (b) (B allocation). These allocations are not entitlements and may be revised by the Community, following the completion of mid-term and end-of term reviews, in accordance with Article 5.7 of annex IV of the ACP-EC Partnership Agreement.
- 3) The A-allocation is destined to cover macroeconomic support, sectoral policies, programmes and projects in support of the focal or non-focal areas of Community assistance. The Indicative Programme under chapter 6 concerns the resources of the A-allocation. It also takes into consideration financing from which FSM benefits or could benefit under other community resources. It does not pre-empt financing decisions by the Commission.
- 4) The B-allocation is destined to cover unforeseen needs such as emergency assistance where such support cannot be financed from the EU budget, contributions to internationally agreed debt relief initiatives and support to mitigate adverse effects of instability in export earnings. The B-allocation shall be triggered according to specific mechanisms and procedures and does therefore not yet constitute a part of the Indicative Programme.
- 5) Pending the entry into force of the Financial Protocol of the ACP-EC Partnership and within the framework of the present Country Strategy Paper and Indicative Programme, financing decisions for projects and programmes can be taken by the Commission at the request of the Government of the FSM, within the limits of the A- and B-allocations referred to in this document and under the condition that sufficient resources are available in the general reserve of the eight EDF. The

respective projects and programmes shall be implemented according to the rules and procedures of the eighth EDF until entry into force of the Financial Protocol for the Ninth European Development Fund.

- 6) The European Investment Bank may contribute to the implementation of the present Country Strategy Paper by operations financed from the Investment Facility and/or its own resources, in accordance with Articles 3 and 4 of the Financial Protocol of the ACP-EC Partnership Agreement (see chapter 6 for further details).
- 7) In accordance with Article 5 of Annex IV to the ACP-EC Partnership Agreement, the National Authorising Officer and the Head of Delegation shall annually undertake an operational review of the Indicative programme and undertake a mid-term review and an end-of-term review of the Country Strategy Paper and the Indicative Programme in the light of current needs and performance.
- 8) The agreement of the two parties on this Country Strategy Paper and the National Indicative Programme, subject to the ratification and entry into force of the ACP-EC Partnership Agreement, will be regarded as definitive within eight weeks of the date of the signature, unless either party communicate the contrary before the end of this period.

Signatures

For the Government of
the Federated States of Micronesia

For the Commission

.....

.....

Date:

TABLE OF CONTENTS

Part A :	CO-OPERATION STRATEGY
	EXECUTIVE SUMMARY
Chapter 1:	EC Co-operation Objectives
Chapter 2:	The National Policy Agenda
	2.1 The National Development Strategy
Chapter 3:	Analysis of the political, economic and social situation
	3.1 Political situation
	3.2 Economic situation
	3.3 Social situation
	3.4 Environment and Resource Management
	3.5 Medium-term challenges
Chapter 4:	Overview of past and ongoing co-operation
	4.1 EC Co-operation
	4.2 Bilateral assistance
	4.3 Multilateral assistance
Chapter 5:	EC Response strategy
	5.1 Objectives of future co-operation
	5.2 Areas of future co-operation
	5.3 Coherence and complementarity
Part B:	INDICATIVE PROGRAMME
Chapter 6:	Indicative Programme
	6.1 Introduction
	6.2 Financial instruments
	6.3 Areas of concentration
	6.4 Macro-economic support
	6.5 Intervention logic and timetable
	6.6 Intervention framework focal sector
	6.7 Chronogramme of activities
	6.8 Indicative timetable for commitments and disbursements
Annexes	

<p style="text-align: center;">PART A : FEDERATED STATES OF MICRONESIA COUNTRY STRATEGY PAPER</p>
--

-

EXECUTIVE SUMMARY

The purpose of this Country Strategy Paper is to provide a framework for EC co-operation with the Federated States of Micronesia (FSM) under the Cotonou Agreement, based on global objectives of EC-ACP co-operation, FSM's own development policy and a comprehensive analysis of the political, economic and social situation of the country.

The FSM, which is made up of four states, has a total land area of 701 km², with a population of 116,000, and an Exclusive Economic Zone (EEZ) of 2.9 million km². The GDP per capita is € 2,079. The FSM gained independence in 1986 under an agreement with the United States, which provided considerable financial assistance to the FSM during the last 15 years. This period has been marked by an overdependence on U.S. aid.

Compact funding has resulted in the development of the government as the core influence on the economy. Public sector growth combined with relatively high wages paid to public servants has removed private sector initiatives and incentives for individuals to contribute to the productive base of the economy.

With the progressive reduction of U.S. grants, the Government has begun to implement a comprehensive adjustment programme which focuses on government expenditure reductions and structural measures aimed to promote private sector activities. Renegotiations with the U.S. on a new long-term assistance package are currently holding up domestic and foreign investment.

The major challenges facing the Government are to develop and diversify the productive capacity of the economy and accelerate private sector development in view of employment creation. The focus of private sector development should be on the key areas of fisheries, tourism and agriculture, which have the largest long-term growth potential.

Consistent with these objectives and taking into account activities of other donors, the Government of the FSM has selected the energy sector as the focal sector for support, absorbing 85 percent of the A-envelope (€ 4.08 million). The main objective is to improve - through the identification and promotion of new and renewable sources of energy - the development of the outer islands, where social indicators suggest lower standards of living and a higher incidence of poverty.

The remaining 15 percent (approx. € 0.72 million) will be allocated for support to the work of Non-State Actors in the areas of conservation and environmental protection. The B-envelope amounts to € 1.4 million.

1. EC-COOPERATION OBJECTIVES

In accordance with Article 177 of the Treaty Establishing the European Community, community policy in the sphere of development co-operation shall foster:

- the sustainable economic and social development of the developing countries, and more particularly the most disadvantaged among them;
- the smooth and gradual integration of the developing countries into the world economy;
- the campaign against poverty in the developing countries.

These objectives have been confirmed and reinforced in Article 1 of the ACP-EC Partnership Agreement, signed in Cotonou on 23 June 2000, which puts main emphasis on the objective of reducing and eventually eradicating poverty. Co-operation between the Community and FSM shall pursue these objectives, taking into account fundamental principles laid down in Article 2 of the Agreement – especially the principle of encouragement of ownership of the development strategies by the countries and populations concerned – and essential and fundamental elements as defined in Article 9.

In their Statement on the European Community's Development Policy of 10 November 2000, the Council of the European Union and the European Commission determined a limited number of areas selected on the basis of their contribution towards reducing poverty and for which Community action provides added value: link between trade and development; support for regional integration and co-operation; support for macro-economic policies; transport; food security and sustainable rural development; institutional capacity-building, particularly in the area of good governance and the rule of law. The Statement also specifies that in line with the macro-economic framework, the Community must also continue its support in the social sectors (health and education), particularly with a view to ensuring equitable access to social services.

