



Report and Recommendation of the President to the Board of Directors

Project Number: 54309-001
November 2020

Proposed Countercyclical Support Facility Grant Federated States of Micronesia: Health Expenditure and Livelihoods Support Program

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Asian Development Bank

CURRENCY EQUIVALENTS

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

ABBREVIATIONS

ADB	–	Asian Development Bank
C-HAP	–	COVID-19 Health Action Plan
COVID-19	–	coronavirus disease
CPRO	–	COVID-19 Pandemic Response Option
CTF	–	Compact Trust Fund
DFA	–	Department of Finance and Administration
DSA	–	debt sustainability analysis
ESP	–	Economic Stimulus Package
FSM	–	Federated States of Micronesia
GBV	–	gender-based violence
GDP	–	gross domestic product
IMF	–	International Monetary Fund
PFM	–	public financial management
PUA	–	Pandemic Unemployment Assistance
SPP	–	social protection program
TA	–	technical assistance
US	–	United States
WHO	–	World Health Organization

NOTES

- (i) The fiscal year (FY) of the Government of the Federated States of Micronesia and its agencies ends on 30 September. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2020 ends on 30 September 2020.
- (ii) In this report, “\$” refers to United States dollars, unless otherwise stated.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 54309-001	
Project Name	Health Expenditure and Livelihoods Support Program	Department/Division	PARD/PASP
Country	Micronesia, Federated States of	Executing Agency	Department of Finance and Administration
Recipient	Federated States of Micronesia		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=54309-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=54309-001-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Economic affairs management		2.10
	Public expenditure and fiscal management		2.10
	Social protection initiatives		7.00
Health	Disease control of communicable disease		1.40
	Health system development		1.40
Total			14.00
3. Operational Priorities		Climate Change Information	
✓ Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0
✓ Accelerating progress in gender equality		Climate Change impact on the Project	Low
✓ Strengthening governance and institutional capacity			
		ADB Financing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		Cofinancing	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 1.3, 1.5		Effective gender mainstreaming (EGM)	✓
SDG 3.c, 3.d			
SDG 5.2			
SDG 8.1			
SDG 9.3			
SDG 10.2			
SDG 17.17			
4. Risk Categorization:		Poverty Targeting	
Low		General Intervention on Poverty	✓
5. Safeguard Categorization		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		14.00	
Sovereign COVID19 Pandemic Response Option: Asian Development Fund		14.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		14.00	
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed Countercyclical Support Facility grant to the Federated States of Micronesia (FSM) for the Health Expenditure and Livelihoods Support Program under the COVID-19 Pandemic Response Option (CPRO).¹

2. The program is part of an integrated package of assistance by the Asian Development Bank (ADB) to the FSM to support short-term efforts to mitigate the potential health consequences and socioeconomic impacts of the coronavirus disease (COVID-19) pandemic. It is aligned with the Pacific Approach's priority of managing risks and building economic resilience to protect the population from hardships;² and the Strategy 2030 priority of directing ADB grant resources to the most vulnerable developing member countries.³ The FSM meets all of the access criteria of ADB's CPRO, which include sound macroeconomic management, undertaking key structural reforms, a pro-poor countercyclical expenditure program, and debt sustainability (Table 1).⁴

Table 1: Summary Assessment of Compliance with the Access Criteria for the Countercyclical Support Facility and the COVID-19 Pandemic Response Option

Access Criteria	ADB Assessment
1. Adverse impact of exogenous shock	The FSM economy is projected to contract by 5.4% in FY2020 and by a further 1.8% in FY2021. Total formal job losses across sectors are estimated at 1,975 (up to 70% are women) by the end of FY2021. Per capita income is expected to fall by 3.6% from FY2019 to FY2021, with the poverty rate rising from 32.3% to 36.8% over the same period. This translates to more than 4,500 people falling below the poverty line, with more severe impacts on female-headed households.
2. Countercyclical development expenditure	The government has approved total countercyclical expenditures of \$58.7 million (\$28.6 million in FY2020 and \$30.1 million in FY2021). Mainly funded through grants and funds realignment, these development expenditures include (i) a health action plan (\$29.0 million) on COVID-19 preparedness and response, (ii) an economic stimulus package (\$18.4 million) to assist affected businesses and workers, and (iii) social protection programs (\$11.3 million) for the poor and vulnerable groups.
3. Pre-shock record of generally sound macroeconomic management	The FSM's GDP grew by an average of 1.9% annually in FY2015–FY2019, largely driven by the services sector (trade, financial intermediation, and real estate). Inflation was low, at 0.1%, over the same period. With higher grants and revenues (74.6% of GDP in FY2015–FY2019), and restraints on recurrent expenditure (at 59.8% of GDP), annual fiscal surpluses rose to 14.8% of GDP in FY2015–FY2019. The surpluses were used mainly to build up the FSM Trust Fund and reduce public debt.
4. Structural reforms	Strong actions in the form of early travel restrictions and border closures have prevented a COVID-19 outbreak. The government is implementing a COVID-19 Response Framework to develop quarantine and isolation facilities across the nation, provide mandatory infection control training for all first responders, and increase testing capacity and ventilators for each island state in the FSM. All four state hospitals are now equipped with COVID-19 testing machines. Risk communication and community outreach are ongoing to educate the public on COVID-19 awareness, in coordination with development partners. Under the 2023 action plan to enhance economic and financial stability, the government is working to improve public financial management, strengthen tax reforms, and contain expenditures, including on the public wage bill. Annual contributions to the FSM Trust Fund were increased through laws mandating mandatory percentages from fishing license fees and corporate income taxes.
5. Debt sustainability	The FSM's public debt stock is relatively low (at 20% of GDP in FY2019), but the IMF classifies the country to be at high risk of debt distress in view of the fiscal uncertainties after FY2023, with the expiration of the economic provisions of the second Compact of Free Association with the US. Debt sustainability analyses conducted by ADB and the IMF

¹ ADB. 2020. [Policy Paper: ADB's Comprehensive Response to the COVID-19 Pandemic](#). Manila.

