

**ASIAN DEVELOPMENT BANK**

**TAR: FSM 32215**

**TECHNICAL ASSISTANCE**

**TO THE**

**FEDERATED STATES OF MICRONESIA**

**FOR**

**PRIVATIZATION OF PUBLIC ENTERPRISES AND**

**CORPORATE GOVERNANCE REFORMS**

**June 1999**

## **CURRENCY EQUIVALENTS**

The Federated States of Micronesia uses the US dollar as its currency.

## **ABBREVIATIONS**

DEA	-	Department of Economic Affairs
EMPAT	-	Economic Management Policy Advisory Team
FSM	-	Federated States of Micronesia
PDMC	-	Pacific Developing Member Country
PERU	-	public enterprise reform unit
PSE	-	public sector enterprises
PSRP	-	Public Sector Reform Program

## **NOTES**

- (i) The fiscal year (FY) of the Government ends on 30 September. "FY" before calendar year denotes the year in which the fiscal year ends, e.g., FY1999 begins on 1 October 1998 and ends on 30 September 1999.
- (ii) In this report, "\$" refers to US dollars.

## I. INTRODUCTION

1. During the 1998 Country Programming Mission, the Government of the Federated States of Micronesia (FSM) requested advisory technical assistance (TA) for formulation and implementation of public enterprise reforms. The TA is included in the approved 1999 Country Assistance Program.<sup>1</sup> The initial fact-finding was carried out from 25 January to 2 February 1999. The TA follow-up Fact-Finding Mission visited the FSM from 19 to 23 April 1999. The Mission and the Government reached an understanding on the rationale, scope, and implementation arrangements for the TA.

## II. BACKGROUND AND RATIONALE

2. In 1995, the Government of FSM initiated its policy reform program aimed at strengthening the economy. The Bank, through its Public Sector Reform Program (PSRP)<sup>2</sup> loan and associated TA has been supporting these reforms. As a part of the PSRP, the Government has started to (i) reduce the size and operating costs of the civil service; (ii) increase domestic revenue generation; (iii) restructure government operations and public sector enterprises (PSEs); (iv) mitigate the social and economic impact of such public expenditure adjustment; and (v) foster private sector development. While the PSRP has concentrated on the issues related to the retrenchment of public servants and restructuring of Government operations, the reforms related to privatization of PSEs are yet to be adequately advanced. To facilitate this process, during the 1998 Country Programming Mission, the Government requested further TA for reforming public sector enterprises through privatization and corporate governance reforms.

3. The Bank-financed Economic Management Policy Advisory Team (EMPAT)<sup>3</sup> has been providing some ad hoc assistance by reviewing PSE operations and providing a broad outline of directions for PSE reforms. In addition, EMPAT assisted the national and state governments in identifying a list of departmental functions that could be corporatized and/or privatized. Furthermore, Bank TA is being provided to set up a more coherent framework for the performance monitoring of the PSEs.<sup>4</sup> However, the TAs focus primarily on formulation of general economic strategies, issues related to civil service reforms, social impacts of the ongoing PSRP, and reforms of the budget processes; consequently, more focused assistance is needed for public enterprises reforms.

4. The FSM has a large number of PSEs, owned both by national and state governments (Appendix 1). The PSEs can be subdivided into four major groups: (i) utilities (e.g., Telecommunications Corporation of FSM, and state-level electricity, water, sewerage, and transportation agencies); (ii) fishing (National Fisheries Corporation and its state-level subsidiaries—e.g., Pohnpei Fisheries Corporation and Pacific Tuna Incorporated), (iii) finance (Bank of FSM and Development Bank of FSM); and (iv) other miscellaneous activities (e.g., housing authorities, broadcast stations, and coconut authorities).

5. Quantitative analysis of PSEs is severely hampered by the lack of the up-to-date reliable data. No complete inventory is currently available for the FSM PSEs. While incorporated PSEs

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<sup>1</sup> The TA first appeared in the *ADB Business Opportunities* in November 1998. The proposed Country Assistance Program for 2000–2001 includes additional assistance in this area.

<sup>2</sup> Loan 1520-FSM: *Public Sector Reform Program*, for \$18 million, approved on 29 April 1997.

<sup>3</sup> TA 2294-FSM: *Economic Management and Policy Advisory Team*, for \$2.5 million, approved on 31 January 1995; and TA 3024-FSM: *Economic Policy Reform and Management*, for \$2.877 million, approved on 2 June 1998.

