ECONOMIC & FISCAL UPDATE

March 2015

FSM Office of Statistics, Budget & Economic Management,
Overseas Development Assistance and Compact Management

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Abbreviations

ADB	Asian Development Bank
COM	College of Micronesia
CPI	Consumer Price Index
EU	European Union
FAA	Federal Aviation Administration
FSM	Federated States of Micronesia
FSMPC	FSM Petroleum Corporation
FY	Fiscal Year
GDP	Gross Domestic Product
ICT	Information, Communications and Technology
JEMCO	Joint Economic Management Committee
ODA	Overseas Development Assistance
PetroCorp	FSM Petroleum Corporation
PMU	Project Management Unit

1. ECONOMIC & FISCAL UPDATE SUMMARY

1.1. Fiscal Setting Overview

1. Strong government revenue in recent years has eased the pressure on the fiscal position of the National Government, with the national budget in surplus annually since Fiscal Year (FY) 2008. In FY2013 the surplus rose above $10 million for the first time as a result of the increasing fishing license fee collections. FY2014 was an exceptional year for the Federal States of Micronesia (FSM) National Government with a further increase in fishing licence fees and a one-off $22 million payment in corporate tax by a captive insurance company, resulting in a fiscal surplus of $42.7 million for the year.

2. Surpluses have allowed the National Government to make contributions of $7 million and $30 million into the FSM Trust Fund from FY2013 and FY2014 surpluses respectively. The medium term outlook for National Government is for continued surpluses of around $15 million, with at least $10 million annually proposed for Trust Fund investment.

3. The FY2016 National Budget was developed under reasonably unrestricted fiscal circumstances, although from a policy stance the National Government has kept a tight rein on operational expenditures. The FY2016 Budget provides a balance between investing for the future and the need to stimulate the economy now. At this stage, it is projected that the Budget will have a fiscal surplus of $15.3 million.

4. The FY2016 Budget reflects three key components of the 2023 Action Plan. Firstly, the need for continued fiscal discipline with regard to the overall operation budget with an increase of only 1.9 percent over FY2015 levels. Secondly, the need to grow the economy, highlighted by allocating $10 million for the 2023 Investment Development Fund, a contribution of $10 million for State economic infrastructure, and for the first time a significant contribution of $2 million for tourism development, one of the key sectors for growth. Lastly, the need to invest for the future, with a further $15 million into the FSM Trust Fund.

5. Domestic revenue has been growing consistently over the last four years on the back of rising fishing licence fees. Tax revenue effort however, at 12 percent of GDP, continues to be low by international standards.

6. External grants have been declining in recent years, with the major decline in grants coming from capital grants which peaked at $57.6 million in FY2012 and dropped to only $7.2 million and $10.1 million in FY2014 and FY2015 respectively. Following the Infrastructure Development Plan update and Project Management Unit (PMU) institutional Review being conducted in 2015 the Compact infrastructure grants are expected to be made available again from FY2016 onwards.

7. Current expenditure levels have remained flat over the last 5 years and in real terms have declined. Expenditure on personnel as a percentage of domestic revenue has declined from a peak of 49.8 percent in FY2010 to 22.6 percent in FY2015. Expenditure on goods and services, although volatile in the early years of the Amended Compact, has only grown by an average 0.1 percent per annual since FY2004. This along with the 2.3 percent average annual growth in personnel costs suggest the National Government has been successful in keeping government current expenditure under control since the beginning of the Amended Compact.

8. Capital expenditure funded from grants was very strong from FY2009 – FY2012, peaking at $61.5 million in the later year, and this provided the impetus for economic growth during this period. Over the last two years external grants have declined as projects were completed and Joint Economic Management Committee (JEMCO) suspended Compact infrastructure grants which has negatively impacted on the economy. It is with this is mind that the FY2016 Budget proposes a repeat of the FY2015 $10 million infrastructure allocation from domestic revenue to the States to keep infrastructure investment moving.

9. The National Government, through Congress, continues to support the States with a number of initiatives in recent times which have seen an increase in the share of revenue to the States. Public Law 18-57 saw the change in calculation of the division formula for Compact Grant funds for the second year in succession. In FY2014 the National Government share of Compact grants was decreased from 10 percent to 5 percent and from FY2015 onwards, the National Government allocation is zero. This will see an additional $7 million annually in grants being available for the States.

10. Public Law 18-107 in FY2015 amended the tax collection allocation to the States from 50 percent to 70 percent of net taxes collected for import taxes, income tax and gross revenue tax. The impact of this tax policy change see a $5.0 million decline in tax revenue for the National Government from FY2016 onwards. This revenue has not been passed directly to the States but by law is invested in the FSM Trust Fund on their behalf. It is estimated that $40 million will be invested in the Trust Fund on behalf of the States by 2023.

11. In addition to the $10 million domestic funding of infrastructure grants to the States in FY2015 and FY2016 the National Government responded to an urgent call for assistance and supplied $2 million for electricity generators in FY2014 for Pohnpei State. The National Government also provided $1 million for outer island airport development in FY2015.

12. In recent years the FSM has maintained a prudent external debt profile. The current debt to GDP ratio is relatively low at 27.9 percent in FY2014. The recent approval, subject to State guarantee, of the Asian Development Bank (ADB) loan for Pohnpei Port will provide much needed expansion of economic infrastructure which will provide growth opportunities in the future.

1.2. Economic Setting Overview

13. From the historical low of FY2008 FSM experienced three years of economic growth stimulated mainly by infrastructure projects linked to the Amended Compact grant and Federal Aviation Administration (FAA) funded airport renovations. During this period construction activity averaged 33.2 percent growth per annum. However, FY2012 saw a decline in construction activity of -2.7 percent, and the economy stagnated. Not only were the FAA funded projects drawing to close but also a JEMCO imposed suspension on any new Infrastructure Grant projects in August 2012 further restricted economic activity.

14. The economic impact of this JEMCO decision was severely felt in FY2013 with construction activity declining by 25.9 percent for the year and this coupled with a decline of 14.7 in fishing activity, as a result of planned dry docking of domestic based fishing vessels, has seen a 4.0 percent decline in GDP for FY2013. The economy further declined in FY2014 by 1.5 percent as construction activity hit its lowest levels since the Amended Compact began.

15. Economic growth prospects for the FSM remain suppressed in the short term, due in part to the freezing of the Amended Compact infrastructure grant. The 2023 Action Plan has as a key financing component the fast tracking of expenditure of infrastructure and sector grant arrears to stimulate economic growth. The updated Infrastructure Development Plan is anticipated to resolve the sector grant issue and see a return to annual infrastructure grants.

16. Inflation, as measured by the FSM Consumer Price Index, was 0.9 percent in FY2014 following 2.5 percent growth in FY2013. There has been an inflationary slowdown over the last 12 months and FY2015 will see a further contraction as fuel price declines trickle through the economy. In the medium term, inflation is forecast to increase to 2.0 per cent per annum from FY2016 onwards.

1.3. 2023 Action Plan

17. The 2023 Planning Committee was established in 2012 with the primary mandate to develop and present to the leadership a realistic and credible action plan for addressing the looming financial shortfall in 2024 and beyond. The 2023 Action Plan was endorsed by the 8th State and National Leadership Conference in January 2015. The March 2015 International Monetary Fund mission to FSM gave a strong endorsement to the 2023 Action Plan and stressed the need to move forward on implementation.

18. From 2024 the Amended Compact grants will be replaced by investment income from the Compact Trust Fund. The fiscal challenge stems from the initial poor performance and inadequacy of the structure of the Fund. The projected income from the Fund will not generate sufficient investment returns to replace Amended Compact Grants, with a projected fiscal gap of $41.3 million in FY2024. As all sector grants from FY2015 onward are passed on to the State Governments to fund education, health and infrastructure, it is here that the fiscal impact will be severely felt.

19. The key to solving the fiscal challenge is TO unlock the economic challenge facing FSM, which is to reverse the trend of the first 10 years of the Amended Compact where real GDP growth has averaged -0.5 percent per annum. Implementing a long-term sustainable growth strategy is the Government's top priority. However, the challenge of growing the private sector at a rate sufficient to produce jobs and entrepreneurial opportunities and to close the fiscal gap by FY2024 is daunting.

20. A key component to the Action Plan is to kick start the economy through fast tracking expenditure of the infrastructure grant arrears of $126 million and sector grant arrears of $30 million over the period of FY2016-FY2019. This will give space for the implementation of economic and fiscal reforms to take effect.

21. A major part of fiscal adjustment will need to come from revenue increases at the State level in order to avoid seriously jeopardizing social service delivery. The FSM has a very low tax to GDP ratio of 12 percent and this needs to be raised to at least 16 percent, which would still leave it as one of the lowest in the Pacific. To this end implementation of tax reforms becomes critical, as they have the potential to close the fiscal gap in the remaining 10 years of the Amended Compact.

22. Some form of revenue sharing will also need to be undertaken by the National Government after 2023 as its surpluses continue to grow. However, this should only be undertaken after the states have taken appropriate measures, such as enabling tax reform legislation, improvements to the investment environment, and expenditure reforms. This is to ensure revenue sharing is part of the long-term economic solution and not a stop gap approach.

23. The achievement of the required economic growth to meet the key fiscal challenge in 2024 depends upon a complex array of economic and social drivers. Establishing the underlying conditions and context for FSM to flourish is, therefore, a critical step. An improved enabling environment for economic growth will be achieved through the FSM commitment to economic reform and the provision of an environment to support open, outward-oriented and private sector led development.

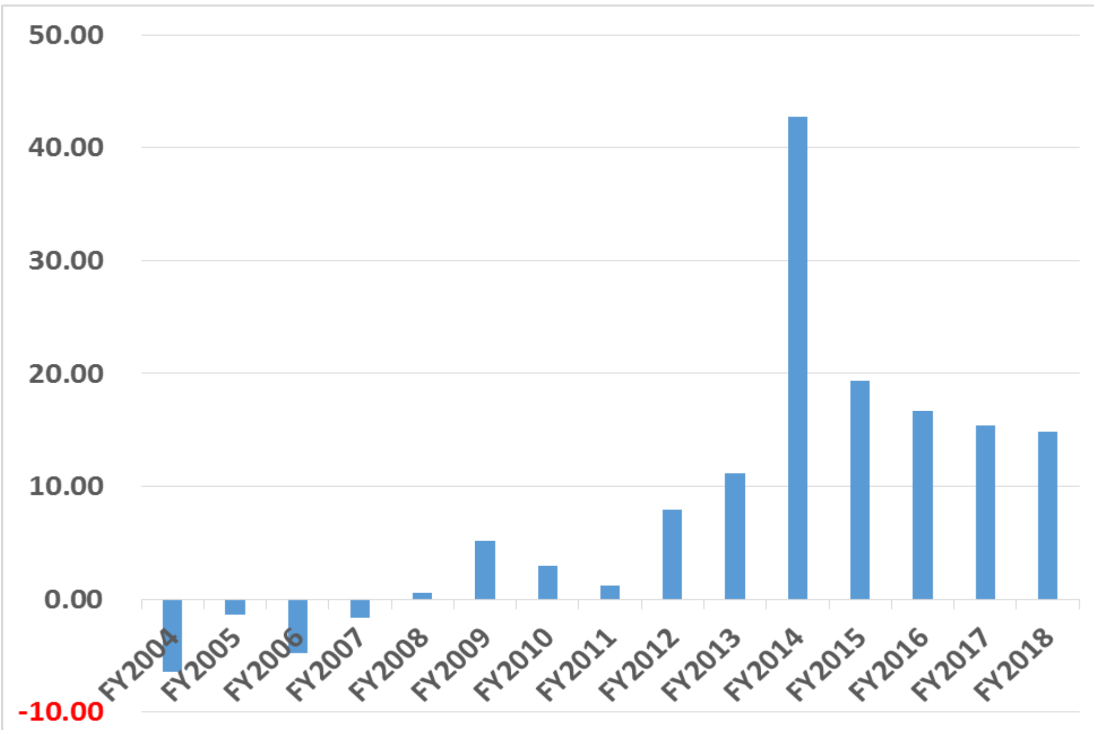
24. The 2023 Action Plan macroeconomic framework suggests that with a focus on driving the key sectors to achieve long term average 2 percent real growth, undertaking fiscal and business environment reforms, the FSM will be able to meet the fiscal challenge of FY2023 head on. However, there will be an imbalance at the State level and without some form of revenue sharing to the States most in need, Chuuk and Kosrae, they will face impossible fiscal challenges from FY2024 onwards.

