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October 25, 2021

**Statement by Mr. Zhang and Mr. Bai on Federated States of Micronesia
(Preliminary)
Executive Board Meeting
October 27, 2021**

We thank staff for their comprehensive set of reports and Mr. Huh and Mr. Tui Siliva for the helpful Buff statement. Thanks to the authorities' strong containment measures, the Federated States of Micronesia (FSM) is COVID-free. Although the fishing license fees and foreign grant inflows are still stable, pandemic and containment measures have delayed the major investment projects and impacted the near-term economic growth outlook. Going forward, supportive fiscal policy, a resilient and inclusive financial sector, and more targeted structural reforms will help to support an inclusive recovery and promote social convergence. We broadly concur with staff's appraisal and would like to limit ourselves to the following points.

On the fiscal front, we commend the authorities' strong response to the COVID-19 shock, including the fiscal resources to safeguard health, support vulnerable groups, and provide stimulus for pandemic-affected firms. Given the risks related to the expiration of the U.S. Compact grants, we agree with staff that a gradual fiscal consolidation is needed once the recovery is firm, through domestic revenue mobilization and expenditure rationalization. Effective public financial management (PFM) and public investment management (PIM) is also critical to enhance fiscal sustainability. *Could staff elaborate more on when the major investment projects would be expected to restart, and what impact these projects would have to the FSM's fiscal revenue and expenditure in the baseline scenario?*

On the financial front, we associate ourselves with staff on the recommendations of continuing near-term support of borrowers and accelerating financial sector reforms. We welcome the authorities' commitments of upgrading banking laws, adopting prudential banking regulations, and strengthening the supervisory capacity. These supervisory measures are essential for the Bank of FSM to maintain its correspondent banking relationships, and secure U.S. dollar CBRs. Given the FSM is still challenged by a significant infrastructure

gap, improving internet and telecom infrastructures are important to harvest the benefits of digitalization and promote financial inclusion.

On the external sector front, *could staff elaborate more on the potential impact of the recent increase in international oil prices and inflation pressure to the FSM's import and trade balance?*

On the structural front, we agree that economic diversification, private sector development, and friendly business environment are key to lifting productivity and mitigating future shocks. We commend the authorities for recognizing the need to promote the private sector and improve digital connectivity. We also encourage the FSM's continued efforts in building a climate resilient economy and enhancing climate mitigation efforts. The Fund's advice and support to the FSM will play a constructive role.

With these remarks, we wish the authorities all the best in these challenging times.