² ADB. 2016. [Pacific Approach, 2016–2020](#). Manila.

³ ADB. 2018. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#). Manila.

⁴ Assessment of Compliance with Access Criteria for the Countercyclical Support Facility and COVID-19 Pandemic Response Option Access Criteria (accessible in Appendix 4).

Access Criteria	ADB Assessment
	maintain the high risk of debt distress rating but conclude that public debt remains sustainable.
6. IMF coordination	ADB has been closely coordinating with the IMF and has built strong relationships through active participation during Article IV missions and staff visits to the FSM. The IMF is supportive of the proposed CPRO and has provided an Assessment Letter (dated 25 June 2020), which aligns with ADB's views.

ADB = Asian Development Bank, COVID-19 = coronavirus disease, CPRO = COVID-19 Pandemic Response Option, FSM = Federated States of Micronesia, FY = fiscal year (ending 30 September), GDP = gross domestic product, IMF = International Monetary Fund, US = United States.

Sources: ADB estimates; Graduate School USA Pacific Island Training Initiative. 2019. [Federated States of Micronesia Fiscal Year 2018 Statistical Appendices](#). Honolulu, HI; Government of the FSM, Department of Finance and Administration; FSM Statistics Office; and International Monetary Fund.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. The FSM is a remote Pacific small island developing state, encompassing 607 islands that are spread over the world's 14th largest geographic exclusive economic zone. It is a lower middle-income island nation with a small population of 104,468 in 2018, of whom about 45% live in Chuuk, 37% in Pohnpei, 11% in Yap, and 7% in Kosrae. The country is vulnerable to climate change, facing frequent natural hazards and rising sea levels. The public sector dominates the economy, with private economic activities focused mainly on subsistence farming and fishing, wholesale and retail trade, transportation, and tourism services. Less than 15% of the population was in formal employment in 2010, with significantly more people directly or indirectly depending on them: those under the age of 15 (36%), outside the labor force (27%), or in the subsistence sector (16%).⁵ In FY2018, the government and public enterprises accounted for 32% of gross domestic product (GDP), followed by households (26%), private enterprises (19%), and financial institutions (16%).⁶ The FSM has one of the highest estimated rates of poverty in the Pacific, with 41% of the population living below the total poverty line and 10% below the food poverty line in 2014.⁷ The United Nations Development Programme's Human Development Index ranked the FSM 135th out of 189 economies for 2019.⁸

4. Despite the geographic isolation of the Pacific, the risk of COVID-19 transmission to vulnerable populations remains high, with confirmed cases in Fiji, Papua New Guinea, and Solomon Islands.⁹ As a small island developing state, the FSM faces distinct challenges in addressing the threat of the pandemic, such as weak health infrastructure, geographically dispersed populations, and institutional capacity constraints. While COVID-19 has not yet spread to the FSM (no confirmed cases), the projected health, economic, and social impacts of the COVID-19 pandemic are already significant.

5. **Vulnerability to external shocks.** The narrow economic base, reliance on external revenue sources, and vulnerability to climate change and natural hazards make the FSM susceptible to external shocks. The economy benefited greatly from the fishing industry, which has attracted substantial increases in domestic revenues from fishing licenses sold to foreign

⁵ FSM Office of Statistics, Budget, Overseas Development Assistance and Compact Management. 2012. [Summary Analysis of Key Indicators from the FSM 2010 Census of Population and Housing](#). Palikir.

⁶ Graduate School USA Pacific Island Training Initiative. 2019. [Federated States of Micronesia FY2018 Statistical Appendices](#). Honolulu.

⁷ Government of the FSM and World Bank. 2017. [Poverty profile of the Federated States of Micronesia](#). Palikir.

⁸ United Nations Development Programme. [Micronesia \(Federated States of\) Human Development Indicators](#) (accessed 22 June 2020).

⁹ World Health Organization (WHO). 2020. Novel Coronavirus (COVID-19) [Health Sector Preparedness and Response. Joint External Situation Report for Pacific Islands. No. 27](#). Suva.

fleets for tuna fishing in the FSM's exclusive economic zone. However, fiscal policy is dependent on official development assistance and grants, particularly from the United States (US) via the amended Compact of Free Association Agreement that became effective in 2004.¹⁰ Compact grants provide funding for education, health, private sector development, environment, public sector capacity building, and enhancing reporting and accountability. The annual sector grants started at \$76 million in FY2004 and have been reduced by \$0.8 million annually since FY2007. The difference between the total contribution and the annual sector grant levels is deposited into the Compact Trust Fund (CTF). Compact grants, at around 20% of GDP, are projected to be replaced by investment returns from the CTF (expected to be around 11% of GDP) beyond 2024, a substantial reduction in revenues. Unless arrangements under the Compact are renewed before expiry in 2023, the FSM's fiscal position will experience severe revenue volatility afterward.

