

**EXECUTIVE
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MEETING**

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To: Members of the Executive Board

From: The Acting Secretary

Subject: **Federated States of Micronesia—Staff Report for the 2017 Article IV Consultation—Informational Annex**

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* Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.



FEDERATED STATES OF MICRONESIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 4, 2017

Prepared By

Asia and Pacific Department
(In consultation with other departments)

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FUND RELATIONS

(As of June 30, 2017)

Membership Status: Joined June 24, 1993; accepted Article VIII

General Resources Account:

	SDR Million	Percent Quota
Quota	5.10	100.00
Fund holdings of currency	5.10	100.00
Reserve tranche position	0.00	0.01

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	4.81	100.00
Holdings	6.23	129.67

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to Fund¹

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Principal					
Charges/Interest		0.00	0.00	0.00	0.00
Total		0.00	0.00	0.00	0.00

Exchange Rate Arrangement

The de jure and de facto exchange rate arrangement is an arrangement with no separate legal tender. The U.S. dollar is legal tender and the official currency. The Federated States of Micronesia maintains an exchange system that is free of restrictions on international payments and transfers for current and capital transactions.

Article IV Consultation

The Federated States of Micronesia is on a 24-month consultation cycle. The 2015 Article IV consultation discussions were held during March 9–20, 2015. The Executive Board discussed the staff report and concluded the consultation on May 11, 2015.

Technical Assistance: STA, MCM, LEG, and PFTAC have provided technical assistance on statistics, banking supervision, tax policy and administration, and combatting of financial crime.

Resident Representative: Mr. Tubagus Feridhanusetyawan has been the Resident Representative for Pacific Island countries since September, 2014. He is based in Suva, Fiji.

¹ When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

RELATIONS WITH THE WORLD BANK

The World Bank and the IMF country teams maintain a close working relationship and have an ongoing dialogue on a range of macroeconomic and structural issues. The teams agreed that FSM's main macroeconomic challenges are to prepare for the expiration of Compact grants after FY2023. To achieve this goal, the FSM needs a prudent fiscal adjustment plan. In parallel, improving the business environment, such as through removing structural impediments in energy and telecommunication sectors, will support private sector development. The following structural reform areas are macro-critical, in view of their central role in achieving long-term budgetary self-reliance and sustained growth:

- **Public financial management.** The FSM invited PFTAC in 2016 to assist in the preparation of a Public Expenditure and Financial Accountability (PEFA) self-assessment for the national government, which is developing a roadmap to strengthen public financial management. The World Bank is preparing a project that will help the national and state governments strengthen budget execution and financial reporting systems.
- **Investment climate.** The FSM's investment climate remains challenging, hindering the private sector to become an engine of growth. The World Bank is assisting in the areas of energy, fisheries, and telecommunications, in cooperation with other donors.

The specific activities planned in the coming year are the following:

- Strengthening budget execution and financial reporting systems in the FSM (preparation)
- Maritime transport sector - (preparation)
- FSM-Palau connectivity project (ongoing)
- FSM energy sector development project (ongoing)
- Pacific islands regional oceanscape program - FSM (ongoing)

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

1. **Since 1990, the Asian Development Bank (AsDB) has been work with the Federated States of Micronesia (FSM).** Its assistance has comprised of ten loans amounting to US\$84.2 million and 51 technical assistance projects worth US\$23.4 million.² Through its engagement with the FSM, AsDB has supported good governance, focusing on economic management and accountability; infrastructure development, including renewable energy; provision of social services; and stimulating private sector activity. As of January 2017, the FSM has been reclassified as a Group A country under the AsDB's country classification system and is now eligible for 100 percent grant financing through the Asian Development Fund (ADF).
2. **In line with the FSM's policy priorities, the AsDB supports: (i) developing key growth drivers; (ii) providing efficient and sustainable infrastructure; and (iii) establishing better public sector management** through its Country Partnership Strategy with the FSM (Pacific Approach 2016–20). AsDB is exploring support for developing sustainable ecotourism, while also continuing parallel complementary efforts to improve the business environment and encourage private investment. AsDB's infrastructure investments include projects for water and sanitation, renewable energy and improving the efficiency of power utilities, and basic education services. Technical assistance and policy dialogue continue to focus on measures to improve policymaking at both the national and state governments, including support for public administration reforms and tourism strategy and planning.
3. **Currently, there is only one active AsDB loan.** The Yap Renewable Energy Development project (totaling US\$9 million), approved in 2013, focuses on the development of renewable energy to reduce dependency on imported diesel fuel, and raising energy efficiency on the supply side of the electricity grid. Project resources are also being utilized to support capacity development of the Yap power utility.
4. **AsDB's assistance pipeline includes the regional project of Improving Quality of Basic Education in the North Pacific,** which covers the FSM and the Marshall Islands. Ongoing technical assistance provides support for public administration reforms at the FSM state-level through the preparation of a medium-term public sector reform plan.