The Treaty establishing the European Community foresees that the Community and the Member States shall co-ordinate their policies on development co-operation and shall consult each other on their aid programmes, including in international organisations and during international conferences. Efforts must be made to ensure that Community development policy objectives are taken into account in the formulation and implementation of other policies affecting the developing countries. Furthermore, as laid down in Article 20 of the Agreement, systematic account shall be taken in mainstreaming into all areas of co-operation the following thematic or cross-cutting themes: gender issues, environmental issues and institutional development and capacity building.

The above objectives and principles and the national policy agenda presented in the next chapter constitute the starting point for the formulation of the present Country Strategy Paper, in accordance with the principle of national ownership of development strategies.

2. THE NATIONAL POLICY AGENDA

During the last 15 years, the United States has provided considerable financial assistance to the Federated States of Micronesia (FSM) under the Compact of Free Association. With the progressive reduction of U.S. grants, the Government of the FSM began to implement a comprehensive adjustment programme in 1996. It was mainly designed to correct large imbalances in the public sector and external accounts and to increase the economy's self-reliance by reducing the role of the public sector in economic activity. The reform programme focuses in particular on government expenditure reductions and on structural measures aimed to promote private sector activities.

2.1 The National Development Strategy

The FSM Planning Framework (PF) document for 1999-2002 contains a comprehensive set of policies and strategies for achieving the overall economic goal of the Government, which is "to strengthen the economy and make it more resilient to changes in the world economy".

The objectives and strategies outlined in the FSM PF document are:

Objective 1: Reduce reliance on external aid funds.

Strategies:

- Reduce the size of the public sector.
- Increase public and private savings and investment.

Objective 2: Diversify sources of external funding and investment.

Strategies:

- Attract additional sources of foreign aid.
- Access finance from multilateral agencies.
- Attract foreign private investment.

Objective 3: Increase the size and competitiveness of the productive sectors.

Strategies:

- Provide incentives to productive activities.
- Improve efficiency of land use.
- Focus human resource development investments on productive sectors.

3. ANALYSIS OF THE POLITICAL, ECONOMIC AND SOCIAL SITUATION

The Federated States of Micronesia (FSM) comprises the four states of Yap, Chuuk, Pohnpei and Kosrae. The country has limited land-based resources, but is endowed with abundant and varied marine resources. The national capital and the centre of the national government is in Palikir in the state of Pohnpei.

The population was just over 116,000 in 1999. Annual growth rate was around 2 percent in 1990-1999. Growing urbanisation and a decline in subsistence production have increased the population density in each of the four state capitals. Over the past 15 years Pohnpei has rapidly developed as the most westernised state, in large part because the national government is located there. Chuuk is the most populous state, accounting for about 50 percent of the total population. Emigration, mainly to the United States, in the 1990s played a key role in lowering the population growth rate. About 16 percent of the population live abroad.

The four states of the FSM are separated by large expanses of water. Prior to western contact, the isolation led to the development of unique traditions, customs and languages on each of the islands. Cultural diversity is typified by the existence of eight major indigenous languages. Sharing, communal work and the offering of tributes to the traditional leaders are fundamental to the subsistence economic system and the culture of the island societies of the FSM.

3.1 Political Situation

The Federated States of Micronesia became an independent nation in 1986 under an agreement with the United States, known as the Compact of Free Association, which set out the economic and political ties between the two countries over the period 1986-2001. The period of independence has been marked by an overdependence on U.S. aid. The national currency is the U.S. dollar.

An overview of the Compact Agreement is provided in Annex 2.

Australia and New Zealand are relatively minor players given the dominance of U.S. influence.

Since independence, the FSM has maintained a stable government. However, geographic dispersion and the linguistic, cultural and historical differences between the states can make national consensus difficult, i.e. it delays decision making as all four states have to be consulted before there is agreement at the national level. Each state must be concerned with the demands of its population centre and the unique requirements of its outer islands. The traditional chiefly systems are amongst the most critical factors underpinning community cohesion. The divergence of living standards between the states may cause resentment. Given the strong cultural and social systems, the role of government is much larger than would normally be the case in most market economies and will be slow to change.

Each of the four states has a high degree of autonomy with its own constitution. There are three layers of government, with the legislative, executive and judicial branches replicated at national and state levels. Traditional leaders (in Pohnpei and Yap) also continue to exert political influence.

The Congress of the FSM is unicameral with fourteen senators, one from each state elected for a four-year term, and ten serving two-year terms and elected on the basis of population apportionment. The President and Vice President (who cannot be from the same state) are elected to four-year terms by the Congress, from among the four-year senators, and the vacant seats are then filled in special elections. Election outcomes generally hinge on peneinei (family) and keinek (clanship).

The state governments under their constitutions are structurally similar to the national government, with each state having executive, legislative and judicial branches. Each state has its own governor elected by popular vote for a four-year term, an elected state legislature and a state court.

At the municipal level, the traditional village leaders play an active role in government in some of the states. Heads of local government are mostly traditional chiefs or other

prominent members of the community. The Council of Chiefs has veto power over legislation affecting traditional ways.

3.2 Economic Situation

While the Compact agreement has been successful in meeting the political goals of establishing independence and a stable democratic government, it has been less successful in stimulating economic development and self-sustaining growth in the country. Over the last decade, and despite more than US\$ 1 billion worth of U.S. assistance, real GDP per capita (€ 2,079) has stagnated.

GDP per capita	€ 2,079
GDP growth rate (2000)	2.5
Inflation rate (2000)	3.2
Current expenditure (2000 est.)	€ 141.3 million
Current expenditure as % of GDP	54
Fishing access revenue (2000 est.)	€ 19 million
Total exports to the EU (1999)	€ 0.8 million
Total imports from the EU (2000)	€ 1.1 million

The economic assistance provided by the U.S. exerts an enormous influence on the economy of the FSM. Although this assistance has diminished in both absolute and relative terms over the past decade, it remains an extremely important factor to the economy. The termination of secure Compact related funding at the end of 2001 and renegotiations with the U.S. on a new assistance package are currently holding up domestic and foreign investment. In its negotiations with the U.S. on a new assistance package, FSM has proposed the creation of a trust fund which would be mainly funded through official transfers and concessional lending and would enable investors to lengthen their planning horizons.

Compact funding has resulted in the development of the government as the core influence on the economy. Almost half of total Compact assistance has been spent to support government operations (wages, salaries and benefits). Public sector growth combined with relatively high wages paid to public servants has removed incentives for private sector initiatives. Private sector activity comprises largely services and distribution and there is little indigenous private commercial production or investment. A money economy with modern communications, transport and utilities has developed, but is limited to the population centres of the main islands.

The FSM economy is dominated by three types of economic activity: 1) subsistence farming and onshore fisheries, 2) wholesale/retail trade, 3) the provision of government services. FSM has rich fisheries resources. The main source of income from the offshore fishery is from annual access fees for foreign vessels, which amounted to US\$19 million in 1999. The traded goods sectors of commercial agriculture, fisheries and tourism contribute between only one and two percent of GDP.