6. Weak health system and preparedness to deal with a pandemic outbreak. The state governments manage and regulate the FSM's health care system. Each of the four states has a main public hospital, and the country has one private hospital. At the municipal level, including the outlying islands, health care is available only through dispensaries, which function as health clinics for basic diagnosis and treatment. The FSM lacks the health infrastructure and preparedness to cope with a pandemic outbreak, with less than 20 beds available for the isolation of suspected or confirmed COVID-19 patients, and isolation rooms only available in one of the four island states. Essential medical supplies and equipment, such as personal protective equipment and ventilators, have arrived in the FSM in batches; and the training of frontline workers has yet to be completed. The capacity to undertake infectious disease surveillance and contact tracing is limited, with inadequate routine reporting of severe acute respiratory illnesses and influenza-like illnesses. The FSM has only 38 skilled health workers per 10,000 population, short of the recommended indicator of 59.4 of the World Health Organization (WHO).¹¹

7. The high incidence of noncommunicable diseases and comorbidities in the FSM increases its population's susceptibility to COVID-19, and to the risk of a heightened mortality rate. A COVID-19 outbreak would be even more challenging for people living in communal and informal settlements, which are densely populated and have poor access to basic services such as health care, water, and sanitation facilities. The impact of a localized epidemic in the Pacific was seen in October 2019 during a measles outbreak in Samoa. The FSM has had epidemic outbreaks related to dengue and waterborne diseases, which have been expensive for the cash-strapped state and national health departments. In 2019, the Global Health Security Index, which benchmarks countries on pandemic preparedness, ranked the FSM 124th of 195 countries.¹²

8. Strong government measures to contain the threat of the COVID-19 pandemic. The government enacted strong and timely containment measures to limit the risk of a local outbreak by introducing travel restrictions and closing its borders, requiring 14-day self-quarantine in a COVID-19-free area before entry to the FSM, restricting residents from traveling abroad and implementing social distancing standards. A state of public health emergency remains in effect since 31 January 2020. The government has been implementing its COVID-19 Response Framework, with important progress in strengthening health screening and surveillance at points of entry in airports and seaports, and in procuring essential medical supplies and equipment. All four state hospitals have COVID-19 testing capacity. While these measures are critical from a

¹⁰ The Compact of Free Association between the FSM and the US provides for US economic assistance (including eligibility for certain US federal programs) and defense of the FSM in exchange for US military and other operating rights within the FSM's territory. The US and the FSM negotiated a second (amended) Compact agreement that took effect in 2004.

¹¹ WHO. 2017. [WHO Country Cooperation Strategy, 2018–2022: Federated States of Micronesia](#). Manila: WHO Regional Office for the Western Pacific.

¹² Global Health Security Index. 2019. [Global Health Security Index, 2019: Building Collective Action and Accountability](#). Washington, DC.

health perspective, vulnerabilities remain as the state health departments lack, among others, quarantine facilities, intensive care units, and health professionals to manage a potential COVID-19 outbreak. The FSM has established local capacity for COVID-19 testing, with 96 tests conducted as of September 2020. No confirmed cases have been reported.

9. **Pre-COVID-19 sound macroeconomic management.** The FSM's economy has generally been performing well in the past 5 years, with GDP growth averaging 1.9% per annum in FY2015–FY2019 (Table 2 and Appendix 4). Its fiscal position has recorded budget surpluses because of strong revenues from fishing license fees and large-scale offshore corporate tax payments, while expenditures (in particular, public sector wages) were restrained.¹³ With revenues averaging 74.6% of GDP, while expenditure was 59.8% of GDP, the average surplus was 14.8% of GDP in FY2015–FY2019. The government has been allocating a significant part of the fiscal surplus to its sovereign wealth fund, the FSM Trust Fund, which totaled \$270 million at the end of FY2019.¹⁴

Table 2: Pre-COVID-19 Macroeconomic Indicators

Item	FY2015	FY2016	FY2017	FY2018	FY2019e
GDP growth (% , constant prices)	4.6	0.9	2.7	0.2	1.2
Inflation (CPI period average)	0.0	(1.0)	0.7	1.7	(1.0)
Total revenue (% of GDP)	36.9	35.9	41.3	53.7	53.3
Total revenue and grants (% of GDP)	66.1	69.0	78.3	79.9	79.8
Expenditure (% of GDP)	55.7	61.7	63.9	55.6	62.2
Overall fiscal surplus (deficit) (% of GDP)	10.4	7.3	14.3	24.3	17.6
Gross external public debt (% of GDP)	25.6	24.2	21.9	18.9	20.2
Current account balance (% of GDP)	3.6	7.2	10.3	20.4	24.8

() = negative, COVID-19 = coronavirus disease, CPI = consumer price index, e = estimates, FY = fiscal year, GDP = gross domestic product.

Source: Asian Development Bank estimates; and Graduate School USA Pacific Island Training Initiative. 2019. [Federated States of Micronesia FY2018 Statistical Appendices](#). Honolulu, HI.

10. **Key channels for COVID-19 impacts.** The COVID-19 pandemic has severely impacted FSM's economy. Extended border closures amid the pandemic are projected to result in economic contractions of 5.4% in FY2020 and 1.8% in FY2021, largely through constraints on trade and travel flows affecting agriculture and services.¹⁵ Table 3 summarizes the adverse economic consequences of the pandemic for the FSM through several channels.