2. NATIONAL GOVERNMENT BUDGET

2.1. Fiscal Outcome

25. The first five years of the Amended Compact witnessed a difficult period of fiscal adjustment, as the nation was forced to adapt to the new fiscal procedure arrangements. At the start of the amended Compact in FY2004 the National Government recorded a deficit of $6.4 million (refer figure 1), reflecting the National Governments transfer of $8.5 million to the Compact Trust Fund. In the subsequent three years much smaller deficits were incurred as continuing adjustments were made to the new Amended Compact fiscal procedures and by FY2008 the overall fiscal balance had turned positive and has remained that way since.

Figure 1: National Government Fiscal Balance ($ million)



26. In FY2013 the surplus rose above $10 million for the first time as a result of the increasing fishing license fee collections. FY2014 was an exceptional year for the FSM National Government with a further increase in fishing licence fees and a one-off $22 million payment in corporate tax by a captive insurance company, resulting in a fiscal surplus of $42.7 million.

27. The National Government fiscal balance outlook remains strong for FY2015 and FY2016 with projected fiscal surpluses of $19.4 million and $16.6 million respectively. This has allowed the National Government to make contributions of $7 million and $30 million into the FSM Trust Fund from the FY2013 and FY2014 surpluses respectively. The budgets for FY2015 and

FY2016 propose further $10 million Trust Fund investments each year from the forecast surpluses.

28. The medium term outlook for the National Government is for continued surpluses of around $15 million.

2.2. Government Revenue

29. Strong government revenue in recent years has eased the pressure on the fiscal position of the National Government (refer table 1 below).

Table 1: National Government Revenue ($ million)

Item	FY2012 Audit	FY013 Audit	FY2014 Estimate	FY2015 Budget	FY2016 Budget
Domestic Revenue	**47.5**	**56.4**	**91.2**	**70.9**	**67.6**
Tax revenue	16.0	17.3	40.0	20.8	15.2
Non-tax revenue	31.5	39.1	51.2	50.1	52.4
Fishing license fees	26.4	35.0	47.5	46.0	50.0
Other	5.1	4.0	3.7	4.1	2.4
External Grants	**71.5**	**43.8**	**26.2**	**19.4**	**33.0**
Compact Sector Grants	2.3	2.4	2.4	2.4	1.7
Supplemental Education	0.4	0.3	1.1	1.1	1.1
Federal & Other	11.2	9.9	5.9	5.8	5.3
Capital Grants	57.6	31.3	7.2	10.1	24.9
Revenue	**118.9**	**100.3**	**117.4**	**90.3**	**100.6**

Source: Audited Reports, Budgets

30. Tax revenue in the FSM is a relatively low proportion of domestic revenue. However, in FY2014 corporate tax showed a large gain of $22 million. This income was related to a one-off tax on capital gains of a captive insurance company. The corporate tax from this industry has been increasing steadily over the past three years and is anticipated to be $7 million in FY2016.

31. Public Law 18-107 in FY2015 amended the tax collection allocation to the States from 50 percent to 70 percent of net taxes collected for import taxes, income tax and gross revenue tax. This was a welcome move towards assisting the States although it is more an investment for the future as by law this additional tax allocation is invested in the FSM Trust Fund on behalf of the States. However, there needs to be a balance between investing in the future and the immediate needs of the States to manage their operational budgets. The impacts of this tax policy change see a $5.0 million decline in tax revenue for the National Government from FY2016 onwards.

32. Fishing day license fees increased by 30 percent on 1 January 2015 but at the same time there was to be a reduction in days fished. As a result the FY2016 Budget takes a conservative approach and it estimates fees of $50 million for the year. Increasing fees may be good for government revenues but these should not be pursued at the expense of a viable

domestic based fishing industry. Fishing licences do not necessary translate into a growing economy and more attention needs to be paid to developing the domestic and value added component of the sector.

33. External grants have been declining in recent years. This reflects the National Congress amending the allocations for Compact Sector grant disbursal to the States, with Public Law 18-57 seeing the National Government allocation being zeroed out from FY2015 onwards. FY2016 sees Amended Compact funding for the College of Micronesia (COM-FSM) drop to $1.7 million as per the 2011 JEMCO resolution to reduce COM-FSM support from $3.8 million to $1.0 million per annum by FY2017. However the major decline in grants comes from capital grants which peaked at $57.6 million in FY2012 and dropped to only $7.2 million and $10.1 million in FY2014 and FY2015 respectively.

34. Following the Infrastructure Development Plan update and PMU institutional Review being conducted in 2015 the Compact infrastructure grants are expected to be made available again from FY2016 onwards.

35. A major part of fiscal adjustment for FY2023 will need to come from domestic revenue increases in order to avoid seriously jeopardizing State social service delivery. The FSM tax to GDP ratio of 12 percent is very low by international standards and well below other pacific island countries. Both our nearest neighbours, Palau and the Republic of Marshall Islands, have ratios of 17 percent. This very low revenue effort means there is very little domestic resources to fund government expenditures, especially in the States. Raising the FSM revenue effort to 16 percent of GDP over the next three years, through tax reforms, or other compliance and tax measures, is necessary to partially avert the fiscal crisis in FY2024.

36. Some form of revenue sharing will also need to be undertaken by the National Government after 2023 as its surpluses continue to grow. However, this should only be considered after the States have taken appropriate measures, such as enabling tax reform legislation, improvements to the investment environment, and expenditure reforms. This is to ensure revenue sharing is part of the long-term economic solution and not a stop gap approach.

2.3. Government Expenditure

37. Overall national government expenditure has been declining, reflecting the slowdown in capital grants. Current expenditure levels have remained flat over the last 5 years and in real terms have declined.

38. Personnel costs have grown from $13.3 million in FY2004 to a peak of $18.5 million in FY2012 before declining to $16.0 million in FY2013 and FY2014. The average growth rate for this period is 2.3 percent, almost half the average annual inflation rate of 4.4 percent for the same period. Expenditure on personnel as a percentage of domestic revenue has declined from a peak of 49.8 percent in FY2010 to 22.6 percent in FY2015.

39. Public Law 18-114 introduced the Cost of Living Adjustment which takes effect on 1 July 2015 with a $40 per fortnight contribution for all government employees. As a result personnel costs rise by $0.3 million in FY2016 to reflect a full year expenditure.

Table 1: National Government Expenditure ($ million)

Item	FY2012 Audit	FY013 Audit	FY2014 Estimate	FY2015 Budget	FY2016 Budget
Wages and Salaries	18.5	18.2	16.0	16.0	16.2
Goods and Services	28.9	29.3	29.6	30.2	30.6
Interest Payments	0.6	0.7	0.4	0.4	0.4
Subsidies	0.3	0.3	0.1	0.1	0.1
Transfer	1.2	1.0	2.7	2.7	2.7
Current Expenditure	**49.5**	**49.5**	**48.8**	**49.4**	**50.4**
Capital Expenditure	61.5	39.5	25.8	21.1	34.9
Total Expenditure	**111.0**	**89.1**	**74.7**	**70.5**	**85.5**

Source: Audited Reports SBOC estimates

40. Expenditure on goods and services, although volatile in the early years of the Amended Compact, has only grown by an average 0.1 percent per annual since FY2004. This along with the personnel cost average annual growth rates suggest the National Government has been successful in keeping government current expenditure under control since the beginning of the Amended Compact.

41. Capital expenditure funded from grants was very strong from FY2009 – FY2012, peaking at $61.5 million in FY2012. This was the impetus for the only economic growth during so far during the Amended Compact time. Over the last two years external grants have declined as FAA projects were completed and JEMCO suspended Compact infrastructure grants, resulting in a negative impact on the economy. It is with this is mind that the FY2016 Budget proposes a repeat of the FY2015 $10 million infrastructure allocation to the States to keep infrastructure programs moving.

42. Economic growth prospects for the FSM remain suppressed in the short term and the 2023 Action Plan has as a key financing component the fast tracking of expenditure of infrastructure and sector grant arrears to stimulate economic growth. The updated Infrastructure Development Plan (currently being completed with technical assistance) is anticipated to resolve the JEMCO infrastructure grant issues and see a return to annual infrastructure grants at normal levels in FY2016 until the end of Sector Grant funding in FY023.

2.4. Revenue Sharing

43. The National Government, through Congress, continues to support the States with a number of initiatives in recent times which have seen an increase in the share of revenue to the States. Public Law 18-57 saw the change in calculation of the division formula for Compact Grant funds. From FY2015 onwards, the National Government allocation is zero. This has seen an additional $7.0 million in grants being available for the States annually.

44. Although this increased allocation to the States is welcomed, it must be noted that it has created an issue for infrastructure. The Project Management Unit funding has historically come from Compact Grant funding but unlike the operational grants, where COM-FSM allocations are

made before the funding formula is applied, no such mechanism currently exists for the infrastructure sector. Due to the zero Compact grant allocation for National Government FY2016 budget sees a request for PMU funding from domestic revenue.

45. Public Law 18-107 in FY2015 amended the tax collection allocation to the States from 50 percent to 70 percent of net taxes collected for import taxes, income tax and gross revenue tax. The impact of this tax policy change see a $5.0 million decline in tax revenue for the National Government from FY2016 onwards. This revenue has not been passed directly to the States but by law is invested in the FSM Trust Fund on their behalf. It is estimated that $40 million will be invested in the Trust Fund on behalf of the States by 2023.

46. The National Government continues to work hard at JEMCO on behalf of the States and in terms of the relationship with the US. However, the economic impact of the suspension of any new Infrastructure Grant projects at the August 2011 and August 2012 meetings has severely restricted economic activity. It is with this is mind that the FY2016 Budget proposes a repeat of the FY2015 $10 million infrastructure allocation to the States.

47. Expenditure by the National Congress on Public Projects rose from $6.8 million in FY2013 to $10 million in FY2014 as a result of a second appropriation during the year as the National Congress determined there would be a significant surplus for the second year in succession. Over 50 percent of this money was expended on infrastructure projects in the States while a further 25 percent went to assist with funding of municipalities in the States.

