Opening Remarks

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Joint Economic Management Committee Meeting

August 28, 2008

Secretary's Conference Room
United States Department of the Interior

I want to welcome you today to the annual meeting of the Joint Economic Management Committee, the JEMCO.

On June 10 of this year, the Office of Insular Affairs presented its formal views of the progress of the amended Compact of Free Association to the House of Representatives. I want to recommend to the Committee that it review that testimony, as it reflects, in more words than I want to offer today, the perspective from which the U.S. members of the JEMCO view the FSM's progress. I will however, repeat the most important themes of that testimony.

The Compact of Free Association creates a workable model for assisting the Government of the Federated States of Micronesia to meet its goals of promoting the economic advancement and budgetary self-reliance of its people. With financial support limited to six important sectors, the Compact was never intended to underwrite the entire FSM economy, nor all of the operations of its national and State Governments. The Compact was intended to be an economic springboard and, to a lesser extent, a safety net for the FSM.

As a springboard, the Compact provides the resources to allow the FSM to improve essential Government services and infrastructure while it reforms its business climate and fiscal policies, and improves its capacity to govern. But as a safety net, the substantial Compact resources can serve as a disincentive for making those reforms. They can create an illusion that the status quo can be maintained, even in the face of annual decrements to grant funding. In the first five years, the FSM has far too often taken refuge in the safety net by putting much effort into maintaining Government payrolls at the expense of effective programs and has not expeditiously taken steps toward reform and economic development. The result is lost time, lost opportunities, a declining economy and a continuing over-reliance on public-sector employment.

The Compact and its related agreements create a workable framework for development. However no arrangement can be successful unless all parties are committed to the framework, and comply with the agreements. In our view, the FSM Governments often have not complied with our agreements. This deficiency has been especially visible in five areas: in providing coherent and accurate budgets, in performance and economic reporting, in organizing to implement the infrastructure grant program, in organizing the efficient delivery of basic social services, and in adhering to the purposes of the following sector grants: Public Sector Capacity Building, Environment, and Private Sector Development. Some of the shortfalls can be attributed to gaps in capacity in the FSM governments, but others have resulted from institutional unwillingness to adapt to the changes negotiated in the amended Compact.

As the amended Compact was implemented, the FSM requested that JEMCO allow FSM a transitional period to adapt to the limited operational support provided by the amended Compact. The FSM's Fiscal Year 2004 Capacity-Building grant proposal included basic operational funding of $10.6 million for the national and State Governments that did not comply with the Compact agreement. The FSM stated that its non-Compact resources were too limited to maintain certain critical basic operations without which it could not support. In August 2003, JEMCO accepted the FSM's rationale for funding for Fiscal Year 2004, and required a five-year phased reduction in non-compliant operations funding. That five-year period is now at end, but the FSM has yet fully to develop the economic, fiscal and public-sector reforms to meet its operational requirements. Some current sector proposals still seek funding for non-compliant activities. Some of the FSM States also continue to propose Environment and Private Sector Development grants that seek no more than to cover the recurring costs of personnel in Government offices whose output is ill-defined, and only very loosely related to the purposes of these sectors. I do not foresee we can support such projects in Fiscal Year 2009.

At the same time, there is a long list of obvious needs to which the FSM can commit Public Sector Capacity-Building, Environment and Private Sector Development funds that can help alleviate key challenges in these sectors. For economic progress, the FSM must initiate substantial reform of its tax and fiscal policy, the public sector and public-sector enterprises, land titling and foreign investment. The FSM, however, has not taken action in these areas that are so crucial to its economic well-being. The Government lacks expertise in economic planning for growth and for declining U.S. assistance, yet does not seek to allocate the funding established for that purpose. It seeks instead to find ways to maintain public-sector payrolls as an apparent first priority.

At the same time, the use of Infrastructure Sector Grants has been disappointing. The FSM has not profited from new facilities and employment that an active capital improvements program could have produced. Progress in this sector has been hampered by a number of factors. The FSM has not produced an implementable nationwide infrastructure-development plan that is prioritized and focused upon the replacement, renovation or repair of education and health facilities throughout the nation. Without such a roadmap, the selection of projects has often been ad-hoc, and based upon short-term needs. The FSM needs to develop a strategic approach to the selection and prioritization of projects, and the basic needs in education, health, providing clean water and sanitation must be at the top of the list.

The fiscal and economic future of the FSM is of concern to the U.S. members of the JEMCO. The FSM has limited prospects for achieving budgetary self-reliance and long-term economic advancement, and the FSM Government has not yet implemented policy reforms needed to enable economic growth. The FSM economy depends on public-sector spending of foreign assistance. Government expenditures, two-thirds funded by external grants, account for more than half of the FSM's gross domestic product (GDP). The FSM government's budget is characterized by limited tax revenue and a growing wage bill, and the two private-sector industries identified as having growth potential—fisheries and tourism—face significant barriers to expansion because of the FSM's remote geographic location, inadequate infrastructure, and poor business environment.

Progress in implementing key tax, public-sector, land, and foreign-investment policy reforms necessary to improve growth has been slow. For example, although the FSM has agreed on principles of reform to address its inefficient and inequitable tax system, the FSM Government has made limited progress in implementing fundamental tax reform. Also, the FSM's failure to implement key public sector reforms to reduce wage and subsidy expenditures resulted in fiscal crisis in the States of Chuuk and Kosrae. The short-term solutions to this problem, reducing the Government work force and insisting on balanced budgets, while necessary, are precursors of more rounds of cuts unless the FSM can stimulate economic growth.

The most immediate concern in today's meeting is the dangerous decline of Chuuk State. The State suffers from a deadly strain of tuberculosis, an outbreak of hepatitis, an electrical-power crisis that undermines its medical-care system, a growing problem with law enforcement, and continuing problems with state finances. JEMCO attempted to address the state's financial management difficulties last year, and assisted Chuuk's reforms by sanctioning the use of Compact funds to underwrite the cost of a reduction-in-force of the state's employees. Recent actions by the Governor in firing a qualified manager and not replacing him, and unclear evidence that the State Government is implementing other elements of the reform make us concerned the reform efforts in Chuuk have ground to a halt. We are also troubled, that despite the intervention of President Mori in the fiscal-reform efforts, that the FSM National Government seems unable to provide leadership in solving Chuuk's ever-growing problems.

We have a full agenda ahead of us, and only two days to complete our mission. Our goals today are many and our hours are few, but I know we will make good use of our time. Today we will: 1) receive updates on fiscal reform efforts in both Kosrae and Chuuk States along with steps taken by the FSM National Government to fully address Chuuk financial management issues; 2) discuss on Compact implementation issues and challenges regarding the implementation of the amended Compact; 3) receive an update on measures taken to address the outbreak of multi-drug resistant tuberculosis outbreak in Chuuk; 4) receive sector grant performance updates for infrastructure, health and education; 5) discuss the basis for awarding FY 2009 grants in the Private Sector Development, Environment and Public Sector Capacity Building sectors; 6) allocate Fiscal Year 2009 Compact funding and carry-over funding among sectors and apply special grant terms and conditions; and 7) discuss other issues.

I welcome you to Washington, and I look forward to today's discussion.