Table 3: Key Transmission Channels for COVID-19

Transmission Channel	Issues
Agriculture	Agriculture is largely based on smallholder farms producing root crops, vegetables, fruit, and livestock for household consumption and local sale. Commercial agriculture remains largely undeveloped. Although 63% of households engage in agriculture activities, only 24% sell any of their production. Hence, agriculture's contribution to GDP remained low at an average of 14% in FY2015–FY2019. Restrictions on international and local travel constricted demand, severely limiting opportunities available to small farmers to sell their produce.
Fisheries	Although fisheries contributed only about 11.5% of GDP in FY2015–FY2018, royalties from fishing license fees increased significantly from 6.0% of GDP in FY2011 to an average of 19.4% of GDP in FY2015–FY2018. Travel and quarantine restrictions have prevented purse seine fishing vessels,

¹³ In 2005, the FSM passed corporate tax legislation that enabled the creation of an overseas domicile for companies with a corporate tax rate of 21%, which makes the FSM an attractive domicile (primarily for Japanese captive insurance companies and other corporations).

¹⁴ Under a series of legislation (Public Law 18-107 and Public Law 20-134), the government has specified annual commitments to the fund. Under Public Law 20-134, it allocated 50% of corporate tax earnings from the captive insurance and large corporation segment to the FSM Trust Fund (about \$6 million in normal years). It also allocated 20% of fishing fee revenue to the fund (about \$12 million). In total, the government has legislated to contribute \$24 million annually to the FSM Trust Fund on a conservative basis.

¹⁵ ADB. 2020. [Asian Development Outlook 2020 Update: Wellness in Worrying Times](#). Manila.

Transmission Channel	Issues
	which are required to transship their catch outside the reef, from docking. Transshipment output is expected to fall by more than a third from FY2020 to FY2021. Container vessel visits have also fallen, especially to the two smaller states of Yap and Kosrae. Fishing license fee revenues are expected to decline from 20.6% of GDP in FY2019 to 18.0% in FY2020 and 16.2% in FY2021. Trade and travel restrictions are also affecting small-scale exporters of fish and other agricultural products, which are transported by air cargo or hand-carried by travelers.
Tourism	Tourism-related industries contributed revenues of about \$43 million in 2019 (15.3% of total revenues and grants). It is one of the largest formal sector employers outside the public sector, employing 1,048 people directly in FY2019 and more indirectly through ancillary services. More than 60% of employees in accommodation and food service activities are women. The hotel and restaurant industry, which caters mostly to overseas and interstate visitors, is projected to lose 669 jobs. It accounted for 6.7% of formal employment in FY2019 and 1.7% of GDP during FY2016–FY2018 but is projected to fall by 46% in FY2020 and a further 75% in FY2021.
Transport and trade	With international passenger flights reduced to one flight per month and only outbound traffic permitted, the cargo airline that picks up fresh fish from Pohnpei and Kosrae provides a cargo service 3 days a week, which allows continued imports by air of critical medical equipment and supplies. The country also depends on food imports, which creates an added challenge of ensuring food security during the pandemic crisis. Despite some difficulties with transport to the outer islands and delays related to quarantine restrictions, no shortages of supplies have been reported. The transport sector is projected to decline by 27% in FY2020 and a further 14% in FY2021. An additional loss of 609 jobs across transport, shipping, port services, aviation, and airport ground handling is projected, along with 248 extra job losses in wholesale and retail trade.
Construction	Current travel restrictions and the border closures impact the supply of construction materials and constrain the travel of engineers and personnel, resulting in project delays (as seen in delays in the construction of PetroCorp's coconut processing project in Chuuk). Infrastructure projects—funded by the World Bank in the maritime industry, involving port development and resilient road development (\$80 million); and ADB in renewable energy (\$15 million) and water sanitation projects (\$5 million)—are being delayed and are likely to have a direct impact on the economy. Projections indicate that the construction output will fall from its already low level in FY2019 by 7% in FY2020 and a further 6% in FY2021, with 167 job losses estimated during this period.

ADB = Asian Development Bank, COVID-19 = coronavirus disease, FSM = Federated States of Micronesia, FY = fiscal year, GDP = gross domestic product.

Sources: Asian Development Bank estimates, FSM FY2018 Statistical Compendium, Government of the FSM, Department of Finance and Administration; FSM Statistics Office; International Monetary Fund; and Graduate School USA Pacific Islands Training Initiative. 2020. [Assessing the Impact of COVID-19 on the Federated States of Micronesia Economy](#). *EconMAP Technical Note*. 3 June. Honolulu, HI: Economic Monitoring and Analysis Program.

11. Economic contraction deepens. The continued threat of COVID-19 and the closure of the FSM's borders are severely affecting the economic activities and livelihoods of its already small and vulnerable population. Total formal job losses across sectors are projected to reach 1,975 (of whom women may account for up to 70%) by the end of FY2021, a 12% drop from FY2019 employment levels.¹⁶ Unemployment will be more significant in the private sector. Poverty levels are heightened for people in the informal economy, comprising small businesses and individual workers, as businesses shut down and those reliant on the cash-based enterprises lose their income. As the FSM also depends on food imports, the loss of employment and reduced incomes create the added challenge of ensuring food security. Increasing poverty levels heighten the vulnerability of women, children, the elderly, and persons with disabilities. All these shocks have an adverse effect on the government's fiscal position, creating urgent financing needs. In the event of a COVID-19 outbreak in the FSM and community transmission, the negative economic and social impact could be more severe than anticipated.

