

**ASIAN DEVELOPMENT BANK**

**TAR: FSM 33316**

**TECHNICAL ASSISTANCE  
(Cofinanced by ADB and Government of the United States)**

**TO THE**

**FEDERATED STATES OF MICRONESIA**

**FOR**

**ECONOMIC POLICY REFORM AND CAPACITY BUILDING,**

**PHASE I**

**November 2001**

## **CURRENCY EQUIVALENTS**

The unit of currency of the Federated States of Micronesia is the United States dollar.

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
EMPAT	–	Economic Management Policy Advisory Team
EPIC	–	Economic Policy Implementation Council
FSM	–	Federated States of Micronesia
PSIP	–	Public Sector Investment Program
PSRP	–	Public Sector Reform Program
TA	–	technical assistance
US	–	United States

## **NOTES**

- (i) The fiscal year (FY) of the Government ends on 30 September. FY before a calendar year denotes the year in which the fiscal year ends.
- (ii) In this report, "\$" refers to US dollars.

## I. INTRODUCTION

1. The Government of the Federated States of Micronesia (FSM) is undertaking far-reaching structural adjustment policies and national reform programs to adjust to reduced external funding including that anticipated after the next renewal of the Compact of Free Association between the FSM and the United States (US)—now expected to be concluded by the beginning of fiscal year (FY) 2004.<sup>1</sup> The Government has requested the Asian Development Bank (ADB) for technical assistance<sup>2</sup> (TA) to support these efforts during this two-year transition period. The ADB Fact-Finding Mission visited the FSM in July 2001. Discussions were held with representatives of the Government and the private sector, and understandings reached on the objectives, scope, and implementation arrangements. Consultations were also held with the US Department of the Interior in September 2001 to finalize the cofinancing arrangements. The TA framework is given in Appendix 1.

## II. BACKGROUND

2. In 1986, the Compact came into effect. It precipitated a substantial expansion in the economy—driven by growth in public sector expenditures. With declines in the resource transfer in two major step-downs in FY1992 and FY1997, the economic growth slowed. The economy suffered a major shock in 1997, as a 21 percent reduction in financial resources available as a result of the step-down in Compact funding worked its way through the system. With the next renegotiation of the Compact and likely further reductions thereafter, the nation has embarked on an adjustment process to downsize and reform the public sector and encourage private sector development.

3. A series of economic summits at the national and state level were organized in 1995 and 1996 in advance of the major reduction in transfers under the Compact funding. The summit process paved the way for a public sector reform program (PSRP) that was supported by ADB through a program loan and associated TAs. While the main focus of the PSRP was fiscal compression through public sector restructuring and an early retirement program, it was also designed to develop a favorable environment for private sector development through establishment of an open and transparent foreign investment regime, deregulation of financial markets, and tax reforms.

4. At the end of 1999, ADB assessed that the PSRP had been implemented in a generally successful manner. The Government payroll had been reduced by 30 percent in nominal terms and the number of public servants had been cut by 23 percent. The major program components promoting the private sector had also been implemented. The components were passage of legislation enabling foreign direct investment, deregulation of interest rates, and removal of tax on exports. However, there was a noticeable emergence of reform fatigue and an FSM summit was held in September 1999 to regain the momentum. The summit created the national Economic Policy Implementation Council (EPIC) as a participatory forum of the FSM state and national leadership to advance the reform agenda. The EPIC has now held three meetings and has established itself as a major element of the FSM institutional mechanism for economic management.

5. ADB has provided substantial economic management and policy advisory TAs. As

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<sup>1</sup> The Compact came into effect in 1986. Under the Compact, the FSM is receiving assistance over a 15-year period until 2001 with a transition provision for an extension of two further years until October 2003. The FSM is currently renegotiating the economic provisions of the Compact with the United States.

<sup>2</sup> The TA was first listed in the *ADB Business Opportunities* on 13 July 2001.

Compact renewal has yet to be finalized, in the transition period pending the renewal, continuing economic policy advice is needed at the national, and more importantly, at the state level. Assistance is also needed to support the ongoing Compact negotiations, and then to design a structural adjustment program that takes into account and responds to the new Compact arrangements.

6. ADB has assisted the FSM reform effort through a PSRP loan and two previous TAs for the economic management policy advisory team (EMPAT).<sup>3</sup> The EMPAT played a role in increasing awareness of the need for reform, facilitating a series of economic summits, analyzing policy, initiating and supporting the national EPIC, and advising the governments on policy formulation. The EPIC process has strengthened the institutional mechanism for intergovernmental and national economic policy making.

