

Chapter 11. Emerging Economic Management and Policy Issues

The emerging economic management and policy issues discussed in this chapter are critical in the sense that maintaining the status quo, rather than making a firm commitment to policy changes, is likely to result in less growth and development and increased hardship for segments of the already struggling community. Some of the issues covered have been apparent for some time and others have emerged more recently as FSM governments have had to meet the more restrictive conditions for receiving Compact II grant assistance.

11.1 Out-Migration

Although there is almost total agreement that emigration will have an economic impact on the FSM, there is little agreement on whether the effects will be negative or positive. Most of this uncertainty comes from not having factual information on the number, socioeconomic characteristics, and motivations of FSM citizens who have emigrated to the US and other countries.

Anecdotal information indicates that many, if not a majority, of the emigrants to the US are going for the purpose of earning a four-year degree in Mainland schools. Another significant group of emigrants are those joining the US armed services.

To the extent that large numbers of younger residents out-migrate, population growth will decline and the demographic profile (age distribution) will change. Without appropriate demographic studies and data on the rate and characteristics of out-migration, it is difficult to predict likely impacts. One possibility would be an increase in the dependency ratio (i.e., ratio of number of non-working age to number of working age population). Fewer workers to support those that cannot work will have consequent household hardships. Also, there would likely be more of the nation's most intelligent and capable persons leaving, with the potential consequence of lower workforce productivity. Given that lack of jobs and income tend to be more prevalent in rural and out-island areas, there may be much greater out-migration from these areas, with consequent disruption in delivery of social services as facilities must be closed because of cost factors. School enrollments would also likely be reduced, and again the pattern of reductions would very likely affect rural areas to a higher degree.

On the positive side, greater out-migration in the long-run could result in significant benefits, if citizens living in the US and other countries became a major source of remittance income to relative living in the FSM. In many South Pacific nations such as Tonga and Samoa, overseas remittances are a major source of foreign exchange and household income. Another potential longer-term benefit would be the return of citizens who have lived abroad that have acquired occupational and entrepreneurial skills needed in the FSM economy. A number of Pacific countries have adopted policies to recruit or promote the return of citizens with critically needed skills.

11.2 Public Sector Capacity and Efficiency

There is an urgent need to strengthen economic and financial management and planning at state and national government levels to formulate and implement more effective SDPs, and to effectively monitor and report on achievements. While the work of the Third Economic Summit resulted in a set of sectoral Strategic Planning Matrices (SPMs) intended to provide the basis for government budgeting of Compact and other expenditures, considerable difficulty has been encountered in obtaining the necessary legislative endorsement.

Institutional strengthening involving both training and technical assistance, is needed to raise productivity of the public service and to enable the capacity to efficiently carry out the programmatic reporting mandated under the Compact. However, not only has Compact II funding been significantly reduced, but JEMCO has directed that the Capacity Building sector grant may not be used for government recurrent expenditures. FSM representatives appealed this decision, and the US has agreed to a five-year phase-out period during which FSM governments may use a declining portion of the capacity building grant for recurrent government costs. As noted in Chapter 7, beginning in fiscal year 2009, any funding received for capacity building cannot be used to fund government recurrent costs.

There is a need to undertake a review of all organizational functions and associated personnel requirements. There must be an ongoing policy mandate to gradually reduce public sector employment in conjunction with rising productivity resulting from the institutional strengthening. Other human resource development (HRD) elements would include more rigorous applications of job position skill and education requirements, elimination of non-essential government functions (or contracting services to other parties), and implementation of measures to enable a transition of job position pay rates to

levels comparable to equivalent jobs in the private sector (and equivalence across governmental levels – state and national).

With well-designed institutional strengthening and associated HRD programs, the FSM should be in a good position to request Compact II capacity building sector grant funding to pay for public service training and technical assistance.

11.3 Reducing Hardship

The FSM is a participatory country in the ADB’s regional project on National Poverty Reductions Strategies. As part of this project, an updated hardship assessment was conducted in late 2003. This assessment was part of the ADB’s program for achieving Millennium Development Goals (MDG) which the FSM committed to in 2002. This commitment requires that government: (a) better define and assess the concept of hardship in the FSM; (b) monitor progress towards the achievement of the MDGs; (c) design appropriate strategies to reduce hardship; and (d) incorporate these strategies into the country’s development plans.