Over the past five years, the FSM has designed and implemented an economic reform programme. The principles underlying the overall economic strategy are: 1) long-term

stability and security, 2) improved economic, and environmentally sustainable, growth and development, 3) improved efficiency and effectiveness of social services, 5) self-reliance. The challenge the FSM faces is to negotiate a new economic assistance package with the United States based on promoting social and economic development.

3.2.1 Economic Challenges and Opportunities

Both the national and state governments recognise the importance of expanding foreign investment, diversifying the productive base and supporting private sector activity in order to generate employment for a rapidly expanding labour force.

The adoption of a new Foreign Investment Act, in October 1998, should help to improve the foreign investment regulatory framework. The remaining obstacles to investment include access to land, its use for collateral, and procedures for land lease. Private sector development should focus on the key areas of fisheries, tourism and agriculture as the sectors with the largest long-term growth potential.

Fisheries

Given the extensive area of the Exclusive Economic Zone and the large and valuable marine resources, the fisheries sector offers substantial potential for economic growth. FSM has an EEZ of almost 3 million km² which contains large stocks of commercially valuable tuna species, the country's largest and most valuable natural resource. To date nearly all commercial offshore fishing activity has been undertaken by foreign vessels. There are only 300 full-time FSM employees in the offshore fisheries sector. Annual access fees for foreign tuna vessels amount to US\$19 million. In 1999, 478 foreign fishing vessels were active in FSM's EEZ.

Agriculture

The agricultural sector is essentially dualistic with a dominant "subsistence" component accounting for one third of national employment, together with a relatively low level of semi-commercial and commercial activity. Agricultural production for export is a minor consideration for the FSM. The limited natural resource base for agricultural production and the narrow industrial base for food processing limit the range and quality of export commodities and the potential for substituting for highly processed food imports.

Federal and state government policies and strategies place high priority on improving subsistence and semi-commercial smallholder production and self-sufficiency. Subsistence agriculture serves as a potential safety net in case of a fall in formal employment and cash income. The value of subsistence production at present is US\$21.9 million, whereas food imports amount to US\$25.3 million.

Tourism

The tourism sector in the FSM is still in its infancy and has been experiencing difficulties with falling arrivals and low occupancy rates during the 1990s. The service being provided is generally of low quality and high cost compared with other regional destinations. Weak infrastructure affects the quality of the tourism services and makes access difficult to many destinations. Tourist and visitor arrivals have slumped from a peak of 26 000 in 1994 to an estimated 17 000 in 2000. The sector has been adversely affected by the Asian (and particularly Japanese) recessions.

3.3. Social situation

The external support provided to the FSM has produced a standard of living, especially in the urban centres, that is generally higher than elsewhere in the region. Income per capita and literacy rates have been well above the regional average, with most health indicators comparable to the average of other Pacific Island countries.

The outer islands are different demographically, culturally and economically, and are generally located at such distances that all aspects of central governance are expensive, demanding and generally plagued by inefficiencies. People living in the more remote outer islands are among the most vulnerable groups in society. They have limited opportunities for economic activity and for creating adequate avenues for employment. This lack of opportunity results in an outflow of youth from the outer islands to the major population centres.

The FSM has a young and rapidly growing population, with some 50 percent less than 18 years of age. Unemployment rates are highest among the youth and career opportunities in the public sector will be reduced as a result of the reform process. The working-age population is under-employed and underpaid, especially the women. Wage differentials remain a critical issue. Average public sector wages are close to double those of the private sector, which is a disincentive for participation in the private sector. As the reform process implies a major reduction in public sector wages at all levels, migration may continue to be significant.

POPULATION AND SOCIAL INDICATORS 1998

POPULATION INDICATORS	1998
Total population	114.1
Annual population growth rate (% change)	2.1
SOCIAL INDICATORS	
Total fertility rate (births per woman)	5.0
Maternal mortality rate (per 100 live births)	-
Infant mortality rate (below 1 year, per '000 live births)	46.0
Life expectancy at birth (years)	67.0
Female	67.0
Male	63.0
Adult literacy (%)	71.0
Primary school enrollment (% of school age)	83.0
Secondary school enrollment (% of school age)	44.0
Child malnutrition (% age under 5 years)	15.0
Population with access to safe water (%)	44.0
Population with access to sanitation (%)	51.0
Human Poverty Index	26.7

3.3.1 Social indicators

The basic economic unit in the FSM is the household, which consists of extended families. A recent Household Income and Expenditure survey indicated that about 40 percent of FSM households might be considered low income. The UNDP Human Poverty Index of 26.7 indicates the fourth highest extent of poverty amongst the Pacific Island countries, taking into account the number of illiterate adults (29%), the percentage

of households without access to safe water (55%), without access to health services (25%), and the percentage of children over the age of five who are underweight (15%).

3.3.2 Women's rights

In the FSM women lag significantly behind males in almost every respect. They have a smaller share of the job market, are mainly employed in subordinate, low-paid jobs, are weakly organised and underrepresented in the policy-making process at state and national level. The government, recognising the need to improve the status of women and to include them in the development policy-making process, has recently incorporated women's issues within planning and operations practices. A Women's Coordination Unit has been established within the Department of Health, Education and Social Affairs. At state levels, Women's Interest Officers have been appointed with broad responsibilities for input into policy-making, especially for the social sectors.

3.3.3 Education and health

The FSM is not producing the range of skills required by a modernising economy. Levels of adult literacy and primary and secondary school enrolments are high by regional standards, but there are concerns over the declining standards and poor quality of education. Education funding is almost totally reliant on U.S. assistance. Local revenues contribute less than 2 percent of total funds for education. Total expenditure (national and state) on education amounts to approximately 13.4 percent of GDP.

The people of the FSM view free health care as entitlement. The quality of health care is questionable. There is a high demand for and use of out-of-country referrals, even for routine medical services. Inadequate maintenance and management as well as the lack of supplies, drugs and equipment are major obstacles to improving the health care system. There is also concern over the equal distribution of health care between income groups and among islands.

The FSM allocates less than 6 percent of GDP for health, compared to 13,4 percent for education. U.S. grants account for most of FSM's health expenditure.

3.3.4 Water and sanitation

Other health problems are related to the quality and availability of water and sanitation, such as safe drinking water supply, solid and hazardous waste disposal, and domestic and commercial wastewater disposal. Sanitation is a major concern in the urban centres and the outer islands, especially on the atolls, where the high water tables prevent the effective use of septic tank systems. An improper and poorly maintained waste management system - less than 50 percent of the urban population is connected to sewerage systems - has led to waterborne diseases. Shortcomings in these areas are due to limited awareness and understanding of water use and conservation issues.