7. The first EMPAT TA was approved in 1995 and was extended to a second phase in 1998 (EMPAT II). The principal objectives underlying these TAs were to:

- (i) assist the FSM governments in formulating economic strategies and policies to restructure the economy from reliance on the public sector toward private sector initiatives and attain more rapid and self-sustaining growth;
- (ii) strengthen government institutions and build their capacity—comprising preparing and implementing a broad approach to establishing local capacities in economic analysis and public sector management, and policy advice including training of local counterpart economists, and development of demand for economic policy making at the highest levels of Government;
- (iii) reform the public sector through restructuring, downsizing by fiscal compression, tax reform, improved efficiency in service delivery through performance management, and reform of the public enterprise sector; and
- (iv) develop the private sector through improvements in the policy environment.

The major outputs of EMPAT I and II are presented in Appendix 2.

8. EMPAT I and II helped provide economic policy advice and capacity building in the FSM. A major shift in emphasis is clearly required now to achieve similar results at the state level. The nature of the FSM political structure and the decentralized form of government results in many key economic and financial functions taking place at the state level. The establishment of a firm basis for sound policy making and day-to-day advisory support at the state level is thus important, while simultaneously maintaining core strength at the national level. The present TA has been designed to meet this requirement. The summit and EPIC process has broadened capacity building to a wider audience in the FSM Government. The proposed TA will continue to emphasize the provision of economic policy advice through participatory high-level meetings and replicate the national level success at the state level. It will build on the progress made under EMPAT I and II and respond to the Compact renegotiation.

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<sup>3</sup> TA-2294-FSM: *Policy Advisory Team for Economic Management* for \$2,500,000, approved on 31 January 1995; supplementary TA-2294-FSM: *Expansion of the Economic Management Policy Advisory Team*, for \$540,000, approved on 29 April 1997; and TA 3024-FSM: *Economic Policy Reform and Management*, for \$3,876,000, approved on 2 June 1998.

9. Progress has been made in developing the capacity of a cadre of local economic advisers in the Department of Economic Affairs. Three young trained economists have returned from Master's degree programs, but with little accumulated experience at the policy advisory level. Support of a professional institutional environment remains critical to the successful development of a local cadre of economic policy advisers and eventual replacement of foreign support. Some of the returned counterpart staff economists are to return to the state governments and further recruits will be taken on at the Department of Economic Affairs to be schooled and trained to enlarge the pool of trained economists in the FSM.

10. The Compact negotiations are now under way and a significant adjustment in the FSM economy will likely be required when the new agreement with the US becomes effective. A new economic strategy will be required, tax reform will be necessary, and adjustments will be needed in the provision of public services. The FSM continues to require experienced professional support. This need for continued policy advice and capacity building at national and state levels has been confirmed by the FSM Government and conveyed to ADB by the President of the FSM. The Government has requested assistance for a two-year period until the new Compact is in place. Subsequently, economic policy advice will be provided by trained local counterparts funded by the Government and supported by separate capacity building sectoral grants under the renewed Compact.

11. Accordingly, to shift the emphasis to greater capacity building at the state level, it will be necessary to supplement the core team at the national level with state-level financial and economic specialists resident in the states. These resident specialists will work closely with state officials and are expected to promote an increased sense of ownership at the state level. While the specialists will be responsible for state-level capacity building in financial management, budgeting and public sector investment, the core team will continue to take the lead on policy formulation and provide advisory support to the national government.

12. For the national government, more attention needs to be devoted to the work of the Department of Finance and Administration, particularly with respect to budget policy and formulation, and tax reforms. Public sector management must (i) focus at the state level, on service delivery improvement and capacity building; and (ii) coordinate and support mainstreaming of performance budgeting and management.<sup>4</sup> Efforts to improve the environment for private sector development remain critical and will be supported through ADB's private sector development program loan. Finally, public outreach will need to be maintained to increase the awareness of the importance of economic issues.

### **III. THE TECHNICAL ASSISTANCE**

#### **A. Objectives**

13. The primary emphasis of the TA will be to strengthen and develop the institutional capacity for economic policy making required during the transitional phase covering about two years. Compared to the earlier TAs, this TA will play a greater role in providing economic policy advice and public sector management at the state level of government, in particular to help plan reduced levels in the Compact provisions expected to come into effect by the end of 2003. The extent of economic policy advice from external consultants is being gradually reduced and will eventually be eliminated as local counterparts take on increasing responsibilities. Accordingly, the proposed TA has much lower level core team inputs to the national Government than did

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<sup>4</sup> To be implemented under (35443) FSM: Implementation of Performance-Based Budget Management.

earlier assistance. Increased state-level capacity building is expected to raise the awareness and need for economic policy and planning among the state government officials. Priority will be given to training counterpart economists at the Department of Economic Affairs, maintaining regular meetings of participatory fora such as EPIC, and facilitating a third economic summit once Compact economic provisions are renegotiated. Macroeconomic policy advice will concentrate on tax reform and fiscal policy, while public sector management will help institutionalize performance management and the public sector investment program. Support and preparation for the ongoing Compact negotiations will focus on achieving an outcome consistent with the long-run development potential of the economy.