² The ten loans are for: (i) fisheries development project; (ii) water supply and sanitation project; (iii) public sector reform program; (iv) basic social services project; (v) private sector development program; (vi) private sector development project; (vii and viii) omnibus infrastructure development project (OCR and ADF); and (ix and x) Yap renewable energy development project (OCR and ADF).

Table 1. Loans to the Federated States of Micronesia, by Sector

(In millions of U.S. dollars, at end-2016)

Sector	No.	Amount
Agriculture and Natural Resources	1	6.5
Energy	2	9.0
Industry and Nonfuel Minerals	0	0.0
Transportation	0	0.0
Communications	0	0.0
Law, Economic Management and Public Policy	3	31.0
Water Supply, Sanitation & Waste management	3	29.6
Multisector	1	8.0
Other	0	0.0
Total	10	84.2
Memorandum:		
Technical Assistance Provided	51	23.4

Table 2. Loan Approvals and Disbursements to the FSM, 2007–16

(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	1990– 2016
Loan Approvals	0.0	0.0	0.0	0.0	0.0	0.0	9.0	0.0	0.0	0.0	84.2
Loan Disbursements	3.5	3.6	0.8	1.0	6.3	2.6	3.0	3.1	2.0	5.4	48.6
Undisbursed Balance (at end of the year)	29.7	23.8	19.0	17.7	11.5	8.9	15.0	11.5	9.1	3.7	
Memorandum: TA Approval	0.4	0.8	0.0	0.0	0.7	1.1	0.2	0.6	0.5	0.0	23.4

RELATIONS WITH THE PACIFIC FINANCIAL TECHNICAL ASSISTANCE CENTRE

Background

FSM has been a moderate user of PFTAC technical assistance (TA). Most recent support has been of a fiscal nature covering both public financial management (PFM) and revenue reforms, as well as support with government finance statistics and national accounts statistics. With the Unified Revenue Agency establishment reversed in 2015, efforts have been redirected to strengthening core tax administration functions. Following the Public Expenditure and Financial Accountability (PEFA) assessment in November 2016, PFM support is now directed towards developing a PFM roadmap. Fiscal support will continue into FY2018, in addition to support financial sector supervision. The volume of TA planned for FY2018 expected to marginally increase from FY2017.

Strategy 2017–18

PFTAC's TA strategy is guided by the Fund's overall capacity development framework and APD's Regional Strategy Note (RSN) and is consistent with the PFTAC's results framework.

PFTAC TA aims to support the authorities continue to move towards long-term fiscal sustainability. Activities will focus on assisting the authorities achieve tangible results from the foundations laid with previous PFTAC assistance, with an emphasis on strengthening tax compliance. Financial sector support will increase over recent levels.

In the PFM area, the focus will be on supporting the authorities to develop a PFM roadmap following the November 2016 PEFA assessment. Activities to support the roadmap's implementation in the medium-term will be planned in coordination with other partners, including the AsDB. These are expected to include strengthened monitoring of state-owned enterprises and state governments, and multi-year budgeting.

In the tax administration area, the authorities have indicated that they would proceed with administrative reforms which commenced with PFTAC: (a) facilitating the design of a Compliance Improvement Strategy; and (b) assisting to strengthen on-time filing and payment and management of arrears and outstanding returns. Technical assistance scheduled FY2018 will continue to focus on core tax functions.

In the financial supervision area, PFTAC is assisting the Banking Board in enhancing its regulatory framework for banks and providing training on supervision of key banking risks. The Banking Board attended PFTAC's Regulatory Framework Workshop in July 2017, where TA was provided to enhance banking legislation and prudential standards, in line with current international practice. The Banking Board has also requested training for bank examiners, which PFTAC has earmarked for FY2018.