12. Gender impacts. Gender inequalities are exacerbated during crises. In the event of a COVID-19 outbreak, women are at increased risk of infection because of their roles as frontline

¹⁶ ADB estimates using data from the FSM Statistics Office; and Graduate School USA Pacific Islands Training Initiative. 2020. [Assessing the Impact of COVID-19 on the Federated States of Micronesia Economy](#). *EconMAP Technical Note*. 3 June. Honolulu, HI: Economic Monitoring and Analysis Program.

health workers and carers. Indirect health risks include worsening health outcomes for women and girls, as essential services such as maternal and reproductive health have a lower priority because of COVID-19 and women may be reluctant to seek health care because of fear of COVID-19 infection. Women are more vulnerable to economic hardships given their reliance on remittances and informal work, particularly in travel and tourism-related industries. In the formal sector, 39% of employees were women, who received 36% of gross earnings and earned 13% less than men, on average.¹⁷ About 20% of total households are female-headed, and they face an increased risk of poverty. Before the COVID-19 crisis, 50% of female-headed households were below the poverty line compared with 39% of male-headed households. Existing prevalence data indicate that one in three women in the FSM have experienced some form of gender-based violence (GBV) in their lifetime, and this is likely to increase because of COVID-19 measures.¹⁸

B. Government Countercyclical Development Expenditure Program

13. To mitigate the adverse impacts of COVID-19, the government has formulated a comprehensive countercyclical response program of \$58.7 million—\$28.6 million for FY2020 and a \$30.1 million for FY2021—comprising three components, as summarized in Table 4.

Table 4: Federated States of Micronesia's Countercyclical Response Program (\$)

Component	Implementation Period	FY2020 ^a	FY2021
Health Action Plan			
A. COVID-19 preparedness and response	Mar 2020–Sep 2021	20,000,000	
B. Vulnerable population mitigation plan	Jan 2021–Sep 2021		9,000,000
Economic Stimulus Package			
A. Tourism Mitigation Fund			
1. Stimulus check for wage subsidies, social security, and tax rebates	Mar 2020–Sep 2021	7,000,000	7,000,000
2. Debt relief (interest payments)	Feb 2020–Dec 2020	500,000	500,000
3. Unemployment assistance to migrant workers	Feb 2020–Dec 2020	400,000	
B. Small business loans from the FSMDB	Jan 2021–Sep 2021		3,000,000
Social Protection Programs			
A. Cash transfer to low-income households	Jan 2021–Jun 2021		5,000,000
B. Community-based food security program	Jan 2021–Jun 2021		2,000,000
C. COVID-19 community-based grant	Jan 2021–Sep 2021		2,000,000
D. Financial assistance to vulnerable groups (elderly, persons with disabilities, gender-based violence and sexual abuse survivors)	Jan 2021–Jun 2021		
1. Utility subsidy allowance			500,000
2. Medical waiver			300,000
3. Support for gender-based violence and sexual abuse survivors			300,000
E. Assistance to stranded citizens abroad	Jan 2020–Sep 2021	500,000	500,000
F. Assistance to FSM students in COVID-19 jurisdictions	Jun 2020–Aug 2021	200,000	
Total		28,600,000	30,100,000

COVID-19 = coronavirus disease, FSMDB = Federated States of Micronesia Development Bank, FY = fiscal year.

^a Remaining budget allocation from FY2020 will continue to be expended in FY2021.

Source: Government of the Federated States of Micronesia, Department of Finance and Administration.

14. **COVID-19 Health Action Plan (\$29.0 million).** As part of the whole-of-government COVID-19 Health Action Plan (C-HAP), the government approved a \$20 million COVID-19 Response Framework for health sector strengthening in April 2020.¹⁹ This framework is an action

¹⁷ Pacific Community. 2017. [Women's Economic Empowerment in the Pacific: Regional Overview](#). Paper prepared for the 13th Triennial Conference of Pacific Women and 6th Meeting of Ministers for Women. Fiji. 2–5 October.

¹⁸ Government of the FSM, Department of Health and Social Affairs. 2014. [Federated States of Micronesia Family Health and Safety Study: A Prevalence Study on Violence Against Women](#). Bangkok: United Nations Population Fund Regional Office for Asia and the Pacific.

¹⁹ Government of FSM. 2020. [FSM COVID-19 Response Framework](#). Palikir.

plan that guides all four state governments' efforts on COVID-19 preparedness and response, including preparations for building quarantine and isolation facilities across the country; providing infection prevention control training for first responders; increasing local laboratories' testing capacity; providing essential medical equipment and supplies, including personal protective equipment, ventilators, and COVID-19 test machines for each state; and strengthening local surveillance capacities for routine national and regional reporting. It also includes a risk communication plan that guides the mitigation interventions in the event of community transmission. As the pandemic shows no signs of abating, the government is increasing the health stimulus by another \$9 million as part of the FY2021 budget to include a vulnerable population mitigation plan to decentralize clinical services and establish remote consultation options for vulnerable groups, such as the elderly and those with pre-existing comorbidities.

15. **Economic Stimulus Package (\$18.4 million).** In March 2020, the FSM Congress passed Public Law 21-104 setting up the Tourism Mitigation Fund, appropriating an initial \$1 million of financial assistance for the tourism industry, which is heavily affected by travel restrictions and border closures. As COVID-19 evolved into a global pandemic, with a sustained and deep impact on the economy, the government formulated the Economic Stimulus Package (ESP). On 22 April 2020, the government passed Public Law 21-105, which temporarily diverts funding from fishing access fees and revenue derived from major corporations to the country's ESP, which otherwise would have been diverted to the FSM Trust Fund. The ESP includes:

- (i) Financial support to an estimated 186 affected tourism businesses that have been heavily hit by the pandemic through the provision of wage subsidies, interest payment relief on business loans, and social security and gross revenue tax rebates to help cushion the impact on economic activity and protect job losses. Assistance will also be expanded to other business sectors affected by the pandemic, subject to approval by Congress.
- (ii) A concessional credit line through the FSM Development Bank to provide loans to at least 200 micro and small enterprises, with up to 50% of the loan amount to be allocated to women-owned businesses. This provides access to affordable credit and grants to support the growth of microenterprises and small businesses.
- (iii) Temporary unemployment assistance to support an estimated 100 migrant workers who have lost their jobs because of the COVID-19 pandemic.