The hardship assessment conducted in the FSM utilized data from the Household Income and Expenditure Study (HIES) done in 1998, and the 2000 Census. A Participatory Assessment of Hardship (PAH) survey was held in nine communities, three each in the States of Chuuk, Pohnpei, and Yap. The PAH was undertaken to obtain a qualitative assessment of the perceptions of the community on hardship. Groups interviewed (about 30-40 persons in each community) included traditional leaders and elders, church leaders, youth, and representatives of women’s groups.

Based on the PAH, poverty in the FSM was perceived to be hardship. This concept has been defined as: “An Inadequate Level of Sustainable Human Development”, manifested by:

- *A lack of access to basic services;*
- *A lack of opportunities to participate fully in the socio-economic life of the community; and*
- *A lack of adequate resources (including cash) to meet the basic needs of the household or customary obligations to the extended family, village community and/or the church”*

An analysis of the HIES and Census data determined that there was a large incidence of low income families experiencing periodic cash shortages that kept

them from meeting all their basic needs. The hardship assessment defined food 'poverty' lines (FPLs) and basic needs 'poverty' lines (BNPLs) in relation to the cost of providing an inexpensive, minimally nutritious diet for each state. The BNPL excludes food and is calculated as a percentage of the FPL. The BNPL for Pohnpei was 74.5% of the FPL (which in 1998 was calculated to be US\$437 per capita per annum) and for Kosrae the BNPL was 114%. Based on the FPL and BNPL criteria, a surprisingly large proportion of households in the states had incomes below the BNPL. In the FSM overall, 27.9% of households were below the BNPL, meaning that this proportion of all FSM households had insufficient incomes to meet the level of expenditures required to provide basic needs. By state, 32.9% of Chuuk households, 12.3% of Kosrae, 29.5% of Pohnpei, and 14.4% of Yap households fell below the BNPL (ADB TA 6047-REG: Table 8).

The HIES data in 1998 indicated substantial inequality in distribution, whether measured in terms of household expenditure or income, particularly for Chuuk and Pohnpei, the states accounting for over 80% of total national population. With respect to expenditure, in Chuuk 56.0% of all households are in the bottom quintile and in Pohnpei 39.1% are in the lowest quintile. In contrast, in Kosrae only 0.8% and in Yap only 4.0% of households are in the bottom quintile. The results for distribution according to income are similar, with Chuuk and Pohnpei having nearly the same proportions of households in the bottom quintile.

Two indices defined by the United Nations Development Programme (UNDP) are used to make cross-country comparisons of human development and hardship status. Based on 1999 rankings, the FSM ranked 7th among 12 Pacific developing countries (ADB member countries), and 9th in terms of 'poverty.' The human development index takes into account life expectancy, adult literacy, school enrollments, and per capita GDP. The human poverty index takes into account underweight children under 5, people without access to safe water and health services, as well as specific measures of illiteracy and life expectancy. Inadequate social services in the rural and outer islands contributes significantly to the FSM's low ranking on these indices.

The MDGs have been set to define quantitative targets to be achieved by 2015. For example, current infant mortality rate of 40 (per 1000 live births) is to be reduced by two thirds to below 14 by 2015. The goals for hardship, defined in the FSM in accordance with the FPL and BNPL criteria, call for reducing hardship by 50% by 2015.

The FSM governments in general have not addressed the hardship issue in their strategic planning. In part, this is may be based on a gap between the perceptions of government leaders and those of the community groups assessed in the PAH work. That is, most government executives and politicians are of the

view that the traditional customs and systems of social obligations provide a “safety net” that keep families from experiencing hardship. Another reason may be that many officials do not believe the underlying data (HIES and Census) are reliable or applicable for measuring hardship.