In the area of statistics, the FSM implemented the enhanced General Data Dissemination System (e-GDDS) in July 2017, with support from the IMF's Statistics Department. PFTAC will continue to support enhancements in national accounts and provide hands-on annual training in compilation methods, provided that staffing remains adequate in the Statistics Office. For Government Finance Statistics (GFS), FSM received TA and training under the Japan Funded Administered Account (JSA 1) for selected Asia and Pacific countries up to October 2015. With the conclusion of the JSA 1 project, PFTAC, in collaboration with IMF headquarters, assumed the responsibility for delivery, staffing, and funding of GFS capacity development. The most recent GFS mission was in October 2016 and focused on expanding the coverage of GFS data and increasing the frequency of reporting for the budgetary central government. On external sector statistics (ESS), a PFTAC mission is tentatively planned for later 2017 to assess the progress made since the last ESS mission in November 2015.

In macroeconomics, no direct input is currently anticipated. However, support to forecasting of long-term economic and fiscal scenarios may be provided, in cooperation with other TA providers.

STATISTICAL ISSUES

**Table 1. Federated States of Micronesia: Statistical Issues Appendix
As of July 19, 2017**

I. Assessment of Data Adequacy for Surveillance	
<p>General: Data provision has serious shortcomings that significantly hamper surveillance. While coverage of key macroeconomic data is broadly sufficient (except external sector statistics), they are not compiled in a timely manner. Most affected areas are: national accounts and external sector statistics, where data are compiled annually with nearly a year lag. This makes it difficult to make accurate and timely evaluation of economic developments on an ongoing basis. To improve data dissemination, the authorities implemented the enhanced General Data Dissemination System (e-GDDS) in July 2017, with technical assistance from STA.</p>	
<p>National accounts: National accounts have been prepared, with the support of the U.S. Graduate School, dating back to FY1995. Annual GDP estimates based on the production and income approaches are compiled and released with a lag of 11 months. GDP data have not been rebased for more than 10 years (current base year is FY2004). A national census was conducted in 2010 and a household survey in 2013. GDP estimates based on the expenditure approach are not compiled, leading to a lack of investment/savings indicators. Fixed ratios are used in estimating value added for private sector operating surplus. The authorities are planning to conduct a business survey that would help with the rebasing of GDP.</p>	
<p>Employment: Data on employment and wages are available on an annual basis and classified by sectors based on the filings to Social Security Administration. However, no unemployment data are available except for 2013 when the household survey was conducted.</p>	
<p>Price statistics: A quarterly consumer price index (CPI), rebased to 2008Q2 and utilizing expenditure weights derived from an earlier household survey, is published for the FSM and for each state. However, data releases are often delayed. The authorities are in the process of rebasing the CPI.</p>	
<p>Government finance: Fiscal data for the central and general government have been prepared, with the support of U.S. Graduate School, going back to FY2004. Data are compiled in line with <i>Government Finance Statistics Manual 2001 (GFSM 2001)</i> based on annual audit reports of the national and state governments. The fiscal accounts are consolidated between the national and state governments. However, government agencies and local governments (municipalities) are not covered. Work to improve coverage and periodicity of fiscal data submitted to the Government Financial Statistics Yearbook is continuing, with PFTAC support.</p>	
<p>Monetary statistics: The Banking Board compiles monthly monetary data with a three-month lag. The data comprise interest rates, the accounts of commercial banks, and the FSM Development Bank. The depository survey data are not compiled with standardized report forms (SRFs), hindering international comparability.</p>	
<p>Financial sector surveillance. The FSM started compiling Financial Soundness Indicators (FSIs) data in 2016 (data are available on a quarterly basis going back to 2013). The FSM also participates in the Financial Access Survey (FAS), with data going back to 2004. Both data are often reported with delays.</p>	
<p>External sector statistics: The authorities compile annual balance of payments and international investment position statistics in broad conformity with the sixth edition of the <i>Balance of Payments and International Investment Position (BPM6)</i>. However, there are persistent large errors and omissions in the balance of payments, which complicate the assessment of external sustainability. The coverage and classification of imports of goods, personal transfers, direct investment liabilities, and public external assets require enhancements. A PFTAC technical assistance mission is planned for 2017 to follow up on these shortcomings.</p>	
II. Data Standards and Quality	
<p>Participant in the Fund's General Data Dissemination System (GDDS) since November 2014. Implemented the enhanced GDDS (e-GDDS) in July 2017. The National Summary Data Page (NSDP) is available at: http://www.fsmstats.fm/?page_id=605</p>	<p>Data ROSC is not available.</p>

