CER: FSM 2000-13

COUNTRY ECONOMIC REVIEW

FEDERATED STATES OF MICRONESIA

November 2000

CURRENCY EQUIVALENTS

(as of 30 November 2000)

Currency Unit	–	United States dollar (US$)

ABBREVIATIONS

ADB	–	Asian Development Bank
Compact	–	FSM Compact of Free Association with the United States
FSM	–	Federated States of Micronesia
GDP	–	gross domestic product
MTN	–	medium-term notes
PDMC	–	Pacific developing member country
PSDP	–	Private Sector Development Program
PSRP	–	Public Sector Reform Program
TA	–	technical assistance
US	–	United States
VAT	–	value-added tax

NOTES

(i) The Government's fiscal year (FY) ends on September 30. FY before a calendar year denotes the year in which the FY ends. For example, FY2000 began on 1 October 1999 and ended on 30 September 2000.

(ii) In this report, "$" refers to US dollars.

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EXECUTIVE SUMMARY

During the current Compact of Free Association with the United States (US) that dates from 1987, economic growth in the Federated States of Micronesia (FSM) has averaged a 1.9 percent rate of annual increase in gross domestic product (GDP). Taking into account the population growth of 2.0 percent, GDP per capita declined during this period. At the beginning of the Compact, the FSM was endowed with a weak policy environment, which was inward looking, not conducive for private sector development, and supported a large Government. Supported by large external transfers, the economy initially boomed and grew by over 4 percent annually between fiscal year (FY)1987-FY1995, with the private sector growing by 7.1 percent as a modern cash economy established itself in nontraded activities. However, this period was not to be long-lived.

The economy was not well positioned to withstand the second step-down in Compact funding, which occurred in FY1997 and was followed by a period of painful adjustment. GDP growth declined, averaging 1.1 percent in FY1995-FY2000. This led to a realization that full reliance for growth on public sector and external grants was not sustainable. The First FSM Economic Summit in FY1996 resulted in a consensus on needed policy reform. A Public Sector Reform Program (PSRP) was initiated with Asian Development Bank (ADB) assistance and the decline in external resources was adjusted largely through expenditure reduction. By FY1999, the fiscal balance was restored. The program also initiated a variety of reforms to improve the enabling environment for private sector development, including improvements in the foreign investment regime.

With the period of adjustment complete, the economy has shown signs of improving. After several years of economic decline, an increase in GDP of 2.6 percent is forecast for FY2000. With some relaxation in the austere fiscal policy stance, improved project implementation capacity, and repayment of the medium term note (MTN) issues, a more favorable result is expected in FY2001 and FY2002.

The labor market in the FSM is relatively free from regulatory distortions and institutional rigidities, except for high public sector wages. Public sector wages average twice the private sector wages, which discourages the development of competitive, export-oriented industries. Another factor affecting the labor market in the FSM is the ease of migration to Guam and the US, which have comparatively higher wages. Until the beginning of the downturn in FY1995, employment opportunities grew at an annual average of 3.2 percent during FY1987-FY1995,, a rate sufficient to absorb many of the new entrants to the labor force. However, thereafter employment stagnated and failed to provide a source of gainful opportunities to the growing population and labor force. While final results of the 2000 census are not yet available, preliminary indications suggest that significant migration has occurred since the last census in 1994. Lack of employment opportunities is consistent with this outcome as the unemployed sought gainful employment in neighboring islands and in the US.

Recent fiscal developments have generally been good at the state level, while being a cause for concern at the national level. With the exception of overall deficits resulting from large-scale capital projects in two states, the states have adjusted their expenditure patterns to available resource levels. The national Government, on the other hand, has run overall deficits from FY1997-FY2000 in the range of 3-5 percent of GDP. Financing of these deficits has largely been achieved by the draw-down of fund balances that were invested abroad. Expenditures have declined as a share of GDP from a peak of 105 percent of GDP in

FY1989 to 66 percent of GDP in FY2000. This reflects reductions in resources, particularly as external grants have fallen to 42 percent of GDP in FY2000 from levels exceeding the GDP during early years of the Compact assistance. A range of challenges faces the governments, most notably the uncertainty of funding levels under the Compact. Fiscal adjustments required after the FY1997 reduction in grant funding from the US under the Compact were concentrated on reducing recurrent expenditures, particularly the payroll costs. The total Government wages were reduced by over 16 percent in nominal terms between FY1996-FY2000. Domestic revenue efforts remain relatively low, suggesting scope for revenue policies in the event that further fiscal adjustments are required.

The FSM has adopted the US dollar as the currency in circulation. This has served the FSM well. The use of the dollar has precluded the use of inflationary deficit financing. The FSM banking system is well regulated and free from market restrictions, and interest rates are market determined. However, the financial system displays large excess liquidity indicating that capital is not in short supply. The sluggishness in domestic credit growth reflects impediments to secure lending, limited entrepreneurial ability, and uncertainty over the future of the Compact. The recently established consumer price index indicates that prices fell in 1998 with the down turn in the economy and greater competition in the market place. The inflation is projected at about 3 percent for FY2000.

Paucity of trade data has limited the estimation of balance of payments in the FSM. However, preliminary estimates have recently been compiled. The structure of the external account is dominated by a large trade account deficit, which is financed through official transfers, primarily from the Compact, and indicates the dependent nature of the economy. Clearly, the attainment of economic self-reliance and progress in replacing transfers through other foreign exchange earning sources will be a long-term process and presents the single most important challenge facing the economy.

The FSM's high external debt in the mid-1990s was highlighted by the International Monetary Fund (IMF) Article IV missions as a serious threat to the country's potential for economic growth. The external debt position improved dramatically in the subsequent years. The debt undertaken in the early period through the issue of medium-term notes in the bond market was fully secured by Compact revenues. No new borrowing under the program or any other nonconcessional facility has been undertaken since 1993. Nearly half of the borrowing was used by Yap State to invest in investment grade securities that have yielded a greater return than the cost of the borrowing, leaving that state with an ample surplus as a result. The ratio of FSM external debt to GDP is projected to be a relatively low 21 percent and the debt service to export earnings ratio is projected to be just 4.5 percent at the end of FY2001. These ratios indicate a healthy external debt position and considerable room for the FSM to undertake additional concessional borrowing. However, in light of uncertainties related to Compact negotiation outcome, the FSM has adopted a sound medium-term strategy of setting aside assets in a sinking fund to secure repayment of new borrowings.

A major objective of the Compact was attainment of self-reliance. While the establishment of a modern economy has been achieved, poor policy environment still impedes the development of outward-orientated private sector. The FSM Government has initiated a series of policy changes, which will help rectify this position. In this regard, some priority items for the FSM are: (i) improvements in the foreign direct investment (FDI) regime; (ii) improvements in the regulatory environment; (iii) provision for secure long-term land leasing, leasehold, and chattel mortgages; (iv) reforms and privatization of the public enterprises; (v) establishment of a broad-based tax regime; and (vi) performance orientation of public. In particular there is a need to support the private sector in developing exports and niche market products, and promote appropriate public-private partnership to circumvent the size and remoteness constraints.

I. RECENT ECONOMIC DEVELOPMENTS

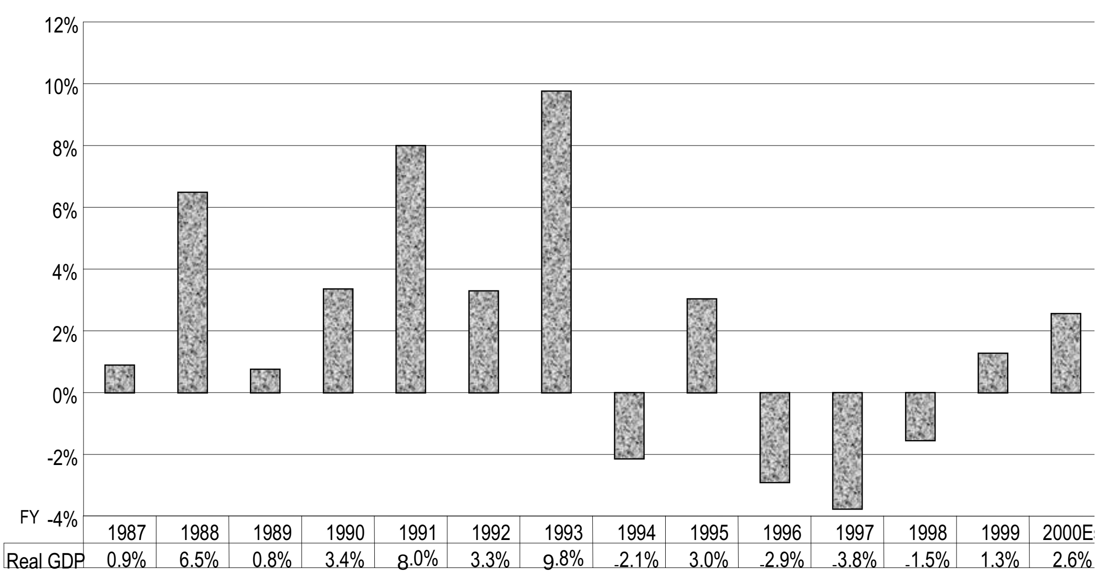
A. Growth and Employment

1. Aggregate Growth

1. Recent developments in the Federated States of Micronesia (FSM) economy date to the inception of the Compact of Free Association with the United States (US) in FY1987 and the commencement of large external transfers to support the operations of the Government and public sector investment. While these transfers appear to have decreased the cost of support to the FSM, they certainly represented a large increase in the budgetary sources under the management of FSM national and state governments. The structure of the current Compact economic assistance, which is of 15 years duration (until 2001), was front-loaded with two stepdowns after 5 and 10 years. The first entailed a 15 percent reduction, and the second a 22 percent reduction in base grant funding. Further, transfers were only partially indexed to US inflation, resulting in an annual real reduction in resource flows. In 1987, the economic structure was heavily dominated by Compact flows, supporting a level of government expenditures that represented 88 percent of gross domestic product (GDP). The economic structure was simple, with a private sector dominated by nontraded goods production, virtually no export activity, and a small, nascent tourism sector. Against this background, recent developments in the economy can be divided into two periods: 1987-1995 and 1995-2000. The statistical Appendix provides this and other detailed information.

2. The initial period saw strong growth in economic activity as the economy adjusted to increased flows and grew by an annual average rate of 4.2 percent in real terms (Figure 1). While the Government contribution to GDP (wages) grew at a modest average of 1.4 percent, the private sector recorded an impressive annual growth of 7.1 percent. However, while private sector activity was strong, this did not reflect growth in the traded goods sectors or the emergence of significant export activities. The growth represented the

Figure 1: Real GDP Growth



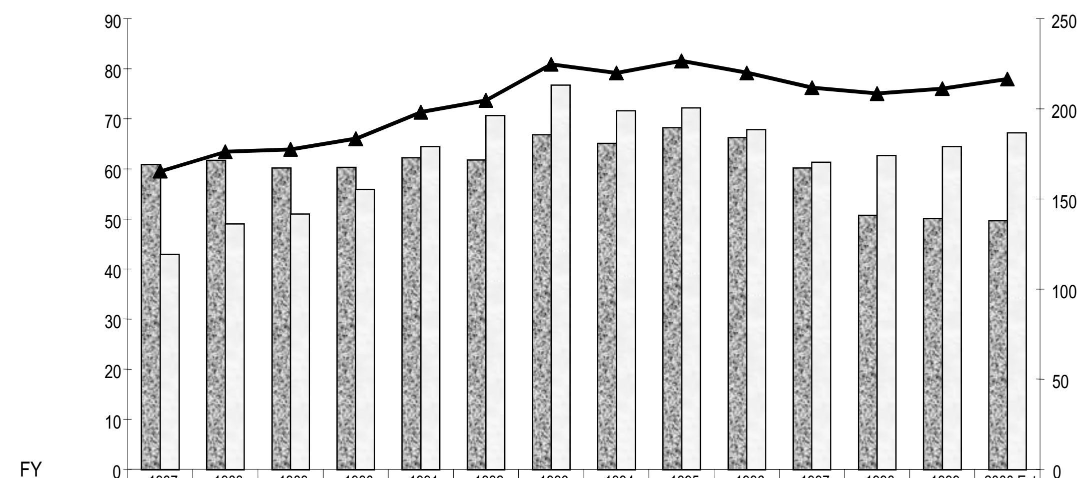
Source: FSM Department of Finance and Administration, FSM Social Security Administration, FSM Department of Economic Affairs/Statistics Division, US Bureau of Labor Statistics.

emergence of a modern cash economy as nontraded goods production expanded to meet growing demands. The first stepdown in Compact funding in FY1992 was adjusted to with relatively little pain, in part because expenditures had not fully adjusted to the new levels of funding. Further, borrowings against future flows through the issue of medium term notes to fund public enterprise investment in the fisheries sectors enabled levels of expenditures to be maintained through much of the second five-year period of Compact assistance.

3. However, the second stepdown in FY1997 was larger in magnitude and resulted in a painful adjustment. An early retirement program, supported by an ADB public sector reform program (PSRP) loan,[1] was initiated to reduce the number of public servants to an affordable level. By the end of the Program loan in December 1999 the work force was reduced by 23 percent against a target of 27 percent, and the wage bill was cut by 29 percent against a target of 35 percent. This included a reduction in the number of hours in the working week. The program was largely successful in avoiding a potential destabilizing financial situation, and fiscal balance was restored by the end of FY1998. However, the adjustment had a significant impact on the economy. The Government contribution to GDP declined by an average of 7.4 percent annually between FY1995 and FY2000, while total GDP declined at an annual rate of 1.1 percent.

4. However, private sector output declined by only 1.4 percent during the period and managed to hold some of the ground lost by Government. Figure 2 indicates these developments. Government activity declined by average 1.3 percent annually between FY1987 and FY2000, the private sector managed to grow at an average annual rate of 2.5 percent, and with GDP growth averaged 1.9 percent. The ability of the economy to achieve positive growth in the face of large reductions in external transfers is a significant achievement. This suggests that the economy is capable of accelerated growth if sound economic practices and policies are pursued.

Figure 2: FSM Real GDP by Sector
(FY1998, $million)



FY	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 Est
Government	61	62	60	60	62	62	67	65	68	66	60	51	50	50
Private Sector	43	49	51	56	64	71	77	72	72	68	61	63	64	67
Real GDP	165	176	177	183	198	205	225	220	227	220	212	208	211	216

Source: FSM Department of Finance and Administration, FSM Social Security Administration, FSM Department of Economic Affairs/Statistics Division, US Bureau of Labor Statistics.

[1]Loan FSM 1520 (SF): *Public Sector Reform Program,* for SDR12,979,000, approved on 29 April 1997.

2. State Economic Developments

5. The FSM is frequently described as a loose federation with considerable autonomy in each of the four states. Accordingly, an analysis of developments at the state level is important to explain economic performance of the nation. Further, the varying economic policy regimes and governance performances of the states are reflected in their economic performances. Table 1 indicates recent economic performance of the four states and relative growths of private and government sectors.