48. In addition to the $10 million domestic funding of infrastructure grants to the States in FY2015 and FY2016 the National Government responded to an urgent call for assistance and supplied $2 million for electricity generators in FY2014 for Pohnpei State. The National Government also provided $2 million for outer island airport development in FY2015.

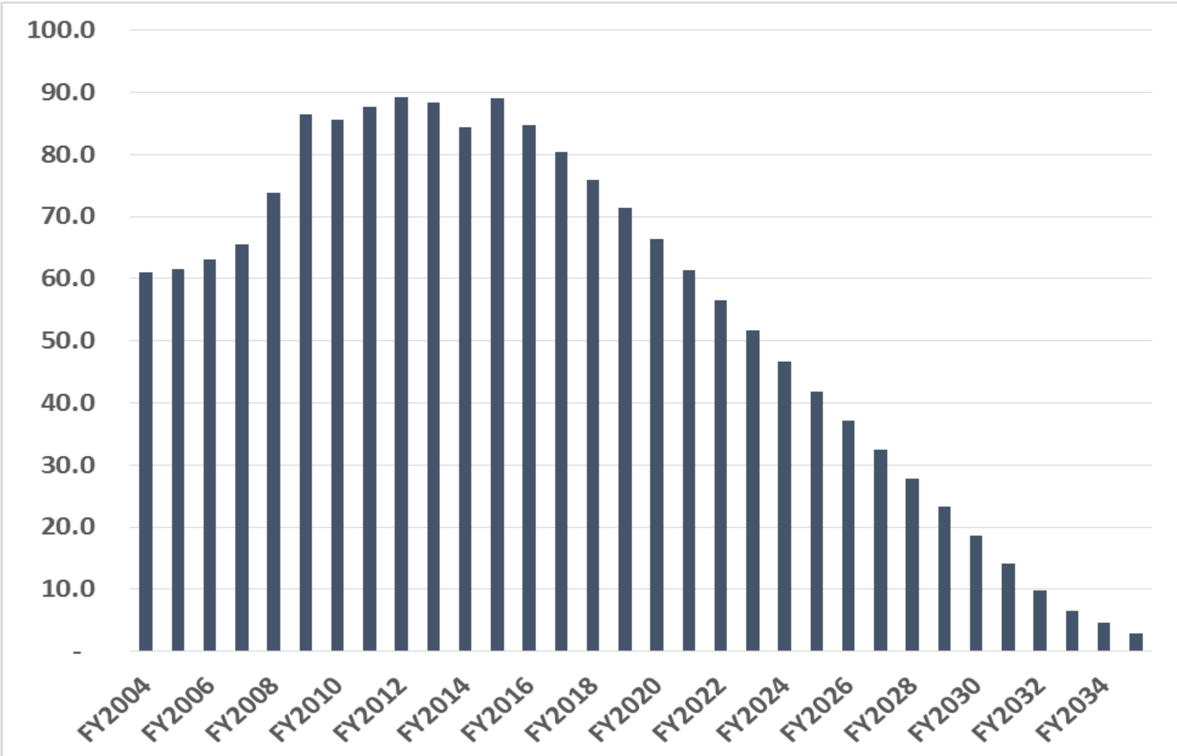
2.5. Government Debt

49. Although many indicators do not suggest a vibrant picture of recent economic performance, the FSM has maintained a prudent external debt profile. After a period of sizeable borrowing in the early 1990s to finance development projects external debt has fallen significantly. The Debt-to-GDP ratio has fallen from 54 percent in FY1995 to 27.4 percent in FY2014. Debt service ratios also remain very favorable by international standards, reflecting the concessionary nature of the remaining outstanding debt.

50. Substantial borrowing occurred in FY2008 and FY2009 that raised the level of debt by more than $20 million from the FY2007 level $65 million (refer figure 2). Debt levels have been declining since FY2012 with external debt of the FSM at the end of FY2014 of $84.3 million, which is down from the peak of $89.2 million in FY2012. FY2015 sees a slight rise in external debt as the Yap Renewable Energy loan comes on stream but without further borrowing debt will continue to decline in the medium to long term.

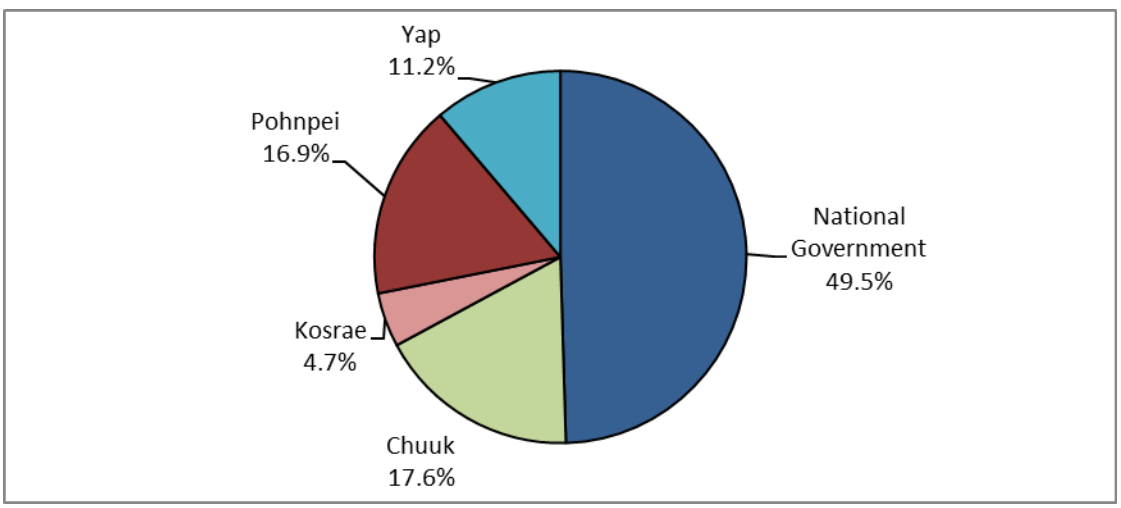
51. The bulk of the public external debt, $55.0 million (65.2 percent), is owed to the Asian Development Bank, while 34 percent is publicly guaranteed debt, mainly FSM Telecom debt owed to the United States Rural Utilities Services, and 1.5 percent is debt owed by the FSM Development Bank to the European Investment Bank.

Figure 2: External Debt ($ million)



52. By government, almost half of total external debt is owed by the National Government and component units, 17.6 percent by Chuuk, 16.9 percent by Pohnpei, 11.2 percent by Yap, and 4.7 percent by Kosrae (refer figure 3).

Figure 3: External Debt by National &State (% share)

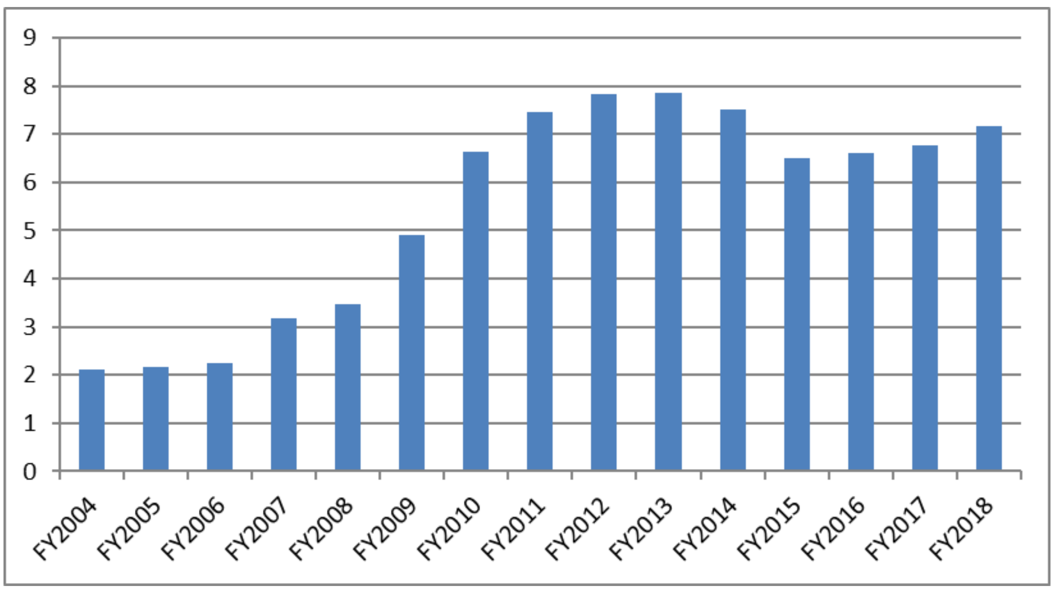


53. In the past, it has been ADB's policy to lend only to the FSM National Government and not directly to the FSM States. As the National Government obtained the loans to finance the implementation of FSM-wide projects including those in the states, a significant portion of the loans were on-lent to the States and/or to public enterprises. For the on-lent loans, the on lending agreement between the national government and the state government specified the terms and conditions as the same as the ADB loan agreement signed between the National Government and ADB.

54. A new loan for Pohnpei Port is currently being negotiated with the ADB and this loan will be lent directly to the Port Authority with an initial State Government guarantee and a National Government guarantee of last resort. This project is anticipated to have a significant economic impact for Pohnpei State.

55. FSM's external debt service peaked at $5.9 million in FY2015 and has increased steadily from just $3.9 million in FY2009, as some maturing debts required increased principal payments (refer figure 4). External debt service is projected to decline in FY2015 and to remain below the FY2014 level up to FY2018. As a share of domestic revenues, debt service has been declining since FY2011 and was at 5.0 percent in FY2014. In the absence of new external debt, the debt service ratio is expected to decline to 7.6 percent by FY2018. As FSM has $13 million in trust accounts reserved for debt servicing, the actual debt servicing burden is effectively less.

Figure 4: Debt Service ($ million)



2.6. FSM Trust Fund

56. The FSM Trust Fund was established through Public Law 10-150 in April 1999. By September 2004 the Trust Fund Board had not been established nor had a separate bank account been opened for the Fund, with all appropriations remaining in the National Government General Fund.

57. Public Law 13-48, September 23 2004, gave the President the authority to transfer the appropriated balance of $7,015,000 in the FSM Trust Fund in to the Compact Trust Fund as the National Government's contribution to the Fund. This transfer took place on 30 September 2004, reducing the Fund balance to zero.