<sup>4</sup> TA 2983-FSM: *Performance Based Public Resource Management*, for \$988,000, approved on 26 January 1998.

are required to be audited annually, not all PSEs meet this requirement. Furthermore, the Government does not have an official report that provides consolidated, comparative financial data on PSEs. Existing estimates show that PSEs accounted for approximately 14 percent of formal sector gross domestic product in 1996.<sup>5</sup> PSEs employ around 1,400 people, or about 10 percent of formal sector employment. National and state governments invested more than \$300 million in PSEs. The PSEs sector appears to be profitable, showing a positive return of around \$8 million (1996). However, after subtracting various subsidies and implicit capital costs, on a consolidated basis, PSE losses exceeded \$15 million in 1996.<sup>6</sup> In the past such inefficiencies were tolerated because of the relatively generous funding provided under the Compact of Free Associations. With the declining funding from the Compact and uncertainties related to its renewal in 2001, the fiscal impact of continuing to finance inefficient PSEs is increasingly hard to bear.

6. In connection with PSRP, the Government has started downsizing and restructuring its public sector, and emphasizing a resource and policy shift to support private sector development. As a part of the reforms, the state and national governments have reviewed the functions of several departments and PSEs in order to identify activities that can be privatized, corporatized, or abolished. The states have transferred the major utilities of power, water, and sanitation to independent public utility authorities, which are run on a commercial basis. However, utilities continue to receive significant funds through the Compact agreements. Furthermore, several other activities, which had been part of departmental operations, have been privatized or contracted out. The national Government also indicated that it is considering divestment of its ownership in the Bank of FSM, privatization of Telecommunications Corporation of FSM, and corporatization of FSM postal services.

7. While the need for PSE reforms is widely recognized by the national and state governments, the implementation of these reforms has seldom gone beyond commercialization and corporatization. In only a few cases has PSE ownership been transferred to the private sector. The general government commitment to privatization needs to be translated into a concrete, comprehensive policy framework and detailed time-bound action plan that establishes the basis for implementation of the privatization process.

8. Constraints to privatization include, among other things, the lack of a clear policy that determines the kind of activities the national and state governments should be involved in and the activities in which they should cease to be involved. Moreover, the governments continue to sponsor risky, purely commercial operations. While the goal of setting up these operations has been to make up for the perceived deficiencies of the private sector, in many cases these ventures have resulted in substantial financial losses for the governments and the policy has not contributed meaningfully to sustainable economic development. In addition, such sponsorship of commercially-oriented enterprises in some cases has crowded out private sector activities. Thus, this strategy should be reevaluated.

9. National and state levels lack an institutional framework adequate to manage the complex process of privatization. Experience in other countries indicates that adequate institutional capacity, coupled with a clear set of policies and transparent procedures, is essential for successful implementation of a privatization program. The Government has agreed

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<sup>5</sup> Consultant's (EMPAT) report on Public Enterprise Reform, 1997.

<sup>6</sup> The estimates do not include public enterprises operating as proprietary and revolving funds, and many activities included in various national and state government departments, thus significantly underestimating the role of PSEs in the FSM economy.

that initially a public enterprise reform unit (PERU) will be established within the Department of Economic Affairs (DEA) to coordinate and facilitate formulation and implementation of privatization policies. Under ongoing TA 2983-FSM (footnote 4), consultants will prepare specific recommendations on the role and objectives of PERU and propose an appropriate structure and adequate staffing levels.

10. Awareness among policymakers and stakeholders must be increased about issues related to privatization policy, and the capacity of policy makers and selected PSE managers must be enhanced through training and exposure to relevant international experience, to manage PSE restructuring and privatization, including financial, legal, labor and environmental aspects of the PSEs reforms.

11. Experience in transitional countries has shown that privatization is not a panacea against the inefficiency of enterprises. Thus, issues related to corporate governance of PSEs and the effectivity of a government's exercise of its ownership rights must be examined. To avoid the appointment of boards of directors and chief executives on the basis of political expediency and cronyism, operational autonomy should be improved and professionalism and accountability increased. PSEs are obliged to combine commercial and development functions, without a transparent mechanism for compensation of the losses incurred in carrying out the developmental functions. TA 2983-FSM (footnote 4) is assisting with clarifying issues of transparency, autonomy and professionalism in PSEs. Under the TA, a draft public enterprise act has been prepared and a monitoring framework is being developed.