6. Economic performance at the state level has been varied despite similarities in economic circumstances. Pohnpei and Yap have been the fastest growing, with GDP averaging 3.5 percent in Pohnpei and 3.2 percent in Yap during FY1987-FY2000. Performance in Chuuk and Kosrae was poor, with Chuuk recording a negative 0.2 percent and Kosrae just managing to achieve positive real growth rate. In the early parts of the Compact, growth was strong in Pohnpei and Yap, which experienced rates of growth averaging 6 percent. While the Government sector stagnated commensurate with declining Compact flows, private sector growth was strong—recording average annual rates of growth of 9 percent in Pohnpei and 11 percent in Yap. In Chuuk and Kosrae, private sector performance was weaker. In the more recent period between FY1995 and FY2000 all of the State economies stagnated and fell by an annual average between 1 and 2 percent with the exception of Yap, which recorded a positive growth of nearly 2 percent. Again private sector growth was the leading factor in Yap, with stronger private initiative associated with stronger overall performance.

Table 1: Real GDP Growth by State and Economic Sector[a]

	Full Compact Period To-Date FY1987-FY2000			Early Compact Period FY1987-1995			Recent Compact Period FY1995-2000		
	GDP	Gov	Private	GDP	Gov	Private	GDP	Gov	Private
Chuuk	-0.2	-3.3	0.0	2.5	1.5	3.8	-1.5	-11.1	0.4
Kosrae	0.5	-2.3	2.0	0.7	-0.5	2.0	-1.3	-9.3	1.3
Pohnpei[b]	3.4	0.6	2.9	6.0	2.4	8.6	-1.6	-4.7	-4.8
Yap	3.2	-2.4	6.0	5.5	-0.7	11.2	-1.8	-7.5	3.8
FSM	**1.9**	**-1.3**	**2.5**	**4.2**	**1.4**	**7.1**	**-1.1**	**-7.4**	**-1.4**

[a]Pohnpei inclusive of National Government.
[b]Growth rates computed using least squares method.
Source: FSM Department of Finance and Administration, FSM Department of Economic Affairs.

7. Chuuk State suffered a severe financial crisis in the mid-1990s due to weak fiscal management compounded by the reduction in Compact flows. Chuuk State ran up large debts with vendors and failed to make allotments on the public servant payroll. At the height of the crisis in FY1996, Chuuk had accumulated debts of over $17 million—equivalent to 30 percent of state GDP. However, in late FY1996, Chuuk initiated a recovery program with conditioned financial support from the FSM National government. This, coupled with the early retirement program (ERP), rapidly reversed the adverse fiscal position of the State. By FY2000 the State had repaid the accumulated debts and was running a significant fiscal surplus. Chuuk State GDP rose by 5 percent in FY1999 and 12 percent in FY2000 after several years of negative growth largely due to the airport renovation project, the Weno road resurfacing, and increased capacity to implement development projects. However, the level

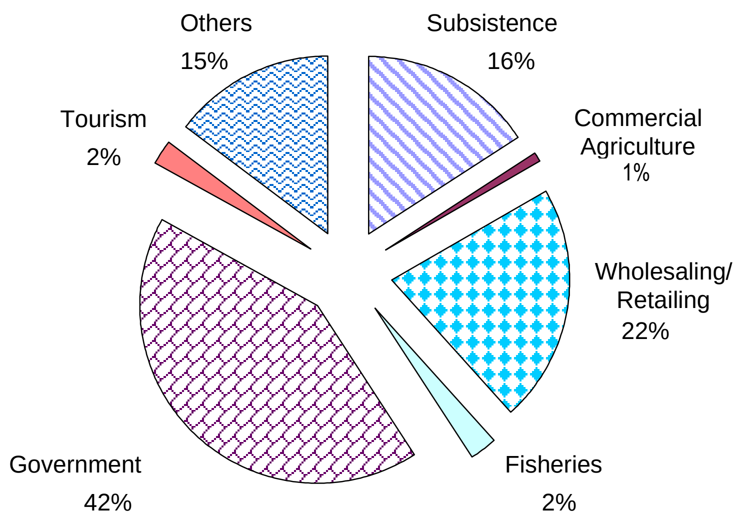
of economic activity in the state still remains about 8 percent below the peak achieved in FY1993.

8. Pohnpei State, which had achieved the strongest growth during the initial period, also experienced the most rapid decline in the latter period. Pohnpei was unable to replace the strong stimulus to growth in early 1990s obtained by private sector growth. An inward looking policy environment associated with high levels of investment in unprofitable public enterprises contributed to economic stagnation. Kosrae State could not compensate for geographical remoteness and limited resource endowments with an attractive policy regime. The Kosrae economy remained stagnant and in FY2000 GDP remained about 8 percent below the peak level of FY1996 and slightly below the level of FY1987. Only Yap State managed to achieve positive growth in the later period, reflecting more stable fiscal policies and a more laissez-faire policy environment, although high levels of investment in unprofitable public enterprises surely restrained potential growth.

3. Sectoral Developments and the Structure of the Economy

9. The structure of the FSM economy is dominated by a large public sector. In FY1996, Government activities contributed 42 percent of GDP, with distributed trades representing 22 percent and other services 19 percent (Figure 3). The other main sector is production for own consumption or subsistence production, which accounts for 16 percent. Most striking is the very small role played by the traded goods sector, including commercial agriculture, fisheries, and tourism; these are the activities with long-run growth potential and comparative advantage of the FSM.

Figure 3: Share of GDP by Economic Activities, 1996



Source: FSM Department of Finance and Administration, FSM Social Security Administration, FSM Department of Economis Affairs/Statistics Division, US Bureau of Labor Statistics.

10. This structure has two important policy implications. Firstly, the economy remains adversely positioned to weather further large downturns in external resource flows. A reduction in Compact flows immediately requires adjustment in the public sector, either

through expenditure compression or increased tax effort, both of which reduce the demand for non-traded goods and services. The next largest subsistence sector is outside the cash economy and thereby insulated from external shocks. However, it is also unable to provide significant cushion for any major downturn in the modern economy. Secondly, the absence of any sizeable or established traded goods sector highlights the challenges facing the FSM. Very rapid rates of growth in exportables will be required for many years before the objective of self-reliance as declared in the Compact is attained. Clearly, while reforms need to be sustained, considerations of macroeconomic stability indicate the need for continued external support in the mid to long term.

11. The national accounts data do not provide a sectoral breakdown of production to facilitate analysis of economic developments. However, some comment on developments in the traded goods sectors can be made. While subsistence activities make a substantial contribution to GDP, agricultural production for either the domestic or export market is surprisingly small. Local growers believe that returns from agriculture are low and slow to materialize compared with other sources of cash income, such as general wage employment. Copra production has all but disappeared due to inefficiencies and low prices. However, profitable export opportunities exist, such as kava (Pohnpei), betel nut (Yap), processed traditional foods (Chuuk), citrus (Kosrae), and banana (all states).

12. Recent attempts to stimulate commercial production (for exports and import substitution) of pepper, chickens, and pork failed despite direct and indirect government subsidies. These failures suggest weak business practices on the part of government support services, producers, and farmers. The pepper industry, identified as a commodity with comparative advantage, failed despite direct Government subsidies and subsidized loans, public sector intervention, and foreign investment. These underline the need for the private sector to identify business opportunities and take risk, and for the Government to refrain from influencing commercial decisions.

a. Fisheries

13. With the vast marine resources under FSM jurisdiction, fisheries were expected to make a significant contribution to GDP. However, the sector could not achieve the expected growth. In the early 1990s, the FSM embarked on a strategy of substantial public sector investment in fisheries. Joint ventures with foreign partners in purse seine fishing operations were initiated in Chuuk, while direct public sector investment were undertaken in Pohnpei and Yap. Investment in freezing, storage, and transshipment plant was undertaken in all four States. A longline fishing company was set up with ADB loan finance for eventual sale to the private sector.

14. However, none of the public sector fisheries enterprises has achieved profitability. In most cases, the operations are defunct or continue with losses. While there is a growing awareness that the Government should not be involved in productive sectors of the economy, no public sector enterprise in fisheries has yet been privatized or liquidated. Divestment and establishment of an improved environment for the private sector will help develop this sector. However, whether the FSM has a long-run comparative advantage in fishing given the current cost factors, is yet to be established. The main benefit of the resource has been the annual rents earned from fishing access fees which make a substantial contribution to government revenues.

b. Tourism

15. As with other neighboring tourist destination economies, the Asian crisis had a significant negative impact on FSM tourism. Visitor arrivals slumped from a level of 18,200 in 1997 to 13,700 in 1998, reflecting a downturn in tourists from both Japan and US. This partly reflected a reduction in flights as Continental Micronesia, the major carrier in the FSM, reduced its capacity in the region. Resurfacing of the Yap airport and the Chuuk financial crisis also had negative affects. In 1999, the number of visitor arrivals increased to 15,600 as the US market strengthened, but arrivals from Japan remained at 1998 levels. Improvements in tourist facilities in Chuuk coupled with an improved fiscal position assisted the recovery. Data for the first eight months of 2000 suggest a record total of 18,700 in the year. The US market continues to strengthen and visitors from Japan have returned to their pre-crisis level.

16. While tourism represents the major potential growth sector of the economy, many factors hinder its development. Although policies affecting foreign direct investment have been recently improved, the foreign investment climate is still considered unattractive. Difficulties in obtaining secure long-term land leases have been reported as an impediment, although there are some success stories in this area. Many of the facilities offer a standard of accommodation that is unattractive to international travelers. Reliance on a single carrier in a remote geographical location operating high priced flights has also reduced demand. However, while these factors have all impeded tourist development, the FSM has substantial potential, particularly as a niche market in ecotourism and dive areas. Recent developments include the refurbishment of a major resort on Chuuk, the commencement of operations of a high quality hotel in Yap, and opening of an ecotourist resort in the outer islands of Yap. Other significant developments include the establishment by Japanese travel wholesalers of FSM package tours, a commitment by Continental airlines to establish connecting flights (from January 2000) to Yap without Guam stopover for weekend tourists from Japan, and improvements in FSM tourism promotion through tourism trade shows.

4. Incomes, Distribution of Income, and Poverty

17. While the rate of economic growth of the FSM economy during the Compact period may be considered satisfactory given the decline in Compact funding, the impact of a rapidly increasing population eroded per capita income levels. By FY2000 the level of GDP per capita was largely unchanged from the level achieved in FY1987 as population growth of 2.0 percent outstripped economic growth. Preliminary indications from the 2000 census suggest that population growth has stabilized or declined after the last census in 1994. If this proves to be the case, the loss of real incomes may not be as great as the figures in Table 2 suggest. However, the census also indicates that the reduction in population growth has largely occurred due to outward migration, which reflects the ailing economy of the late 1990s and the adverse impact of the decline in Compact funding. While decrease in population growth clearly has beneficial implications for real incomes, migration of economically active people reduces the country's productive labor force and domestic economic potential.

Table 2: Real GDP Per Capita
($, 1998 constant prices)

	FY 1987	FY 2000
Chuuk	1,207	1,039
Kosrae	2,502	2,011
Pohnpei	2,420	2,656
Yap	2,473	2,964
FSM	**1,834**	**1,826**

Source: FSM Department of Finance and Administration, FSM Social Security Administration, FSM Department of Economic Affairs/Statistics Division, US Bureau of Labor Statistics.

18. Table 2 also indicates the significant difference in per capita incomes across the four states of the FSM. While some of the difference is due to the structure of the Compact and that the smaller states receive a larger per capita share, much of the difference is due to the impact of economic development. In FY2000, real per capita income in Yap was approximately three times the level of real income in Chuuk and twice that of Kosrae. Over time, the differential has widened. While Pohnpei and Yap have benefited from economic growth, Chuuk and Kosrae experienced significant declines.

19. The FSM has yet to prepare a poverty profile, although analysis of a recent household income and expenditure survey does provide some initial indications. Based on estimates of the cost of a basic nutritious diet and allowing for associated nonfood expenses, approximately 40 percent of FSM households may be considered low income. Most lower income households are in the outer islands. Further, Chuuk is the poorest state in the FSM. These suggest the direction toward which poverty-orientated programs could be targeted. Suggestions from other sources include a greater focus on poverty and vulnerability arising from lack of access to basic social services.

5. Employment

20. Employment in the formal sector grew by an annual average rate of 3.2 percent during the early part of the Compact (FY1987-FY1995, Table 3) reflecting the growth in GDP. This rate of growth was higher than the rate of population growth but approximated the growth in the labor force. Thus it was sufficient to provide jobs for FSM youth entering the labor market for the first time. However, in the later part of the Compact, between FY1995 and FY2000, the labor market remained stagnant and was unable to provide enough jobs for new job seekers.

Table 3. Changes in Employment by Sector and State
(annual averages)

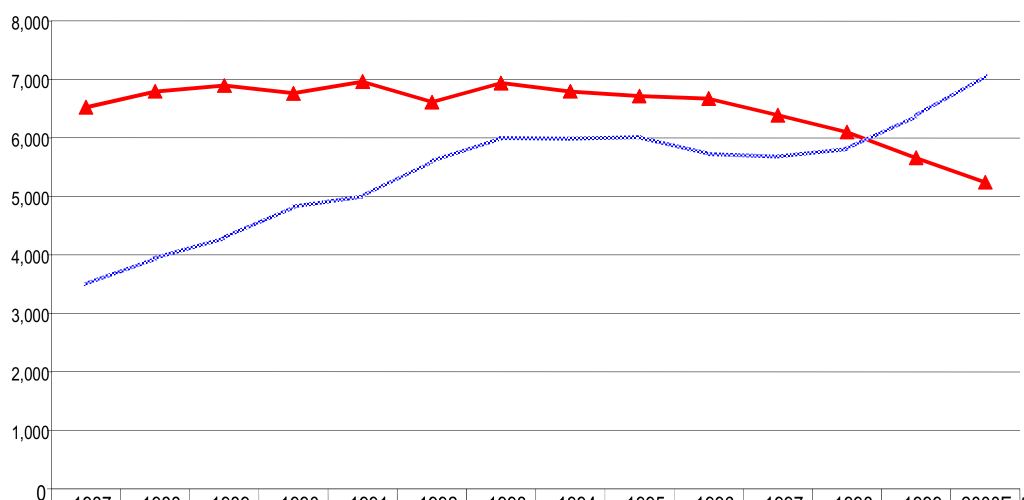
	FY1987-FY2000			FY1987-FY1995			FY1995-FY2000		
	Total	**Govt**	**Private**	**Total**	**Govt**	**Private**	**Total**	**Govt**	**Private**
Chuuk	-0.3%	-3.2%	2.5%	1.2%	-0.3%	3.3%	-2.7%	-8.3%	-0.6%
Kosrae	1.1%	-2.4%	5.1%	0.6%	-2.0%	2.4%	1.8%	-5.4%	5.3%
Pohnpei	3.3%	-0.7%	6.0%	4.6%	0.8%	8.7%	1.3%	-1.2%	-0.1%
Yap	4.2%	-2.6%	10.4%	5.9%	0.6%	12.7%	1.7%	-8.8%	5.1%
FSM	2.0%	-1.4%	5.6%	3.2%	0.8%	7.0%	0.2%	-5.0%	1.2%

Note: Data for FY2000 are estimates based on first 6 months.
Source: Social Security Administration.