16. The program will support the implementation of the FY2021 stimulus response. The ESP is complemented by a separate grant of \$36 million from the US through a temporary Pandemic Unemployment Assistance (PUA) program for both US and FSM citizens in the country who have lost their jobs or suffered reduced hours as a direct result of the pandemic.²⁰

17. **Social protection programs (\$11.3 million).** Recognizing the severe challenges and vulnerabilities facing the poor, the elderly, persons with disabilities, and survivors of GBV during the crisis, the government developed social protection programs (SPP) comprising:²¹

- (i) Cash transfer grants to support an estimated total of 4,500 low-income households outside the PUA program (inclusive of low-income female-headed households).

²⁰ In March 2020, the Government of the US signed into law the Coronavirus Aid, Relief, and Economic Security Act, 2020, creating the temporary PUA program. Eligible individuals receive a minimum payment of \$166 per week backdated from 27 January up to the end of December 2020. The FSM Department of Finance and Administration administers the PUA and the US Department of Labor oversees the PUA program. The PUA, like all grants, flows through the FSM Government General Fund account. Only off-budget amounts are in-kind grants (medical equipment and supplies).

²¹ Details of the estimated number of target beneficiaries, eligibility criteria, and implementation mechanisms (including grievance mechanisms) of the subcomponents under the ESP and SPP are in the Summary of Economic and Social Protection Measures of the Government's COVID-19 Response Program (accessible from the list of linked documents in Appendix 2).

- This will provide temporary cash relief for affected informal workers to help meet their immediate cash needs in the absence of any income replacement.
- (ii) A food security program for community groups and low-income households to enhance food production through subsistence livelihood training and the distribution of seeds, planting, and fishing materials at no cost.
 - (iii) COVID-19 community-based small grants, working with nongovernment organizations and civil society organizations to strengthen community awareness of COVID-19; education on handwashing and social distancing; distribution of soaps, masks, and information materials to remote areas; and adapting GBV service provision, including pilot testing a GBV hotline in Pohnpei.
 - (iv) Financial assistance to vulnerable groups (including low-income households, the elderly, persons with disabilities, and survivors of GBV) through (a) temporary waivers of medical expenses not included under the Compact Funds (i.e., in-patient, medicine, ambulance, transportation from households to hospitals, and physical therapy); (b) electricity subsidies to an estimated 2,000 low-income households with dependents who have disabilities; (c) the distribution of solar lamps to at least 5,000 households on the outer islands, which are not connected to the grid; and (d) clinical management of rape and intimate partner violence kits and consultation options for survivors of GBV in community health centers.
 - (v) One-off cash payments to an estimated 900 stranded FSM citizens and students abroad.

C. Proposed Program, Impact, and ADB's Value Addition

18. The government has requested CPRO assistance. The proposed program will provide the government with fiscal space and timely support for the implementation of its countercyclical COVID-19 response. It will contribute to the government's efforts in containing the pandemic and addressing its economic and social impacts, particularly on the poor and vulnerable. The effect of the program will be adverse effects of COVID-19 on the FSM's citizens and businesses reduced. The program will have three outputs: (i) measures to combat the entry and spread of COVID-19 in the FSM delivered; (ii) measures to provide economic stimulus relief to businesses implemented; and (iii) measures to provide social protection to poor and vulnerable groups enhanced. The program is also aligned with ADB's Strategy 2030's operational priorities of addressing remaining poverty and reducing inequality, accelerating progress in gender equality, and strengthening governance and institutional capacity. The design and monitoring framework is in Appendix 1.

19. **ADB's value addition.** The program is part of a comprehensive package of ADB assistance that covers the immediate response to COVID-19, short-term financing support for the government's fiscal response to manage adverse socioeconomic impacts, and medium-term interventions to promote recovery and resilience. In the immediate aftermath of the pandemic, the FSM drew down \$6 million in grants from the Pacific Disaster Resilience Program for contingent disaster financing.²² ADB provided \$474,000 in technical assistance (TA) and collaborated with UNICEF in the procurement of essential medical equipment and supplies.²³ The FSM also accessed \$470,000 from the Asia Pacific Disaster Response Fund to meet immediate financing gaps, such as overtime remuneration for frontline workers, quarantine and contact tracing costs of suspected COVID-19 patients, and other logistics costs. The FSM received a further allocation of \$1.03 million from the Asia Pacific Disaster Response Fund, financed by the Government of

²² ADB. 2017. [*Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loans, Grants, and Technical Assistance Grant for the Pacific Disaster Resilience Program*](#). Manila.

²³ ADB. 2020. [*Technical Assistance for Regional Support to Address the Outbreak of Coronavirus Disease 2019 and Potential Outbreaks of Other Communicable Diseases*](#). Manila.