12. Investment and operational decision-making can be enhanced by up-to-date, comprehensive financial information. In FSM PSEs, such information is often unavailable as audits are often delayed and accounts are not presented in accordance with international accounting standards. The Government cannot, therefore, exercise its role in an effective manner.<sup>7</sup>

13. The legal status of PSEs varies widely. While certain PSEs are corporatized pursuant to applicable company law or under a special law or statute, others operate as proprietary or revolving funds, or are run as part of national or state government departments. While some statutes are comprehensive, others do not contain adequate corporate governance covenants. Furthermore, some statutes create unfair advantages with the private sector, by giving some PSEs tax exemptions and other privileges. Such statutes should be reviewed and measures recommended to create a coherent PSE legal framework to facilitate privatization and improve corporate governance.

14. Overall, the national and state governments are committed to further the process of public enterprise reforms. Building upon the assistance provided by the Bank under previous TAs, such government commitment needs to be supported through a focused advisory TA.

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

#### **A. Objective**

15. The TA will assist the Government to formulate an overall privatization strategy and initiate effective, smooth, and transparent PSE-related reforms. Such reforms will constitute an

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<sup>7</sup> This issue is being partially addressed under ongoing TA 2983-FSM (footnote 4), which will be completed in June 1999.

integral part of the broader public sector reforms initiated under the PSRP. The PSE reforms will also provide impetus to increase the efficiency and profitability of PSEs by introducing new management techniques, business practices, and technological innovations (see Appendix 2 for the TA Framework).

## **B. Scope**

16. The TA will include the following components:

- (i) assistance to the national and state governments in formulating the PSE reform strategy, and preparing a detailed corporatization and privatization master plan, a five-year corporatization and privatization program, and an institutional framework for privatization;
- (ii) technical advice on corporatization and privatization of individual PSEs on a pilot basis, including areas such as asset valuation; corporate and financial restructuring; corporate management; legal, taxation, and regulatory frameworks; and associated labor issues;
- (iii) advice on strengthening the management framework and corporate governance of PSEs to remain under majority government ownership in the medium term, including review of existing institutional arrangements and the applicable legal framework as well as development of specific proposals for their improvement;
- (iv) capacity building of the proposed PERU; and
- (v) advice on consensus building and increasing awareness of stakeholders about issues related to PSE reforms.

17. The consultants are expected to provide a comprehensive set of policy recommendations on PSE reforms. Consultants will (i) prepare a report on establishing the PERU, (ii) prepare a draft privatization strategy, (iii) review and analyze the information collected on PSEs, and (iv) select PSEs to be studied in detail for the pilot privatization. The consultants will also assess the readiness of the individual states for PSE reforms. After Government approval of the recommendations, the consultants will (i) finalize policy guidelines and procedures for corporatization and privatization, (ii) prepare a monitoring framework for PSEs, (iii) initiate a public relations strategy, (iv) prepare detailed proposals and an action plan for corporatization and privatization of selected PSEs, and (v) assist in implementation of pilot privatization. Finally, the consultants will help implement the PSE restructuring program under the TA and assess the need for a follow-up TA.

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

18. The total cost of the TA is estimated at \$565,000, including foreign exchange costs of \$386,000 and \$179,000 equivalent in local currency costs. The Bank will finance \$450,000 comprising the entire foreign exchange cost and a portion of the local exchange costs. The TA will be financed by the Bank on a grant basis from the Bank-funded TA program. The Government will finance the remaining local currency cost equivalent to \$115,000 through provision of office space, counterpart staff, local transportation, and other services. The detailed cost estimates are in Appendix 3.

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

19. DEA of the National Government of the FSM will be the Executing Agency for the TA, in close coordination with the Department of Foreign Affairs. Prior to the commencement of the TA, DEA will establish the PERU to facilitate the formulation of privatization policies, implement the policies, and act as counterpart to the consultants. DEA will coordinate activities related to the state-level PSEs with the state governor's offices. DEA will provide office space, counterpart staff, and transportation. DEA and state governors will ensure access to all relevant information the PSEs. National and state public resource reform committees established under the ongoing PSRP will provide general guidance on TA implementation.

20. A team of international consultants will be engaged through a consulting firm. The TA is expected commence in August 1999 and will be completed by July 2000 with implementation phased as appropriate. The team will include the following international consultants for a total of approximately 13 person-months: (i) a public enterprise reforms expert, (ii) a lawyer, and (iii) a financial adviser. A locally based lawyer and a financial analyst will assist the international consultants in their work for a total of 6 person-months. The team of consultants will be selected and engaged in accordance with the Bank's *Guidelines on the Use of Consultants* and other arrangements on the engagement of domestic consultants. The TA includes funds for office equipment, which will be procured by the consultants in accordance with the *Bank's Guidelines for Procurement*. The consultants will closely collaborate with the Bank-financed EMPAT II and any other ongoing Bank-financed and other externally-assisted projects related to reforms of public enterprises, to achieve a maximum utilization of resources and avoid duplication of efforts. The consultants' terms of reference are shown in Appendix 4.