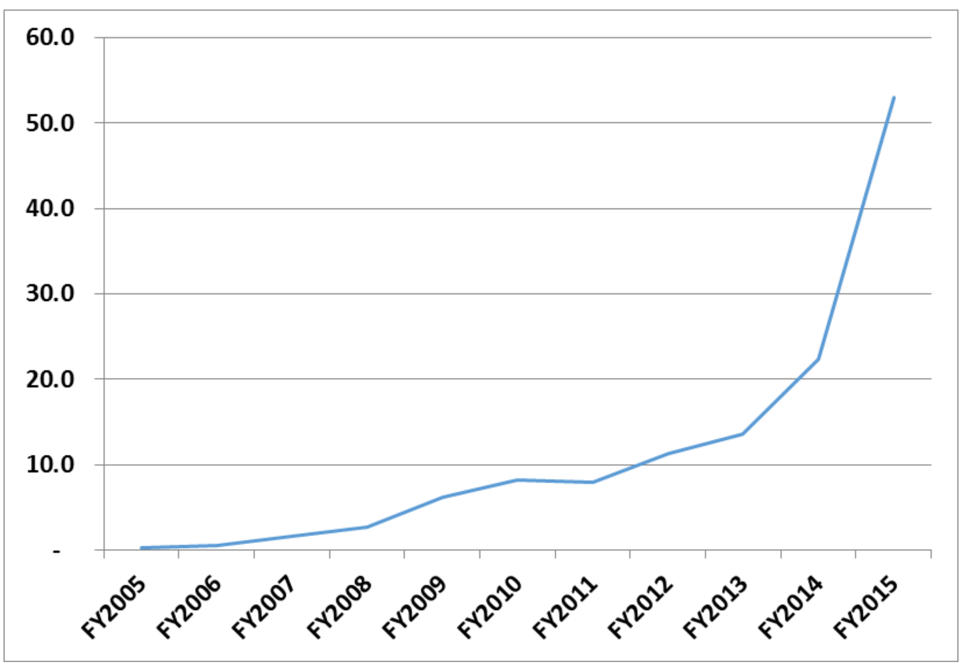
58. On 20 June 2007 the FSM Trust Fund bank account was opened at Bank of Hawaii with an initial deposit of $500,000. The Bank then invested this amount in the Pacific Capital Cash Assets Trust on FSM's behalf. This Trust had a current annual yield of 4.8 percent at the time. The current status of the FSM Trust Fund is shown in table 4 below.

Table 4: FSM Trust Fund Balance ($ million)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Net Assets, Beginning	2.7	6.2	8,2	8.0	11.3	13.6
Appropriations	2.5	2.5		1.8	1.0	7.0
Investment income:	1.0	-0.5	-0.2	1.5	1.3	1.8
Net Assets, Ending	6.2	8.2	8.0	11.3	13.6	22.4

59. Growth in the FSM Trust Fund is shown in figure 5 below. From FY2005 to FY2013 the National Government invested $11 million into the Trust Fund. Additional deposits to the Trust Fund were made by Congress Resolutions 15-88 (FY2008) and 16-97 (FY2010) sourced from Chinese Grants of $1 million each. The National Congress made a considerable deposit into the Fund of $7 million in FY2014 and this has been further increased with a $30 million investment in FY2015. The current value of the Fund is $53 million as at 31 March 2015.

Figure 5: FSM Trust Fund Appropriations



60. From FY2016, through Public Law 18-107, the National Congress has committed $5 million of tax revenue annually to the Trust Fund in behalf of the States. It is estimated that the FSM Trust Fund will reach $250 million by FY2023, providing a valuable contribution to the projected fiscal deficit in FY2024.

61. To date, no Board of Trustees exists for the FSM Trust Fund. This is a serious governance issue for the Fund.

2.7. Overseas Development Assistance

62. The FSM is dependent upon support from the international development community and the depth and diversity of challenges facing the country mean that it will remain dependent on assistance for the foreseeable future. The Overseas Development Assistance (ODA) priorities will be used to direct allocations to those activities that are deemed most urgent and crucial. Alignment between the process for identifying official ODA requests and the budget cycle will help to ensure that ODA resourcing is met with adequate local implementation capacity.

63. Table 8 below provides a summary of ODA activity by key sector. The table is not complete, but an estimate based on information available to date. In particular, donor allocations work on 3-4 year cycles so in some cases data is not available for the later years.

Table 8: ODA Activity by Key Growth Sector ($million)

Item	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018
Agriculture		0.5	0.2	0.2	0.2		
Fishing	0.4		0.9	0.5	0.5		
Tourism			0.3	0.4	2.0		
Energy		0.6	2.3	9.4	11.4	4.7	14.7
ICT			0.5	1.0	14.0	20.0	
Infrastructure	0.5		4.6	11.3	10.0	7.0	
Social sectors	2.0	2.0	2,1	2.2	2.0		
Environment	4.1	2.7	0.1	0.5	0.4	0.4	0.4
Government	0.6	0.8	0.7	0.8	0.8	2.0	2.0
Total	**7.5**	**6.4**	**11.7**	**26.3**	**41.3**	**34.1**	**17.1**

Source: Estimates based on latest available donor information

64. Budget support as a delivery modality is a stated goal of the FSM and, as agreed in 2011 in Busan, the preferred modality of many development partners. This form of support affords the FSM the flexibility to align external resourcing with domestic priorities, including 2023 Action Plan strategies. Negotiations with the European Union (EU) on the Fund-11 allocation of $18 million have resulted in an agreement to consider a budget support modality related to the energy sector.

65. The major goal of the Energy Policy is ‘to become less dependent on imported fossil fuels by having an increased share of renewable energy sources and having cross-sectorial conservation and efficiency standards in place. By 2020, the share of renewable energy sources will be at least 30 percent of total electricity production, while energy efficiency, including a reduction in energy loss, will increase by 50 percent. Total fossil fuel usage by the four State utilities was $23 million in FY2013 and thus a reduction of 30 percent for renewable energy would see foreign exchange savings of around $7 million per annum.

66. The energy policy is accompanied by a National and four State Action Plans that cover energy development programmes as well as the promotion and adoption of energy efficient appliances, energy conservation, and energy awareness campaigns.Commitments and support from Development Partners are in place, giving FSM a positive outlook to achieve its energy target by 2020.

67. The Yap Renewable Energy Development project ($9.0 million) aims to reduce fossil fuel dependency in the State through the development of renewable energy and improved supply side energy efficiency of the current grid. The project will include construction of 1.4MW wind power, 300kW grid-connected solar power, and installation of a 1.8MW diesel generator to improve the efficiency of the current grid.

68. The World Bank energy project ($14.4 million) will increase the available power generation capacity and efficiency of the four state power utilities which will over time lead to more sustainable and affordable electricity tariffs throughout the country.

69. Information, Communication & Technology (ICT) has been globally acknowledged as an essential tool for sustainable social and economic development. In an information society, distances reduce, good governance emerges, globalization occurs, corruption reduces and unprecedented opportunities for development of countries and regions are created.

70. Together with the World Bank Group, the governments of FSM and Palau are undertaking an FSM-Palau ICT Regional Connectivity Project which will finance investments in key telecommunications infrastructure to provide enhanced connectivity in FSM and to strengthen the regulatory environment. Project components include: (i) laying a submarine cable system for Yap and Palau; (ii) providing faster and more reliable ICT connectivity for Chuuk and Kosrae; and (iii) financing technical assistance for advisory services to support sector regulation and regulatory capacity development and promoting universal access throughout FSM. The World Bank project is funded by utilising the FSM International Development Association 17 allocation of $12.4million to leverage a further $38.6million in regional funds.

71. The Japanese are due to deliver a new inter-island ferry for FSM in April 2015 with a value $11 million. This ferry will replace the Caroline Voyager.

2.8. Compact Trust Fund

72. The summary highlights of the Compact Trust Fund for FY2014 were:

- The Fund’s total net position value increased 17.9% to $380.9 million from $323.1 million in FY2013. The increase was primarily due to a contribution from the United States government of $26.1 million and net investment income of $31.9 million.

- The Fund had a dollar-weighted annual rate of return of 8.7 percent for FY2014 compared to 13.5 percent for FY2013 and 14.8 percent for FY2012. Gains in the last 3 years have helped to offset negative performance in FY2008, FY2009 and FY2011.
- Given the positive return, an allocation of $9.9 million was made to the "C" account for FY2014 bringing the total of the account to $73.7 million.

73. Recent performance of the Compact Trust Fund is shown in table 9 below.

Table 9: Statement of Changes in Net Assets ($ million)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Restricted Net Assets, Beginning	117.5	138.1	177.2	198.5	257.4	323.1
United States contributions	20.9	21.5	22.4	23.6	25.0	26.1
Net investment income	-0.2	17.8	-1.0	35.5	40.9	31.9
Less Administrative expenses	0.1	0.2	0.1	0.2	0.2	0.2
Restricted Net Assets, Ending	**138.1**	**177.2**	**198.5**	**257.3**	**323.1**	**380.9**

Source: FY2014 Compact Trust Fund Annual Report

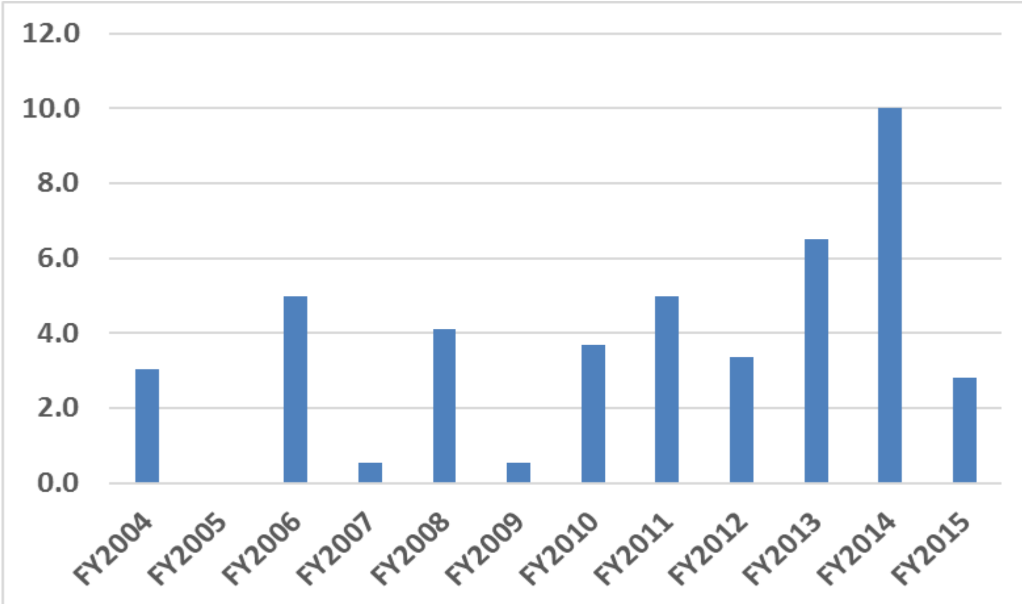
74. The current value of the Fund as at 28 February 2015 was $420 million. Taking into account the US Government deposit of $26 million in the first week of October and the opening balance of $380.9 million, the Fund's return for the first five months of FY2015 is slightly below the previous three years growth rates.

2.9. Public Projects

75. Since the beginning of the Amended Compact $44.6 million has been appropriated on public projects. Of this amount, Chuuk has received $19 million, Pohnpei $12 million, and Kosrae and Yap $6 million each.

76. Prior to FY2013 annual public project appropriations had not exceeded $5 million. In FY2014 public projects expenditure doubled with two appropriations to the value of $4.9 million and $5.1 million (refer figure 7 below). In FY2015 there has been one appropriation to date of $2.8 million in November 2014.

Figure 7: Public Projects Appropriations ($million)



77. An analysis of these projects by expenditure category are given in table 8 below. The 'Other' category is projects which are not deemed to be in the "public interest" or do not meet any economic or social development criteria. The majority of "government" projects are funding of municipalities or offices. These are appropriated every year and should not be funded under public projects but be appropriated through the annual budget process.