21. Preliminary indications from the 2000 population census suggest that the population declined or was stagnant during the period since 1994 reflecting substantial out-migration and some decline in fertility. Clearly, the inability of the economy to provide jobs for a growing labor force provided a strong incentive to the unemployed and underemployed to migrate to neighboring US territories, Hawaii, and the US mainland in search of employment and incomes. While the safety valve of migration to the US may have restored equilibrium in the labor market, it has been achieved with a loss of productive population, leaving the FSM with a skewed age structure as the young and old remained in the country. Clearly, a major challenge facing the FSM is to expand opportunities in the private export sectors to provide jobs to the growing labor force.

22. As noted in the discussion on economic developments, the FSM has been able to achieve significant expansion in the private sector despite the reductions in Government. Figure 4 indicates recent trends in private and Government employment since FY1987. Government employment remained relatively static through the period until 1997, when a major fiscal adjustment was undertaken. The ADB-financed PSRP (footnote 1) enabled implementation of an early retirement program that facilitated the needed adjustment. By FY2000, employment in the Government had fallen from a height of approximately 7,000 in the early 1990s to just over 5,000. Employment in the private sector expanded rapidly in the early part of the Compact as the economy adjusted to large levels of external inflows and as a modern cash economy emerged in non-traded goods. Private sector employment stagnated in the mid-1990s, but began to rise again in FY1999 and FY2000 as the economy expanded after adjusting to the second step-down and the Chuuk financial crisis had been resolved. By FY1999, private sector employment surpassed, for the first time, the level of Government employment—a significant achievement. (Caution should be placed in the figures for FY2000, which are based on first six months only.)

Figure 4: Trends in Employment by Sector, FY1987-FY2000



FY	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000Est
Government	6,525	6,795	6,895	6,760	6,962	6,612	6,937	6,793	6,714	6,674	6,390	6,103	5,658	5,245
Private Sector	3,497	3,941	4,291	4,820	4,998	5,595	5,999	5,987	6,012	5,727	5,680	5,812	6,374	7,059

Source: Social Security Administration.

6. Wages

23. The labor market in the FSM is relatively free from regulatory distortions and institutional rigidities. Pohnpei State is the only state that imposes a minimum hourly wage (currently set at $1.35) for the private sector. While this wage may leave the demand for skilled workers unaffected, it may be an active constraint in labor-intensive activities such as garments. However, private sector operators are not vocal about this subject. All Governments have set minimum hourly wages for Government employees ($2.00 for Pohnpei, $1.25 for Chuuk; $1.35 for Kosrae; and $0.80 for Yap), but these levels coincide with the lowest step on the public servant pay scale and are thus redundant. The FSM currently has no unions and no indexation of wage rates (until recently there had been no consumer price index).

24. While the labor market is relatively free from regulatory distortions and institutional rigidities, it is distorted by high public sector wage rates. Other factors affecting the labor market include the ease of migration to and comparatively higher wages in Guam and the US. Table 4 indicates real wages by state and between the private and government sectors. For the FSM as a whole, government wages are nearly double those of the private sector. While the skill mix of the two activities affects the differential, the public sector clearly asserts an upward pressure on wages and influences the allocation of labor between the sectors. Unrestricted external migration is part of the basic rights of FSM citizens under the Compact, and is not subject to policy change. However, policy can be exerted to ensure the differential between the private and public sectors does not widen. Data in Table 4 suggest that differentials have widened in the last 10 years, although the impact has been uneven by state. This should be an area of further analysis and policy focus.

Table 4. Employment Growth Rates by Sector and State
(annual averages)

Place	Real Government Wages (1998 $, average)		Real Private Sector (1998 $, average)		Differentials (average)	
FY	Average FY87-FY95	Average FY96-FY00	Average FY87-FY95	Average FY96-FY00	Average FY87-FY95	Average FY96-FY00
Chuuk	7,133	5,658	3,395	3,081	210%	184%
Kosrae	6,766	7,129	3,588	3,383	189%	211%
Pohnpei	10,864	10,950	4,770	4,646	228%	236%
Yap	7,406	7,106	4,900	3,753	151%	189%
FSM	**8,436**	**8,064**	**4,212**	**3,945**	**198%**	**204%**

Source: Social Security Administration.

B. Fiscal Developments

1. Fiscal Policy Background

25. Fiscal policy in the FSM is complicated because the national and each of the four state governments formulate separate expenditure and revenue policies. This section provides background information on the issues affecting fiscal management in the FSM. Fiscal analysis in the FSM continues to be hampered by the lack of timely and comprehensive financial reporting by the five governments. The analysis here is based on audited financial statements completed as of the time of reporting. The financial outturn for FY1999 has been estimated for the national Government, while fiscal performance for all five governments in the FY2000 are based on estimates. These estimates use timely payroll

and tax collection data; however, for all other revenue and expenditure components the estimates derive from budget documents and trend assumptions.

26. The national Government has the power to collect import and income taxes (just under $25 million in FY1999), which constitute about three-fourths of all domestic taxes. By the Constitution, at least 50 percent of domestic taxes (and 80 percent of the fuel import tax) must be shared with the state in which the taxes were collected. Beginning in FY1999, the national Government has shared a further 20 percent with the states, although the use of these extra transfers, amounting to about $4 million annually, is restricted to health and education capital projects. The states, with widely varying levels of tax effort, collect the remaining one-fourth of domestic taxes, primarily through general sales taxes and excise taxes on alcohol, tobacco, and other goods. While overall tax revenues remain low relative to other Pacific developing member countries (PDMCs), there has been some gradual increase over time. In FY2000, tax revenues are 11.4 percent of GDP. This is about half of the average level across PDMCs.

27. The nontax revenues are dominated by fishing access fees, which represent nearly one third of all domestic revenues. The national Government manages and keeps all of the revenues from these fees. This source of revenue, which grew rapidly from less than $4 million in FY1987 to a peak of over $21 million in FY1995, was contested by the states in a series of attempts to amend the FSM Constitution to share the fishing access fees. The states also pressed and lost their case in the FSM Supreme Court.

28. The national Government acts as an agent in distributing to each government, according to statutory formulas, the grant funds received from the US under the Compact. The national Government receives just less than 15 percent of current grants and 10 percent of capital grants. The remainder is distributed to the states based on a formula that splits 30 percent of funding evenly among the four, and remaining 70 percent according to population. Total Compact transfers have declined over time due to the programmed stepdowns in FY1992 and FY1997 and because most grants are adjusted by a factor of only two thirds of inflation in the US. Some components of Compact assistance, notably the health and education grants, are not indexed at all. Total grants, which exceeded the level of GDP in the initial years under Compact assistance, have fallen to 42 percent of GDP in FY2000.

29. On the expenditure side of fiscal policy, all five governments operate within "balanced budget" requirements based on either Constitutional or statutory provisions. However, the definition of a balanced budget is not actually restricted to the operations of a single budget year. Funds unexpended in one year are reported as revenues in the following year. The use of this "carry-over" component in revenue projections tends to cloud fiscal management and can mask the onset of significant structural imbalances.

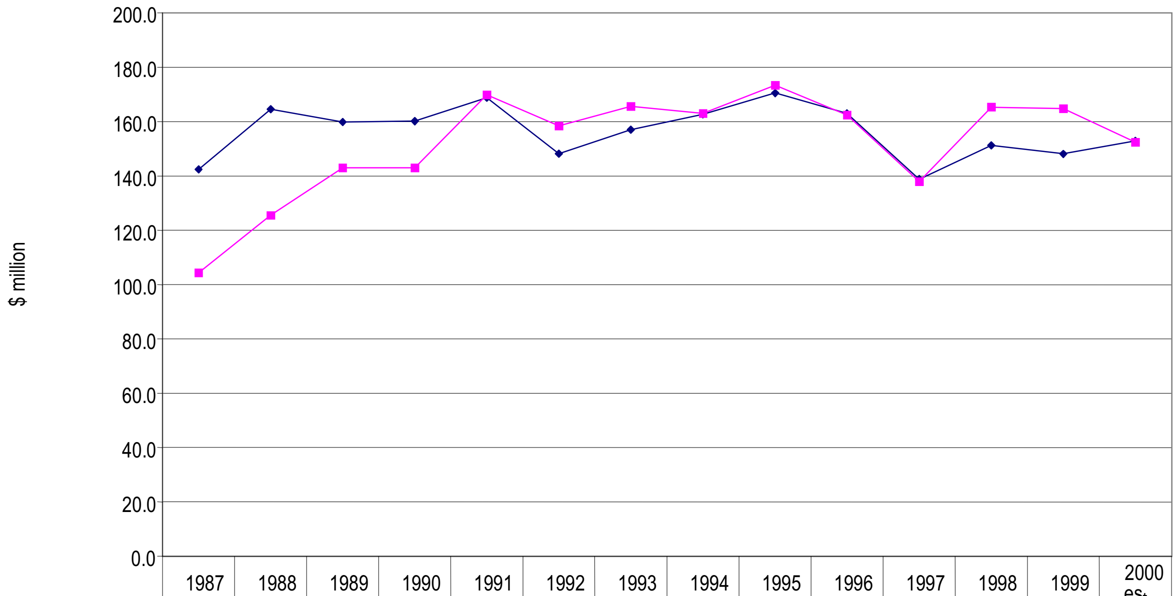
30. The governments conduct budgetary operations through a series of separate funds, the most important being the general fund, special fund, and capital fund. Transfers are made between these funds for specific purposes; however, there is limited flexibility or authority to use funds from the special and capital funds to finance current expenditures. Thus, standard government financial statistics reporting, aggregating across funds, and accurately distinguishing between "above-the-line" revenues and expenditures and "below-the-line" financing operations do not always highlight the constraints faced by fiscal policy-makers.

31. Total expenditure as a share of GDP has declined from a peak of 105 percent in FY1988 to 66 percent in FY2000. Capital expenditures have averaged about 20 percent of GDP over the Compact assistance period, though a large share of the investment went to commercial public enterprises that have incurred losses. Recently, with the decline in Compact capital grants, capital expenditures have been falling and are likely to stay in the range of 10-14 percent over the next three years. Total expenditures have declined less rapidly than total revenues due to the smoothing effect of spending fund balances built up during earlier years.

2. Recent Fiscal Performance

32. The FSM has undertaken a series of fiscal reforms from FY1996 to the present. The greatest effect of these reforms has been to reduce current expenditures, particularly on payroll costs, and, to a more modest extent, to increase tax revenues. As such, the fiscal position of the FSM has been strengthened despite the shock caused by the scheduled reduction in Compact economic assistance that took effect at the outset of FY1997.

Figure 5: FSM Consolidated Revenues and Expenditures



	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 est.
Revenue	142.3	164.5	159.8	160.1	168.8	148.1	157.0	162.6	170.5	163.0	138.8	151.2	148.1	152.8
Expenditure	104.3	125.5	143.0	143.0	169.9	158.4	165.6	163.0	173.4	162.4	137.9	165.3	164.8	152.4

Source: Department of Economic Affairs and FSM audits.

33. Tables 8 and 9 in the statistical appendix show the fiscal performance of the FSM on a consolidated basis and national government finances respectively, on the standard government financial statistics format.

34. Recently, the FSM has experienced a significant reversal of past trends. Six years of large and growing deficits in the current account have been addressed. Capital expenditures had been reduced during FY1994 to FY1997 in order to repay the medium-term notes bonds that had funded a rapid expansion in capital outlays in the early 1990s. In FY1998-FY1999, capital expenditures returned to near their average level of 20 percent of GDP.

Consolidated revenue and expenditure trends are shown in Figure 5. The large overall deficits, amounting to 7 percent of GDP in FY1998 and 8 percent of GDP in FY1999, resulted from the increases in capital outlays. These expenditures were influenced by large airport renovation projects in Chuuk and Yap and by a general increase in Chuuk's capital development program. In both cases, financing was achieved through the drawdown of accumulated reserves that had been invested abroad. Capital spending in Chuuk had been seriously curtailed due to cash management and administrative problems stemming from the deficits that affected the general fund. The large current deficit of 5 percent of GDP in FY1997 resulted from the reduction in Compact grants beginning in the year and delays in implementation of the expenditure reforms that were subsequently effective in eliminating the current deficit.

35. The consolidated fiscal accounts show the high dependence on external grants (Table 5). As government expenditures have declined as a share of GDP from a peak of 105 percent in FY1989 to an estimated level of 66 percent of GDP in FY2000, the dominance of Government in the economy has been reduced. Still, grants make up some 63 percent of government revenues in FY2000, down from 83 percent in FY1987. Tax revenues have grown as a share of total revenues from 7 percent in FY87 to 17 percent in FY2000. Tax revenue as a share of GDP has also grown from 8.3 percent in FY1987 to 11.4 percent in FY2000. The most prominent change in the structure of revenues has been the growth in fishing access fees, which have recently averaged about $16 million annually compared to less than $4 million in FY1987.

Table 5: Comparative Analysis of Fiscal Structure
FY1987 and FY2000

Item	Chuuk	Kosrae	Pohnpei	Yap	National	FSM
FY 1987						
Grants as % of GDP	98	115	48	99	24	102
Grants as % of Total Revenue	92	87	80	88	74	83
Tax Revenue as % of GDP	7	8	8	10	7	8
Current Expenditure as % of GDP	72	66	36	65	17	72
Capital Expenditure as % of GDP	11	44	3	23	5	17
Overall Balance as % of GDP	25	22	21	25	11	33
Current Ba;ance as % of GDP	2	10	8	15	9	15
FY 2000						
Grants as % of GDP	45	62	21	51	7	42
Grants as % of Total Revenue	77	84	68	71	39	63
Tax Revenue as % of GDP	11	12	11	12	9	11
Current Expenditure as % of GDP	45	52	21	41	20	54
Capital Expenditure as % of GDP	13	20	4	21	2	12
Overall Balance as % of GDP	0	2	5	11	-3	0
Current Balance as % of GDP	-1	-2	4	20	-2	1

Notes: Taxes include all taxes collected in each state, irrespective of revenue sharing arrangements.
State GDP is used for each of first four columns; FSM GDP used for final two columns.
Source: Department of Economic Affairs and FSM audits.

36. State governments show considerably different patterns of fiscal accounts. Grants make up less than 40 percent of national Government revenues. National taxes represent about 75 percent of total taxes in the FSM; however, the national Government retains only about 30 percent of the amount under a Constitutionally mandated revenue sharing arrangement with the states. The national Government's expenditure pattern over time is one of rapid growth from FY1987 to FY1998. During this period, total expenditures doubled,

from $25.1 million to $55.8 million. Current expenditures followed a similar pattern, although the downward adjustment began a year earlier. The national Government faced little pressure to adjust expenditures at the time of the first step-down in Compact grants, as this was more than offset by the growth in fishing access fees. But the impact of the second step-down in FY1997 was worsened by a large reduction in fishing access fee revenue during the year. The combined revenue losses, together with a failure to reduce current expenditures, created a current deficit of nearly 5 percent of GDP. This completely erased the combined current surpluses of the four states in the same year. Payroll costs have been reduced very little in aggregate, from a peak of $13.5 million in FY1997 to the current $13.0 million, a cut of just 4 percent. The recent increase in personnel supported by federal grant masks the actual cut of some 14 percent of payroll costs funded from non-grant resources.