21. The consultants will prepare an inception report within one month of the start of TA implementation. An inception meeting will be held, if necessary. An interim report will be submitted within six months from the commencement of the consulting services. The interim report will provide an input for the Private Sector Forum to be held in FSM in early 1999. The draft final report will be circulated one month before the end of the consulting services for comments by DEA and the Bank. The recommendations of the draft final report will be discussed at a tripartite meeting between the Government, the consultants, and the Bank. The final report, incorporating the comments of the Government and the Bank, will be prepared and submitted to the Bank within a month of the tripartite meeting (Appendix 4).

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

22. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance, on a grant basis, to the Government of the Federated States of Micronesia in an amount not exceeding the equivalent of \$450,000 for Privatization of Public Enterprises and Corporate Governance Reforms, and hereby reports such action to the Board.

**FSM: PUBLIC SECTOR ENTERPRISES**  
(\$'000)

Enterprises	Total Assets	Total Equity	Operating Revenue	Profit/ (loss)	Revenue Transfers	Capital Injections	Year
<b>National</b>							
Bank of FSM	47,675.4	7,872.6	4,986.4	1,108.7	0.0	0.0	1996
FSM Development Bank	59,604.8	57,076.9	1,870.9	49.9	250.0	3,000.0	1997
FSM Telecommunications Corp	55,886.1	25,609.0	8,839.0	1,162.0	882.0	0.0	1998
Micronesia Long-line Fishing Corp	104.0	(13.4)	0.0	(311.0)	0.0	1.3	1996
National Fishing Corporation	21,562.4	(3,808.0)	13,610.6	(4,141.9)	450.0	819.4	1996
Coconut Development Authority	666.7	655.6	31.6	113.9	341.7	0.0	1997
FSM Post Office	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Inter-state Shipping	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Chuuk</b>							
Chuuk Coconut Authority	844.1	145.9	25.2	(150.3)	58.9	0.0	1996
Chuuk Housing Authority	2,270.7	2,202.8	115.8	26.0	58.1	217.8	1996
Chuuk Public Utilities Corporation	649.5	649.5	661.9	448.4	2,403.2	0.0	1996
Chuuk Fresh Tuna Inc	7,151.9	2,504.0	1,377.5	(759.3)	0.0	0.0	1996
Dubloon Cool Store	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Chuuk Field Shipping	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Yap</b>							
Yap State Public Service Corporation	9,195.4	8,988.2	2,220.2	(80.7)	79.1	0.0	1997
Yap Public Transport System	505.0	498.8	204.7	83.1	108.9	0.0	1996
Yap Fishing Authority	5,332.7	5,220.1	269.6	(448.1)	0.0	0.0	1997
Yap Fresh Tuna Inc	6,539.3	1,819.8	2,379.2	(557.5)	0.0	0.0	1996
Yap Economic Dev Auth	1,107.3	(996.4)	0.0	(2,014.5)	0.0	0.0	1997
Yap Investment Trust	7,392.9	893.0	0.0	0.0	0.0	0.0	1997
Yap Field Shipping	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Kosrae</b>							
Kosrae Utilities Authority	6,384.1	6,229.2	1,311.2	445.7	578.7	1,083.2	1996
Micronesia Petroleum Corporation	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pacific Tuna Industries	n.a.	131.5	n.a.	(144.5)	n.a.	n.a.	1996
Kosrae Sea Venture	1,194.0	898.3	288.8	426.3	0.0	0.0	1996
Airport Trust	109.2	108.1	54.2	18.6	0.0	0.0	1996
Housing Revolving	725.3	693.2	229.7	(101.6)	0.0	0.0	1996
<b>Pohnpei</b>							
Pohnpei Utilities Corporation	37,461.8	36,544.6	7,208.9	(618.4)	507.2	1,037.1	1997
Pohnpei Fisheries Corporation	6,687.0	1,758.8	1,777.1	(2,491.8)	0.0	0.0	1997
Pohnpei Port Authority	8,455.9	8,065.9	799.7	(632.6)	29.5	11.7	1997
Caroline Fisheries Corporation	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pohnpei Housing Authority	3,899.6	3,888.7	211.3	99.0	130.9	0.0	1997
Rural Development Authority	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pohnpei Transport Authority	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pohnpei Radio	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Economic Development Authority	1,396.7	1,268.9	1,132.1	(150.4)	113.5	0.0	1997

Note:

1. FSM = Federated States of Micronesia; n.a. = not available; NFC = National Fishing Corporation
2. The year indicates the most recent audit report sighted.
3. Micronesia Long Line Fishing Co, Yap Fresh Tuna, Chuuk Fresh Tuna, and Kosrae Venture are subsidiaries of NFC. As such the NFC figures include consolidation of NFC's share of profits, losses etc.