## **B. Scope**

14. The TA has the following components: (i) improvement of the institutional capacity for economic management, (ii) state-level capacity building, (iii) macroeconomic policy advice, (iv) public sector management, (v) Compact advisory support, (vi) development of the post Compact structural adjustment program, (vii) coordination and support for private sector development, and (viii) outreach and information systems.

15. Details are provided in Appendix 2. The major areas of expected outputs and impact of the TA are presented in a logical framework in Appendix 1. Quantitative indicators will be developed at the time of the TA inception, which includes a workshop involving the main participants.

16. The proposed assistance to the FSM for Economic Policy Reform and Capacity Building will be considered in two phases as described under para. 17.

## **C. Cost Estimates and Financing Plan**

17. The first phase, to be approved at this time, will cover the cost of the first year of the activities, estimated at \$1,138,000, including a foreign exchange cost of \$900,000 and \$238,000 in local currency cost. The Government has requested ADB to finance \$550,000 and the US government to finance \$333,000 to cover foreign and local currency costs. The ADB financing will be provided on a grant basis from the ADB-funded TA program. The Government will finance the remaining \$255,000, including the foreign exchange cost of the scholarship program and the balance of the local currency cost, in cash and in kind (costs of remuneration, per diem, housing, and domestic travel for counterpart staff, office accommodation, supplies and equipment, printing, reporting, secretarial services, and part of the housing costs for the resident advisers). The detailed cost estimates and financing plan are given in Appendix 3.

18. Toward the close of the first year of implementation, the performance of the TA will be evaluated. Based on the assessment of needs and continued funding commitment from the US, the provision of technical assistance for the second phase may then be considered and if appropriate, submitted for approval.

19. The two-phase approach is appropriate to ensure that the US grant funding is made available in accordance with the agreed cofinancing arrangements. The US government, through its Department of the Interior, is committed to fund \$333,000 from FY2002 budget appropriations, and is expected to fund another \$333,000 for FY2003 once ADB approves the second phase. It is anticipated that these funds will be released to ADB no later than December 2001 and December 2002, respectively.

#### **D. Implementation Arrangements**

20. The first phase of the TA will be implemented over a period of 15 months, commencing in January 2002 and ending in March 2003. The Department of Economic Affairs will be the Executing Agency. This department has the responsibility for coordinating the nation's economic development strategy. A steering committee will be established comprising the secretaries of economic affairs, finance, and foreign affairs and other officials as deemed appropriate. It will meet quarterly and be headed by the Secretary of Economic Affairs.

21. The consultants will comprise a core team of resident advisers in Palikir and specialists resident in the states. The inception of the TA will include a workshop involving all stakeholders to draw up a detailed program of activities. The workshop will also result in preparing the annual work plan, identifying responsibilities, and specifying measurable performance indicators. The performance will be monitored against verifiable indicators. The TA implementation will be evaluated after nine months.

22. The work program of the core advisers and state-level specialists will be integrated and aligned. The core team will consult frequently with the state specialists and hold periodic meetings with all team members. The work agenda of the state specialists will be closely defined and set in consultation with the core team and the state governments. The specialists will be attached to the state government finance departments, and will be responsible to both the executive and legislative branches.

23. An international firm experienced in economic policy analysis and public sector reform will be engaged by ADB to provide the core team comprising the two economic advisers and one expert on public sector management for a total of 21 person-months. Individual international consultants will be recruited separately for the two state-level specialists, for a total of 15 person-months. Core team and individual consultants will be recruited in accordance with ADB's *Guidelines on the Use of Consultants*. The outline terms of reference for the consulting services are given in Appendix 4. No financial commitment or contracts with consultants will be signed until ADB has received the US cofinancing. Procurement of equipment and supplies under the TA will be in accordance with arrangements acceptable to ADB.

#### **IV. THE PRESIDENT'S DECISION**

24. The President, acting under the authority delegated by the Board, has approved (i) ADB administering a portion of technical assistance to be financed by the Government of the United States on a grant basis in an amount not exceeding the equivalent of \$333,000, and (ii) the provision of technical assistance to be financed by ADB on a grant basis in an amount not exceeding the equivalent of \$550,000, both to the Government of the Federated States of Micronesia for the purpose of Economic Policy Reform and Capacity Building, Phase I, and hereby reports such action to the Board.

### TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance <sup>1</sup> Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<b>Goal</b> Productive economy in the Federated States of Micronesia (FSM) with balanced growth and equitable distribution among states	<ul style="list-style-type: none"> <li>2-3 percent average growth in gross domestic product (GDP), particularly in productive sectors</li> <li>Growth in exports</li> <li>5 percent reduction in food imports</li> </ul>	<ul style="list-style-type: none"> <li>Data from national statistics office on social security payroll information</li> <li>Governments' annual budget appropriations</li> </ul>	<ul style="list-style-type: none"> <li>Renewed Compact revenues are sufficient</li> <li>Governments remain stable</li> <li>Private sector is confident in future of the FSM</li> </ul>
<b>Purpose</b> <ul style="list-style-type: none"> <li>Financially self-reliant economy supported by trust funds</li> <li>Reduced dependence on external assistance</li> <li>Decreased dependence on international consultants</li> </ul>	<ul style="list-style-type: none"> <li>20 percent of GDP from external sources</li> <li>Economic planning at state and national levels carried out with minimal external consultants</li> <li>In-house capability at state level to undertake economic and financial planning</li> </ul>	<ul style="list-style-type: none"> <li>Review by Asian Development Bank (ADB) of pertinent documents</li> <li>Interviews with state and national leadership</li> </ul>	
<b>Outputs</b> A. Institutional capacity for economic management in the FSM improved  B. Capacity-building done to improve states' financial and economic policy making and management	<ul style="list-style-type: none"> <li>Micronesian economist counterparts experienced, trained, and independently productive by December 2002</li> <li>Economic Policy Implementation Councils (EPICs) and state equivalents held regularly in 5 governments in 2002</li> <li>At least one person in each state government has completed relevant training, and received considerable on the job support by December 2002</li> <li>Demonstrated capacity to produce timely financial reporting</li> <li>Internationally accepted budgeting principles and performance management integrated into the budget</li> </ul>	<ul style="list-style-type: none"> <li>Project/individual consultant reports</li> <li>Trained Micronesian economists assigned to each state</li> <li>State level officials sensitized to economic planning through at least two summits/ seminars per year in each state</li> <li>At least two more economists are given post graduate training</li> <li>Annual economic briefings for states conducted by Micronesian economists</li> <li>State Counterpart staff trained/evaluated by resident advisers</li> <li>Financial reports produced by state governments and Micronesian counterparts</li> <li>Financial reports online for fiscal year (FY) 2004</li> <li>All states have a uniform compatible accounting system with trained staff</li> <li>Monthly expenditure statements available by the third week of the following month</li> </ul>	<ul style="list-style-type: none"> <li>Micronesian staff at national and state levels do not depart from the FSM for at least two years</li> <li>National and state governments accept Micronesians as fully qualified and prepared to be economic and management advisers</li> </ul>



Design Summary	Performance <sup>1</sup> Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>C. National- and state-level macroeconomic policy analysis, advice, and advocacy provided</p> <p>D. Public sector management advice and advocacy provided</p> <p>E. Compact advisory support provided</p> <p>F. Assistance provided to help prepare for structural adjustment to new economic provisions in FY2004</p> <p>G. Coordination and support for private sector development</p>	<p>process</p> <ul style="list-style-type: none"> <li>Economic progress toward targets for external assistance and GDP growth</li> <li>Analytical economic reviews and statistics produced for each government in 2002</li> <li>Management, productivity, and organizational assessments and recommendations of each state government produced, discussed, and adopted by each government in 2002</li> <li>Participation and dialogue with budget review committees and public sector investment program</li> <li>Preparation for Compact negotiations</li> <li>Design strategy responsive to each round of United States (US)-FSM negotiations</li> <li>Preparation of economic strategy plan once outcome of Compact is known</li> <li>Fiscal and structural adjustment package prepared with options, when details of Compact package are fully known in 2002</li> <li>Preparation and support to the third FSM economic summit</li> <li>Assist in implementation of the private sector development loan</li> <li>Coordinate public-sector enterprise (PSE) transformation program as per masterplan</li> </ul>	<ul style="list-style-type: none"> <li>Budgets/accounts, etc. presented in GFS format</li> <li>FY2003 budget presented with input/output relations clearly established in line with performance-based budgeting methods</li> <li>Local economists to undertake the role of the fiscal economic policy advisory team</li> <li>Presentations made by national and state counterparts</li> <li>provide macro-level fiscal, budgetary, and economic analysis reports</li> <li>Reports, presentations by technical assistance (TA) counterparts</li> <li>Preparation of FSM economic strategy for presentation to third summit</li> <li>Meeting briefs</li> <li>Strategy documents</li> <li>Counter offer proposals</li> <li>Regular on-line review of EMPAT website</li> <li>Material produced by TA for presentation and/or publication</li> <li>Actual transformation of PSEs</li> <li>Passage of land legislation</li> </ul>	