3.4 Environment and Resource Management: Natural Resources

High birth rates, a limited land area, and migration to state capitals have contributed to growing environmental problems. There is a need for proper waste management and sewage disposal. Policies to restrict pollution, to effectively manage coastal water resources and preserve the country's bio-diversity need to be further developed. Appropriate national and state environmental regulations exist, but enforcement is hindered by limited institutional capacity. Sustainable management of resources such as

aggregate, offshore minerals and renewable energy are other issues in the quest for development in the FSM.

3.4.1 Energy

The FSM relies mostly on imported fossil fuels for its energy generation. This places an increasing strain on the economy, as oil imports have increased in recent years due to a steady growth of the urban population and an increase in the load on power stations. A priority objective of the government is the provision of an adequate and secure supply of energy to meet the needs of households, commerce and industry and considered to be crucial for the sustainable growth and equitable development of the country.

Diesel plants supply the main urban centres and surrounding areas in each state with electricity. Compact funding worth more than US\$97 million has been spent to improve power generation capacity, mainly to build electricity-generating plants for the urban centres. In 2000, more than 50 percent of FSM dwellings had access to a secure supply of electricity. This figure does not include most of the rural areas and outer islands which have no access to grid electricity. The supply of conventional energy to rural areas and outer islands is generally considered to be uneconomic.

In the past, the South Pacific Applied Geo-science Commission (SOPAC) has assisted the FSM in the identification of renewable energy sources in order to reduce the dependence on imported fossil fuels – although the FSM has not yet fully exploited the potential of renewable energy resources. A national energy database compiled by SOPAC has identified the country's new and renewable energy sources and revealed an ample supply of indigenous energy sources that could be exploited, such as wind and solar energy, coconut oil/diesel hybrid systems, and hydro-electric power. It is expected that the use of new and renewable sources of energy in the outer islands will contribute:

- to improving the standards of living of the people in the outer islands and increase their productivity;
- to the protection of the environment and to preventive health. People in the outer islands are currently relying mainly on wood fuel and batteries for their energy needs. This leads to fast depletion of forested areas and, because batteries are not disposed of in due form, to dangerous pollution constituting also a serious health hazard. In more general terms, the use of renewable energy, as opposed to fuel sources (all energy production in the FSM is presently generated from diesel), is one of the most efficient ways of countering global warming;
- to strengthening the balance of payments position. The gradual substitution of fossil energy generation by renewable sources should contribute to decrease the import bill. This is of particular importance in view of the progressive reduction in Compact funding.

3.5 Medium term challenges

With the progressive reduction of U.S. grants, the immediate challenges facing the Government are to reduce the size of the public sector, reduce its reliance on foreign aid and strengthen the balance of payments position. The other most important issues concern the diversification of the productive base of the economy, the expansion of foreign investment and the support to private sector development in view of employment

creation. Private sector development should focus on the key areas of fisheries, tourism and agriculture.

Another major challenge is to spread the benefits of growth more widely across the country by improving the living conditions in the rural areas and outer islands. Addressing the basic energy needs of the people in these areas through a sustainable, environmentally sound and secure energy supply can supplement the long-term energy needs of the country, reduce the dependence on imported fossil fuels and decrease the Government's import bill.

4. OVERVIEW OF PAST AND ON-GOING COOPERATION

4.1 EC Cooperation

The FSM is a new ACP Member State in the Pacific and has no record of past cooperation with the European Union.

4.2 Bilateral assistance

The United States of America is by far the most important donor of the FSM. Compact funds support most of FSM's national and state government services, including the education and health services. Apart from the Compact, the U.S. is also providing federal grants on a project basis, through different U.S. departments.

The sheer magnitude of Compact financial assistance (around US\$1000 per capita per year) has had a dramatic impact on the country. Compact funding has resulted in the development of the government as the core influence on the economy. Almost half of total Compact assistance has been spent to support government operations (wages, salaries and benefits). Public sector growth combined with relatively high wages paid to public servants have removed private sector initiatives and incentives for individuals to contribute to the productive base of the economy.

Hence the lessons learned from the U.S. experience suggest that aid should be focused on specific actions and closely monitored and audited.

FSM is involved in Compact renegotiations for a new long-term funding package for the next 20 years. Part of the funds to be allocated will be invested in a trust fund so as to allow the U.S. to withdraw its financial support at the end of the 20-year period. U.S. assistance will be targeted to health, education and infrastructure.

Transition funding will be provided during 2002 and 2003 (US\$97 million per annum). More details about Compact funding are provided in Annex 2.

Japan is a major donor of technical and grant assistance in the area of infrastructure. Technical support has been provided for a road maintenance programme in the state of Chuuk. More than US\$4 million was allocated for seaport improvement and artisanal fisheries development in Kosrae. A grant of US\$4 million was provided for the development of a fishing port in Pohnpei.

Australia provides approximately US\$1 million of grant aid each year to the FSM for social infrastructure projects (health and education) and scholarship awards.

4.3 Multilateral Assistance

4.3.1 Asian Development Bank

Policy reform and dialogue are the major focus of ADB's assistance to the FSM. ADB technical assistance is intended to help build capacity at state level and aid coordination with other funding agencies. ADB's operational strategy for the FSM focuses on the need to shift the economy from one that is overly controlled by the public sector to an economy that is increasingly sustained by an open and competitive private sector. The Private Sector Development Programme aims to create more jobs and reduce dependence on external assistance and is backed by loans totaling US\$ 13 million. In social sector reforms, emphasis has been put on the outer islands to help improve basic social services delivery, consistent with ADB's poverty reduction strategy. The Basic Social Services Project provides the start in improving health and education services delivery. Subsequently, the needs of this sector will be addressed through Compact funding with ADB providing the necessary aid coordination.

The ADB has recently signed a Poverty Partnership with the FSM. Under this agreement, ADB and the FSM Government will jointly prepare a poverty reduction strategy by drawing on existing and forthcoming national development strategies, supplemented by community-based poverty consultation workshops. The strategy will guide future ADB assistance to the FSM.

Since joining the ADB in 1990, the FSM has received four loans for a total amount of US\$43.2 million. Social infrastructure accounts for 50 percent of the loans, while agriculture, natural resources and other sectors account for 25 percent each.

United Nations

Multilateral donor agencies like those of the United Nations system, primarily UNDP and UNICEF, offer grants mainly in the form of technical assistance.

5. EC RESPONSE STRATEGY

5.1 Objectives for future co-operation

The response strategy takes into consideration the basic principles of EC's Development Policy, as well as the results of the preceding analysis of the political, economic and social situation in FSM, the longer-term development goals and Government's own priorities. Past experiences of other donors activities are also included in the strategy. The future co-operation between FSM and the EC in the context of the Cotonou Agreement has been designed to contribute in particular:

- to ensure that EC funded projects have a positive impact on living conditions of all beneficiaries, in particular the people in the rural areas and the outer islands, without a distinction according to social, ethnic, political, religious or gender criteria;
- to ensure that the operations can be sustained in order to guarantee a long-lasting flow of benefits to the target groups and to the country as a whole;
- to ensure that the projects and programmes funded under the present Agreement are in areas where the EC is perceived to have a comparative advantage, compared to other donor organisations, and where it is possible to operate in close partnership with established and reputable regional agencies that have already established networks in the FSM.