37. The fiscal performance of the national Government is a concern at this stage as it has had large overall deficits, in the range of 3-5 percent of GDP, in each year from FY1997-FY2000. These deficits are largely funded from surplus balances accumulated in prior years—in effect by drawing down portfolio assets from abroad. Two revenue factors have also negatively affected the fiscal outturn in recent years. Fishing access fee revenues peaked at $21.5 million in FY1995 and have subsequently fallen to $13-16 million in the most recent four years. The shift in revenue-sharing formula to transfer an additional 20 percent of national taxes to the states resulted in a structural decline in revenues in the range of $4 million per year. Meanwhile, the national Government has not made any significant cuts in its overall expenditure pattern.

38. Fiscal performance in the states has been highly variable over the years; however, recent performance has been good in all four states. The impact of the reduction in Compact grants in FY1997 required particularly difficult adjustments in state expenditure patterns. In Chuuk, where the largest adjustment was required, expenditures were cut in FY1997 to just $25 million from a peak of $54 million in FY1991. Chuuk's financial crisis resulted from the lack of adequate adjustment to the initial reduction in Compact grants in FY1992 and the subsequent build-up of arrears during FY1993-1997. Current expenditures in FY1998 and FY1999 do not fully reflect the reduction in structural expenditures as the state was paying about $5 million to $6 million of its arrears each year. Reductions in payroll expenditures from a peak of $21.9 million in FY1995 to $12.8 million in FY1998, reflected a 42 percent nominal cut. The state restored half of the working hour cut, up from 64 to 72 hours every two weeks, at the start of FY2000. The overall deficit in FY1999 was primarily a result of doubling capital expenditures from trend levels. This reflected the airport renovation project and implementation of previously delayed projects. The capital fund balance remains at over $30 million at the end of FY2000, although less than one third of this is unreserved. Thus the deficit, amounting to 18 percent of state GDP in FY1999, is not a cause for alarm.

39. Looking forward, the Chuuk state budget calls for a return to 80 hours every two weeks, a policy that will increase payroll by about $1.5 million in FY2001. In the absence of further arrears, this appears to be manageable. Payroll costs will still have been reduced from their FY1995 peak of $21.9 million to $16.9 million in FY2001. This is a 23 percent cut in nominal terms. However, the state needs to address the long-standing financial management problems related to medical referral debts. Recent efforts to reconcile accounts with medical providers in Hawaii and Guam have clarified the need for some $3 million to be added to the obligations of the state for debts incurred during FY1996-FY2000. The state has also benefited over the past few years from high returns to its investment portfolio; such returns are not projected to continue, especially since the stock of assets has been reduced with the increase in capital outlays in FY1999.

40. Chuuk State remains dependent on external grants to fund government operations and investment. The share of grants in total revenues is 77 percent in FY2000, having declined from 92 percent at the outset of the Compact economic assistance period. Improvements in tax collections, coupled with an increase of the state sales tax from 3 percent to 5 percent effective in FY2001, will further reduce this measure of dependency. Chuuk State's economy is still reliant on sustained government expenditures of some 58 percent of state GDP. However rapid economic growth in FY1999 and FY2000 cannot be fully attributed to increased capital spending. The challenge remains for Chuuk State to live within its means and still support sustained economic growth. Capital expenditures in Chuuk State have fluctuated tremendously from a low of 4 percent of state GDP to a high of 32 percent during the period recorded. The average level of capital investment was 17 percent. However, the predominance of investments in commercial public enterprises and in a wide-range of small, unvetted, "constituency-based" projects have contributed little to sustained economic growth, as evidenced by the 0.2 percent average annual decline in state GDP from FY1987 to FY2000.

41. Kosrae State has maintained a relatively consistent fiscal balance since FY1987. The period of overall deficits from FY1991-FY1993 was driven predominantly by large-scale capital expenditures financed by medium-term notes in the amount of $5 million and spending down fund balances. The state had a current deficit of about 7 percent of state GDP in FY1997 as a result of the reduction in Compact grants and a delay in implementing expenditure cuts. Notably, the fall in revenues in FY1997 amounted to over 12 percent of state GDP. While current expenditures have been reduced and the current balance had been restored, the outturn for FY2000 leads to some concern that further fiscal tightening may be required. Payroll levels have not been reduced as significantly in Kosrae as in other states, despite working 56 hours every two weeks. Payroll costs have been cut from a peak of $5.8 million in FY1996 to a current level of $4.8 million, a nominal cut of 17 percent. However, a mandated annual step increase of 5 percent provides significant upward pressure on the state wage bill.

42. The structure of Kosrae State's fiscal accounts has changed the least among the five FSM governments. Notably, grants as a share of total revenues have been reduced only from 87 percent in FY1987 to 84 percent in FY2000. Domestic revenues have been stagnant in nominal terms while grants have declined. Tax revenues as a share of state GDP have grown from 8 percent in FY1987 to 12 percent in FY2000. Nontax revenues have declined markedly, primarily as a result of spending fund balance assets that had been earning interest and dividends in the FSM investment portfolio. Capital expenditures in Kosrae have fluctuated less than in some other states and have been very high as a share of state GDP by FSM standards. Capital expenditures have ranged from 20 to 57 percent of state GDP and have averaged 34 percent over 14 years recorded. This exceedingly high investment does not compare favorably with the average annual state GDP growth rate over the same period of just 0.5 percent. Clearly investments, predominantly in commercial public enterprises, have not succeeded in contributing to economic growth.

43. Pohnpei State has shown considerable fiscal discipline since FY1996. As with Chuuk State, the government financial statistics presentation masks some budgetary problems that were faced with respect to the general fund. However, the state appears to have adequately adjusted to current resources. FY1995 represented a year of extreme fiscal difficulties with a 9 percent increase in payroll costs and a near doubling of other purchases of goods and services. The current deficit in FY1995, amounting to over 8 percent of state GDP, was financed by the depletion of assets invested abroad and by the build-up of domestic arrears.

Since FY1995, the State has restored positive fund balances in the general fund. Payroll costs have been reduced from their peak of $17.9 million in FY1996 to the current level of $14.2 million. This is a cut of some 21 percent in nominal terms. More than any other state, Pohnpei responded significantly to the adjustment challenge by increasing state tax revenues. State taxes have nearly doubled in the past four years, although total tax revenue is still just 11 percent of state GDP.

44. The structure of Pohnpei State's fiscal accounts shows they have the least reliance on external grants among the four states. However, grants make up 68 percent of government revenues, down from 80 percent in FY1987. In terms of capital outlays, the state aggressively invested in commercial enterprises during the early 1990s, mostly financed by medium-term notes. Capital expenditures fluctuated in the range 3 to 21 percent of GDP. Of necessity, capital outlays in recent years have been restricted as those debts are repaid. The average capital expenditures of 9 percent of GDP compares relatively favorably with the average annual GDP growth rate of 3.5 percent.

45. Yap State has shown the most consistent fiscal performance within the FSM. The state experience a current deficit only during FY1993, and the adjustment to the step-down in FY1997 was done in an impressive manner. Despite running consistent surpluses on its current account, the state has maintained discipline on recurrent expenditures. The payroll has been reduced from a peak of $7.3 million in FY1996 to $5.7 million in FY2000, a cut of 22 percent in nominal terms. However, tax revenues have stagnated despite economic growth. In particular, revenues from state taxes have fallen over 10 percent since FY1996. Tax revenues from Yap State are equal to 12 percent of state GDP in FY2000.

46. Yap State has reduced dependence on external grants to fund government operations and capital expenditures more than any other state. Grants made up 88 percent of all revenues in FY1987 and 71 percent in FY2000. Capital expenditures have been high and relatively stable in Yap, ranging from 12 to 42 percent of state GDP during the period of Compact economic assistance. However, this does not compare favorably to the average annual GDP growth of 3.2 percent from FY1987 to FY2000, due to the dominance of investments in commercial public enterprises that have not proven successful. Yap State will end the secure period of Compact economic assistance with a large reserve of assets invested abroad. The state's monetization scheme has proven successful. In FY1991, the state borrowed $71 million by issuing medium-term notes (MTN) bonds secured by future Compact assistance flows under full faith and credit provisions provided for in the Compact treaty by the US government. Having borrowed at a weighted average interest rate of 8.52 percent, the state has earned investment earnings in excess of the cost of borrowing in the range of $17 million. This is reflected in the unreserved fund balance of the state's general fund of $19 million at the end of FY1999.

C. Monetary Developments and Prices

1. Money and Banking

47. The FSM adopted the US dollar as the currency in circulation and thus chose to forego an independent monetary and exchange rate policy. This leaves fiscal policy as the major macroeconomic tool of adjustment. The use of a foreign metropolitan country's currency has served the FSM well. While the range of macroeconomic policy options is limited, it has removed the potential to use inflationary monetary policy to adjust to the step-downs in Compact funding. It has also removed exchange rate realignment and devaluation

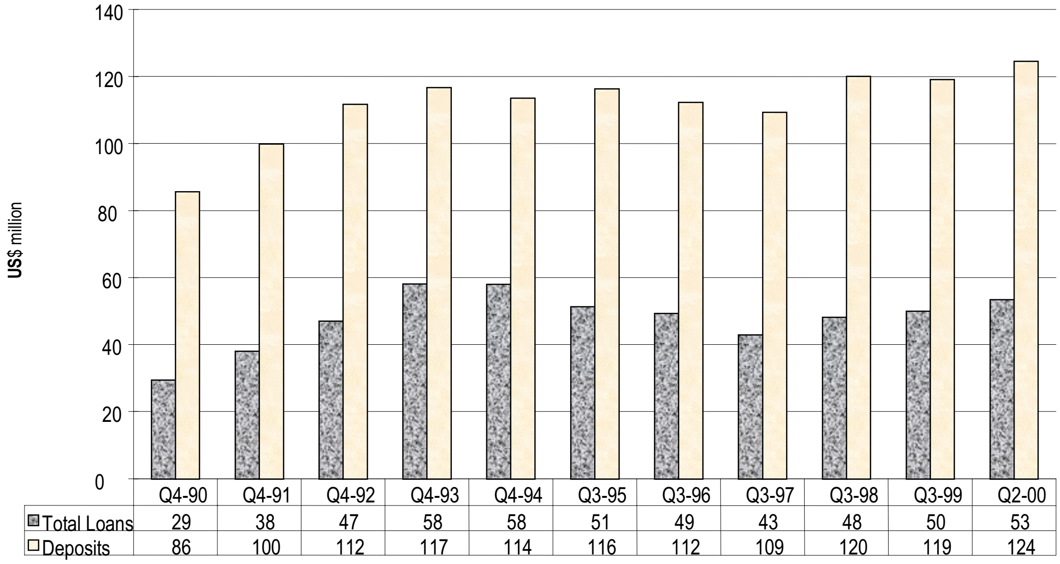
to encourage the export and traded goods sectors of the economy and to reduce real domestic costs. However, this has left the FSM with no other means of adjustment to reduced levels of resource transfers other than through the painful means of directly cutting Government expenditures, reducing public sector employment and wages, and increasing domestic revenues.

48. The lack of an independent monetary policy and use of US currency also results in domestic interest rates being closely aligned with US rates. Deposit interest rates are broadly similar to those throughout the insular US, while lending rates are generally higher, reflecting the additional risk and costs of doing business in the FSM. Initially, the higher rates charged on loans resulted in regulation and limits were placed on both consumer and commercial loan interest rates. As part of the PSRP, removal of regulation was recommended and was a loan condition. The interest rate limits were effectively removed (leaving only a non-binding usury limit at 24 percent) in 1998 and there was no adverse change in the local interest rate structure as the financial system was allowed to adjust to market forces.

49. The FSM's banking system benefits from the US Federal Deposit Insurance Corporation as part of the Compact arrangement, as it plays a critical role in supervising the banking system and ensuring a sound and stable financial system. As the components of the Compact are renegotiated, maintenance of this facility will be an important objective for the FSM, so that it can continue to avoid the adverse consequences of banking system failures. The Banking system is also regulated by the FSM Banking Board, which is enhancing its capacity for the banking supervisory role. Two US banks and the locally owned Bank of the FSM are operating in the country. The US banks are branches, and thus also come under the supervisory requirements of the US Federal Reserve. The present system is thus well supervised and provides a sound basis for financial intermediation.

50. Reporting of banking statistics in the FSM commenced in 1990. The deposit base rose rapidly through the early part of the 1990s reflecting strong growth in nominal GDP. However, the system fell back in 1994, reaching its lowest point in 1997 with the onset of the second Compact step-down. The Chuuk financial crisis also occurred during this period, as the state financial system came under considerable strain as the Government failed to pay local vendors, withheld allotments from public servant paychecks, and ran up a large accounts payable. There are currently no state-based banking statistics. In 1998, the economy began to recover and the deposit base expanded through FY2000. These developments are described in Figure 6.

Figure 6: Trends in Commercial Bank Loans and Deposits
(end of period)



	Q4-90	Q4-91	Q4-92	Q4-93	Q4-94	Q3-95	Q3-96	Q3-97	Q3-98	Q3-99	Q2-00
Total Loans	29	38	47	58	58	51	49	43	48	50	53
Deposits	86	100	112	117	114	116	112	109	120	119	124

Source: FSM Banking Board.

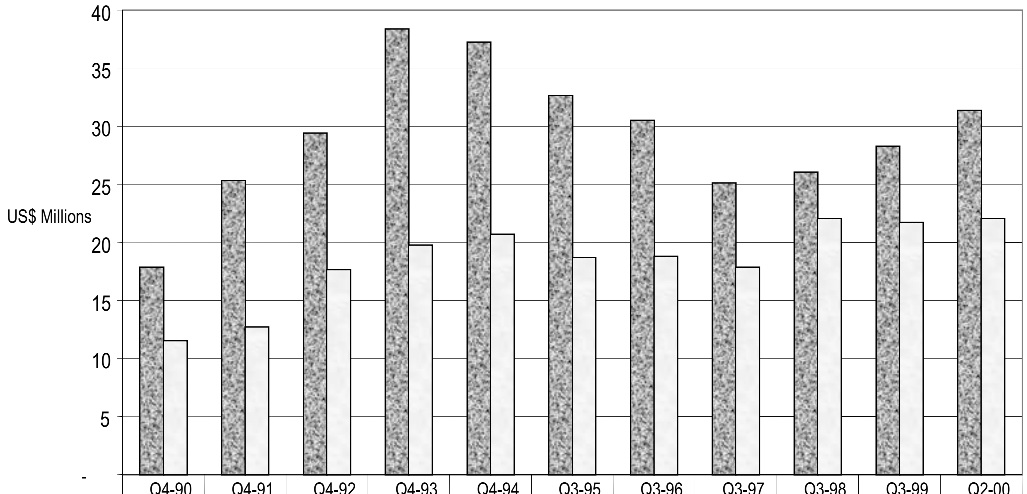
51. Following a pattern similar to the growth in deposits, commercial bank loans doubled from $29 million to $58 million by the end of the fourth quarter in 1994, reflecting the booming economy during the period. As in the case of deposits, a period of stagnation set in as the banks cut their portfolios down to $43 million in 1997, reflecting the second step-down and Chuuk financial crisis. The position began to improve and credit rose to $53 million by the end of the second quarter 2000, but is still below the level attained in 1994. The difference between loans and deposits indicates the large level of liquidity in the FSM banking system, and reinforces the widely observed phenomenon in the Pacific island region that capital is not in short supply. The loans-to-deposit ratio rose from 34 percent in 1990, peaked at 51 percent in 1994, and fell back to 39 percent in 1997, and eventually recovering to 43 percent by the end of the second quarter of 2000. The difference between the levels of deposits and loans is invested offshore.