Design Summary	Performance <sup>1</sup> Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
H. Outreach and information on economic policy issues provided	<ul style="list-style-type: none"> <li>• TA website maintained and updated by selected Micronesian counterpart(s)</li> <li>• Presentations and lectures to College of Micronesia and other groups on economy, public sector management, etc.</li> <li>• Publication of occasional TA policy notes in local newspapers</li> </ul>		
<b>Activities</b> A1. On-the-job and formal training and support to five Micronesian counterparts at national government  A2. Active support to national government in planning for and conducting two EPIC meetings annually  A3. Direct support to state governments in convening and conducting regular EPIC meetings in each state  B1. Develop improved financial management tools and practices in each state government  B2. Analyze in depth and report real time on each state's financial position  B3. Assist with budget preparation and performance management  C1. Provide ongoing, as needed, macro-level fiscal, budgetary, and economic	Start: Jan 2002 Finish: Mar 2003  Start: mid 2002 Finish: early 2003  Start: mid 2002 Finish: early 2003  For FY2003  For FY2003  Preparation of FY2003 budget starting in April 2002  Start: Jan 2002 until end of TA	<ul style="list-style-type: none"> <li>• Project budget documents</li> <li>• Government budget document and reports</li> </ul>	<ul style="list-style-type: none"> <li>• Required resources are available and forthcoming</li> <li>• Qualified, motivated, productive personnel hired as consultants and as counterparts</li> <li>• Support from national and state governments is forthcoming</li> <li>• States support open, regular assessments of their respective economies</li> </ul>

Design Summary	Performance <sup>1</sup> Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>analysis and advice to each government</p> <p>C2. Prepare regular economic reviews of the FSM and states</p> <p>D1. Work with all governments on the budget cycle process, with proactive support to performance-based management principles and practices</p> <p>D2. Assist with and participate in management and policy reforms in public infrastructure project development and implementation</p> <p>D3. Analyze each government's organization structure and personnel management systems</p> <p>E1. Prepare economic analysis and policy support to the FSM in the Compact renegotiations with the US</p> <p>E2. Dialogue with the FSM Joint Committee on Negotiations members on economic policy issues related to the negotiations</p> <p>F1. Develop in FY02 structural adjustment strategies and options reflecting the new revenue levels and any conditionality required by the new Compact agreement</p> <p>F2. Assist with the</p>	<p>Annually</p> <p>Start: Apr 2002 Finish: Sep 2002 For FY2003</p> <p>During TA implementation period</p> <p>Inputs to budget process for FY2003</p> <p>Prior to each round of negotiation</p> <p>Throughout TA implementation period</p> <p>Throughout TA implementation period</p>		

<b>Design Summary</b>	<b>Performance<sup>1</sup> Indicators/Targets</b>	<b>Monitoring Mechanisms</b>	<b>Assumptions and Risks</b>
preparation for the third FSM economic summit  F3. Help the FSM prepare for a consultative group meeting  G1. Help transform PSEs in each state  G2. Help national and state governments privatize PSEs  G3. Assist in land legislation and preparation of papers for the FSM's Congress' approval  H1. Train one or more Micronesian counterparts in website maintenance and operations  H2. Publication of periodic articles policy in local newspapers  H3. Give public presentations to various groups on economic and public management issues	   Start: Jun 2002 Finish: TA completion  Jan-Mar 2003  Start: Jan 2002 Finish: Mar 2003  Jun 2002  Jun 2002  During TA implementation.		
<b>Inputs</b>			
1. Consultants 2. Scholarship Program 3. Summits and Workshops 4. Equipment	36 months of international consultant \$50,000 \$45,000 \$25,000		

<sup>1</sup> Quantitative indicators/targets will be assigned at TA inception workshop in consultation with FSM Government.

## **MAJOR OUTPUTS OF PREVIOUS TECHNICAL ASSISTANCE, AND SCOPE OF PROPOSED TECHNICAL ASSISTANCE**

### **A. Major Outputs of the Economic Management Policy Advisory Team (EMPAT)**

1. The major outputs will be (i) creation of demand for provision of policy advice at the highest levels in the Federated States of Micronesia (FSM) and State Governments; (ii) initiation of a realization in the FSM of the need for reform through the first round of summit meetings at the national and state levels; (iii) support of the second FSM economic summit, initiation of the Economic Policy Implementation Council (EPIC), and preparation of the FSM economic planning framework; (iv) design of the public sector reform program with early retirement programs in each government, and advice to help the FSM balance its consolidated budget in the face of a 21 percent reduction in Compact funding with the fiscal year (FY) 1997 step-down; (v) advice to resolve Chuuk State's financial crisis through implementation of a national government-sponsored financial recovery program; (vi) advice to improve the economic environment for private sector investment, resulting in passage of a liberalized foreign investment act, drafting of legislation to implement the recommendations from the First FSM Financial Sector Symposium, and support for the second financial symposium; (vii) advice on how to improve the structure and efficiency of the FSM tax regime, resulting in implementation of an improved import tax regime and elimination of disincentives for export-oriented activities (EMPAT I), and preparation of a comprehensive tax reform strategy for administrative reforms and introduction of a broad based consumption tax; (viii) advise for and establishment of the FSM trust fund, and preparation of an analytical framework for the examination of different trust fund arrangements under the Compact; (ix) Compact advisory support and design of the FSM proposal for extending the economic provisions of the Compact, and analysis of the United States (US) counter offer; (x) establishment of statistical time series for the major economic aggregates (based on administrative data) including national accounts, government finance, employment data, and balance of payments; and preparation of a comprehensive economic review of the economy in October 2000, based on this information; and (xi) direct on-the-job training for five Micronesian economists on the team and indirectly to counterparts in the five governments.