In the neighbouring Micronesian country of Kiribati, the EC has already successfully implemented a rural energy programme .

5.2 Areas of future co-operation

In recent years, the focus of investment has been mainly on urban development resulting in a growing urban drift and/or out-migration. The Government recognises the need of spreading the benefits of growth more widely across the country and of improving the living conditions in the rural areas and outer islands. Addressing the basic energy needs of the people in these areas through a sustainable, environmentally sound and secure energy supply can supplement the long-term energy needs of the country and reduce the dependence on imported fossil fuels.

To redress the imbalance between the urban and rural/outer island amenities' provision and achieve a more equitable distribution of resources, the Government has selected the **energy sector** as the focal sector for 9th EDF support, in particular the identification and promotion of new and renewable sources of energy for outer island development. This objective is coherent with the Country Support Strategies of most of the other Pacific Island countries, which also feature outer island development as focal sector.

The focal sector will address a number of crucial development concerns. First, it contributes to improving the living conditions of people in the rural areas and outer islands and allows them to contribute more productively to the economy. Second, it contributes to environment protection and preventive health. People in the outer islands rely mainly on wood fuel and batteries for their energy needs. This leads to fast depletion of forested areas and, because batteries are not disposed of in due form, to pollution constituting also a serious health hazard. Third, it contributes to diversifying the resource base of the economy and to strengthening the balance of payment position, as the gradual substitution of fossil energy generation by indigenous renewable sources should contribute to decrease the country's import bill.

The following specific objectives will be pursued within this sector:

- an environmentally sound, reliable and sustainable energy supply for outer island development;
- sustainable management of indigenous resources with due respect to environmental considerations;
- capacity building and institutional strengthening in the management of FSM's indigenous energy resources.

The Government proposes to make 85 percent of the A-envelope or € 4.08 million available for the development of this sector.

Involvement of Non-State Actors

Conservation and Environmental Protection

FSM is seeking to preserve its natural environment and perpetuate its conservation ethic for the benefit of present and future generations. With recent budget cuts diminishing the government's ability to manage and protect the nation's natural resources, non-government and community-based organisations have begun to assume resource management responsibilities. The government recognizes the important role of non-state actors (NSAs) in this regard and capacity building of NSAs is a stated aim of both national and state governments. The FSM government has recently given its support to

the establishment of a national NGO network, FSMANGO, and is encouraging government/NGO/private sector resource management partnerships to enhance conservation and environmental protection.

Four areas in which NSAs can contribute to sustainable development are:

- the conservation of the country’s unique natural environment through co-operation with municipalities, traditional leaders and communities to establish and/or identify key conservation areas;
- local community support and public awareness about the benefits derived from protecting the country’s natural systems and environment;
- the development of a joint vision by community stakeholders and implementation of action plans to improve their communities;
- acting as an advisory body to the government and project planners as regards traditional community knowledge and incorporation into modern conservation strategies.

The Government has been instrumental in the establishment of a national NGO network, FSMANGO. While the development of this network is the responsibility of the NGOs, the Government will assist in terms of capacity building and funding, by allocating 15 percent (approximately € 0.72 million) of the A-envelope.

5.3 Coherence and Complementarity

Coherence between development cooperation policy and other EC policies (trade, fisheries, agriculture, environment) relevant for the FSM will be assessed on a continuing basis.

In fisheries, the EC will ensure coherence between its commercial interests in harvesting tuna from the Pacific and the developmental imperatives of equitable returns, promotion of onshore fish processing and coastal fisheries, transparency in providing accurate information on fishing effort and catch, and strict adherence to the principles of resource conservation and sustainability. Fisheries matters will be addressed by means of the EC regional programme with its support to the regional agencies of the Forum Fisheries Agency and the Secretariat of the Pacific Community.

Coherence with cross-cutting issues referring to gender mainstreaming, environmental considerations and principles of good governance will be observed in all future projects.

The programme is complementary to the Government’s own efforts to improve the living conditions of people in the rural areas and outer islands and redress the imbalance between urban and rural/outer island development by spreading the benefits of growth more evenly across the country as well as to observe the sustainable use (conservation and protection) of the natural environment.

The programme complements that of other donors which are also concerned with improving the lot of the rural poor in the outer islands, e.g. ADB and UNDP, through improvements to rural water supplies.

The operations of the EIB under the Investment Facility have yet to be defined.

6. 9th EDF INDICATIVE PROGRAMME

6.1. Introduction

Within the framework of the present Country Strategy Paper (see part A) and according to the provisions of Article 4, Annex IV of the Cotonou Agreement, the Parties have agreed on the main priorities for their co-operation and on the sectors on which Community support will be concentrated. A detailed Indicative Programme, including a set of tables on commitment and disbursement forecasts, as well as a preliminary chronogramme of the different activities envisaged under the Programme within the project cycle, is presented hereunder.

The repartition of funds between the focal sector, macro-economic support and other programmes or instruments can be modified in the context of operational performance or ad hoc reviews.

6.2 Financial Instruments

The implementation of the co-operation strategy of the EC with FSM will be financed through different instruments with the following indicative amounts:

- a) 9th EDF A-allocation (€ 4.8 million) made available to cover long-term development operations within the framework of the Support Strategy;
- b) 9th EDF B-allocation (€ 1.4 million) mobilised to provide additional support when this becomes necessary as a result of unforeseen needs such as emergency assistance.

Apart from the above mentioned financial instruments, of which the A-envelope is the main programmable basis for the Indicative Programme, the 9th EDF also includes the "Investment Facility" as a financing instrument managed by the European Investment Bank. The Investment Facility does not form part of the Indicative Programme.

Specific actions could be financed via different EC budget lines administered by the Commission, especially in the areas of decentralised co-operation and NGO co-financing. Budget line funding is subject to specific rules and regulations, and depends on the availability of funds.

FSM will also benefit from the Regional Indicative Programme of the 9th EDF and from trade specific operations, according to needs and availability of funds. More details will be discussed in the framework of the 9th EDF regional programming for the Pacific Island States.

6.3 Areas of concentration

Within the general framework of the present Country Strategy Paper, the Parties have agreed on the main priorities for their co-operation (see previous chapter) and the sector(s) on which the support of the Community will be concentrated. It is based on the resources of the A-allocation.

Amounts mentioned in this chapter indicate the global repartition of funds within the focal sector. This repartition can be modified in the context of operational, performance or ad-hoc reviews.

The A-envelope shall be allocated as follows:

- Identification and promotion of new and renewable sources of energy (e.g. solar, wind, thermal, waves, hydro) for outer island development will absorb **85%** of the allocation, i.e. **€ 4.08 million**.
- For activities implemented by Non-State Actors in the area of Conservation and Environmental Protection will be earmarked **15 %** of the allocation, i.e. **€ 0.72 million**. This allocation shall also support NSA capacity building projects.