52. The high level of liquidity in the economy is frequently misunderstood to indicate that commercial banks are failing to support the domestic economy. However, the lack of more active lending results from the many impediments to increased lending that lie outside the control of the banking sector. The lack of adequate security against which the banks can lend, including land and chattel mortgages, is critical. Limited entrepreneurial experience and a lack of commercial ability to operate profitable modern sector businesses are other key factors that make lending risky. The uncertain outcome of the Compact economic assistance renegotiations also constrains credit creation. An appropriate policy for the FSM is to not to encourage the banks to make unsound loans, but rather to ensure a sound environment for private sector development in the longer term.

53. Reflecting the lack of "bankable projects" the commercial banks have preferred to extend credit to consumers with secure public sector jobs and an identified repayment stream. Lending to consumers represents about 60 percent of domestic credit creation. Trends in commercial bank lending indicate the stagnant nature of lending to the commercial sector, which has remained more or less unchanged since 1994, when

commercial lending peaked (Figure 7). Further, reforms that are currently being proposed as part of ADB's PSDP loan include making provision for long-term leases, leasehold mortgages, and chattel mortgages. These will hopefully ease some of the constraints on bank lending, and encourage a more dynamic private sector once the Compact renegotiations have been concluded.

Figure 7: Commercial Bank Credit by Sector



	Q4-90	Q4-91	Q4-92	Q4-93	Q4-94	Q3-95	Q3-96	Q3-97	Q3-98	Q3-99	Q2-00
Consumer Loans	18	25	29	38	37	33	31	25	26	28	31
Commercial Loans	12	13	18	20	21	19	19	18	22	22	22

Source: FSM Banking Board.

2. Prices

54. In the first quarter of 1999, the FSM commenced establishment of a consumer price index for each state and the country. Since the series has only recently been initiated and has only six quarters of data, it has yet to generate a useful series. Therefore, the US consumer price index has been used as a proxy, as most of FSM's imports originate from the US. While this has some validity, in many areas this approximation is not appropriate, but is probably the best current option.

55. While there is no price index for the nation, there is a continuous quarterly price series for Pohnpei State dating to the first quarter of 1997. Notably, Pohnpei State represents about 50 percent of consumption in the FSM. In the following year the index recorded a significant downward movement in prices, which fell by 2.6 percent for the year and dipped to an annualized rate of negative 4.1 percent in the fourth quarter. In part, this was due to the adjustment of the economy to the second step-down and reduction in demand. It was also a period of significant retail price competition as a large new supermarket opened in Pohnpei offering significant reduction in the price of food and clothing. These movements are indicated in Table 6. As this effect worked its way through the system, inflation picked up averaging 1.9 percent in 1999, and peaked at 3.7 percent in

the fourth quarter. In the first half of 2000, inflation had fallen back to 2 percent by the second quarter. These figures compare with US inflation of 2.6 and 3.2 percent in 1999 and projected for 2000.

Table 6: The Pohnpei State CPI Year-on-Year Change
(average 1997 prices = 100)

	1998				1999				2000	
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**
Food	-5.2	-7.6	-9.2	-10.5	-4.2	1.8	4.4	5.8	6.9	3.4
Tobacco, Alcohol, Sakau and Betel Nut	2.6	4.8	3.9	-2.1	1.2	2.5	3.2	7.7	1.1	-3.8
Clothing and Footwear	-2.7	-1.2	-6.7	-8.2	-5.6	-2.9	-0.8	1.6	1.0	0.2
Housing	7.1	8.8	2.4	2.5	4.0	5.1	5.1	5.0	3.0	0.5
Fuel, Light and Water	0.0	0.9	0.4	-0.1	0.0	0.0	0.0	0.0	-0.1	6.8
Services	1.4	1.6	2.0	2.1	0.7	-0.7	-1.2	-1.6	-0.7	1.4
Miscellaneous	3.1	3.2	3.8	6.0	4.0	1.0	2.3	-0.1	0.1	1.4
Total	**-1.1**	**-1.8**	**-3.3**	**-4.1**	**-0.9**	**1.7**	**3.1**	**3.7**	**3.6**	**2.0**

Source: Statistics Division, Department of Economic A.ffairs.

D. Balance of Payments and External Debt

1. Balance of Payments

56. A major area of statistical weakness in the FSM has been the production of reliable trade statistics, which has been a constraint on informed economic analysis. It has further hindered the development of balance of payments statistics. In an effort to improve this situation, ADB is currently executing a statistics capacity building TA, which is assisting the FSM to implement a new trade statistics system. While these efforts will take time to develop and establish a series, preliminary balance of payments estimates were recently compiled to aid current analysis of economic performance. Care should be taken in use of these statistics, though the estimates provide useful information about the structure of the external account and approximate order of magnitudes. Preliminary figures are included in Table 7.

57. The trade account of the balance of payments runs a significant deficit reflecting the excess of imports over exports. Exports currently include a small amount of agricultural produce and fish. While small volumes of inshore reef fish are exported to neighboring islands, the majority of fish exports are of Tuna caught by local purse seine and longline vessels operated by public enterprises. The FSM has yet to establish a sustainable fishing industry and the sector is highly fragile and financially vulnerable. The majority of the fish caught in FSM waters are caught by foreign vessels under license and the associated fishing access fees are treated as a factor income in the balance of payments. Imports dominate the trade account. However, these statistics should be treated cautiously as imports have been estimated from customs revenues. There are no discernable trends in exports as volumes have been stagnant and prices have fluctuated reflecting international tuna prices. The level of imports on the other hand reflects the state of health in the economy and rises in the later part of the 1990s with the economy.

Table 7: Balance of Payments
(FY1994-FY2000, $ millions)

FY	1994	1995	1996	1997	1998	1999	2000
Current Account	13.4	49.3	55.7	18.3	12.7	9.5	6.5
Trade Balance	-118.3	-92.2	-85.5	-95.0	-108.8	-117.8	-122.3
Exports, f.o.b.	8.8	22.2	27.1	25.2	13.4	11.2	23.1
Imports, f.o.b.	-127.1	-114.4	-112.7	-120.2	-122.3	-129.1	-145.4
Services Account	-15.4	-12.5	-11.5	-16.3	-14.0	-9.0	-12.0
Receipts	17.8	20.4	21.4	21.1	20.9	22.0	23.3
Travel	11.9	14.1	15.4	15.5	15.3	16.2	17.5
Payments	-33.1	-33.0	-32.9	-37.5	-34.9	-31.0	-35.3
Freight and Insurance	-19.1	-17.2	-16.9	-18.0	-18.3	-19.4	-21.8
Income, Net	23.4	25.5	26.2	21.7	21.7	24.7	28.5
Receipts	32.9	34.3	33.9	28.4	27.3	29.3	32.2
Fishing Rights Fees	21.3	21.5	20.5	14.4	13.5	15.9	16.8
Interest Dividend Income	11.5	12.7	13.4	14.1	13.8	13.4	15.4
Payments (Interest)	-9.5	-8.7	-7.7	-6.7	-5.6	-4.6	-3.7
Unrequited Transfers	123.7	128.6	126.6	107.9	113.9	111.6	112.3
Private	2.7	2.8	3.0	3.2	3.4	3.7	3.9
Official	121.0	125.7	123.6	104.7	110.4	107.9	108.4
Compact Funds	90.7	91.8	93.0	77.6	78.9	78.9	79.4
Other	30.3	33.9	30.6	27.1	31.5	29.0	29.0
Capital Account	**-12.0**	**-1.7**	**-1.2**	**-2.4**	**-9.3**	**-12.1**	**-15.2**
Short term, Net	-2.5	7.8	14.4	1.8	-5.9	-1.2	1.8
Medium Term, Net	-9.5	-9.5	-15.6	-4.2	-3.4	-10.9	-17.0
Inflows (Borrowing)	2.2	0.3	0.8	11.7	11.8	3.8	2.2
Outflows	-11.7	-9.8	-16.4	-15.9	-15.2	-14.7	-19.2
Medium-Term Note Amortizn	-8.6	-9.2	-15.8	-8.3	-11.3	-11.0	-18.5
Other Amortization	-3.1	-0.6	-0.6	-7.6	-3.9	-3.7	-0.7
Overall Balance	**1.4**	**1.1**	**3.9**	**19.8**	**-9.4**	**-10.2**	**-5.0**
Errors and Omissions	-0.1	46.5	50.5	-3.9	12.8	7.6	-3.8

58. The service account is dominated by two main factors: tourism and the cost of freight for imports to the FSM. The demand for tourism has remained relatively stagnant in recent years, but it picked up in FY99 and FY00 with recovery from the Asian crisis and improvements in hotels in the FSM. The factor account is comprised of fishing access fees, earnings of dividends and interest on overseas investments, and payment of interest on debt. The FSM Governments maintain a sizeable level of foreign investments currently approximating $120 million reflecting accumulation of past surpluses, the Yap MTN scheme, and unspent Capital Improvement Project (CIP) funds. However, current fiscal policy at the National Government has been to spend past surpluses, which coupled with greater project implementation capacity in Chuuk will erode the level of reserves and their earnings. Repayment of the Yap MTN scheme will be complete by the end of FY2001, when it is expected that Yap will hold about $40 million in reserves including surpluses from operating prudent fiscal policy.

59. The most significant component of the balance of payments is the transfers account, which includes Compact funds and other aid flows. Private remittances appears to be relatively small in the FSM, but may well be underestimated and are likely to rise in the future as migration has increased significantly since the last census. Compact flows represent about 45 percent of current account receipts, and are the most significant source

of foreign exchange. “Other” official transfers include aid from other sources and in kind. In total, the balance on the transfers account approximately matches the trade account deficit, and indicates the dependent nature of the economy. Clearly, the attainment of economic self-reliance, and progress to replacing transfers through other foreign exchange earning sources, will be a long-term process and presents the single most important challenge facing the economy.

60. The capital account indicates lower flows, with external borrowing and repayment, and with MTNs as the major item. The FSM has adopted a prudent external debt management strategy and capital account flows are correspondingly small. In FY1997 and FY1998, draw-down of the ADB PSRP loan provided a major source of funds to finance the Early Retirement program. With most of the FSM’s external debt financed from concessional sources with amortization not due for several years, the only major component of debt service is MTN repayment. This is due in full before November 2001, after which it will drop out of the balance of payments.

61. With the exception of FY1995 and FY1996 the current account recorded small surpluses in all years of the series, while the capital account indicated a deficit throughout. The overall balance recorded surplus from FY1994 through FY1997, and the last three years show a small deficit in the range of 2-4 percent of GDP, which is not considered a cause for concern.

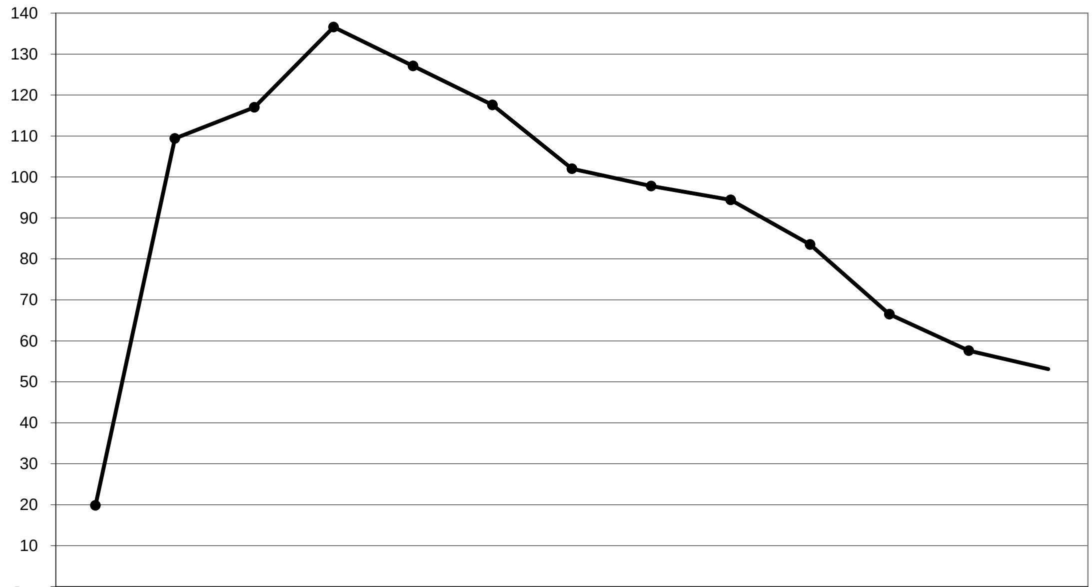
62. The errors and omissions are generally small, but very large values are shown for FY1996 and FY1997. The series suggests that estimation of the trade account in those years is in unreliable, and indicates the preliminary nature of the balance of payments estimates. Emphasis has thus been placed on the structure of the FSM’s external account rather than on a detailed time series analysis.

2. External Debt

63. Prior to FY1990, the FSM had no official public sector debts to offshore lenders. Nearly all of the nation’s public borrowing was undertaken during the FY90-93 period. This borrowing included MTN bonds issued for $71 million to finance portfolio investments by Yap State, and $42.9 million for fisheries-related investments in Chuuk, Kosrae, and Pohnpei and for the National Fisheries Corporation. Public guaranteed borrowing included $41 million from the US Rural Electrification Administration by the FSM Telecommunications Corporation and $9 million by the Yap Fishing Corporation.

64. Figure 8 shows that the nation’s total official external debt peaked at $137 million at the end of FY1993 representing 69 percent of GDP in the year due to heavy borrowing by FSM governments. The only significant borrowing after FY1993 has been through ADB's concessional lending facility.

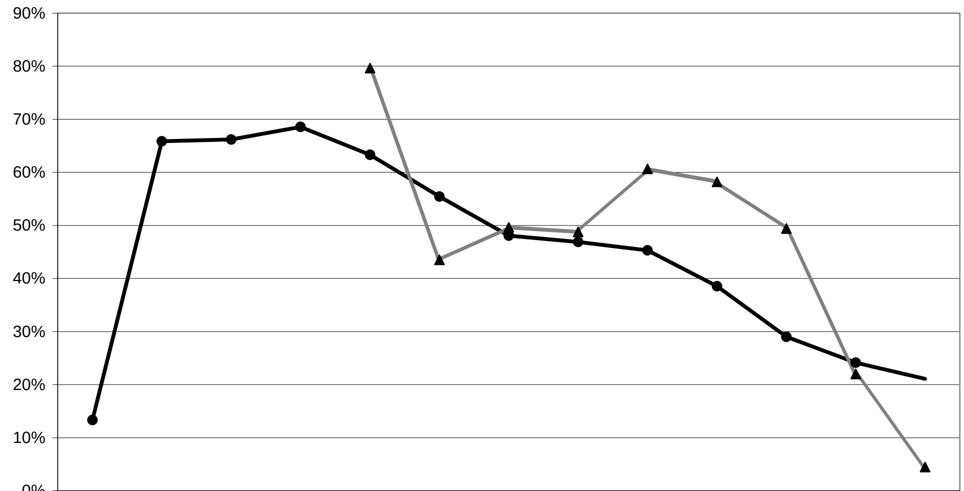
Figure 8: FSM External Debt
($million)



	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02
External Debt	20	109	117	137	127	118	102	98	94	84	67	58	53

65. The FSM's external debt level has shifted from an extremely adverse position in the early 1990's to a comfortable one now. The completion of the MTN program with final repayments taken from Compact revenues in FY2001 will result in this favorable position (Figure 9). With a debt-to-GDP ratio of just 21 percent, down from a high of 69 percent, the FSM's debt level will be low by PDMC standards. Furthermore, with the remaining debt on concessional terms, the debt service ratio in 2002 is projected at a low level of 4.5 percent of exports of goods and services. Each of these ratios is somewhat overstated in light of the fact that the FSM holds a sinking fund equal in value to the amount outstanding for ADB's PSRP loan. Adjusting for this asset held against external debt, the debt to GDP ration in FY2002 would be 14 percent and the debt service-to-exports ratio would be 4.1 percent. The FSM has outlined a medium-term policy objective of minimizing further external borrowing and using a sinking fund mechanism to secure repayment of concessional loans that are currently being considered for FY2000 and FY2001. As the borrowing party for loans from the international development institutions, the national Government has established a mechanism to facilitate such "secured" borrowing on behalf of the four states.