11.4 Governance

The federal structure has come with costs as well as benefits for the nation’s citizens. As a larger nation state having territorial sovereignty over a vast expanse of ocean, the FSM has realized benefits in its international relations (e.g., fisheries licensing agreements). However, perhaps less obvious, there have been significant costs in terms of the multi-levels of government, particularly the state-national relationships. From the beginning of the Compact of Free Association and national independence, there has been the inevitable political friction between the states and the national government as each state competed for Compact assistance and other bilateral and multilateral assistance that had to come through the national government. With the high degree of autonomy given the states under the FSM constitution, building cooperative and efficient working relationships at the beginning of a new federation probably could have been expected to take some time. However, after nearly 20 years there may be a reasonable expectation that inter-governmental relations would be functioning much more efficiently than they have in the last five years.

Political in-fighting and non-productive competition has also extended to the executive and legislative branches with detrimental results. With the outcome of the Compact II negotiations, it was apparent that the new economic aid regime was not only less generous, but would come with many conditions attached in terms of eligible expenditure purposes and the degree of required planning, budgeting and accountability. Governments thus far have not responded well to the new regime, as required, planning and budgeting tasks have been delayed.

With the difficult medium-term transition required of FSM governments to adjust fiscally to the lower initial grant assistance of Compact II and the continuing decline in grant funding over the entire assistance term, it is imperative that governments strengthen their policy and management linkages, including capacity for executive and legislative branches cooperate to enact and implement policies and measures.

Good governance extends to many other aspects of development besides the efficient utilization of Compact and donor assistance. The four basic elements of good governance identified by Mellor include: (a) accountability – making public

officials answerable for government behavior and responsible to the entity from which they derive their authority. Criteria must be established to measure the performance of officials along with oversight mechanisms to ensure that the criteria are met; (b) participation – people (citizens) must participate in the process of governance, as people are the heart of development; (c) predictability – means rule of law, which refers to the existence of laws, regulations and policies to regulate society, and their fair and consistent application; and (d) transparency – refers to the availability of information to the general public and clarity about government rules, regulations, and decisions. Policies or decisions that are known only to the preparers and administrators of the information, distort the governance process. Mellor notes that, while “governance means different things in different contexts and to different people ... for its purposes, ADB defines governance as ‘the manner in which power is exercised in the management of country’s economic and social resources for development.’ Thus the concept of governance is concerned directly with the management of the development process, involving both the public and private sectors.”

Good governance is necessary in providing the requisite enabling environment or business climate to achieve sustainable development of the private sector. Transparency and accountability are critical in establishing a favorable policy and regulatory environment for building a more diversified, competitive private sector. Attracting foreign investment is a case in point. Not only has there been friction between the states and national government over jurisdiction, but there has been no consensus regarding the steps or measures that should be implemented to attract foreign investment. Law and regulations for issuing foreign investment permits must be transparent to attract investors. This has been an ongoing issue for nearly two decades, and remains unresolved.

Public confidence in the integrity of government is important for obtaining and maintaining support of policies and programs. Timely financial audits (accountability), openness (transparency) in informing or disclosing program performance, dialogue and opportunity to contribute or comment on the making of policies, plans and budgets, are all important elements in building public confidence. While the series of economic summits provided an opportunity for the public to participate in the making of policies, there were little or no follow-on provisions to enable participants to learn what policies or actions were adopted, and what progress was made in their implementation. Also, since a large share of the funding and other resources required to convene the summits came from donors, it is questionable whether they would have been held if government had to depend only on its own resources.

Fairness in the application of laws and regulations, and due process in the adjudication of law or regulatory violations, also is very important for building and maintaining public confidence in government, and in promoting both political stability and participation in the political process (backing issues and petitioning legislators to support specific legislative bills or proposals, for instance). Appointment or election of an independent ombudsman to handle citizen complaints or appeals, promotes fairness and hence good governance. Loss of confidence in government to effectively manage the economy and to deliver satisfactory social services is almost certainly a factor contributing to the large out-migration in the last six years.

At this juncture, it is very important for FSM governments to critically examine their position on all the elements that contribute to raising the level or standard of governance. Not only is this important from the standpoint of promoting public confidence and support of the citizenry, but improved governance also can be expected to result in greater efficiency in the conduct of government.