### **B. Technical Assistance Scope (Phase I)**

2. **Improving the Institutional Capacity for Economic Management.** Continued on-the-job training and support will be provided to five staff economists, further recruitment and formal training for Micronesian counterparts, and continued support for the FSM EPIC.

3. **State-Level Capacity Building.** The TA will support (i) implementation of sound financial management and fiscal policy, (ii) coordination and support for the performance budgeting and management system developed under a separate TA, (iii) institutionalized public sector investment programming, (iv) transformation of state public enterprises, (v) training and capacity building of government officials at the state level, (vi) deployment at the state level of EMPAT-trained counterpart staff economists, and (vii) establishment of state EPICs.

4. **Macroeconomic Policy Advice and Monitoring.** The TA will support (i) development and implementation of sound fiscal policies at national and state government levels, with special emphasis on tax reform and state level fiscal management; and (ii) monitoring and reporting on economic developments, provision of advice on monetary, interest rate, external debt, and trade policy.

5. **Public Sector Management.** The TA will (i) continue coordination and support to improve performance budgeting and management, expenditure management, and efficiency in service delivery with special emphasis at the state level; (ii) develop, introduce, and implement improved systems for project management and public sector investment; and (iii) support improvements in personnel management systems and procedures.
6. **Compact Advisory Support.** The TA will provide advice and preparatory support to the Compact negotiations to ensure the economic provisions are consistent with sound economic policy and long-run development of the FSM; however, this will be clearly delineated from the ongoing bilateral negotiations between the FSM and US.
7. **Post Compact Structural Adjustment Program Development.** When the negotiations are complete, the FSM will need assistance to design a structural adjustment program for the new economic provisions of the Compact. This will include preparing a long-run economic strategy for the FSM, facilitation of the 3rd FSM economic summit, and support for the fifth consultative group of donors meeting.
8. **Private Sector Development Coordination and Support Advisory.** The TA will provide advice to improve the economic environment for private sector investment and incorporate private sector development strategy as part of overall macroeconomic strategy.
9. **Outreach and Information Systems.** The TA will (i) provide information to a wide audience and general public on economic policy issues, (ii) maintain the EMPAT web site, and (iii) continue active but limited support to statistical systems to ensure a sound basis for economic management.

## COST ESTIMATES AND FINANCING PLAN PHASE I

**Table A3.1: Cost Estimates**  
(\$)

Item	Foreign Exchange	Local Currency	Total Cost
<b>A. Cofinanced by ADB and the US Government<sup>a</sup></b>			
1. Consultants			
Core Team (21 person-months)			
a. Remuneration	420,000	0	420,000
b. Per Diem	25,000	0	25,000
c. International Travel (6 round trips)	30,000	0	30,000
d. Domestic Travel	0	20,000	20,000
e. Miscellaneous	5,000	0	5,000
2. Resident Advisers (15 person-months)			
a. Remuneration	225,000	0	225,000
b. Per Diem	18,000	0	18,000
c. International Travel (2 round trips each)	20,000	0	20,000
3. Equipment and Supplies <sup>b</sup>	20,000	5,000	25,000
4. Workshops	0	5,000	5,000
5. Miscellaneous Administration and Support Costs	20,000	0	20,000
6. Contingencies	67,000	3,000	70,000
<b>Subtotal (A)</b>	<b>850,000</b>	<b>33,000</b>	<b>883,000</b>
<b>B. Government Financing</b>			
1. Counterpart Staff:	0	50,000	50,000
Resident Specialists (15 person-months)			
a. Housing	0	15,000	15,000
b. Domestic Travel	0	15,000	15,000
c. Local Transportation	0	15,000	15,000
2. Scholarship Program	50,000	0	50,000
3. Office Accommodation	0	20,000	20,000
4. Facilities	0	50,000	50,000
5. Summits/Workshops	0	40,000	40,000
<b>Subtotal (B)</b>	<b>50,000</b>	<b>205,000</b>	<b>255,000</b>
<b>Total</b>	<b>900,000</b>	<b>238,000</b>	<b>1,138,000</b>

ADB = Asian Development Bank, US = United States.