Table 2. Federated States of Micronesia: Table of Common Indicators Required for Surveillance
As of July 19, 2017

	Date of Latest Observation	Date Received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates ¹	NA	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities	NA	NA	NA	NA	NA
Reserve/Base Money	NA	NA	NA	NA	NA
Broad Money	Mar 2017	Jun 2017	M	M	M
Central Bank Balance Sheet	NA	NA	NA	NA	NA
Consolidated Balance Sheet of the Banking System	Mar 2017	Jun 2017	M	M	M
Interest Rates ²	Mar 2017	Jun 2017	M	M	M
Consumer Price Index	End-FY2016	Jun 2017	Q	Q	Q
Revenue, Expenditure, Balance/Composition of Financing ³ General Government ⁴ and Central Government	FY2016	Jun 2017	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	End-FY2016	Jun 2017	A	A	A
External Current Account Balance	FY2016	Jun 2017	A	A	A
Exports and Imports of Goods and Services	FY2016	Jun 2017	A	A	A
GDP/GNP	FY2016	Jun 2017	A	A	A
Gross External Debt	End-FY2016	Jun 2017	A	A	A
International Investment Position ⁶	End-FY2016	Jun 2017	A	A	A

¹The U.S. dollar is legal tender and the official currency.

²Includes the interest rate on consumer loans and commercial loans, as well as deposit rates.

³Foreign, domestic bank, and domestic nonbank financing.

⁴The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments.

⁵Including currency and maturity composition.

⁶Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

Table 3. Federated States of Micronesia: Data Adequacy for Surveillance and Dissemination Practices Compared with the e-GDDS Framework

Data Category	Methodology			Periodicity		Timeliness		Advance Release Calendar
	Base year	Coverage (adequate)	Other	e-GDDS	FSM	e-GDDS	FSM	
Real Sector 1/								
National accounts (GDP)	>10Y	Yes	Exp. approach; fixed ratios	Q	A	1Q	11M	No
Consumer price index (CPI)	>5Y	Yes	...	M	Q	2M	1Q-3Q	No
Fiscal Sector 2/								
General government operations	...	Broadly	...	A	A	3Q	11M	No
Central government operations	...	Yes	...	Q	A	1Q	3Q	No
Central government gross debt	...	Yes	...	Q	A	2Q	3Q	No
Financial Sector 3/								
Depository corporations survey	...	Yes	Classification (no SRFs)	M	M	1Q	3Q	No
Central bank survey (not applicable)								
Interest rates	...	Yes	...	M	M	...	3Q	No
Stock market (not applicable)								
External Sector 4/								
Balance of payments	...	Partially	...	Q	A	1Q	11M	No
External debt	...	Yes	...	Q	A	2Q	11M	No
Foreign exchange reserves (not applicable)								
Merchandise trade	...	Duty-free imports	...	M	A	12W	11M	No
International investment position (IIP)	...	Partially	...	A	A	3Q	11M	No
Exchange rates (not applicable)								
Supplementary Data								
Labor market	...	Yes	...	A	A	3Q	11M	No
Financial soundness indicators (FSI)	...	Yes	...	Q	Q	1Q	1Q-3Q	No
Note: The timeliness benchmark is typically three quarters (3Q) for annual data and one quarter (1Q) for quarterly data. 1/ Annual GDP data are compiled and released with a lag of 11 months, which complicate timely assessment of economic developments. GDP data have not been rebased for more than 10 years (current base year is FY2004). GDP estimates based on the expenditure approach are not compiled, leading to a lack of investment/savings indicators. Fixed ratios are used in estimating value added for private sector operating surplus. The CPI is compiled quarterly, but is often disseminated with long lags. The CPI has not been rebased for more than 5 years. 2/ The FSM compiles fiscal data for central and general government operations based on GFSM 2001. The fiscal accounts are consolidated between the national and state governments. However, government agencies and local governments (municipalities) are not covered. 3/ The FSM does not have a central bank and uses the U.S. dollar as legal tender. The depository survey data are not compiled with standardized report forms (SRFs), hindering international comparability. The FSIs are being compiled since 2016, but disseminated with occasional long lags. 4/ The FSM reports balance of payments and international investment position statistics in broad conformity with BPM6. However, the coverage and classification of imports of goods, personal transfers, direct investment liabilities, and public external assets require enhancements. In particular, the coverage of imports data suffers from non-inclusion of duty-free imports.								