Table 8: Public Projects Expenditure by Category (percent)

	FY2010	FY2011	FY2012	FY2013	FY2014
Economic Development	10.8	13.9	10.3	10.1	11.2
Infrastructure	40.6	40.1	40.1	43.3	37.0
Social Development	20.4	20.2	23.0	21.7	24.5
Government	26.4	19.0	23.3	21.2	19.3
Other	1.7	6.8	3.4	3.6	8.0
Total	100	100	100	100	100

Source: SBOC Analysis

78. As can be seen above, just over 50 percent of public projects are spent on what would be classed as projects that foster economic growth (economic development plus infrastructure). Infrastructure spend is consistently around 40 percent per annum and is mainly for secondary and rural roads.

79. Table 9 below gives a breakdown of FY2014 public projects by State and by category. Chuuk has the highest portion on economic projects reflecting the importance of fishing projects for the State. For both Pohnpei and Yap over 50 percent of their public projects are on infrastructure.

Table 9: Public Projects by State by Category, FY2014 (percent)

	Chuuk	Kosrae	Pohnpei	Yap	Total
Economic Development	20.9	6.6	3.2	1.4	11.2
Infrastructure	24.2	32.3	50.5	55.5	37.0
Social Development	25.7	26.6	19.2	28.3	24.5
Government	18.1	22.4	26.7	6.9	19.3
Other	11.1	12.1	0.4	7.9	8.0
Total	100	100	100	100	100

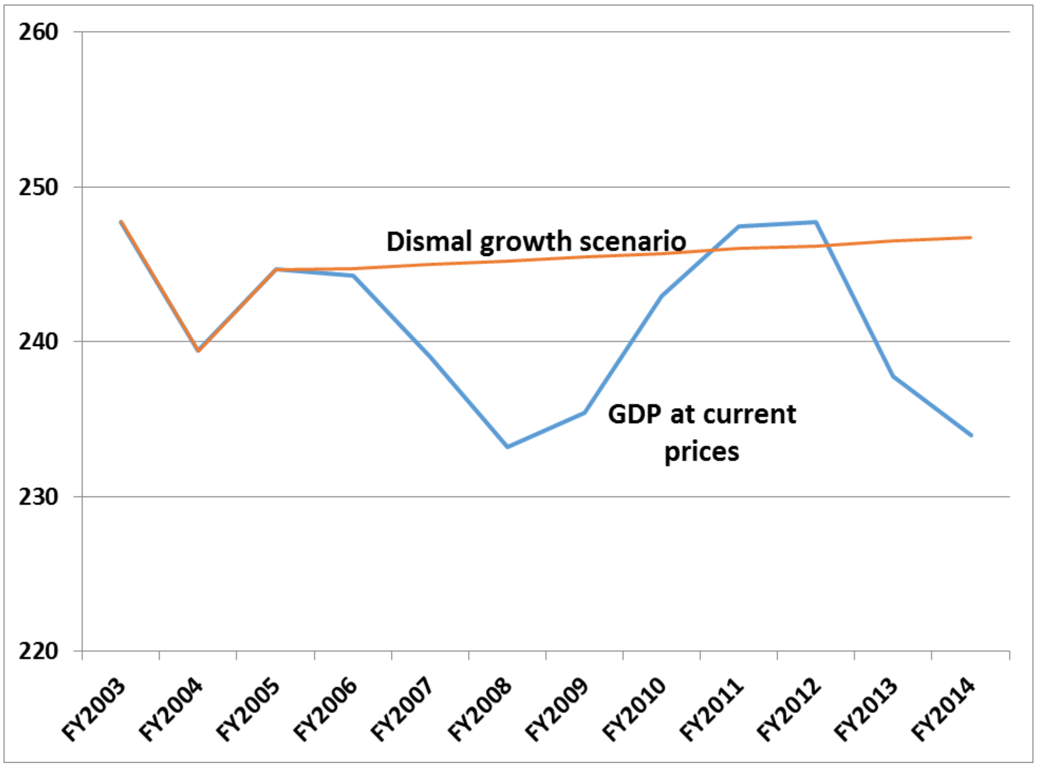
80. The 2023 Action Plan focuses on a unified nation that focuses on the fundamental goal of economic and financial independence. The National Government sees a clear opportunity for public projects to compliment what is being developed under the Action Plan and for these projects to play a vital role in stimulating the economy.

3. ECONOMIC UPDATE

3.1. Gross Domestic Product

81. The FSM economy continues to underperform in the Amended Compact period, with economic levels in FY2014 below those in FY2003 (refer figure 8). The economy in fact has not attained the level of the dismal growth scenario[1] as outlined in the Strategic Development Plan, 2004 - 2023. Average real GDP growth over the period has been -0.5 percent.

Figure 8: Real GDP Levels ($ million)



Source: FSM Statistics Office

82. At the start of the Amended Compact the economy went into a period of decline as the level of external transfers fell to the new, lower negotiated levels, with a grant reduction from $84 million (the trend Compact I level) to $76 million. Other factors that had a negative impact on the economy included the loss of the Compact energy grant which resulted in rises in electricity prices in all States, absorptive capacity constraints due to more stringent fiscal procedures requirements, and the failure to use the infrastructure grant.

[1] Projections in the Strategic Development Plan 2004 - 2023 were after the initial adjustment in FY2004 and FY2005 to the Amended Compact

83. In FY2004 the economy contracted sharply by 3.2 percent with the reduction in Amended Compact funding. Some of the lost ground was recouped in the following year, but growth turned negative in FY2007 as both Chuuk and Kosrae were required to implement a sizeable Reduction-In-Force to restore fiscal balance as the capacity building sector grant was phased out from non-conforming purposes. As a result the economy contracted by 2.1 percent in FY2007. In FY2008, with the fiscal restructuring ongoing, the negative shock of the world recession impacted on the FSM economy. Higher fuel and food prices eroded real incomes and GDP fell by a further 2.5 percent.

84. While the international economic conditions remained adverse in FY2009, strong growth in construction through Federal Aviation Administration (FAA) funded airport renovation resulted in a return to positive growth in the economy of 1.0 percent. FY2010 turned out to be a good year for the FSM economy. This reflected continuing expansion in construction as use of the infrastructure grant picked up momentum, and there was a further injection of funds from FAA projects. After several years of fiscal consolidation, FY2010 saw a return to growth in public administration and the economy expanded by 3.2 percent overall. These trends continued to exert themselves in FY2011 although good performance in fisheries replaced public administration as a source of growth, and the economy grew by 1.8 percent. The economy was static in FY2012 as strong growth in fisheries was offset by declines in the construction, wholesale/retail, and hotels and restaurant industries.

Table 10: Real GDP Growth by Sector (annual percentage change)

	2009	2010	2011	2012	2013	2014
Agriculture, Hunting & Forestry	0.0	0.7	1.7	1.1	0.8	2.1
Fisheries	-2.3	1.9	7.7	12.5	-14.7	0.7
Manufacturing	1.0	5.6	1.8	-11.0	-15.2	-0.2
Electricity, Gas & Water Supply	4.9	-0.1	-5.4	5.1	2.1	-0.6
Construction	60.4	26.6	18.0	-2.7	-25.9	-35.2
Wholesale & Retail Trade & Repairs	-6.4	3.8	-1.5	-6.7	-3.9	-0.6
Hotels & Restaurants	-11.0	3.2	-1.7	-1.8	-3.4	1.8
Transport & Communications	0.3	-2.1	-1.3	-0.4	3.7	-5.4
Financial Intermediation	-18.2	5.9	5.5	1.1	-5.4	7.1
Real Estate, & Business Activities	-0.1	2.9	2.2	2.8	1.5	5.3
Public Administration	-1.0	5.3	1.1	0.0	0.0	0.0
Education	1.6	-2.1	-2.4	-3.4	-3.1	-0.1
Health & Social Work	2.7	6.4	1.5	3.4	0.5	0.6
Other Personal Services	-2.3	5.7	-0.6	-8.5	2.0	2.2
Total GDP	**1.0**	**3.2**	**1.8**	**0.1**	**-4.0**	**-1.5**

Source: FSM Statistics Office

85. In FY2013 the economy experienced a 4.0 percent decline in real GDP due to a major decline in construction activity of -25.9 percent. In addition to FAA funded projects drawing to a close, the economy has felt the adverse impact of JEMCO's resolution to freeze any new

Infrastructure Grant projects at the August 2011 JEMCO meeting, which further restricted economic activity. Adding to this, the fishing industry declined by 14.7 percent in FY2013, following three years of solid growth.

86. FY2014 saw a further contraction in the economy as construction activity reached the historical low experienced at the beginning of the Amended Compact when no infrastructure grants were available.

87. Historically, the government sector has been dominant in the FSM. The Education sector, following growth in the early years of the Amended Compact, has declined by over 10 percent since its peak in FY2009 and has now returned to the levels of the beginning of the Amended Compact. The Health sector on the other hand has grown by over 40 percent since FY2004.

88. Despite being a priority sector for economic development, the agriculture sector's contribution to GDP growth remains minimal. Agriculture has been growing steadily from FY2009 to FY2014 as a reflection of subsistence and informal activity rather than any major cash based activity. In FY2012 FSM endorsed its Agriculture Policy 2012 – 2016. This Policy provides the basis for action by both public and private sectors to invigorate sustainable agriculture growth in FSM. Following the policy endorsement, the four States have developed State Agriculture Action Plans for each of the eight key outcomes identified in the Agriculture Policy. Action Plans for Pohnpei and Kosrae are completed and the States are entering their implementation phase which should result in increased agriculture activity in the medium term.

89. Coconuts are one agriculture commodity that is in abundance in FSM. It is a resource that almost every household has access to and PetroCorp has been given the mandate to revitalize this industry (refer box below).

The Roadmap to Coconut Industry Sustainability[2]

"*The coconut industry development project will be considered sustainable when it is able to deliver an appropriate level of benefits for an extended period of time after major financial, managerial and technical assistance from the PetroCorp and its partners cease*."

In June 2014 Congress passed the Coconut Tree Act. The Act was designed to enhance the capacity for the buying, selling, exporting, manufacturing, processing, and distribution of copra and other coconut tree products. The Act dissolved the Coconut Development Authority and transferred its responsibilities and functions to the FSM Petroleum Corporation. The PetroCorp has designed a three (3) Phase project aimed at revitalizing the coconut industry.

Phase I is complete and involved the Vital Coconut Development Unit being established with a Project Management Team formed and staff of the Coconut Development Authority transitioned into the Unit.

Phase II included conducting preliminary technology assessments, increasing fresh nuts processing capacity from 300 to 1000 nuts per day, and increasing Copra processing capacity from 50 to 5000 nuts per day. By May 2015, will have installed new equipment

[2]Source: From the Vital Paper presented to the 8Th SNLC on January 27th, 2015

and machinery to increase copra and fresh nut processing capacity by 100 and 30 fold respectively. This will enable the processing of copra produced in the FSM into crude coconut oil for fuel, and coconut meat for animal feed.

Phase III focuses on growth and sustainability. A comprehensive assessment of international markets reveal a high demand for food grade coconut products ranging from coconut flour, virgin coconut oils and more recently coconut water. Targeted markets include Hawaii, Guam, and U.S Mainland and Japan. Based on the supply side logistics to maintain capital and operational efficiency on the most appropriate processing facility requires 55,000 coconuts supply per day.

To sell high value finished goods into international markets requires standards and regulatory food safety analysis. Consumers are focused on food safety which has seen the rapid growth in sales of premium priced organic produce. For engineering, plant, equipment and building it is expected that investment will exceed $16 million per processing plant.