6.4 Macroeconomic Support

The Indicative Programme does not foresee macroeconomic support. However, in the light of current needs, it may be decided to reallocate funds from other headings in the Indicative Programme to this type of support. Such a decision may be taken through a specific agreement between the Chief Authorising Officer and the National Authorising Officer or in the context of an operational, performance or ad hoc review.

6.5 Intervention logic and timetables

Details of the intervention framework, an activity chronogramme and tentative forecasts of commitments and disbursements of the 9th EDF over the next years are presented in the following tables.

6.6

INTERVENTION FRAMEWORK FOCAL SECTORS

FOCAL SECTOR	Performance Indicators	Sources of Verification	Assumptions
<p>Long-term national sector targets. Provision of new and renewable sources of energy to the rural areas and outer islands.</p>	<p>30% of households in the outer islands will have access to appropriate new or renewable energy sources.</p>	<p>Statistical data – FSM energy department</p>	<p>National and state governments co-operate to achieve goals and objectives.</p>
<p>Intervention Objectives:- National energy study – work programme. Cost-effective and appropriate new and renewable energy sources. Drafting of national environmental policy. Environmental guidelines and regulations. Develop programmes of energy conservation and efficiency for the government, commercial sector and households. Provide the infrastructure for appropriate new and renewable sources of energy.</p>	<p>Work programme and timetable for electrification of outer islands. Identification of least cost option for the provision of appropriate technology. Draft and adopt national energy policy including environmental guidelines and methods of enforcement. A well functioning information campaign undertaken in consultation and cooperation with the community – the campaign to reach at least 50% of the outer islands. 30 percent of the outer islands receive electrification from alternative sources of energy.</p>	<p>FSM department of energy. Workable programme identifying alternative sources of energy – that takes into account local conditions – includes survey data. Document – ratified by Government. Public awareness and acceptance of new and renewable sources of energy. Statistics from the Department of energy</p>	<p>Continuing government support for electrification of outer islands. Community groups fully involved and represented in discussions on electrification of outer islands. Community groups are involved in the design, evaluation and implementation of development strategies.</p>

6.7

CHRONOGRAMME OF ACTIVITIES

Title	2003				2004			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
New and renewable sources of energy	Project identification and programming		Financing Proposal	Financing Agreement	Tenders and mobilisation		Implementation	
Conservation and Environment Assistance to NSAs	Project identification and programming			Financing Programme	Financing Agreement	Implementation		

6.8

INDICATIVE TIMETABLE FOR COMMITMENTS AND DISBURSEMENTS

Title	Amount €	2002		2003		2004		2005		2006	
		S1	S2	S1	S2	S1	S2	S1	S2	S1	S2
Area of concentration: New and renewable energy	Comm.			4,080,000							
	Disb.					850,000	750,000	750,000	750,000	750,000	230,000
Support to NSAs: Conservation and Environmental Protection	Comm				720,000						
	Disb.					150,000	150,000	150,000	150,000	120,000	
Total Com. Disbursements				4,080,000	720,000	1,000,000	900,000	900,000	900,000	870,000	230,000

6.9

COUNTRY DONOR MATRIX

FEDERATED STATES OF MICRONESIA NATIONAL DEVELOPMENT STRATEGY OR CDF/PRSP				
Country Matrix	Economic Development	Social Development	Productivity Sector	Thematic/crosscutting Issues Treaties and Agreements 1990's
Government (Public Sector Investment Programme, Funding source Compact CIP for year 2001–2003. (expenditure to date and estimated cost of completion).	<p>International Airport Safety US\$9.2 millions, (est cost US\$27.9 millions) Chuuk State/national government.</p> <p>Airport Development (Kosrae) US\$1 million. (est cost US\$8.1 million – State and FSM).</p> <p>Weno Islands Road, US\$2 millions (est cost US\$10 millions). Chuuk State.</p> <p>Upgrade Malem-Utwe Road, US\$1.3 millions (est cost US\$2.1 millions (Kosrae state)</p> <p>Complete Circumferential Road. US\$0.4 millions, (est cost US\$10.0 millions), Kosrae State.</p> <p>Infrastructure maintenance, US\$0.6 millions (est cost US\$0.8 millions, Kosrae state.</p>	<p>Water Supply Weno US\$0.8 millions (est cost US\$6.7 millions) – Chuuk state.</p> <p>Preventative Health Care, US\$0.1 millions (est cost US\$5 millions), Chuuk State.</p> <p>Education Reform, US\$0.3 millions, (est cost US\$4 millions). Chuuk state.</p> <p>Electricity Supply US\$2.1 millions (est cost US\$2.9 millions. Kosrae state/US Fed.</p> <p>Water Supply US\$0.4 millions (est cost US\$3.7 millions). Kosrae State.</p> <p>Preventative Health Care, US\$0.3 millions (est cost US\$0.7 millions) Kosrae state and FSM.</p> <p>Education Reform pro-</p>	<p>Agriculture Development, US\$0.4 millions (est cost US\$0.5 millions), Kosrae state/FSM.</p> <p>Tourism Development, Utwe Walung Marine Park, US\$0.2 millions (project complete) Kosrae state/FSM.</p> <p>Tourism Development, US\$0.2 millions (est cost US\$0.3 millions), Kosrae state/FSM.</p> <p>Marine Resources Production (Dry Docking) US\$1.7 millions (est cost US\$1.4 millions), Kosrae state.</p> <p>Marine Resource Development, US\$0.04 millions (est cost US\$0.25 millions) Pohnpei state.</p> <p>Agricultural Production US\$0.1 millions (est cost US\$0.5 millions).</p>	<p>Membership of the United Nations, 1991.</p> <p>Asian Development Bank, 1990.</p> <p>Economic and Social Commission for Asia and the Pacific, 1992.</p> <p>Global Conference on the Sustainable Development of Small Island Developing States, 1992.</p> <p>International Bank for Reconstruction and Development (World Bank) 1993.</p> <p>International Monetary Fund (IMF), 1993.</p> <p>Committee on New and Renewable Sources of Energy, 1992.</p> <p>Global Environmental Facility.</p> <p>Intergovernmental Negotiating Committee for a Framework Convention on Climate Change, 1990.</p>
Government Expenditure				