Japan, to support additional immediate response needs.²⁴ The program supports the government's short-term stimulus response. ADB's regular dialogue with the government was key in the design of the SPP. In terms of post-COVID-19 recovery efforts, ADB will continue to support climate and disaster-resilient infrastructure; build a social protection system for the poor and vulnerable groups; reorient the design of health and social sector projects to strengthen the resilience of the FSM to health emergencies and outbreaks; and replenish the contingent disaster financing for future disasters caused by natural hazards and health emergencies.²⁵ ADB is working closely with key development partners in the Pacific to encourage policy and legislative reforms that will strengthen the business environment, spur investment and private sector-led growth, and support financial inclusion, including for women.

20. **Lessons learned.** The program applies lessons from ADB's experience in providing budget support for effective countercyclical aid to its developing member countries in response to crises, as evident in the Economic Recovery Support Programs for Pacific countries during the 2008 global financial crisis.²⁶ Timeliness is critical in crisis response—earlier responses are usually more effective. Social protection programs are also effective crisis-mitigating and response instruments, as they protect the poor and vulnerable who are the first to be affected by a crisis. The program leverages these lessons and ensures that ADB support is timely and targeted at the poor and vulnerable groups.

21. **Development partner coordination.** To ensure the pandemic responses are well-aligned and complementary, ADB coordinated with partners during virtual country programming and fact-finding missions in July and August 2020.²⁷ ADB provided immediate support for the implementation of the government's stimulus response for FY2020, under various TA funds (para. 19). The government also received funds and donations of medical supplies and equipment from partners. The US provided (i) an emergency allocation of \$7 million from unexpended Compact sector grant funds for health sector needs; (ii) a \$36 million PUA to compensate for job losses under the US Coronavirus Aid, Relief, and Economic Security Act (para. 16); and (iii) an allocation of about \$1.3 million from the US Centers for Disease Control and Prevention's emergency response. The World Bank provided \$2.5 million contingency emergency response for health sector preparedness and the procurement of medical supplies. The People's Republic of China and the Government of Japan provided cash donations and in-kind assistance through medical masks, protective clothing for first responders, and medical supplies.

22. ADB took the lead in coordinating policy advice from development partners to support the government in preparing the ESP and SPP. The WHO, together with UNICEF, Micronesia Red Cross, and local nongovernment organizations, is supporting the FSM in implementing a comprehensive COVID-19 community outreach package that aims to empower communities to protect themselves from COVID-19 infection. This will also be supported by community-based small grants under the program. Moreover, ADB and the International Monetary Fund (IMF) have had regular bilateral meetings on macroeconomic and fiscal issues through participation during Article IV missions (the latest was held in June 2019 in Pohnpei), and as part of wider development partner discussions on supporting the government during the crisis. The IMF is supportive of the CPRO and has provided ADB with an assessment letter for the FSM.²⁸

²⁴ ADB. 2020. [Regional: COVID-19 Emergency Response](#). Manila (FSM for \$470,000); and ADB. 2020. [Regional: COVID-19 Emergency Response](#). Manila (FSM for \$1.03 million).

²⁵ ADB. 2020. Pacific Disaster Resilience Program (Phase 3). Manila (forthcoming).

²⁶ A summary of the Economic Recovery Support Programs that supported five Pacific developing member countries during the global financial and economic crisis is in ADB. 2011. [Policy-Based Programs for the Pacific Islands](#). Policy Brief. November. Manila.

²⁷ Development Coordination (accessible from the list of linked documents in Appendix 2).

²⁸ The International Monetary Fund Assessment Letter and Debt Sustainability Analysis are accessible from the list of linked documents in Appendix 2.

D. Development Financing Needs and Budget Support

23. **Financing needs.** Because of the adverse economic and fiscal impact of the COVID-19 pandemic, the government's financing needs are projected to increase to \$16.5 million in FY2020 and a further \$33.4 million in FY2021. The government has requested a grant not exceeding \$14.0 million from ADB's Special Funds resources (Asian Development Fund) to help finance the program. The grant proceeds will support development financing needs. The government also plans to seek additional grants from development partners. In the absence of further grants, the government plans to reprioritize expenditures, mobilize revenues, or rely on domestic resource efforts to help narrow the financing gap (Table 5).

Table 5: Federated States of Micronesia—Development Financing Needs, FY2020 and FY2021
(\$ million)

Major Budget Categories	FY2020			FY2021		
	Pre-COVID-19	COVID-19 Adjusted	% of GDP	Pre-COVID-19	COVID-19 Adjusted	% of GDP
Revenues	283.2	252.4	74.4	286.1	236.0	69.7
Expenditures	257.2	268.9	79.3	260.5	269.4	79.6
Overall Fiscal Balance	26.0	(16.5)	(4.9)	25.6	(33.4)	(9.9)
Total Financing Needs	(26.0)	16.5	4.9	(25.6)	33.4	9.9
FSM Trust Fund	(26.0)			(25.6)		
Realignment and transfer from domestic funds		5.5	1.6		17.0	5.0
ADB CDF		6.0	1.8			
ADB CPRO					14.0	4.0
World Bank		2.5	0.7			
To be determined		(2.5)			(2.4)	

() = negative, ADB = Asian Development Bank, CDF = contingent disaster financing, COVID-19 = coronavirus disease, CPRO = COVID-19 Pandemic Response Option, FY = fiscal year, GDP = gross domestic product.

Note: Realignments under consideration by the government include the reduction of travel budgets, contractual services, and other nonessential spending, as well as further diversion of fishing license and corporate income tax revenues toward the Economic Stimulus Package and the Tourism Mitigation Fund. Any unfunded COVID-19 elements will be financed through savings elsewhere in the budget.