<sup>a</sup> \$550,000 from the Asian Development Bank-funded technical assistance program and \$333,000 from the US Government.

<sup>b</sup> Computers and photocopier.

Source: Staff estimates.

**Table A3.2: Financing Arrangements**  
(\$)

Source	Phase I	Percentage
ADB	550,000	48.3
US Cofinancing	333,000	29.3
Subtotal	883,000	
Government of FSM	255,000	22.4
<b>Total</b>	<b>1,138,000</b>	<b>100.0</b>

ADB = Asian Development Bank, FSM = Federated States of Micronesia, US = United States.

## **OUTLINE TERMS OF REFERENCE**

1. The technical assistance (TA) will commence on or about 1 January 2002, and terminate in March 2003. A total of 36 person-months will be utilized by five international technical advisers. The core team will be (i) macroeconomist and team leader (9 person-months); (ii) resident adviser and macroeconomist (7.5 person-months); and (iii) public sector management adviser (4.5 person-months). A resident financial and economic specialist (7.5 person-months) will be based in Chuuk/Kosrae; and a financial and economic specialist (7.5 person-months) will be based in Pohnpei/Yap. An experienced consulting firm will be engaged to provide the core team, and the state-level specialists will be recruited directly by the Asian Development Bank (ADB).

2. The core team must collectively have extensive experience in economic policy formulation, economic management of small economies, and public sector management, preferably in the Pacific, and in effective cross-cultural communication. The state-level specialists must have extensive experience in financial and economic analysis or accounting with a proven capability to access computerized financial management information and accounting systems. The core advisers will have at least a master's degree and relevant working experience in small countries, preferably in the Pacific region. The state-level specialists will have master's degrees, be certified public accountants (CPAs), or have relevant professional qualifications with working experience in small developing countries.

3. All advisers will be selected based on their professional capability and their ability to effectively communicate. Each core adviser will have a close working relationship with one or more counterparts educated in economics to at least the bachelor's degree level. The state specialists will work with identified counterparts in the state finance and budget offices. The macroeconomist will be the team leader and will work on overall macroeconomic policy and advice. Consultants will be used intermittently over the 15-month implementation period.

4. Up to seven staff economists, employed by the Department of Economic Affairs and state governments, will work as counterparts to the TA advisers at the national and state government level.

### **A. Team Leader, Macroeconomist (9 person-months)**

5. The team leader will be a macroeconomist with strong background and experience in economic policy and fiscal management, and will advise the Secretary of Economic Affairs. The adviser will cover the following areas:

- (i) provision of economic policy advice to the national and state governments, to the Economic Policy Implementation Council (EPIC), and state EPICs;
- (ii) provision of regular fiscal policy advice to all five governments, including revenue forecasting, expenditure projections, budget preparation, and debt management;
- (iii) assistance with tax reform and development of a broad-based nondistortionary tax system suitable to the long-run development of the economy;
- (iv) advice on the impact of the economic provisions of renewed Compact economic provisions (as they emerge) to facilitate an economic structure that reinforces the reforms and the long-run development of the economy;
- (v) analysis and reporting on recent economic developments with policy



recommendations through the EPIC participatory process;

- (vi) economic policy advice on trade, monetary and interest rates, wage and labor market analysis, capital markets, and other general areas of economic policy;
- (vii) advice on private sector development strategy in conjunction with the Private Sector Development Program (PSDP) loan implementation as well as the Public Sector Investment Program (PSIP) and transformation of private sector enterprises (PSEs);
- (viii) strengthen economic policy formulation and economic management at the national and state levels;
- (ix) coordinate and manage the work of the core team, state specialists, and counterpart staff economists; and
- (x) prepare brief quarterly reports and more detailed six-monthly reports to the governments of the FSM and ADB on TA progress.

#### **B. Resident Adviser and Macroeconomist (7.5 person-months)**

6. The adviser will support the work of the team leader in providing economic policy advice and advocacy. The adviser will be responsible for developing and oversight of the counterpart training program. While development of statistical series will not form a major component of the work, the adviser will be responsible for maintaining the team's data base. The adviser, working under the guidance of the team leader and the Secretary of Economic Affairs of the National Government, will work in the following areas:

- (i) provision of economic policy advice to the national and state governments, and to the national and state EPICs;
- (ii) provision of regular fiscal policy advice to all five governments, including revenue forecasting, expenditure projections, budget preparation, and debt management;
- (iii) advice on the impact of the economic provisions of renewed Compact economic provisions (as they emerge) to facilitate an economic structure that reinforces the reforms and the long-run development of the economy;
- (iv) analysis and reporting on recent economic developments with policy recommendations through the EPIC participatory process;
- (v) economic policy advice on trade, monetary and interest rates, wage and labor market analysis, capital markets, and other general areas of economic policy;
- (vi) maintenance of a minimum statistical data set to enable the team to carry out its economic management functions;
- (vii) strengthening of economic policy formulation and economic management at the national and state levels; and
- (viii) development of the counterpart-training program and postgraduate placement.