<p>Con'd.</p>	<p>Road Resealing US\$3.5 millions (est cost US\$7 millions), Kosrae state. Road Construction and Maintenance US\$3.6 millions (est cost US\$12.4 millions) Pohnpei State. Private investment promotion in Pohnpei state. US\$1.5 millions (est cost US\$3.5 millions). International Airport Development US\$13.5 millions (est cost US\$15 millions) Yap state/FSM/US. International Seaport Development US\$0.3 (est cost US\$10.1 million) Yap state. Road Construction and Maintenance US\$0.1 millions (est cost US\$13.4 millions).</p>	<p>gramme US\$0.9 millions (est cost US\$1 millions, Kosrae State/FSM). Electricity Outer Islands, US\$0.7 millions (est cost US\$2.0 millions), Pohnpei state. Water Supply Outer islands, US\$0.035 millions (est cost US\$0.8 millions). Pohnpei state. Education Reform programme US\$0.75 millions (est cost US\$1.0 millions). Pohnpei state. Preventative Health Care US\$0.75 millions (est cost, US\$1.8 millions) Pohnpei state. Medical Referral Hospital US\$1.2 millions (est cost US\$1.5 millions) Pohnpei state. Electricity Outer Islands US\$0.12 (est cost US\$2.0).</p>	<p>Forest Protection and Development US\$0.03 millions (est cost US\$0.5 millions) Yap state. Marine Resource Conservation and Development US\$0.2 (est cost US\$0.6). Yap state.</p>	<p>United Nations Environment Programme. World Food Programme. South Pacific Forum Fisheries Convention and Related Agreements. International Civil Aviation Organisation, 1988. International Telecommunications Satellite Organisation, 1993. United Nations Conference on Trade and Development. United Nations Population Fund. International Research and Training Institute for the Advancement of Women. United Nations Children's Fund (UNICEF). United Nations Office of the High Commissioner for Refugees (UNCHR). United Nations Development Fund for Women (UNIFEM). Convention of the Rights of the Child, 1993.</p>
<p>3. Asian Development</p>	<p>Public Sector Reform</p>	<p>Basic Social Services.</p>	<p>Fisheries Development</p>	

Bank (ADB).	<p>Programme, US\$5.2 millions (against est cost of US\$3 millions) Chuuk state.</p> <p>Public Sector Reform Programme US\$2 millions (against est. cost of US\$1.5 millions. Kosrae state.</p> <p>Public Sector Reform Programme US\$4.2 millions (est cost US\$10 millions), Pohnpei State.</p> <p>Public Sector Reform Programme US\$3 millions (est cost US\$4 millions) Yap state.</p>	<p>US\$8.019 millions. Ongoing</p> <p>Water Supply and Sanitation US\$10.6 millions. Ongoing. Technical Assistance ADB and Japan Special Fund.</p> <p>Energy US\$0.665 millions.</p> <p>Social Infrastructure, US\$ 1,732 millions.</p> <p>Others:US\$11,568 millions.</p>	<p>US\$6.5 millions. (ongoing). Technical Assistance ADB and Japan Special Fund.</p> <p>Agriculture US\$3.249 millions.</p> <p>Finance US\$ 1.138 millions.</p>	
4. Donor Activity Japan	<p>Seaport Development and Improvement Japanese grant aid US\$4 millions. US\$2.9 spent to date (est total cost 12.9 million) Financing gap of US\$10 millions. Chuuk state</p>	<p>Japan, provision of a package of goods and services to the FSM US\$700,000 (1998).</p>	<p>Marine Resource Production (Artisinal Fisheries) Japanese aid – project design and feasibility US\$2.6 millions. Kosrae State.</p> <p>Fishing Port Development US\$4 millions. Pohnpei state.</p>	

THE STRUCTURE OF THE FSM ECONOMY (1996 *)**Sectoral shares** (as percentage of GDP)

Government services	43 %
Wholesale and retail trade	22 %
Agriculture and forestry	17 %
- Subsistence	16 %
- Commercial	1 %
Tourism	2 %
Fisheries	2 %
Others	14 %

External debt and debt service (as percentage of GDP)

Total external debt	52.3 %
External debt service	19 %
(in % of exports of goods and nonfactor services)	

Foreign grants (as % of GDP)	40 %
Exports (as % of GDP)	5 %
Imports (as % of GDP)	37 %

Exports by major product category

Agricultural products	7 %
Marine products	85 %
Other	8 %

Imports by major product category

Food and live animals	30 %
Manufactured goods	30 %
Mineral fuels, lubricants and related minerals	17 %
Machinery and transportation equipment	12 %
Other	11 %

*) More recent data are not available

The Compact of Free Association

When the peoples of the FSM chose independence from the United States, a treaty was established between the U.S., the FSM and other Trust Territories of the Pacific Islands jurisdictions, called the Compact of Free Association. This Compact defined relationships between the U.S. and the FSM and provided more than US\$ 1 billion over the last 15 years to ease the transition to independence. Securing self-government for the FSM and assuring the protection of national security rights were important objectives. Relevant terms of the Compact specified that the FSM citizens could freely enter and work in the U.S. and that the U.S. would be responsible for defence of the FSM. The funds provided by the U.S. gradually decreased every five years over the 15-year period, with the assumption that they would end in 2001.

The Compact was seen by both the FSM and the U.S. as a vehicle to secure a responsible level of assistance, financial and otherwise, that would enable the continuation of the FSM's economic progress, ensure the solidification of stable democratic government and provide for the maintenance of essential U.S. security interests in the region.

Compact funds support most of FSM national and state governments services, including most of the education and health services. Funding under the Compact is complex. Funds are provided through a variety of accounts, some of which have limitations on their use. Appendices 8 and 9 provide information on expenditure under the Compact Fund (1987-1999) and use of Compact Federal Grants for 1999.

The complex system of transmitting and monitoring Compact funds has been managed by the U.S. Department of the Interior, while the Department of State has coordinated the Compact-related activities as a number of Executive agencies through the Inter-Agency Group and has encouraged and supported FSM's efforts to establish its role within the international community.

Transition funding equivalent to the average of funding for the full term of the Compact is provided for FY2002 and FY2003 (US\$97 millions per annum). Negotiations on a new Compact Agreement between the US and the FSM are currently underway.

CONSOLIDATED GENERAL GOVERNMENT FINANCES
REVENUES (in of US\$ million)

	1987	1996	1997	1998	1999	2000 (EST)
Total Revenue and Grants	142.3	163.0	138.8	151.2	148.1	152.8
Total revenue	23.9	54.2	48.7	55.6	53.2	56.6
Taxes	9.7	21.1	20.6	26.1	24.6	26.3
Wages & salaries	3.3	5.6	5.4	7.8	5.9	6.3
Gross revenue tax	2.6	6.0	5.5	5.7	5.6	5.9
Import tax (fuel)	0.4	0.9	0.7	0.8	0.8	0.9
Import tax (others)	1.4	3.7	4.1	6.3	6.1	6.5
All other tax (National)	0.0	0.3	0.5	0.2	0.2	0.3
State Revenue tax	2.0	4.6	4.3	5.4	6.0	6.5
Non-tax revenue	14.2	33.1	28.1	29.5	28.6	30.3
Fishing access revenue	3.8	20.5	14.4	13.5	15.9	16.8
Dividend and Interest revenue	4.7	8.1	8.7	8.9	6.8	7.4
Other non-tax revenues	5.6	4.5	5.1	7.2	5.9	6.0
Grants	118.4	108.9	90.1	95.6	94.9	96.2
Grants from abroad	118.4	108.9	90.1	95.6	94.9	96.2
Current grants	78.0	77.3	66.1	71.0	69.7	70.4
Compact general	43.9	45.3	38.0	37.9	37.6	38.4
Compact Special	19.5	18.1	18.1	18.2	18.4	18.7
Other: Current	14.5	13.9	9.9	14.9	13.8	13.3
Capital grants	40.4	31.6	24.0	24.6	25.2	25.8
Compact CIP	29.3	30.2	22.0	23.3	23.7	24.2
Other Capital	11.2	1.4	2.0	1.3	1.4	1.6