(Reference in text: page 1, para. 4)



### TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Project Targets & Measurable Indicators	Means of Verification & Monitoring Mechanisms	Risks & Assumptions
<b>Goal</b> <ul style="list-style-type: none"> <li>Increased efficiency in the public sector enterprise (PSE), and improved allocation of resources and greater economic efficiency</li> </ul>	<ul style="list-style-type: none"> <li>Reduced share of PSEs in the Federated States of Micronesia gross domestic product (FSM GDP) (the latest estimate [1996] is 14 %)</li> <li>Decreased employment in PSEs (the latest estimate [1997] is 1,400 or 14 % of formal sector employment)</li> <li>Improved financial performance of PSEs (economic losses amounted to \$15 million in 1996)</li> </ul>	<ul style="list-style-type: none"> <li>Annual reports of the Public Enterprise Reform Unit (PERU)</li> <li>Annual reports of individual PSEs</li> <li>Consultants' reports</li> </ul>	<ul style="list-style-type: none"> <li>Government is committed to the reforms of PSEs</li> </ul>
<b>Objective/Purpose</b> <ul style="list-style-type: none"> <li>Assist the Government to formulate privatization strategy and carry out the effective and transparent reforms of PSEs</li> </ul>	<ul style="list-style-type: none"> <li>Privatization strategy is approved and reforms of the PSEs are initiated</li> </ul>	<ul style="list-style-type: none"> <li>A copy of the approved strategy</li> <li>Consultants' reports</li> <li>Review mission</li> </ul>	<ul style="list-style-type: none"> <li>Government willingness to undertake PSE reforms</li> <li>Institutional capacity of the Government</li> <li>Interest on the part of the private sector</li> </ul>
<b>3.Components/Outputs</b> <ul style="list-style-type: none"> <li>Assistance to the national and state governments in formulation of the PSE reform strategy, and preparation of a detailed corporatization and privatization master plan</li> </ul>	<ul style="list-style-type: none"> <li>Review and classification of PSEs is completed</li> <li>Corporatization and privatization master plan and five-year corporatization program is finalized and adopted by the Government</li> </ul>	<ul style="list-style-type: none"> <li>A report on the results of the PSE review</li> <li>A copy of the approved strategy and corporatization and privatization plan</li> </ul>	<ul style="list-style-type: none"> <li>Continuing commitment of the Government</li> <li>Privatization program sufficiently resourced</li> <li>Interested private sector buyers</li> </ul>
<ul style="list-style-type: none"> <li>Capacity building of PERU and in the design, structuring, and implementation of corporatization and privatization</li> </ul>	<ul style="list-style-type: none"> <li>PERU is established as a nodal agency for privatization and monitoring of PSEs</li> <li>PERU's five-year work program is finalized and adopted</li> <li>PERU is adequately staffed by local counterparts</li> <li>Three rounds of seminars are completed</li> </ul>	<ul style="list-style-type: none"> <li>Government approval of the establishment of the PERU</li> <li>A copy of the five-year work program</li> <li>Names of counterparts and their appointment letters</li> <li>Consultants' reports and feedback from the participants</li> </ul>	<ul style="list-style-type: none"> <li>Availability of Government funding for setting up PERU</li> <li>Availability of suitable local candidates and counterpart staff to head PERU</li> </ul>
<ul style="list-style-type: none"> <li>Provide technical advice on privatization and corporatization of individual PSEs on a pilot basis</li> </ul>	<ul style="list-style-type: none"> <li>At least two national/state level PSEs are corporatized/privatized and strategy for the rest is developed</li> </ul>	<ul style="list-style-type: none"> <li>Consultants' reports and feedback from the Government</li> <li>Review mission</li> </ul>	<ul style="list-style-type: none"> <li>Government approval of privatization of identified PSEs</li> <li>Interested private sector buyers</li> <li>Adequate implementation capabilities of PERU</li> </ul>
<ul style="list-style-type: none"> <li>Advise on strengthening the management framework and corporate governance of PSEs</li> </ul>	<ul style="list-style-type: none"> <li>Specific proposals to improve management and monitoring framework are adopted and being implemented</li> </ul>	<ul style="list-style-type: none"> <li>Annual PERU Reports</li> <li>Compliance with the Public Enterprises Act</li> </ul>	<ul style="list-style-type: none"> <li>Promulgation of the Public Enterprises Act</li> <li>Enforcement of reporting requirements on PSEs</li> </ul>
<ul style="list-style-type: none"> <li>Advice on consensus building and increasing awareness of stakeholders on the issues related to PSE reforms</li> </ul>	<ul style="list-style-type: none"> <li>Public awareness campaign is designed</li> <li>Initial public awareness seminars are conducted</li> </ul>	<ul style="list-style-type: none"> <li>Developed public information campaign</li> <li>Feedback from the seminar participants</li> </ul>	<ul style="list-style-type: none"> <li>Receptivity of general public</li> <li>Availability of funding for the campaign implementation</li> </ul>