#### **C. Public Sector Management Adviser (4.5 person-months)**

7. The adviser will be principally responsible for assisting with and actively promoting measures to improve the planning, budgeting, structural, and day-to-day operations of the

national and four state governments, including:

- (i) proactive support to the installation and implementation of performance management practices in all the client governments, to support enhanced accountability and transparency, and to improve monitoring and reporting by the public sector leadership and middle management personnel;
- (ii) actively work with the four state governments in establishing, conducting, and institutionalizing state EPICs by 2004;
- (iii) prepare procedures and a manual for public sector project identification and evaluation, and assist with the institutionalizing the public sector investment program at the state level to ensure openness and transparency in project selection according to sound economic and social criteria;
- (iv) work closely in an advisory, capacity-building manner with the budget formulation, review, and oversight process in the national and state governments; this includes helping to improve the quality and relevance of the performance budgeting process, and build the capacity within the line departments to use this process to focus and improve the operations of government;
- (v) work with the Department of Finance and Administration to thoroughly examine the current personnel management and record-keeping systems and procedures, make recommendations for improvement, and provide close support in the implementation of the recommendations; and
- (vi) provide active, continuing on-the-job support and training to the TA staff economists in relevant areas of budgeting and analysis, and other ways to improve performance and efficiency in government.

**D. State-Level Resident Financial and Economic Specialists (2, for 7.5 person-months each)**

8. The two specialists' time will be allocated between the states as needed, but most of the inputs will be devoted to the larger states, with one specialist allocated to Chuuk and the second to Pohnpei. Specifically, the work program will include:

- (i) assistance to (a) enhance financial and economic management in the state government, (b) establish timely reporting of up-to-date information from the financial management information systems for regular fiscal monitoring and for input into the budgetary process, and (c) develop state level capacity for real time financial analysis, and work with the core team economists and counterparts in formulating state fiscal policy;
- (ii) assistance (a) to the state governments in budget preparation, with particular emphasis on financial stability over the medium term; and (b) with the extension of the performance budgeting and management systems currently under development;
- (iii) assistance with the development of financial systems and their enhancement at state-level, including internet based applicators, in close coordination with other programs of the Department of Finance (the specialist will report to the Secretary of Finance);
- (iv) help with developing and institutionalizing the PSIPs as an accountable and

- transparent process in the state governments, based on professional project identification and evaluation procedures;
- (v) provision of regular information and analysis of the PSE sector to state officials and policy makers to increase awareness of the cost of the sector and to assist the transformation process;
  - (vi) assistance to the state and the core team for institutionalizing the state-level EPICs; and
  - (vii) regular consultations on and participation in the activities of the core TA advisers and counterparts, and other ADB TAs, such as Performance-Based Budget Management and Privatization of Public Enterprises and Corporate Governance Reforms.<sup>1</sup>

## **E. Counterpart Staff Economists**

9. By the end of phase II of the TA for Economic Management Policy Advisory Team (EMPAT II), the team will have five full-time staff economists. Three of them will have completed graduate degrees in economics and returned to the FSM, and the two newer members will be scheduled to commence their graduate training in 2002 funded from counterpart sources. During 2002, following a year with the core team in Economic Affairs, one or two of the economists will return to his or her state and work as an economist with the state government. At the same time, replacement staff economists will be recruited and brought on to fill the voids created and continue the project's efforts to build a cadre of trained and experienced Micronesian economists. The new counterparts will have at least the equivalent of a first degree in economics, business and finance, or public administration. They will receive on-the-job training until the initial two return from their overseas graduate programs, at which time the new counterparts commence graduate programs.

## **F. Reports**

10. The team leader will prepare a draft inception report within one month of the commencement of the TA, and an ADB inception mission will review this draft. The TA inception will involve an extensive workshop involving all major stakeholders. It will result in a detailed work program and the establishment of specific quantitative indicators relating to the performance areas currently described on the logical framework (Appendix 1).

11. Every three months, the team will report on the progress against the performance indicators established at the time of the TA inception and during subsequent TA reviews. A brief discussion of the major achievements and issues will be provided. The team will submit a more detailed report every six months to the FSM governments and ADB on TA progress. The TA completion report will include a discussion of the major achievements and recommendations for the direction of future reform effort and institutional development.

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<sup>1</sup> TA 2983-FSM: *Performance-Based Public Resource Management*, for \$988,000, approved on 26 January 1998 and TA 3201-FSM: *Privatization of Public Enterprises and Corporate Governance Reforms*, for \$450,000, approved on 9 June 1999.