Source: Federated States of Micronesia, Economic Review, November 2000

CONSOLIDATED GENERAL GOVERNMENT FINANCES
EXPENDITURES (in of US\$ million)

	1987	1996	1997	1998	1999	2000 (EST)
Total expenditure and net lending	104.3	162.4	137.9	165.3	164.8	152.4
Total expenditure	104.3	162.4	137.9	165.3	164.8	152.4
Current expenditure	84.0	132.8	124.4	124.9	124.7	124.4
Expenditure on goods & services	82.5	119.7	113.6	109.1	114.3	114.9
Wages and Salaries	42.0	63.2	58.5	50.1	52.2	53.2
Travel	5.1	5.1	6.9	6.8	7.3	7.4
Other	35.4	51.4	48.2	52.2	54.8	54.3
Interest Payments	0.0	5.7	4.8	3.6	2.9	1.2
Subsidies	1.1	6.3	3.9	3.4	4.0	3.8
Transfers	0.4	1.1	1.9	8.8	3.5	4.5
Capital expenditure	20.3	29.6	13.5	40.4	40.1	28.0
Acquisition of fixed capital	2.8	4.4	3.3	21.3	14.5	15.7
Multi purpose devel projects	17.3	22.2	10.2	16.9	24.1	12.3
Capital Transfers	0.2	3.0	0.0	2.2	1.5	1.2
Net Lending (domestic)	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	38.0	0.6	0.9	-14.1	-16.7	0.4
Current Balance	17.9	-1.3	-9.6	1.7	-1.8	2.6
Capital Balance	20.2	1.9	10.5	-15.8	-14.9	-2.2
Memo Items						
Nominal GDP	116.5	216.1	210.1	209.6	217.9	230.6
Total Revenue & grants as % of GDP	122	75	66	72	68	66
Grants as % of GDP	102	50	43	46	44	42
Grants as % of total revenue	83	67	65	63	64	63
Tax revenue as % of GDP	8	10	10	12	11	11
Total expenditure and net lending % of GDP	90	75	66	79	76	66
Current expenditure as % of GDP	72	61	59	60	57	54
Capital expenditure as % of GDP	17	14	6	19	18	12
Overall Balance as % GDP	33	0	0	-7	-8	0
Current Balance as % GDP	15	-1	-5	1	-1	1

Source: Federated States of Micronesia, Economic Review, November 2000.

ANNEX 5

COMPARATIVE ANALYSIS OF FISCAL STRUCTURE FY1987 AND FY2000

	CHUUK	KOSRAE	POHNPEI	YAP	NAT	FSM
FY1987						
Grants as % GDP	98	115	48	99	24	102
Grants as % total revenue	92	87	80	88	74	83
Tax revenue as % GDP	7	8	8	10	7	8
Current Expenditure as % GDP	72	66	36	65	17	72
Capital Expenditure as % GDP	11	44	3	23	5	17
Overall Balance as % GDP	25	22	21	25	11	33
Current Balance as % GDP	2	10	8	15	9	15
FY2000						
Grants as % GDP	45	62	21	51	7	42
Grants as % total revenue	77	84	68	71	39	63
Tax revenue as % GDP	11	12	11	12	9	11
Current Expenditure as % GDP	45	52	21	41	20	54
Capital Expenditure as % GDP	13	20	4	21	2	12
Overall Balance as % GDP	0	2	5	11	-3	0
Current Balance as % GDP	-1	-2	4	20	-2	1

Source: Federated States of Micronesia, Economic Review. November 2000

REAL GDP PER CAPITA GROWTH RATES 1998 CONSTANT PRICES

	FULL COMPACT PERIOD 1987-2000			EARLY COMPACT PERIOD' 1987-1995			RECENT COMPACT PERIOD 1995-2000		
	GDP	Gov	Priv	GDP	Gov	Priv	GDP	Gov	Priv
Chuuk	0.1	-3.3	0.0	2.5	1.5	3.8	-1.6	-11.1	0.4
Kosrae	0.5	-2.3	2.0	0.7	-0.5	2.0	-1.3	-9.3	1.3
Pohnpei	3.2	0.6	2.9	5.6	2.4	8.6	-1.6	-4.7	-4.8
Yap	3.2	-2.4	6.0	5.3	-0.7	11.2	1.4	-7.8	3.8
FSM	2.0	-1.3	2.5	4.2	1.4	7.1	-1.1	-7.5	-1.4

Source:- FSM Economic Review November 2000

FSM GROSS DOMESTIC PRODUCT 1987 AND 1995-2000. \$US MILLIONS

	1987	1995	1996	1997	1998	1999	2000
Private Sector	30.2	67.6	65.4	60.4	62.7	66.1	71.2
Wages	11.5	25.3	25.3	24.6	25.3	27.9	30.7
Profits	18.7	42.3	40.1	35.8	37.4	38.2	40.5
Public Enterprises	2.7	14.1	15.3	17.3	18.1	18.8	19.6
Government	42.8	63.9	64.2	59.3	50.7	51.4	52.6
Municipalities	2.3	4.2	4.4	4.3	4.3	4.6	5.0
Non-Profits	2.9	5.0	5.5	5.9	6.7	7.2	8.1
Subsistence	17.5	27.7	29.1	30.3	31.4	32.8	34.5
Home Owner-ship	11.3	17.9	18.8	19.6	20.2	21.1	22.2
Indirect taxes	6.9	14.9	14.6	14.3	16.3	16.9	18.4
Subsidies	-0.1	-2.3	-1.2	-1.3	-0.8	-1.1	-1.1
Nominal GDP	116.5	213.0	216.1	210.1	209.6	217.9	230.6
Nominal GDP per capita	1,292	1,980	1,970	1,879	1,838	1,874	1,945
GDP Deflator	70.3	93.6	96.5	98.5	100.0	102.6	105.9
Inflation rate	4.4	2.5	3.0	2.2	1.5	2.6	3.2
Population (000's)	90.2	107.6	109.7	111.8	114.0	116.3	118.5
Pop growth rate	3.0	2.0	2.0	2.0	2.0	2.0	2.0
Real GDP (98 prices)	165.7	227.5	224.0	213.2	209.6	212.4	217.7
Real GDP growth rate	1.1	3.4	-1.5	-4.8	-1.7	1.3	2.5

Source: FSM Economic Review, November 2000