**COST ESTIMATES AND FINANCING PLAN**  
(\$'000)

<b>Item</b>	<b>Foreign Exchange</b>	<b>Local Currency</b>	<b>Total Cost</b>
<b>A. Bank Financing</b>			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	300	0	300
ii. Local Consultants	0	29	29
b. International and Local Travel	26	10	36
c. Reports and Communications	5	5	10
2. Equipment	10	0	10
3. Training, Seminars, and Conferences	0	10	10
4. Representative for Contract Negotiations	5	0	5
5. Contingencies	40	10	50
<b>Subtotal (A)</b>	<b>386</b>	<b>64</b>	<b>450</b>
<b>B. Government Financing</b>			
1. Office Accommodation and Transport	0	30	30
2. Training, Workshop Facilities	0	5	5
3. Counterpart Staff	0	50	50
4. Contingencies	0	30	30
<b>Subtotal (B)</b>	<b>0</b>	<b>115</b>	<b>115</b>
<b>Total</b>	<b>386</b>	<b>179</b>	<b>565</b>

## **OUTLINE TERMS OF REFERENCE FOR CONSULTANTS**

### **A. Work Program**

1. The TA will be implemented over approximately a 12-month period. The team of consultants will work closely with the staff of the National Government's Department of Economic Affairs (DEA), relevant offices of the state governments, and the Economic Management Policy Advisory Team (EMPAT) to (i) set up the systems and procedures; and (ii) prepare a manual and guidelines for privatization or restructuring of public sector enterprises (PSEs), and documents on organization, management, and personnel restructuring of PSEs, for the guidance of the staff. The TA will also assist the state government in carrying out pilot privatization transactions. The team will ensure that labor and environment impacts are identified, and mitigation measures are incorporated in accordance with the relevant laws prior to privatization. Selected of PSEs could include at the National Government level: (i) Bank of FSM, (ii) FSM Telecommunications Corporation, (iii) National Fisheries Corporation, (iv) FSM Postal Services, and (v) Micronesia Long-Line Fishing Corporation; at the state level (i) Caroline Fisheries Corporation and Pohnpei Fisheries Corporation (Pohnpei), (ii) Pacific Tuna Industries and Micronesia Petroleum Company (Kosrae), (iii) Yap Fresh Tuna Incorporated and Yap Fisheries Corporation (Yap), and (iv) Chuuk Coconut Authority and Chuuk Fresh Tuna Corporation (Chuuk). The PSEs for corporatization/privatization will be selected on the basis of (i) importance to the FSM economy, (ii) commercial viability, (iii) value to the community; (iv) political sensitivity; (v) the need to restructure prior to privatization; and (vi) effect on unemployment.

2. A team of three international experts with the assistance of two domestic consultants will undertake the task identified below. The areas of expertise required for the international consultants are (i) privatization approaches, methods, and policy and corporate restructuring; (ii) corporate law; (iii) corporate governance; and (iv) financial analysis. An international privatization and policy expert will be the team leader. Domestic consultants will have expertise in (i) financial analysis, accounting, and valuation; and (ii) legal matters. The consultants will be assisted by a team of counterpart staff from DEA and relevant offices of the state governments.