Figure 9. FSM External Debt Ratios



	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02
External Debt, % of GDP	13%	66%	66%	69%	63%	55%	48%	47%	45%	39%	29%	24%	21%
Debt Service, % of Exports					80%	43%	50%	49%	61%	58%	49%	22%	4.5%

Source: Department of Finance and Administration. staff estimates.

III. SHORT- AND MEDIUM-TERM PROSPECTS AND POLICY ISSUES

A. Economic Prospects

66. The prospects for the FSM economy are dependent on 3 sets of factors: (i) the economic management and policy environment and the attractiveness of the reforms currently under way to private sector investment, (ii) the outcome of the Compact renegotiations currently in progress, and (iii) by other short-run factors. Clearly, in a small, remote, open-economy, which is particularly dependent on foreign investment to generate growth, the right policy environment is crucial. This is the subject of Section IIIB below. Also important in the long run is the outcome of the Compact re-negotiations. In order to sustain macroeconomic and financial stability, the FSM has requested from the US a package that will maintain external transfers at levels comparable to the present levels. The FSM has also requested the US to fund a trust fund that will provide sufficient yield to replace the annual transfers. The trust fund is likely to take 15-20 years to become fully funded, but in the long term will guarantee the independence of the economy. If successfully combined with maintenance of sound economic management and competition policies this strategy will provide a stable economic environment and a launching pad for future growth. If unsuccessful, the FSM will experience severe reductions in income, a deteriorating fiscal position requiring yet further painful adjustment, and large outward migration.

67. If the negotiations are not complete by November 2001, in the medium term the Compact makes provision for a further two years of funding at the level received at the end of the first stepdown. This implies a substantial increase in funding of some $34 million over the two years. An agreement is not likely to be reached by October 2001. Through the first two rounds of negotiations it has become clear that the format of the new Compact economic assistance arrangements will require greater accountability, and complexity in grant procedures.

68. A period of adjustment will be needed before the new arrangements take place and has been fortuitously provided for in the Compact original design. However, the problem remains with what to do with the temporarily increased funding. The FSM is considering devoting the extra resources to the trust fund, but there will be political pressure to find other uses as receipt of the money approaches. To the extent that the money is used for operational purposes it will be accompanied by a necessary downward adjustment in two years time as the situation reverts to the new arrangements.

69. In the short to medium term a series of factors will benefit the economy, which will help maintain the momentum in economic growth experienced in the last two years. This is important as the uncertainty over the outcome of the negotiations generates a "wait and see" attitude in the private sector and with foreign investors. With an uncertain future, investment in new projects or extension of credit will require taking on unquantifiable risk, which will have a negative impact on economic performance. In FY2001 the economy is projected to grow by 1.5 percent, which is below the rate experienced in FY2000 of 2.6 percent. In Chuuk, the government is scheduled to return to the full 80 hours every two weeks from the current 72 (and the 64 hours in FY1996-FY1998), which was earlier required to restore fiscal balance. In Pohnpei, the government is also planning on returning to a full working pay period, but only after the fiscal position permits. This is projected to be middle of FY2001. Against the stimulative effects of these changes in fiscal position, the substantial stimulative impact of the Chuuk airport reconstruction will be absent in FY2001.

70. In FY2002, the economy is projected to grow by 2.9 percent based on the assumption that the FSM prudently uses the FY2002-FY2003 step-up money. The full stimulative impact of the return to the normal working week in Pohnpei state government will be felt. Further, repayment of projects financed through the MTN bond issue will have been completed at the end of FY2001. This will release about $5 million of funds in 2002 for investment in capital projects and stimulate demand. In FY2003, no additional positive factors are foreseen and the economy is projected to grow at 1.2 percent.

B. Policy Issues

71. A major objective of the Compact was the attainment of self-reliance. This was interpreted in terms of independence of Government revenues from Compact flows. However, a more appropriate economic criterion would be the independence of current account from Compact flows, which is necessary for good prospects of the country in the long run. The FSM has had very little success in developing the traded goods and the exports sectors of the economy. A major reason has been the weak policy environment in the FSM at the beginning of the Compact period: the policy environment was inward looking, not conducive for private sector development, and supported a large government. With the coming of the second step-down in 1995, it was recognized that the situation needed to change. The first FSM Economic Summit resulted in a consensus on policy reforms. With ADB's assistance through the PSRP and TA for economic management, subsequent policy reforms were implemented by the FSM governments.

72. The major focus of the PSRP was the downsizing of the Government sector through an early retirement program, in order to restore fiscal balance after the second stepdown. The reform program was largely successful in achieving fiscal compression, but did not look specifically at improvements in the efficiency of delivery of Government services or performance management. There was an intentional emphasis on expenditure reduction as compared to revenue generation; although improvements were achieved in the structure of

customs collection, shifting from a free-on- board (FOB) to cost-insuarnace-and-freight (CIF) basis and levying tax on all sectors of the economy. Reform of the public enterprise sector was also not initiated. In the private sector, the main emphasis was on improving foreign investment regime and allowing market determination of interest rates.

73. Based on the economic assistance package requested by the FSM for Compact II, the current level of revenue effort, and the level of real Government expenditures, projections indicate that additional revenue effort will be required, even if the FSM is successful in achieving the full Compact II package as requested. With support from the Pacific Financial Technical Assistance Center, the FSM is strengthening the tax administration, and a comprehensive tax reform package has been proposed to introduce a broad based consumption tax, a value-added tax (VAT). While the distortions in the current tax rates are quite low, if rates were to rise to levels similar to those in other island economies, the existing distortions would become a significant constraint on efficient resource allocation. The introduction of a VAT will provide a non-distortionary and broad base for revenue generation with corresponding low rates. It will support the development of an export sector and ease the entry of the FSM into the World Trade Organization.

74. The FSM has made an initial attempt to introduce performance based budgeting and management. However, the new system is still in a formative stage. It has yet to effectively guide the allocation of Government expenditures despite formatting of budgets on a performance basis. Implementation in different states has reached different stages, and ADB is currently launching a TA to advance the process. However, much work needs to be done for the full model to be implemented, involving performance based contracts, accrual accounting, establishing quantifiable performance indicators, and upgrading outdated accounting systems with modern financial management systems. Fortunately, policy makers in the FSM have adopted the system, and support the ongoing process.

75. At the beginning of the 1990s, the FSM embarked on a large-scale involvement in the fisheries sector through investment in public enterprise. Without exception, all of these investments have incurred large losses, and the need for reform is apparent. The FSM governments are involved in about 40 public enterprises, including oil distribution, transportation, banking, and utilities. As part of the 2000 country program, ADB supported an initial TA in public enterprise reform to raise awareness for the need for reform, undertake a financial assessment, and assist the FSM to transform the sector. The TA raised public awareness through two workshops, but as yet no enterprises have been transformed, although a recent workshop attended by all States endorsed the need for further assistance. The proposed Private Sector Development Program (PSDP) loan requires submission of a public sector enterprise master plan by each government as a first tranche draw-down condition. Reform of the public enterprise sector remains a high priority on the policy agenda, particularly since the signals sent out to the private sector as to the commitment of government to removing itself from commercial ventures need to be ambiguous.

76. The PSRP initiated reform of the foreign investment regime through legal changes at national and State levels. However, while all States passed laws as required, the original intent of establishing a transparent and open regime is yet to be fully achieved. Further revisions in laws and regulations have been drafted, which are required to be submitted to state legislatures before first tranche draw-down of the PSDP. Progress with foreign direct investment reform in the FSM is mixed, with some states such as Yap wanting to abolish all laws regulating foreign investments by replacing them with a simple business license system where both domestic and foreign investors are treated alike. Pohnpei on the other hand still

requires all prospective investors to submit business plans and cash flow projections for review and approval. Coupled with public enterprise transformation, reform of the foreign direct investment regime remains a critical ingredient of the policy environment before the FSM will be able to attract large private investments critically needed to improve overall economic performance.

77. Finally, ADB will be assisting the FSM to develop its private sector through the Private Sector Development Program (PSDP). The loan entails both a project and program component. The project component supports major initiatives on land reform, development of small business centers, institutional strengthening of the FSM Development Bank, and improvements of the regulatory environment with modifications to commercial code, and bankruptcy law. The program loan supports these initiatives through conditions maintaining the broad principles established with the PSRP. These include maintaining fiscal balance, restricting growth of government payroll costs, limiting external debt, improving to long term land leasing regime, provision for leasehold mortgages, further improvement in FDI regime, and establishing State PSE master plans.

STATISTICAL APPENDIX

Table A.1 FSM Gross Domestic Product

(current and constant price estimates, $million)

	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00 Est.
Private Sector	30.2	35.9	39.0	45.3	54.0	61.0	68.0	65.4	67.6	65.4	60.4	62.7	66.1	71.2
Wages	11.5	14.0	14.6	17.7	19.5	23.4	26.3	26.2	25.3	25.3	24.6	25.3	27.9	30.7
Profits	18.7	21.9	24.4	27.7	34.6	37.6	41.7	39.2	42.3	40.1	35.8	37.4	38.2	40.5
Public Enterprises	2.7	3.2	3.6	4.2	5.0	5.7	8.7	11.4	14.1	15.3	17.3	18.1	18.8	19.6
Government	42.8	45.2	45.9	48.9	52.2	53.3	59.2	59.5	63.9	63.9	59.3	50.7	51.4	52.6
Municipalities	2.3	2.5	2.6	2.5	3.2	3.6	3.7	3.9	4.2	4.4	4.3	4.3	4.6	5.0
Non-Profits	2.9	3.2	3.0	3.1	3.4	4.0	4.0	4.3	5.0	5.5	5.9	6.7	7.2	8.1
Subsistence	17.5	18.8	20.2	21.8	23.0	24.1	25.3	26.5	27.7	29.1	30.3	31.4	32.8	34.5
Home Ownership	11.3	12.2	13.1	14.2	15.0	15.7	16.4	17.2	17.9	18.8	19.6	20.2	21.1	22.2
Indirect Taxes (net)	6.9	8.6	9.0	9.7	12.1	13.0	15.2	15.4	14.9	14.6	14.3	16.3	16.9	18.4
Subsidies	-0.3	-0.6	-0.9	-0.9	-1.7	-3.7	-1.3	-2.8	-3.2	-4.8	-2.9	-2.0	-2.4	-2.4
Nominal GDP	**116.3**	**129.0**	**135.6**	**148.8**	**166.2**	**176.8**	**199.3**	**200.8**	**212.1**	**212.2**	**208.6**	**208.4**	**216.6**	**229.2**
Nominal GDP per capita	1,289	1,388	1,416	1,524	1,670	1,742	1,926	1,903	1,972	1,934	1,865	1,828	1,863	1,934
GDP Deflator (US CPI FY98=100)	70.3	73.2	76.4	81.1	83.9	86.4	88.7	91.3	93.6	96.5	98.5	100.0	102.6	105.9
Inflation Rate	4.4	4.2	4.3	6.2	3.4	3.0	2.7	3.0	2.5	3.0	2.2	1.5	2.6	3.2
Population ('000)	90.2	92.9	95.7	97.6	99.5	101.5	103.5	105.5	107.6	109.7	111.8	114.0	116.3	118.5
Population Growth Rate %	3.0	3.0	3.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Real GDP (FY98 prices)	**165.4**	**176.2**	**177.5**	**183.5**	**198.1**	**204.7**	**224.7**	**219.9**	**226.5**	**220.0**	**211.7**	**208.4**	**211.1**	**216.5**
Real GDP Growth (percent)	**0.9**	**6.5**	**0.8**	**3.4**	**8.0**	**3.3**	**9.8**	**-2.1**	**3.0**	**-2.9**	**-3.8**	**-1.5**	**1.3**	**2.6**

FSM = Federated States of Micronesia, FY = fiscal year, GDP = gross domestic product.

Sources: FSM Department of Finance and Administration, FSM Social Security Administration, FSM Department of Economic Affairs/Statistics Division, US Bureau of Labor Statistics (CPI)

Table A.2 Gross Domestic Product Projections: FSM
(current and constant price estimates, $million)

	FSM			
	FY2000 Estimate	FY2001 Projection	FY2002 Projection	FY2003 Projection
Private Sector	71.2	72.4	77.6	80.9
Wages	30.7	0.0	0.0	0.0
Profits	40.5	0.0	0.0	0.0
Public Enterprises	19.6	20.6	21.9	22.7
Government	52.6	55.8	57.4	58.4
Municipalities	5.0	5.1	5.3	5.3
Non-Profits	8.1	8.9	9.8	10.8
Subsistence	34.5	36.1	37.8	39.5
Home Ownership	22.2	23.2	24.3	25.3
Indirect Taxes (net)	18.4	19.0	20.0	20.7
Subsidies	-2.4	-2.4	-2.4	-2.4
Nominal GDP	**229.2**	**238.7**	**251.8**	**261.3**
Nominal GDP per capita	1,934	1,975	2,043	2,079
GDP Deflator (US CPI FY98=100)	105.9	108.7	111.5	114.4
Inflation Rate	3.2	2.6	2.6	2.6
Population (‘000)	118.5	120.9	123.2	125.7
Population Growth Rate	2.0	2.0	2.0	2.0
Real GDP (FY98 prices)	**216.5**	**219.7**	**225.8**	**228.5**
Real GDP Growth	2.6	1.5	2.8	1.2

CPI = consumer price index, FY = fiscal year, GDP = gross domestic product, US = United States.
Sources: FSM Department of Finance and Administration, FSM Social Security Administration, FSM Department of Economic Affairs/Statistics Division, US Bureau of Labor Statistics.