The plant will generate $8 million in annual revenue and directly employ 100 full time equivalent permanent jobs. A further 200 full time equivalent jobs in the informal sector for collection and post-harvest handling will also be created

90. Following three years of fisheries growth FY2013 and FY2014 saw declines in the fishing industry. During this period both the Yap Diving Seagull and the Caroline Fisheries Corporation had vessels in dry dock which effected there catch and bottom line results, as high maintenance costs reduced operating surpluses.

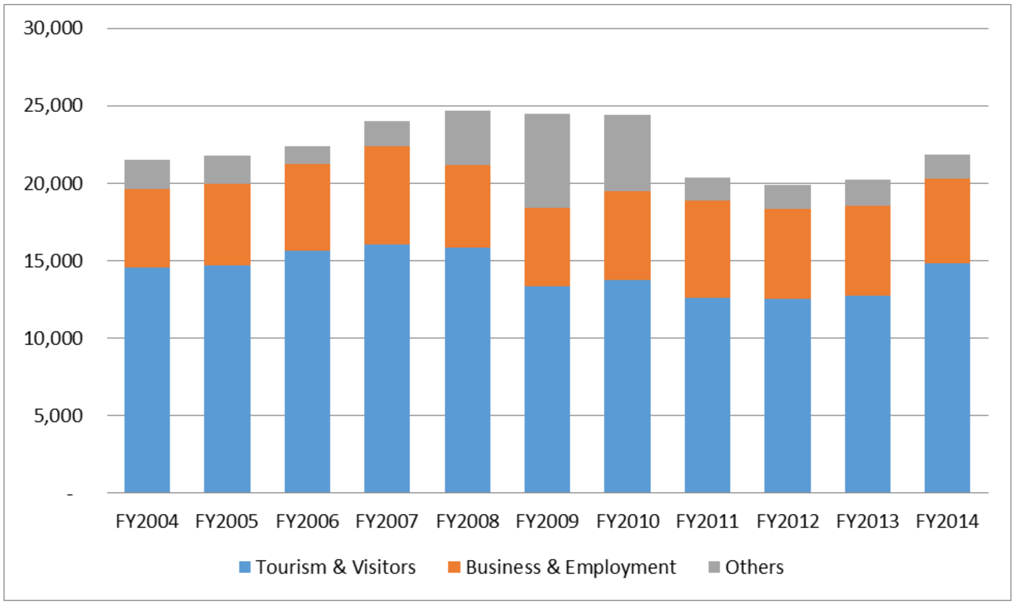
91. The key issue with oceanic fisheries in FSM is the failure to date to fully realize the potential benefits associated with the exploitation of available resources. While FSM has enjoyed an increasing return from receipt of fisheries access fees, attempts to promote returns through infrastructure investment, trans-shipment, domestic fishing, and value added processing, vessel servicing and employment have essentially failed to add significant value or return on investment.

92. Hotels and restaurants, following 3 years of decline, grew by 1.8 percent in FY2014. This is a welcome result after sixth of the last seven years had seen negative growth in the industry. Growth would have been significantly higher had the closure of the Village Hotel on Pohnpei due to land issues not dragged down the final industry result.

93. Visitor arrivals to the FSM grew by 1.8 percent in FY2013 following three years of decline. FY2014 saw significant growth for the first time in many years with visitor numbers up by 7.8 percent and underlying this was a 16.5 percent increase in tourism numbers. This increase resulted from FSM hosting the Micronesian games in Pohnpei in July 2014 with pacific island and US visitors increasing significantly, reflecting the countries and US territories participation in the games.

94. The US continues to be the largest source of tourists with 40 percent of visitor arrivals in FY2014. Other major sources of tourists in FY2014 were Japan (17 percent), Europe (13 percent) and other Pacific Islands (11 percent).

Figure 10: Visitor Arrivals by Purpose of Visit



Source: FSM Statistics Office

95. The key challenge for FSM for the remainder of the Amended Compact is to dramatically alter the economic landscape. Without sustained economic growth the fiscal challenge of FY2024 cannot be met. The economic challenge is being addressed through the 2023 Action Plan where key areas of failure have been identified and strategies for growth are being outlined. The implementation of the 2023 Action Plan will require a commitment from all, National and State Governments, businesses, civil society, community leaders, and FSM citizens. The FSM Government also invites the external community to play a much more active role in addressing the economic sustainability issues.

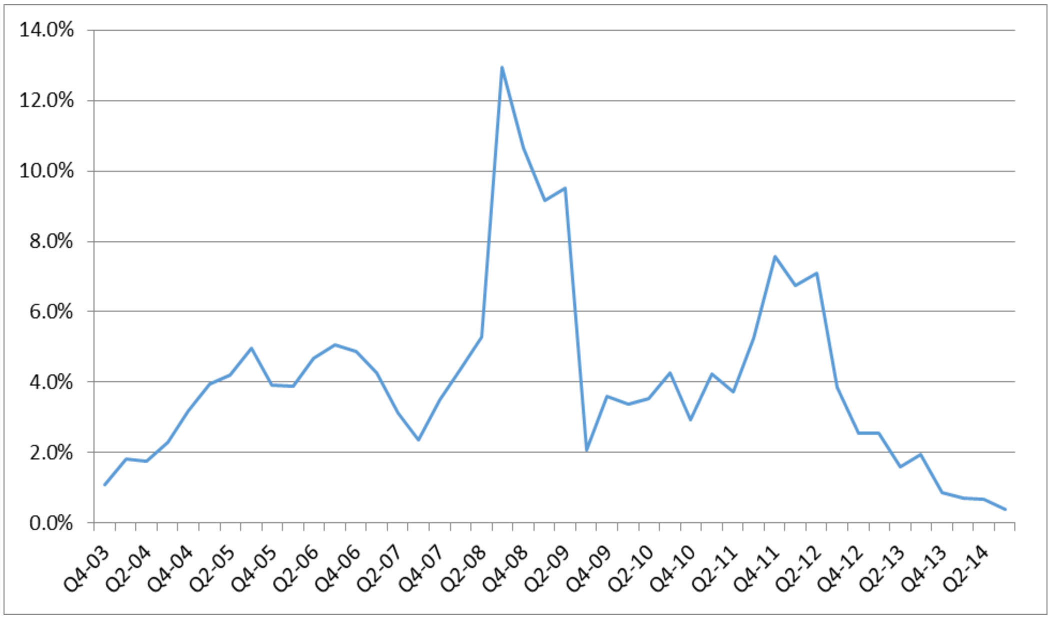
3.2. Consumer Price Index

96. Inflation has generally followed international trends in the FSM, although at higher levels than its developed trading partners (refer figure 11 below). Changes implemented as a result of the Amended Compact saw the loss of the Energy Sector Grant which had been used to subsidise public utility prices in the FSM. As a result significant increases in electricity prices caused a shock to the FSM economy and inflation in the energy group of the Consumer Price Index (CPI) peaked at over 25 percent in the third quarter of 2005, and inflation in overall consumer prices rose to 5 percent.

97. Sizeable increases in world food prices, in particular rice which is the main staple food in FSM, coupled with rising fuel prices, during the second half of 2008 resulted in a rapid rise of the FSM's traditionally low inflationary profile with inflation peaking at 13 percent in the third quarter 2008. Reductions in fuel and a levelling of food prices resulted in inflation moderation towards the end of FY2009. However, further increases in fuel and utility prices once again reasserted themselves in FY2011 and together with a resurgence of food prices towards the

year-end once again put upward pressure on inflation with the CPI peaking at 7.6 percent fourth quarter 2011. Since quarter two 2012 inflation has dropped dramatically to the levels experienced prior to the Amended Compact.

Figure 11: Annual CPI (percent change)



Source: FSM Statistics Office

98. The FSM annual inflation rate for FY2014 was 0.4 percent compared to 2.5 percent for FY2013. The decline in the inflation rate reflected the slowdown in fuel, light and water, and clothing and footwear groups prices.

99. The inflation Outlook for FY2015 is a further contraction as falling world oil prices in late 2014 trickle down through the economy.

4. CONSOLIDATED ACCOUNTS OF THE NATION

100. The first five years of the Amended Compact witnessed a difficult period of fiscal adjustment, as the nation was forced to adapt to the new arrangements. At the start of the amended Compact in FY2004 the FSM recorded a deficit of $36 million, 15 percent of Gross Domestic Product (GDP), reflecting the capital transfer of $30 million to the Compact Trust Fund and the return to funding levels below those prevailing before the pre-bump-up period. In the subsequent years FY2005 and FY2006, deficits of $12 and $13 million—or 5% of GDP in each year—were recorded. The amended Compact restricted the use of resources to specified sectors, and prohibited their use to fund general government. There was a gradual improvement in the fiscal position as the nation adjusted to the new requirements and implemented RIFs in Chuuk and Kosrae. By FY2009 the adjustment to the new sector grant approach was complete, and the FSM recorded a surplus of $4.6 million (1.6% of GDP) for the first time in the amended Compact period.

101. In recent years, consolidated government revenues have been growing faster than consolidated government expenses (refer Table 14 below). This has resulted in fiscal surpluses of $9.4m and $32.2 million in FY2013 and FY2014 respectively. These surpluses are driven by the National Government and the profile is somewhat less positive at the State level.

Table 14: Consolidated Government Finances ($ million)

Item	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Revenue	182.8	200.3	201.0	215.2	196.1	216.7
Tax revenue	31.6	35.6	37.3	38.0	38.2	60.8
Non-tax revenue	27.5	28.0	26.8	36.6	46.1	48.8
Grants	123.7	136.7	136.8	140.6	111.7	97.7
Current	84.6	86.1	84.0	82.0	80.4	90.5
Capital	39.1	50.7	52.8	58.6	31.3	7.2
Expenditure	177.2	197.9	200.9	211.5	186.7	184.5
Wages & salaries	64.7	68.0	68.0	68.3	69.7	71.5
Other goods and services	61.4	62.1	63.7	69.2	68.3	66.5
Interest, subsidies, & grants	5.8	6.6	7.4	6.7	6.0	8.0
Capital expenditure	45.4	61.1	61.7	67.3	42.7	38.4
Overall fiscal balance	5.6	2.4	0.1	3.7	9.4	32.2

Source: FSM Annual Audit Reports

102. Consolidated government revenues increased by $20.6 million in FY2014 following a $19 million decline the previous year. This reflects increased domestic revenue as grant revenue declined for the second year in succession.

103. Domestic revenues increased from $84.3 million in FY2013 to $119.6 million in FY2014. Tax revenues increased by 59.1 percent in FY2014, while non-tax revenues increased by 27.5 percent in the same year. The main contributors were increases of $8.7 million and $12.5

million in fishing license fees respectively, and a one-off $22 million in corporate tax revenue in FY2014 which is related to the captive insurance industry.

104. Consolidated government expenditure grew strongly from FY2008 to FY2010 as a result of increased capital expenditure on infrastructure and airports. In FY2011 and FY2012 growth moderated, but in FY2013 and FY2014 consolidated government expenditure fell by $24.8 million and $2.2 million respectively as capital expenditure continued to drop off.

105. Wages and salaries have grown from $64.7 million in FY2009 to $71.5 million in FY2014, while as a percentage of GDP, wages and salaries have remained constant at 23 percent over the period.