### **B. International Consultants (13 person months)**

#### **1. Public Enterprises Reforms Expert-Team Leader (7 person-months)**

3. The expert will have extensive practical experience in the design and implementation of reforms of public enterprises, preferably with exposure to Pacific Developing Member Countries (PDMCs). He or she will report to the Secretary of Economic Affairs. The expert will guide the team of international and domestic consultants, and coordinate all inputs and outputs of the consultants, including the preparation of reports. He or she will also coordinate the technical assistance (TA) activities with EMPAT team to ensure coherence of policy advice and integration of the public enterprise reform component with overall public sector reforms initiated under the public sector reform program (PSRP). In addition, the expert will:

- (i) assist the national and state governments in formulating the PSEs reform strategy and preparing a detailed privatization master plan, a five-year privatization and corporatization program, and an action plan for improving corporate governance;

- (ii) help establish the public enterprise reform unit (PERU);
- (iii) establish, in consultation with the National and state governments, a transparent process for implementing privatization and rules, procedures, and limits for government involvement in decisions related to the PSEs remaining in the government;
- (iv) undertake studies for developing strategies for corporate restructuring of the PSEs to facilitate their privatization through various modalities, including leasing of assets, management contracts, divestment, and sale of assets ensuring sufficient management autonomy to achieve the enterprises' objectives;
- (v) assess strengths and weaknesses in corporate governance of PSEs and private industrial enterprises, and help implement measures to improve efficiency of government management of PSEs, increase operational autonomy, professionalize the management and ensure accountability, and establish a clear and enforceable decision-making process and management organization in PSEs;
- (vi) discuss the restructuring and privatization modalities and proposals with the national and state governments and PSE managers and develop the required consensus; oversee preparation of the PSE corporate and financial restructuring plans and examine the associated financial and labor implications;
- (vii) develop an action plan, including a timetable for the scrutiny of PSEs and preparatory steps necessary for divesting them, and handle the preparatory work for divestment of PSEs, including prioritizing such activities;
- (viii) enhance the capacity of policy makers and selected PSEs managers by exposing them to international experience on the approach and modalities for PSE restructuring through workshops, training, and information seminars;
- (ix) assist the Government and the Bank in preparation and conduct of the FSM Privatization Forum scheduled for early 2000; and
- (x) help conceptualize the programmed follow-on TA.

## **2. Legal Expert (3 person-months)**

4. The lawyer will have had extensive experience in corporate law, and restructuring and corporatization of PSEs and will:

- (i) review the PSE legal and regulatory framework and prepare a set of draft statutes and regulations for corporatization and privatization of PSEs, ensuring transparency of the process;
- (ii) advise on changes in legislation and rules and regulations necessary for effective PSEs reforms;

- (iii) review the national and state company and business laws, statutes, and articles of incorporation of PSEs; recommend necessary changes; and design a model company charter for corporatized PSEs;
- (iv) prepare draft guidelines on the "best practices" in corporate governance; and develop for members of boards of directors and senior executives, model employment contracts that can be used by enterprises adopting such "best practices" in corporate governance (using as a background, similar documents prepared under the Bank-financed TAs);
- (v) propose introduction of performance contracts and other incentive systems in PSEs and corporatized enterprises;
- (vi) prepare a reference manual to help implementation of the model charter on (a) the convening, conduct, and voting procedures of general meetings of shareholders; (b) rights and responsibilities of shareholders and company officers; and (c) legal and other means of redress within the Federated States of Micronesia (FSM) regulatory environment, in cases of violations of company charters; and
- (vii) conduct training on legal issues related to privatization and corporatization.

### **3. Financial Adviser (3 person-months)**

5. The financial analyst (preferably) a certified financial or public accountant, will have had extensive experience dealing with financial aspects of privatization. The analyst will:

- (i) assist the team leader in structuring privatization proposals by providing financial and accounting expertise;
- (ii) review the accounting systems of PSEs and recommend measures to bring these systems in line with international standards;
- (iii) on the basis of the reviews prepared by the EMPAT team, and with their assistance, prepare a comprehensive set of financial data on the PSEs;
- (iv) prepare documentation providing different approaches and methodologies for valuation of PSEs subject to corporatization and privatization;
- (v) value and appraise PSEs in preparation for their privatization;
- (vi) identify presale corporate and financial restructuring options and steps to increase the sale value of PSEs subject to privatization;
- (vii) assist in the final negotiations of terms and conditions for sale of PSEs and help close the transactions; and
- (viii) provide hands-on training to the counterpart staff in financial analysis.

## **C. Domestic Consultants**

### **1. Financial Analyst-Accountant (3 person-months)**

6. Under the guidance of the team leader, and in close coordination with the international expert, the analyst will:

- (i) review and help update financial accounts of PSEs identified for privatization and corporatization;
- (ii) propose changes, if warranted, in the accounting practices of individual enterprises;
- (iii) help prepare proposals for financial restructuring aimed at enhancing enterprise value;
- (iv) identify possible effects of privatization on the financial status of enterprises; and
- (v) help prepare projected financial statements and the valuation of enterprises.