Table A.3: Employment by Sector and State

(FY1987-FY2000 estimate)

Sector	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00 Est
FSM total														
Agriculture	13	13	13	16	20	33	46	41	36	28	30	32	34	38
Fisheries	44	56	61	71	85	107	207	429	623	505	440	398	404	446
Manufacturing	98	141	322	420	371	547	571	533	550	574	547	574	634	876
Utilities	0	1	2	2	2	2	108	179	207	268	380	388	397	398
Construction	722	856	770	926	929	940	1,020	927	826	746	708	764	797	922
Distribution	1,808	1,978	2,156	2,273	2,423	2,578	2,675	2,723	2,721	2,603	2,709	2,749	2,976	3,120
Tourism	251	271	298	300	338	373	443	494	516	551	540	609	692	692
Transport	347	449	538	689	674	847	869	817	929	923	876	833	850	972
Communications	107	106	118	120	127	132	135	144	141	140	131	135	136	140
Financial Services	138	160	175	185	212	214	241	232	216	209	216	227	225	202
Business Services	68	81	65	71	72	93	104	96	96	88	77	88	94	92
Other Services	280	242	206	198	230	254	283	266	268	261	292	304	391	460
Government	6,765	7,051	7,061	6,902	7,157	6,867	7,155	7,013	6,842	6,840	6,659	6,450	6,204	5,490
Education	364	421	306	332	360	391	376	367	411	458	500	547	580	576
Health	1	1	1	2	5	8	8	9	11	11	7	6	9	12
Municipalities, Agencies	902	967	970	864	949	1,009	1,003	1,030	1,091	1,128	1,062	1,037	1,100	1,156
Private Non-Profits	351	341	323	317	305	287	265	232	245	230	235	247	265	270
Foreign Governments	69	68	66	46	55	87	105	131	145	139	137	148	133	156
Unidentified	1	0	0	0	0	21	1	0	0	0	0	0	0	2
Total	**12,329**	**13,203**	**13,451**	**13,734**	**14,314**	**14,790**	**15,615**	**15,663**	**15,874**	**15,702**	**15,546**	**15,536**	**15,921**	**16,020**

Source Social Security Administration.

Note Data is classified on an “establishment” basis. Some enterprises operate in more than one State, which results in an over statement of employment in Pohnpei State.

Table A.4: FSM Commercial Banking Survey
($ million)

	1990 Dec. 31	1991 Dec. 31	1992 Dec. 31	1993 Dec. 31	1994 Dec. 31	1995 Sept. 30	1996 Sept. 30	1997 Sept. 30	1998 Sept. 30	1999 Sept. 30	2000 June 30
Total Assets	**29.4**	**38.0**	**47.0**	**58.1**	**57.9**	**128.7**	**127.8**	**123.8**	**135.8**	**134.2**	**139.9**
Total Liquid Assets	n.a.	n.a.	n.a.	n.a.	n.a.	75.8	75.8	78.4	83.8	80.6	82.6
Cash & Due from Local banks	n.a.	n.a.	n.a.	n.a.	n.a.	5.4	4.1	4.2	5.5	4.6	$5.0
Foreign Assets - Due from Banks Abroad	n.a.	n.a.	n.a.	n.a.	n.a.	70.4	71.7	74.2	78.3	75.9	$77.6
Total Loans	29.4	38.0	47.0	58.1	57.9	51.3	49.3	42.9	48.1	50.0	53.4
Commercial Loans	11.5	12.7	17.6	19.8	20.7	18.7	18.8	17.8	22.0	21.7	$22.0
Consumer Loans	17.9	25.3	29.4	38.4	37.2	32.6	30.5	25.1	26.0	28.3	$31.4
Other Assets						1.5	2.7	2.5	3.9	3.6	$3.8
Total Liabilities & Capital	**92.0**	**106.2**	**121.0**	**129.1**	**126.3**	**128.7**	**127.8**	**123.8**	**135.8**	**134.2**	**139.9**
Total Deposits:	85.6	99.9	111.8	116.7	113.6	116.3	112.3	109.3	120.0	119.1	124.5
Demand	25.0	20.6	22.2	21.0	24.8	23.7	22.1	21.6	25.9	23.3	26.4
Savings	19.7	35.8	44.7	52.6	40.4	36.0	30.5	31.6	37.9	41.0	39.4
Time	40.8	43.5	44.8	43.1	48.3	56.6	59.7	56.1	56.3	54.7	58.6
Other										55	54
Other Liabilities & Capital	6.4	6.3	9.2	12.5	12.7	12.3	15.5	14.5	15.8	15.1	15.4
Memorandum Items:											
Loan/Deposit Ratio	34	38	42	50	51	44	44	39	40	42	43
Commercial Loan Share of Loans %	39	33	37	34	36	36	38	42	46	43	41
Consumer Loan Share of Loans %	61	67	63	66	64	64	62	58	54	57	59
Deposits Annual Rate of Change %	n.a.	17	12	4	-3	3	-3	-3	10	-1	6
Loans Annual Rate of Change %	n.a.	29	24	24	0	-15	-2	-13	12	-10	7
Commercial Loans Annual Rate Change %	n.a.	10	39	12	5	-13	1	-5	24	8	1
Consumer Loans Annual Rate Change %	n.a.	42	16	30	-3	-16	-7	-18	4	-3	12

_= not available, FSM = Federated States of Micronesia.
Source: FSM Banking Board

Table A.5: Pohnpei State Consumer Price Index All Items: Year-on-Year Change

(average 1997 = 100)

	Weight	Q1-98	Q2-98	Q3-98	Q4-98	Q1-99	Q2-99	Q3-99	Q4-99	Q1-00	Q2-00
Food	49.2	-5.2	-7.6	-9.2	-10.5	-4.2	1.8	4.4	5.8	6.9	3.4
Tobacco, Alcohol, Sakau and Betelnut	7.9	2.6	4.8	3.9	-2.1	1.2	2.5	3.2	7.7	1.1	-3.8
Clothing And Footwear	2.1	-2.7	-1.2	-6.7	-8.2	-5.6	-2.9	-0.8	1.6	1.0	0.2
Housing	11.3	7.1	8.8	2.4	2.5	4.0	5.1	5.1	5.0	3.0	0.5
Fuel, Light and Water	5.1	0.0	0.9	0.4	-0.1	0.0	0.0	0.0	0.0	-0.1	6.8
Services	10.4	1.4	1.6	2.0	2.1	0.7	-0.7	-1.2	-1.6	-0.7	1.4
Miscellaneous	14.0	3.1	3.2	3.8	6.0	4.0	1.0	2.3	-0.1	0.1	1.4
Total	**100.0**	**-1.1**	**-1.8**	**-3.3**	**-4.1**	**-0.9**	**1.7**	**3.1**	**3.7**	**3.6**	**2.0**

Note: *Sakau en Pohnpei* is a Micronesian variant of Polynesian *kava*. It is prepared from the root of the pepper plant by pounding the root upon a basaltic sakau stone. The pounders are also basalt, often rounded river rocks. The sakau is then squeezed through a wrap of the inner bark of the tropical hibiscus tree. The hibiscus tree contributes a viscuous sap to the sakau. The result is a thick brown gooey liquid that is consumed from a communal coconut cup.

Source: Statistics Division, Department of Economic Affairs.

Table A.6: FSM Balance of Payments

($ million)

	FY94	FY95	FY96	FY97	FY98	FY99	FY00 Est.	FY00 Proj
Trade balance	**-118.3**	**-92.2**	**-85.5**	**-95.0**	**-108.8**	**-117.8**	**-122.3**	**-126.2**
Exports and Reexports, f.o.b.	8.8	22.2	27.1	25.2	13.4	11.2	23.1	24.5
Imports, f.o.b.	-127.1	-114.4	-112.7	-120.2	-122.3	-129.1	-145.4	-150.7
Petroleum products	-17.0	-18.1	-17.4	-15.2	-12.6	-11.6	-12.3	-12.8
Services account	**-15.4**	**-12.5**	**-11.5**	**-16.3**	**-14.0**	**-9.0**	**-12.0**	**-13.9**
Receipts	17.8	20.4	21.4	21.1	20.9	22.0	23.3	25.4
Travel	11.9	14.1	15.4	15.5	15.3	16.2	17.5	19.2
Communications	5.5	5.8	5.7	5.4	5.4	5.5	5.8	6.0
Other	0.3	0.5	0.3	0.2	0.2	0.3	0.1	0.1
Payments	-33.1	-33.0	-32.9	-37.5	-34.9	-31.0	-35.3	-39.3
Freight and Insurance	-19.1	-17.2	-16.9	-18.0	-18.3	-19.4	-21.8	-22.6
Transportation	-8.3	-9.8	-9.8	-12.9	-10.0	-4.3	-4.6	-4.8
Travel	-3.8	-4.0	-4.1	-4.0	-4.1	-4.2	-4.4	-4.6
Other	-1.9	-2.0	-2.2	-2.5	-2.5	-3.2	-4.5	-7.2
Income, Net	*23.4*	*25.5*	*26.2*	*21.7*	*21.7*	*24.7*	*28.5*	*30.4*
Receipts	32.9	34.3	33.9	28.4	27.3	29.3	32.2	32.5
Fishing Rights Fees	21.3	21.5	20.5	14.4	13.5	15.9	16.8	16.8
Interest and Dividend Income	11.5	12.7	13.4	14.1	13.8	13.4	15.4	15.7
Payments								
Interest Payments	-9.5	-8.7	-7.7	-6.7	-5.6	-4.6	-3.7	-2.1
Unrequited transfers	**123.7**	**128.6**	**126.6**	**107.9**	**113.9**	**111.6**	**112.3**	**111.6**
Private	2.7	2.8	3.0	3.2	3.4	3.7	3.9	4.2
Inflows	3.4	3.5	3.7	4.0	4.2	4.4	4.7	5.0
Outflows	-0.7	-0.7	-0.7	-0.7	-0.7	-0.8	-0.8	-0.8
Official	121.0	125.7	123.6	104.7	110.4	107.9	108.4	107.4
Compact Funds	90.7	91.8	93.0	77.6	78.9	78.9	79.4	80.2
Other	30.3	33.9	30.6	27.1	31.5	29.0	29.0	27.2
Current Account Balance								
Including official transfers	**13.4**	**49.3**	**55.7**	**18.3**	**12.7**	**9.5**	**6.5**	**2.0**
In Percent of GDP	6.6	22.8	25.4	8.5	5.8	4.2	2.7	0.8
Excluding Official Transfers	-107.6	-76.4	-67.9	-86.4	-97.7	-98.4	-101.9	-105.5
In Percent of GDP	-52.9	-35.3	-31.0	-40.0	-44.6	-43.5	-42.6	-42.1

Table A.6, continued:

	FY94	FY95	FY96	FY97	FY98	FY99	FY00 Est.	FY00 Proj
Capital and Financial Account	**-12.0**	**-1.7**	**-1.2**	**-2.4**	**-9.3**	**-12.1**	**-15.2**	**-6.1**
Short term, Net	-2.5	7.8	14.4	1.8	-5.9	-1.2	1.8	2.8
Medium term, Net	-9.5	-9.5	-15.6	-4.2	-3.4	-10.9	-17.0	-8.9
Inflows	2.2	0.3	0.8	11.7	11.8	3.8	2.2	0.0
Medium-term Note Issues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Borrowing	2.2	0.3	0.8	11.7	11.8	3.8	2.2	0.0
Outflows	-11.7	-9.8	-16.4	-15.9	-15.2	-14.7	-19.2	-8.9
MTN Amortization	-8.6	-9.2	-15.8	-8.3	-11.3	-11.0	-18.5	-8.2
Other Amortization, exl. IMF	-3.1	-0.6	-0.6	-7.6	-3.9	-3.7	-0.7	-0.7
Overall balance	**1.4**	**1.1**	**3.9**	**19.8**	**-9.4**	**-10.2**	**-5.0**	**-4.0**
Errors and omissions	-0.1	46.5	50.5	-3.9	12.8	7.6	-3.8	-0.1

FSM= Federated States of Micronesia, FY = fiscal year, f.o.b. = free on board, GDP = gross domestic product, IMF = International Monetary Fund, MTN = medium-term notes.
Source: Department of Economic Affairs; IMF Article IV Mission, Sept 2000; Preliminary Estimates

Table A.7: FSM External Debt and Debt Service

($ million)

Item	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00 Estimate	FY01 Projection	FY02 Projection
Total External Debt													
New	19.9	91.9	19.3	28.6	2.2	0.3	0.8	11.7	11.8	3.8	2.2	-	-
Outstanding	19.9	111.7	128.7	145.6	138.8	127.4	118.4	113.7	109.6	98.2	85.7	66.5	53.8
Amortization	-	2.3	11.7	9.0	11.7	9.8	16.4	15.9	15.2	14.7	19.2	8.9	0.7
Interest	-	2.2	7.7	9.1	9.4	8.7	7.7	6.7	5.6	4.7	3.8	2.1	1.7
Principal Balance	20	109	117	137	127	118	102	98	94	84	67	58	53
External Debt as % of GDP	13%	66%	66%	69%	63%	55%	48%	47%	45%	39%	29%	24%	21%
Debt Service as % of Exports[a]					80%	43%	50%	49%	61%	58%	49%	22%	4.5%
External Debt Adj. Offsetting Assets[b]													
New	19.9	20.9	10.3	28.6	2.2	0.3	0.8	1.7	3.8	3.8	2.2	-	-
Outstanding	19.9	40.7	57.7	81.4	80.5	75.7	73.9	66.9	60.9	57.5	51.0	45.3	35.8
Amortization		2.3	4.9	3.1	2.5	2.6	8.7	9.8	3.9	5.6	5.7	5.7	0.7
Interest		1.9	2.9	3.7	4.4	4.3	3.9	3.5	2.8	2.6	2.2	1.8	1.5
Principal Balance	19.9	38.4	43.8	69.3	69.0	66.7	58.8	50.7	50.6	48.8	45.3	39.6	35.1
External Debt as % of GDP	13%	23%	25%	35%	34%	31%	28%	24%	24%	23%	20%	17%	14%
Debt Service as % of Exports*					26.2%	16.3%	26%	29%	20%	25%	17%	15%	4.1%
Memorandum items:													
GDP(current year, US$)	148.8	166.2	176.8	199.3	200.8	212.1	212.2	208.6	208.4	216.6	229.2	238.7	251.8
Exports(Goods & Services, US$)	*n.a.*	*n.a.*	*n.a.*	*n.a.*	26.5	42.6	48.5	46.3	34.3	33.3	46.5	49.9	53.6

_= not available, FSM = Federated State of Micronesia, GDP = gross domestic product, US = United States.

[a]Exports of Goods and Services

[b]Both Yap MTN (Monetization Scheme) and PSRP Program Loan hold assets in offshore investments equal/greater than debt.

Source: Department of Finance and Administration and staff estimates.