Table 15: Chuuk State Finances ($million)

Item	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Revenue	**31.2**	**32.6**	**36.9**	**34.3**	**34.1**	**35.6**
Tax revenue	4.6	6.1	6.5	6.7	6.6	6.4
Non-tax revenue	0.8	1.1	1.9	1.6	1.2	2.4
Grants	25.7	25.4	28.5	26.0	26.4	26.8
Expenditure	**28.3**	**33.1**	**34.0**	**33.9**	**33.6**	**39.2**
Wages & salaries	15.9	17.6	17.9	17.2	18.4	22.1
Other goods and services	10.4	12.2	12.1	14.8	13.2	12.6
Interest, subsidies, & grants	0.4	1.1	2.2	0.8	0.5	0.2
Capital expenditure	1.6	2.3	1.8	1.2	1.6	4.3
Overall fiscal balance	**2.9**	**-0.5**	**3.0**	**0.4**	**0.5**	**-3.6**

Source: Chuuk Annual Audit Reports

Table 16: Kosrae State Finances ($ million)

Item	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Revenue	**11.4**	**10.9**	**10.1**	**10.8**	**10.8**	**11.1**
Tax revenue	1.6	1.4	1.6	1.9	1.5	1.9
Non-tax revenue	0.9	1.3	0.7	0.6	0.7	0.5
Grants	8.9	8.2	7.8	8.3	8.6	9.3
Expenditure	**11.0**	**10.8**	**10.4**	**10.5**	**10.6**	**11.5**
Wages & salaries	5.3	5.2	5.1	5.3	5.7	5.9
Other goods and services	5.4	5.0	4.6	4.4	4.4	4.2
Interest, subsidies, & grants	0.1	0.1	0.1	0.2	0.2	0.1
Capital expenditure	0.3	0.5	0.6	0.7	0.4	1.3
Overall fiscal balance	**0.4**	**0.1**	**-0.3**	**0.3**	**0.2**	**-0.4**

Source: Kosrae Annual Audit Reports

Table 17: Pohnpei State Finances ($ million)

Item	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Revenue	**30.6**	**31.9**	**31.0**	**32.4**	**30.9**	**32.6**
Tax revenue	9.4	10.1	10.1	9.9	9.3	9.1
Non-tax revenue	0.7	1.5	1.0	1.1	1.8	3.0
Grants	20.5	20.2	19.9	21.4	19.8	20.5
Expenditure	**32.1**	**32.3**	**33.3**	**34.0**	**32.3**	**35.7**
Wages & salaries	18.1	18.6	18.2	18.4	18.5	18.5
Other goods and services	9.9	10.2	11.5	11.7	10.4	11.4
Interest, subsidies, & grants	2.9	2.9	2.7	2.9	2.9	3.0
Capital expenditure	1.2	0.6	0.9	1.0	0.5	2.8
Overall fiscal balance	**-1.5**	**-0.5**	**-2.3**	**-1.6**	**-1.4**	**-3.1**

Source: Pohnpei Annual Audit Reports

Table 17: Yap State Finances ($ million)

Item	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Revenue	**20.9**	**21.3**	**20.7**	**19.6**	**21.9**	**20.0**
Tax revenue	3.7	4.1	3.6	3.5	3.5	3.4
Non-tax revenue	1.5	1.7	1.3	1.9	3.4	1.7
Grants	15.7	15.5	15.8	14.3	15.0	14.9
Expenditure	**22.3**	**21.0**	**22.3**	**22.7**	**23.1**	**23.4**
Wages & salaries	8.4	8.7	9.0	8.9	9.0	9.0
Other goods and services	11.1	9.9	11.8	9.6	11.1	8.7
Interest, subsidies, & grants	0.9	0.5	0.2	0.7	0.5	1.5
Capital expenditure	1.9	2.0	1.3	3.5	2.5	4.2
Overall fiscal balance	**-1.3**	**0.4**	**-1.6**	**-3.1**	**-1.1**	**-3.4**

Source: Yap Annual Audit Reports

5. APPENDICES

Table 1: FSM Constant Price GDP by Industry ($ million)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Agriculture, Hunting & Forestry	33.7	33.9	34.5	34.9	35.2	36.0
Fisheries	23.2	23.6	25.5	28.7	24.4	24.6
Manufacturing	0.9	1.0	1.0	0.9	0.7	0.7
Electricity, Gas & Water Supply	4.3	4.3	4.1	4.3	4.4	4.4
Construction	10.4	13.1	15.5	15.1	11.2	7.3
Wholesale & Retail Trade & Repairs	24.7	25.7	25.3	23.6	22.7	22.6
Hotels & Restaurants	3.9	4.0	3.9	3.8	3.7	3.8
Transport, Storage & Communications	13.7	13.5	13.3	13.2	13.7	13.0
Financial Intermediation	3.9	4.1	4.3	4.4	4.1	4.4
Real Estate & Business Activities	28.6	29.4	30.1	30.9	31.3	33.0
Public Administration	25.2	26.5	26.8	26.8	26.8	26.8
Education	34.2	33.5	32.6	31.5	30.6	30.6
Health & Social Work	11.1	11.8	12.0	12.4	12.4	12.5
Other Community & Personal Services	3.0	3.2	3.2	2.9	3.0	3.1
less intermediate FISIM	-3.2	-3.4	-3.4	-3.2	-3.1	-3.1
GDP at basic prices	**217.6**	**224.2**	**228.7**	**230.1**	**221.2**	**219.3**
Taxes on products	18.6	19.6	19.6	18.5	17.4	15.6
less subsidies	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
GDP at purchasers prices	**235.4**	**243.0**	**247.4**	**247.7**	**237.8**	**234.1**

Source: FSM Statistics Office

Table 2: Constant price GDP by industry sector (annual percent growth)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Agriculture, Hunting & Forestry	0.0	0.7	1.7	1.1	0.8	2.1
Fisheries	-2.3	1.9	7.7	12.5	-14.7	0.7
Manufacturing	1.0	5.6	1.8	-11.0	-15.2	-0.2
Electricity, Gas & Water Supply	4.9	-0.1	-5.4	5.1	2.1	-0.6
Construction	60.4	26.6	18.0	-2.7	-25.9	-35.2
Wholesale & Retail Trade & Repairs	-6.4	3.8	-1.5	-6.7	-3.9	-0.6
Hotels & Restaurants	-11.0	3.2	-1.7	-1.8	-3.4	1.8
Transport, Storage & Communications	0.3	-2.1	-1.3	-0.4	3.7	-5.4
Financial Intermediation	-18.2	5.9	5.5	1.1	-5.4	7.1
Real Estate, & Business Activities	-0.1	2.9	2.2	2.8	1.5	5.3
Public Administration	-1.0	5.3	1.1	0.0	0.0	0.0
Education	1.6	-2.1	-2.4	-3.4	-3.1	-0.1
Health & Social Work	2.7	6.4	1.5	3.4	0.5	0.6
Other Community & Personal Services	-2.3	5.7	-0.6	-8.5	2.0	2.2
GDP at purchasers prices	**1.0**	**3.2**	**1.8**	**0.1**	**-4.0**	**-1.5**

Source: FSM Statistics Office

Table 3: FSM Current price GDP by industry ($ million)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Agriculture, Hunting & Forestry	39.9	41.4	43.4	44.3	45.5	46.5
Fisheries	28.4	30.1	36.8	46.6	37.1	33.2
Manufacturing	1.2	1.3	1.3	1.3	1.1	1.1
Electricity, Gas & Water Supply	5.2	3.3	3.7	4.8	6.3	6.2
Construction	12.9	16.8	20.6	21.1	16.0	10.3
Wholesale & Retail Trade & Repairs	34.8	36.6	37.2	36.9	36.0	35.9
Hotels & Restaurants	4.8	5.1	5.3	5.5	5.4	5.5
Transport, Storage & Communications	16.7	16.8	17.2	18.0	19.2	18.2
Financial Intermediation	4.8	5.3	5.8	6.2	6.0	6.4
Real Estate, & Business Activities	30.6	32.2	33.3	35.0	35.8	38.2
Public Administration	31.0	31.2	31.8	32.2	33.1	33.8
Education	32.9	34.5	32.9	33.8	33.1	34.5
Health & Social Work	12.2	13.8	14.1	14.6	14.8	15.6
Other Community & Personal Services	3.8	4.2	4.3	4.0	4.3	4.6
less intermediate FISIM	-4.0	-4.4	-4.5	-4.6	-4.5	-4.5
GDP at basic prices	**255.3**	**268.2**	**283.3**	**299.6**	**289.3**	**285.4**
Taxes on products	24.4	26.5	27.5	27.5	26.4	23.7
less subsidies	-2.4	-1.1	-1.7	-1.2	-1.1	-1.1
GDP at purchasers prices	**277.3**	**293.6**	**309.1**	**325.9**	**314.6**	**308.0**

Source: FSM Statistics Office

Table 4: Current GDP by Industry (Growth Rate)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Agriculture, Hunting & Forestry	5.5	3.8	4.8	2.1	2.7	2.1
Fisheries	-6.1	6.0	22.3	26.6	-20.4	-10.6
Manufacturing	8.2	8.3	0.0	0.0	-15.4	-3.6
Electricity, Gas & Water Supply	286.9	-36.5	12.1	29.7	31.3	-1.9
Construction	72.9	30.2	22.6	2.4	-24.2	-35.8
Wholesale & Retail Trade & Repairs	-5.4	5.2	1.6	-0.8	-2.4	-0.3
Hotels & Restaurants	-4.3	6.3	3.9	3.8	-1.8	2.0
Transport, Storage & Communications	6.8	0.6	2.4	4.7	6.7	-5.4
Financial Intermediation	-12.0	10.4	9.4	6.9	-3.2	7.4
Real Estate, & Business Activities	4.3	5.2	3.4	5.1	2.3	6.8
Public Administration	3.3	0.6	1.9	1.3	2.8	2.2
Education	4.6	4.9	-4.6	2.7	-2.1	4.2
Health & Social Work	7.7	13.1	2.2	3.5	1.4	5.2
Other Community & Personal Services	3.5	10.5	2.4	-7.0	7.5	7.1
GDP at basic prices	**5.3**	**5.1**	**5.6**	**5.8**	**-3.5**	**-1.3**
Taxes on products less Subsidies	11.7	8.6	3.8	0.0	-4.0	-10.1
GDP at purchasers prices	**6.1%**	**5.9**	**5.3**	**5.4**	**-3.5**	**-2.1**

Source: FSM Statistics Office

Table 5: CPI by Major Group (annual percent change)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Food	17.9	2.2	2.6	4.5	2.6	1.3
Tobacco & Alcohol	8.1	9.1	5.1	10.8	-0.4	1.2
Clothing & Footwear	6.3	5.4	1.5	6.0	0.6	-0.1
Housing	4.9	2.0	1.2	3.4	1.0	1.5
Fuel, Light & Water	-7.3	6.7	14.5	9.2	5.5	-0.2
Services	-4.4	1.0	4.5	8.9	1.2	0.8
Miscellaneous	4.9	4.5	3.7	3.5	2.6	0.5
Total All Groups	**7.7**	**3.7**	**4.3**	**6.3**	**2.1**	**0.9**

Source: FSM Statistics Office

Table 6: Visitor Arrivals by Purpose

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
By purpose						
Tourism & visitors	13,334	13,727	12,625	12,565	12,714	14,811
Business & employment	5,074	5,770	6,247	5,771	5,852	5,509
Volunteer, religious, etc.	507	747	622	681	663	743
Seamen & crew	2,381	1,126	866	838	1,009	740
Not specified	3,177	3,052	202	36	13	23
Total	**24,473**	**24,422**	**20,565**	**19,891**	**20,251**	**21,826**