### **2. Corporate Lawyer (3 person-months)**

7. The domestic lawyer will assist the international lawyer in reviewing the relevant legislation, including rules and regulations, applicable to PSEs and advise DEA on the legal aspects of restructuring or divestiture of concerned PSEs. The consultant will

- (i) help the team leader identify legal issues pertaining to restructuring and divestiture of PSEs and develop proposals, including any legislative amendments, to resolve such issues;
- (ii) identify the PSEs with state government interest and ensure that each could pass a clear and undisputed title to any prospective buyer when privatized;
- (iii) identify all legal assets of PSEs to be divested and ensure that such assets are included in the relevant divestment documents, in accordance with the law, and ensure that the interests of minority shareholders and financial institutions are identified and any issues pertaining to them are resolved prior to the divestment;
- (iv) work with other consultants to identify a course for restructuring PSEs, consistent with the applicable laws;
- (v) develop proposals for settling outstanding claims and obligations arising from proposed divestment of PSEs;
- (vi) ensure that the proposed privatization complies with all legal processes and in particular that all necessary consents and approvals are obtained;
- (vii) identify and negotiate solutions to management and employees' issues, e.g., pension rights, retrenchments, and early retirements; and

- (viii) prepare legal documents for sale of PSEs and help close the initial public offering of PSEs.

#### **D. Training and Educational Campaign**

8. The team of consultants will design and conduct at least three seminars at selected centers under the direction of the team leader. The seminars will target a wide range of stakeholders involved in PSE reforms, including national and state government employees involved in the reforms of the PSEs, managers of PSEs, politicians, and the local and foreign business community. The seminars will familiarize the stakeholders with concepts and issues related to the reforms of public enterprises.

9. The team of consultants will design and conduct at least three one-week seminars at selected centers, covering (i) principles and modalities of privatization; (ii) principles of corporate governance; and (iii) model company charter and its implementation, corporatization, valuation. Each course will have at least 20 participants consisting of a mix of low- and mid-level officers from the national and state governments and managers of selected PSEs potentially subject to privatization. The consultant team will design the curriculum, prepare case studies on relevant areas adapted to the FSM situation, provide training materials, and field the faculty to conduct the seminars. DEA will be responsible for reproducing the training materials.

10. At the end of each seminar, the consultants will evaluate the choice of participants, and suggest ways to improve participant selection and the seminar design. The consultant's evaluation will be submitted to the Bank. Using a survey form designed by the consultants and approved by the Bank, the participants will be asked to evaluate the appropriateness of the seminar curriculum, usefulness of the training materials, and effectiveness of the faculty. Suggestions for improving the seminar will be requested. DEA will prepare a summary of the evaluations by participants and will submit it to the Bank.

#### **E. Reporting Arrangement**

11. The team leader will submit the following reports to the DEA Secretary and the Bank:

- (i) **Inception Report.** At the end of the first month of TA implementation, the team leader will submit a report on the deployment of the international consultants, local consultants, and counterpart staff, setting out the work program for each consultant and counterpart staff member. The report will also provide information on (a) the structure and role of PERU in facilitating the implementation of this plan, (b) the draft privatization strategy, (c) the results of the review of the PSEs, and (d) a proposal for the pilot corporatization/privatization of PSEs.
- (ii) **Interim Report.** At the end of the 24th week of TA implementation, the team leader will submit an interim report that summarizes the progress of the TA. The report will also include (a) finalized policy guidelines and procedures for corporatization/privatization, (b) a monitoring framework for PSEs, (c) a public relations strategy, and (d) detailed proposals and an action plan for privatization/corporatization of selected PSEs. Furthermore, the report will highlight the required financial, labor, and administrative restructuring envisaged in the process of PSEs reforms.

- (iii) **Draft Final Report.** At the end of the 11th month of TA implementation, the team leader will submit to the Government and the Bank for their review the draft final report, which will include proposals for the divestment and restructuring of at least 10 PSEs, and an overall approach and strategies for restructuring and eventually divesting the remaining PSEs over the medium term. The final report will also include information on the implementation of the restructuring program of PSEs covered under the TA. Furthermore, the report will assess the need for a follow-up TA for further PSE reforms in the FSM. The recommendations of the draft final report will be discussed at a tripartite meeting between the Government, the consultants, and the Bank.
- (iv) **Final Report.** A final report, incorporating the comments of the Government and the Bank, will be submitted to the Government and the Bank within a month of the tripartite meeting.