Table A.8:Consolidated General Government Finances—Revenues

($ million)

Item	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00, Estimate
Total revenue and grants	**142.3**	**164.5**	**159.8**	**160.1**	**168.8**	**148.1**	**157.0**	**162.6**	**170.5**	**163.0**	**138.8**	**151.2**	**148.1**	**152.8**
Total revenue	**23.9**	**28.2**	**46.0**	**42.0**	**49.6**	**48.4**	**55.7**	**56.0**	**58.7**	**54.2**	**48.7**	**55.6**	**53.2**	**56.6**
Tax revenue	**9.7**	**12.3**	**13.3**	**13.6**	**17.0**	**17.7**	**21.5**	**21.2**	**21.1**	**21.1**	**20.6**	**26.1**	**24.6**	**26.3**
Wages and Salary Tax	3.3	4.0	3.9	3.8	4.5	4.6	5.4	5.7	6.2	5.6	5.4	7.8	5.9	6.3
Gross Revenue Tax	2.6	3.2	3.7	4.2	5.2	5.7	6.2	6.0	6.1	6.0	5.5	5.7	5.6	5.9
Import Tax: Fuel	0.4	0.4	0.5	0.5	0.6	0.6	0.5	0.9	0.7	0.9	0.7	0.8	0.8	0.9
Import Tax: All Others	1.4	2.0	2.1	2.0	2.3	2.6	4.6	4.3	3.8	3.7	4.1	6.3	6.1	6.5
All Other Tax (National)	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.3	0.3	0.5	0.2	0.2	0.3
State Tax Revenue	2.0	2.8	3.1	3.1	4.3	4.2	4.2	4.4	4.0	4.6	4.3	5.4	6.0	6.5
Nontax revenue	**14.2**	**15.9**	**32.6**	**28.4**	**32.7**	**30.7**	**34.2**	**34.7**	**37.6**	**33.1**	**28.1**	**29.5**	**28.6**	**30.3**
Fishing Rccess Revenue	3.8	7.7	10.8	12.7	12.9	12.5	18.3	21.3	21.5	20.5	14.4	13.5	15.9	16.8
Dividend and Interest Income	4.7	3.5	13.2	7.7	11.1	10.2	7.4	6.6	8.2	8.1	8.7	8.9	6.8	7.4
Other Nontax Revenues	5.6	4.7	8.7	8.0	8.7	8.0	8.5	6.8	7.9	4.5	5.1	7.2	5.9	6.0
Grants	**118.4**	**136.3**	**113.8**	**118.1**	**119.2**	**99.7**	**101.3**	**106.6**	**111.7**	**108.9**	**90.1**	**95.6**	**94.9**	**96.2**
Grants from Abroad	118.4	136.3	113.8	118.1	119.2	99.7	101.3	106.6	111.7	108.9	90.1	95.6	94.9	96.2
Current Grants	78.0	95.1	77.2	83.3	78.7	69.6	65.3	70.7	77.4	77.3	66.1	71.0	69.7	70.4
Compact General	43.9	44.6	45.7	46.8	44.5	42.2	38.9	39.7	44.7	45.3	38.0	37.9	37.6	38.4
Compact Special	19.5	28.9	15.9	23.8	19.3	17.8	17.9	18.1	18.4	18.1	18.1	18.2	18.4	18.7
Other: Current	14.5	21.6	15.6	12.7	15.0	9.6	8.5	12.8	14.3	13.9	9.9	14.9	13.8	13.3
Capital grants	40.4	41.2	36.6	34.8	40.4	30.1	35.9	35.9	34.3	31.6	24.0	24.6	25.2	25.8
Compact CIP	29.3	29.8	30.5	31.2	35.9	28.2	33.1	33.7	29.8	30.2	22.0	23.3	23.7	24.2
Other: Capital	11.2	11.4	6.2	3.6	4.5	2.0	2.9	2.2	4.6	1.4	2.0	1.3	1.4	1.6

CIP = consumer price index, GDP = gross domestic product.
Source: Department of Economic Affairs and FSM Audits.

Table A.8, continued:

Item	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00, Estimate
Total expenditure & net lending	**104.3**	**125.5**	**143.0**	**143.0**	**169.9**	**158.4**	**165.6**	**163.0**	**173.4**	**162.4**	**137.9**	**165.3**	**164.8**	**152.4**
Total expenditure	104.3	125.5	143.0	143.0	169.9	158.4	161.2	163.0	173.4	162.4	137.9	165.3	164.8	152.4
Current expenditure	84.0	100.4	95.8	100.1	117.7	119.6	123.6	128.3	142.2	132.8	124.4	124.9	124.7	124.4
Expenditure on Goods & Services	82.5	94.2	92.6	95.8	112.4	107.0	109.8	114.7	130.0	119.7	113.6	109.1	114.3	114.9
Wages and Salaries	42.0	44.2	44.8	47.7	50.7	51.9	57.9	58.4	62.9	63.2	58.5	50.1	52.2	53.2
Travel	5.1	4.2	5.1	5.7	6.0	6.2	5.7	5.8	6.2	5.1	6.9	6.8	7.3	7.4
Other	35.4	45.8	42.7	42.4	55.8	48.9	46.3	50.5	60.9	51.4	48.2	52.2	54.8	54.3
Interest Payments	0.0	0.0	0.0	0.0	1.6	6.8	7.3	7.4	6.8	5.7	4.8	3.6	2.9	1.2
Subsidies	1.1	6.2	3.2	4.3	3.7	5.1	5.0	4.9	4.9	6.3	3.9	3.4	4.0	3.8
Transfers	0.4	0.0	0.0	0.1	0.0	0.7	1.4	1.3	0.6	1.1	1.9	8.8	3.5	4.5
Capital Expenditure	20.3	25.1	47.2	42.9	52.1	38.8	37.6	34.7	31.1	29.6	13.5	40.4	40.1	28.0
Acquisition of Fixed Capital	2.8	3.3	4.4	10.2	14.4	13.4	7.7	7.4	8.2	4.4	3.3	21.3	14.5	15.7
Multi-purpose Development	17.3	18.9	27.9	19.9	24.3	21.8	25.1	19.1	18.9	22.2	10.2	16.9	24.1	12.3
Capital Transfers	0.2	3.0	14.9	12.8	13.5	3.6	4.8	8.2	4.1	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	-4.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	**38.0**	**39.0**	**16.8**	**17.1**	**-1.1**	**-10.2**	**-8.7**	**-0.4**	**-2.9**	**0.6**	**0.9**	**-14.1**	**-16.7**	**0.4**
Current Balance	17.9	23.0	27.4	25.2	10.7	-1.6	-7.0	-1.6	-6.1	-1.3	-9.6	1.7	-1.8	2.6
Capital Balance	20.2	16.0	-10.5	-8.1	-11.7	-8.7	-1.7	1.2	3.2	1.9	10.5	-15.8	-14.9	-2.2
Memo items:														
Nominal GDP	116.5	129.2	135.8	148.9	166.9	176.9	199.3	200.9	213.0	216.1	210.1	209.6	217.9	230.6
Total Revenue & Grants as % of GDP	122%	127%	118%	107%	101%	84%	79%	81%	80%	75%	66%	72%	68%	66%
Grants as % of GDP	102%	105%	84%	79%	71%	56%	51%	53%	52%	50%	43%	46%	44%	42%
Grants as % of Total Revenue	83%	83%	71%	74%	71%	67%	65%	66%	66%	67%	65%	63%	64%	63%
Tax Revenue as % of GDP	8%	10%	10%	9%	10%	10%	11%	11%	10%	10%	10%	12%	11%	11%
Total Expenditure & net lending % GDP	90%	97%	105%	96%	102%	90%	83%	81%	81%	75%	66%	79%	76%	66%
Current Expenditure as % of GDP	72%	78%	71%	67%	71%	68%	62%	64%	67%	61%	59%	60%	57%	54%
Capital Expenditure as % of GDP	17%	19%	35%	29%	31%	22%	19%	17%	15%	14%	6%	19%	18%	12%
Overall Balance as % of GDP	**33%**	**30%**	**12%**	**11%**	**-1%**	**-6%**	**-4%**	**0%**	**-1%**	**0%**	**0%**	**-7%**	**-8%**	**0%**
Current Balance as % of GDP	15%	18%	20%	17%	6%	-1%	-4%	-1%	-3%	-1%	-5%	1%	-1%	1%

Table A.9: National Government Finances—Revenues

($ million)

Item	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00, Estimate
Total Revenue and Grants	**38.3**	**48.2**	**38.1**	**47.6**	**40.3**	**37.0**	**48.0**	**50.5**	**54.3**	**52.3**	**42.0**	**47.0**	**41.6**	**43.6**
Total revenue	10.0	15.5	19.1	23.7	24.3	22.3	31.7	32.8	33.8	32.2	26.3	30.1	25.0	26.7
Tax Revenue	3.8	4.6	5.0	5.1	6.1	6.6	8.7	8.0	8.4	8.2	8.2	10.4	5.7	6.2
Wages and Salary Tax	1.7	2.0	1.9	1.9	2.3	2.3	2.7	2.7	2.8	2.7	2.6	3.9	1.8	1.9
Gross Revenue Tax	1.3	1.6	1.9	2.1	2.6	2.9	3.0	3.0	3.1	3.1	2.9	2.8	1.7	1.8
Import Tax: Fuel	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.2	0.2	0.3
Import Tax: All Others	0.7	1.0	1.1	1.0	1.2	1.3	2.3	2.1	2.0	2.0	2.1	3.2	1.8	1.9
All Other Tax (National)	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.0	0.3	0.3	0.5	0.2	0.2	0.3
State Tax Revenue														
Nontax Revenue	6.2	10.9	14.1	18.6	18.1	15.8	23.0	24.7	25.5	24.0	18.2	19.6	19.2	20.5
Fishing Access Revenue	3.8	7.7	10.8	12.7	12.9	12.5	18.3	21.3	21.5	20.5	14.4	13.5	15.9	16.8
Dividend and Interest Income	1.4	1.7	2.2	2.7	3.5	1.9	2.0	2.1	2.4	2.1	1.9	2.2	1.0	1.0
Other Nontax Revenues	0.9	1.5	1.1	3.2	1.7	1.3	2.6	1.3	1.5	1.4	1.9	4.0	2.3	2.7
Grants	**28.2**	**32.7**	**19.0**	**23.9**	**16.1**	**14.7**	**16.3**	**17.7**	**20.5**	**20.1**	**15.6**	**16.9**	**16.6**	**16.8**
Grants from Abroad	28.2	32.7	19.0	23.9	16.1	14.7	16.3	17.7	20.5	20.1	15.6	16.9	16.6	16.8
Current Grants	20.4	24.2	12.9	21.0	9.0	12.0	6.2	8.9	14.4	17.2	13.3	14.6	14.3	14.4
Compact General	6.4	6.5	6.7	6.8	3.3	6.2	0.0	2.1	6.5	6.6	5.2	5.4	5.5	5.6
Compact Special	11.6	15.8	3.9	11.9	3.9	4.0	4.0	4.0	4.0	4.0	4.0	4.1	4.2	4.2
Other: Current	2.4	1.8	2.4	2.3	1.8	1.9	2.3	2.8	3.9	6.6	4.0	5.2	4.6	4.6
Capital Grants	7.8	8.5	6.1	2.9	7.0	2.7	10.0	8.7	6.1	2.8	2.3	2.3	2.3	2.4
Compact CIP	2.7	2.8	2.9	2.9	6.8	2.6	9.0	7.1	2.8	2.8	2.3	2.3	2.3	2.4
Other: Capital	5.1	5.7	3.2	0.0	0.2	0.0	1.0	1.7	3.3	0.0	0.0	0.0	0.0	0.0

Table A.9, continued:

Item	FY87	FY88	FY89	FY90	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00, Estimate
Total expenditure & net lending	**25.1**	**34.7**	**44.0**	**32.3**	**42.0**	**35.7**	**40.1**	**45.4**	**52.0**	**51.0**	**51.3**	**55.8**	**53.2**	**51.4**
Total expenditure	25.1	34.7	44.0	32.3	42.0	35.7	40.1	45.4	52.0	51.0	51.3	55.8	53.2	51.4
Current expenditure	19.7	25.5	25.1	26.7	29.7	32.4	34.9	38.0	43.4	43.7	50.4	48.1	46.4	46.3
Expenditure on Goods & Services	18.6	20.0	22.8	23.3	27.7	30.8	30.1	34.7	41.2	41.4	47.9	44.9	43.8	43.6
Wages and Salaries	7.1	6.5	7.5	7.7	8.3	8.7	9.9	10.3	10.9	11.4	13.5	12.5	13.8	13.0
Travel	2.0	1.6	2.1	1.9	2.1	2.4	2.6	2.5	2.9	2.6	4.3	4.2	4.3	4.4
Other	9.5	11.8	13.2	13.7	17.2	19.6	17.7	22.0	27.5	27.3	30.2	28.2	25.7	26.2
Interest Payments	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subsidies	0.8	5.6	2.3	3.4	2.0	1.4	3.7	2.1	1.7	1.5	1.0	1.3	1.3	1.2
Transfers	0.4	0.0	0.0	0.0	0.0	0.0	1.1	1.2	0.5	0.8	1.4	1.8	1.4	1.5
[Memo: incl. Transfers to state gov.]	1.7	0.7	0.7	1.7	0.9	2.6	2.2	1.7	1.9	4.6	4.5	6.5	4.4	4.5
Capital expenditure	5.4	9.1	19.0	5.5	12.3	3.4	5.2	7.4	8.6	7.3	0.9	7.7	6.8	5.1
Acquisition of Fixed Capital	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.5	0.0	0.0	3.3	3.4	2.2
Multi-purpose devel. Projects	5.2	6.1	5.5	2.0	1.2	0.9	3.2	2.7	4.7	4.3	0.9	2.9	1.9	1.9
Capital Transfers	0.2	3.0	13.5	3.5	11.0	2.5	2.0	4.7	3.4	3.0	0.0	1.5	1.5	1.0
Overall Balance	**13.1**	**13.6**	**-5.9**	**15.3**	**-1.7**	**1.3**	**7.8**	**5.0**	**2.3**	**1.3**	**-9.3**	**-8.8**	**-11.6**	**-7.9**
Current Balance	10.7	14.2	6.9	17.9	3.6	2.0	3.0	3.7	4.8	5.8	-10.7	-3.4	-7.2	-5.2
Capital Balance	2.4	-0.6	-12.9	-2.6	-5.3	-0.7	4.8	1.3	-2.5	-4.5	1.4	-5.4	-4.5	-2.7
Memo items:														
Nominal GDP	116.5	129.2	135.8	148.9	166.9	176.9	199.3	200.9	213.0	216.1	210.1	209.6	217.9	230.6
Total Revenue & Grants as % of GDP	33%	37%	28%	32%	24%	21%	24%	25%	26%	24%	20%	22%	19%	19%
Grants as % of GDP	24%	25%	14%	16%	10%	8%	8%	9%	10%	9%	7%	8%	8%	7%
Grants as % of Total Revenue	74%	68%	50%	50%	40%	40%	34%	35%	38%	38%	37%	36%	40%	39%
Tax Revenue as % of GDP	3%	4%	4%	3%	4%	4%	4%	4%	4%	4%	4%	5%	3%	3%
Total Expenditure & net lending % GDP	22%	27%	32%	22%	25%	20%	20%	23%	24%	24%	24%	27%	24%	22%
Current Expenditure as % of GDP	17%	20%	18%	18%	18%	18%	18%	19%	20%	20%	24%	23%	21%	20%
Capital Expenditure as % of GDP	5%	7%	14%	4%	7%	2%	3%	4%	4%	3%	0%	4%	3%	2%
Overall Balance as % of GDP	**11%**	**10%**	**-4%**	**10%**	**-1%**	**1%**	**4%**	**3%**	**1%**	**1%**	**-4%**	**-4%**	**-5%**	**-3%**
Current Balance as % of GDP	9%	11%	5%	12%	2%	1%	2%	2%	2%	3%	-5%	-2%	-3%	-2%

CIP = consumer price index, GDP = gross domestic product.
Source: Department of Economic Affairs and FSM Audits.