Source: FSM Statistics Office

Table 7: Tourists & Visitor Arrivals by Origin

	2009	2010	2011	2012	2013	2014
Asia	122	801	674	635	690	767
Australia	1,379	952	867	991	907	847
Canada	212	313	217	202	205	341
China	251	228	220	347	246	303
Europe	1,507	1,694	1,543	1,709	1,893	1893
Japan	2,473	2,539	2,467	2,567	2,544	2,535
New Zealand	174	135	127	120	119	129
Pacific Islands	824	734	1,192	1,048	1,108	1,578
Philippines	788	471	268	226	246	280
USA	5,010	5,748	4,944	4,550	4,601	5,946
Other	980	560	450	492	479	192
Total	**13,334**	**13,727**	**12,625**	**12,565**	**12,714**	**14,811**

Source: FSM Statistics Office

Table 8: FSM Commercial Banking Survey ($ million)

	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Total Assets	**155.7**	**178.4**	**190.1**	**228.1**	**237.7**	**270.4**
Total Liquid Assets	102.2	115.3	127.1	163.6	176.2	202.1
Cash & Due from Local banks	2.9	3.5	2.8	4.1	3.8	2.8
Foreign Assets - Due from Banks Abroad	99.4	111.8	124.3	159.5	172.4	199.3
Total Loans	46.7	55.7	55.2	56.8	54.0	60.9
Commercial Loans	30.9	34.0	33.0	31.5	29.4	33.5
Consumer Loans	15.8	21.7	22.2	25.3	24.6	27.4
Other Assets	6.8	7.4	7.7	7.7	7.5	7.4
Total Liabilities & Capital	**155.7**	**178.4**	**190.1**	**228.1**	**237.7**	**270.4**
Total Deposits:	132.5	154.1	166.2	204.3	213.2	243.9
Demand	31.5	34.0	37.6	55.6	45.7	64.3
Savings	70.2	88.5	98.0	120.8	137.2	147.0
Time	30.1	30.8	28.6	27.3	29.6	31.9
Other	0.7	0.8	2.1	0.7	0.8	0.8
Other Liabilities & Capital	23.2	24.3	23.8	23.7	24.5	26.5
Memorandum Items:						
Loan/Deposit Ratio	35	36	33	28	25	25
Commercial Loan Share of Total Loans (%)	66	61	60	57	54	55
Consumer Loan Share of Total Loans (%)	34	39	40	21	46	45
Deposits Annual Rate of Change (%)	11.4	16.3	7.8	22.9	4.3	14.4
Loans Annual Rate of Change (%)	-5.1	19.3	-0.9	2.9	-4.8	12.8
Commercial Loans Annual Rate of Change (%)	-10.8	10.1	-3.1	-4.5	-6.6	13.9
Consumer Loans Annual Rate of Change (%)	8.5	37.1	2.6	13.8	2.6	11.4

Source: FSM Statistics Office

Table 9: Interest rates of domestic money banks

(percent)	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
Deposit rates						
Savings deposits	1.4	1.2	1.0	0.9	0.6	0.5
CDs	1.3	0.9	0.6	0.4	0.4	0.5
Time Deposits	0.8	1.0	0.8	0.7	0.8	0.6
Other Deposits	0.1	0.0	0.0	0.1	0.0	0.0
Loan rates						
Consumer loans	15.4	15.1	14.4	14.3	15.7	15.8
Commercial loans	7.4	6.6	6.6	6.4	7.1	6.8

Source: FSM Statistics Office

Table 10: FSM Balance of Payments ($ million)

	FY2009	FY2010	FY2011	FY2012	FY2013
Current account balance	***-52.3***	***-44.4***	***-55.3***	***-41.2***	***-31.6***
Goods and services balance	*-177.2*	*-169.2*	*-177.3*	*-167.7*	*-170.1*
Goods balance	*-127.0*	*-128.4*	*-134.0*	*-125.7*	*-131.1*
Exports of goods	26.5	31.6	40.4	57.6	47.8
Fish	14.9	19.0	27.7	39.7	28.3
Other	11.6	12.7	12.7	17.8	19.5
Imports of goods f.o.b.	153.4	160.0	174.4	183.2	178.9
Services balance	*-50.2*	*-40.8*	*-43.3*	*-42.1*	*-39.0*
Exports of services	34.7	37.9	35.0	38.2	40.5
Travel	22.1	24.4	21.8	22.3	23.9
Other	12.6	13.5	13.1	15.9	16.6
Imports of services	84.9	78.7	78.3	80.2	79.6
Transport	41.3	41.3	43.9	47.0	44.7
of which: Passenger services	15.7	15.6	15.4	17.2	16.8
of which: Freight and postal services	25.5	25.6	28.4	29.7	27.8
Construction services	18.4	10.2	7.1	7.3	8.1
Other	25.2	27.3	27.3	25.9	26.7
Primary income balance	*16.5*	*11.0*	*10.8*	*16.2*	*27.4*
Receipts	26.6	23.5	23.7	31.4	39.9
Fishing licence fees	20.0	17.7	18.7	26.3	34.9
Other (mainly dividends and interest)	6.6	5.8	5.0	5.1	5.0
Payments	10.1	12.5	12.9	15.2	12.5
Secondary income balance	*108.4*	*113.8*	*111.2*	*110.3*	*111.1*
Receipts	122.8	129.1	126.9	126.7	127.2
Budget grants	84.4	85.9	83.7	81.7	79.7
Off-budget grants	6.4	6.1	5.8	5.2	4.3
College of Micronesia	13.3	16.3	13.4	13.7	12.8
Other (mainly households)	18.7	20.8	24.0	26.2	30.4
Payments (mainly households)	14.4	15.3	15.7	16.4	16.0

Table 10: FSM Balance of Payments ($ million)

	FY2009	FY2010	FY2011	FY2012	FY2013
Capital account balance	***54.9***	***64.2***	***62.0***	***68.3***	***42.2***
Compact capital grants	7.5	16.3	19.2	28.5	16.5
Other	47.4	47.9	42.7	39.8	25.7
Net lending/Borrowing (Curr + Cap)	***2.6***	***19.8***	***6.7***	***27.2***	***10.6***
Financial account balance	***-1.2***	***-19.9***	***-8.1***	***-34.4***	***-15.8***
Direct investment	*0.6*	*0.8*	*0.8*	*1.0*	*0.8*
Portfolio investment (increase in assets: -)	5.1	-8.5	0.2	-1.0	-3.6
Assets	5.7	-8.8	1.4	-0.4	-4.7
Liabilities	-0.6	0.3	-1.2	-0.6	1.1
Other investment (increase in assets: -)	-6.9	-12.2	-9.1	-34.5	-13.0
Assets (mainly bank deposits)	-17.7	-12.5	-12.5	-35.2	-13.0
Liabilities (public sector loans)	10.8	0.3	3.4	0.7	-0.1
Errors and omissions	***1.4***	***-0.1***	***-1.5***	***-7.3***	***-5.2***
Memorandum item					
Exports by FSM incorporated, non-resident fishing vessels	18.7	26.6	18.3	30.7	20.4

Source: FSM Statistics Office

Table 11: FSM external debt (million)

(US$ millions)	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014
External Debt Total (US$ millions)						
New	12.3	1.8	5.5	3.2	3.1	1.4
Amortization	2.2	2.5	3.1	3.3	4.1	3.8
Interest	2.0	2.3	2.3	2.1	2.1	2.2
Principal balance	86.4	85.6	87.6	89.2	88.3	84.3
External debt as % of GDP	31%	29%	28%	27%	28%	27%
Debt service as % of exports*	6.9%	6.9%	7.2%	5.6%	7.0%	n/a

Source: FSM Statistics Office

Table 12: Population by state, 1980 to 2010

	FSM	YAP	CHUUK	POHNPEI	KOSRAE
1973	61,992	7,867	31,596	19,263	3,266
1980	73,155	8,100	37,488	22,081	5,486
1994	105,506	11,178	53,319	33,692	7,317
2000	107,008	11,241	53,595	34,486	7,686
2010	102,843	11,377	48,654	36,196	6,616
Annual Growth rate %					
1973-1980	2.37	0.42	2.44	1.95	7.41
1980-1994	2.62	2.30	2.52	3.02	2.06
1994-2000	0.26	0.10	0.09	0.42	0.89
2000-2010	-0.40	0.12	-0.97	0.48	-1.50

Source: FSM Statistics Office

Table 13: Age and sex distribution, and households, by state and outer islands, 2010

	FSM	YAP	CHUUK	POHNPEI	KOSRAE
Age groups					
0-14	36,697	3,681	17,795	12,807	2,414
15-24	21,349	2,004	10,515	7,550	1,280
25-34	14,239	1,591	6,845	5,002	801
35-59	24,957	3,282	11,045	8,970	1,660
60+	5,601	819	2,454	1,867	461
Sum, all ages	102,843	11,377	48,654	36,196	6,616
Median age	21.5	25.0	20.7	21.7	21.5
Dependency ratios (%) = dependent age population/working age population (15-64)					
Youth (0-14 years)	60.6	53.5	62.6	59.5	64.5
Aged (65+ years)	9.3	11.9	8.6	8.7	12.3
Total	69.9	65.4	71.3	68.2	76.9
Sex and Sex ratio					
Males	52,193	5,635	24,835	18,371	3,352
Females	50,650	5,742	23,819	17,825	3,264
Sex ratio (males per 100 females)	103.0	98.1	104.3	103.1	102.7
Number of households	16,767	2,311	7,024	6,289	1,143

Source: FSM Statistics Office

Table 14: Labour force indicators, by state and outer islands, 2010

	FSM	Yap	Chuuk	Pohnpei	Kosrae
(Number of persons)					
Labour Force (Persons aged 15+)	66,146	7,696	30,859	23,389	4,202
Labor force	37,919	5,181	16,416	14,082	2,240
Employed population	31,789	4,871	12,373	12,820	1,725
Males	18,647	2,392	7,526	7,673	1,056
Females	13,142	2,479	4,847	5,147	669
Subsistence workers	16,658	2,406	7,917	6,000	335
Males	*9,081*	*903*	*4,644*	*3,359*	*175*
Females	*7,577*	*1,503*	*3,273*	*2,641*	*160*
Unemployed	6,130	310	4,043	1,262	515
Males	3,429	190	2,336	627	276
Females	2,701	120	1,707	635	239
(Rates, % of labour force)					
Labor force participation rate	57.3	67.3	53.2	60.2	53.3
Males	*66.1*	*69.1*	*62.7*	*70.3*	*62.9*
Females	*48.4*	*65.7*	*43.3*	*49.9*	*43.6*
Employment rate	83.8	94.0	75.4	91.0	77.0
Males	*84.5*	*92.6*	*76.3*	*92.4*	*79.3*
Females	*83.0*	*95.4*	*74.0*	*89.0*	*73.7*
Unemployment rate	16.2	6.0	24.6	9.0	23.0
Males	*15.5*	*7.4*	*23.7*	*7.6*	*20.7*
Females	*17.0*	*4.6*	*26.0*	*11.0*	*26.3*

Source: FSM Statistics Office