Sources: IMF. 2019. IMF Country Report. No. 19/288. Washington, DC. (pre-COVID-19); and ADB estimates, based on data provided by the Government of the FSM, Department of Finance and Administration (adjusted for COVID-19).

24. **Debt sustainability.** No new loans are expected within the forecast horizon, as the deficits are expected to be financed through external grants and the realignment of domestic resources. Before COVID-19, the IMF's debt sustainability analysis (DSA) assessed the FSM to be at high risk of external and overall debt distress in 2019. The analysis suggests that DSA thresholds on the present value of external debt will be breached within a 20-year horizon. With the outbreak of COVID-19, the FSM economy is now projected to contract while fiscal deficit is expected to deteriorate further, thereby, increasing the public debt–GDP ratio moderately. DSAs by ADB and the IMF (through a June 2020 assessment letter) maintains the high risk of debt distress rating but concludes that the FSM's public debt remains sustainable. The high risk of debt distress stems from a projected fall in revenues in FY2024, with greater revenue volatility afterward, unless economic provisions of the Compact Agreement are renewed. Compact grants and fiscal transfers totaling 20% of GDP will expire in FY2023 and be replaced by investment returns accruing to the CTF, projected at about 11% of GDP in FY2024. While debt is expected to be financed by non-debt creating flows (such as grants), the risk of a fiscal cliff after FY2023 remains. ADB's assessment corroborates these views. Although economic contraction is expected to be more severe than the IMF's post-COVID-19 assessment (–5.4% in FY2020 and –1.8% in FY2021), the revenue shortfall is expected to be covered by grants from development partners and the realignment of domestic revenues and expenditures. Hence, the debt–GDP ratio will remain sustainable. However, longer containment measures and a further decline in domestic

and external demand could have a potential adverse impact on macroeconomic stability and compromise the debt–GDP trajectory. Nevertheless, the analysis suggests the overall debt–GDP ratio will remain sustainable in the medium to long run.

E. Implementation Arrangements

25. A program steering committee co-chaired by the secretary of finance and administration and the secretary of health, and comprising key government officials from the Department of Finance and Administration (DFA) and the implementing agencies, and the finance directors of each state government—will oversee and monitor the budget execution and flow of funds for countercyclical measures through the DFA’s monthly reports. The program steering committee will provide a monthly update to the President of the FSM on the program’s overall progress and outcomes. The DFA will be the executing agency for the program and will oversee and coordinate the program implementation. The implementing agencies will include (i) the DFA, (ii) the Department of Health and Social Affairs, (iii) the Department of Resource and Development, and (iv) the FSM Development Bank, to ensure the efficient implementation, monitoring, and reporting of the C-HAP, ESP, and SPP. The ESP and SPP will mostly use implementation mechanisms already established for the PUA to reach the target beneficiaries. The implementation of the C-HAP will be reported through the National COVID-19 Taskforce. The implementing agencies will partner with municipal governments, nongovernment organizations, or civil society organizations to provide welfare services to the poor and vulnerable. ADB TA will support the implementation of targeted schemes for the poor and vulnerable groups, and monitoring of social outcomes using sex-disaggregated data.²⁹ The executing agency will provide quarterly reporting to ADB for monitoring of the program outcomes and indicators, as specified in the design and monitoring framework, summary of economic and social protection measures of the government’s COVID-19 response program and gender monitoring matrix. The program will be implemented from 1 December 2020 to 30 September 2021. The proceeds of the policy-based grant will be withdrawn, in accordance with ADB’s *Loan Disbursement Handbook* (2017, as amended from time to time).

III. DUE DILIGENCE

26. **Governance.** The FSM’s strong recent record of sound fiscal management is exhibited by the achievement of annual consolidated fiscal surpluses since FY2012, as well as the steady buildup of fiscal buffers in the FSM Trust Fund, which has more than quadrupled in value since FY2015. However, the latest IMF assessments point to lingering weaknesses in public financial management (PFM), including inadequate procurement procedures and deficiencies in the screening of capital projects.³⁰ A Public Expenditure and Financial Accountability self-assessment was conducted by the government in 2016 to assess progress made since the FSM’s first formal Public Expenditure and Financial Accountability assessment conducted in coordination with the Pacific Financial Technical Assistance Centre in 2013. The resulting PFM Roadmap, 2017–2020 prioritizes (i) implementing a new financial management information system (currently supported by a World Bank project); (ii) reviewing and updating the FSM’s financial management regulations; (iii) improving reporting standards, including through a new DFA website; and (iv) sustaining capacity development efforts, particularly in accounting, auditing, and financial management.³¹ The President of the FSM approved the updated financial management regulations in February 2019—strengthening integrity in PFM—but final thresholds for procurement, asset capitalization, and open bidding in the public sector remain pending with

²⁹ ADB. 2020. [Technical Assistance for Strengthening Gender Outcomes in Pacific COVID-19 Response and Recovery](#). Manila.

³⁰ International Monetary Fund. 2019. [2019 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for the Federated States of Micronesia](#). IMF Country Report. No. 19/288. Washington, DC.

³¹ Government of the FSM. 2017. [Public Financial Management Roadmap, 2017–2020](#). Palikir.

Congress. The FSM is a fragile state whose structural constraints translate to thin capacities for effective governance. Based on ADB's 2018 country performance assessment, the country's ratings are particularly low (2.0–2.5 on a scale of 1.0–6.0, where higher scores indicate better results) for critical areas including the business regulatory environment, the equity of public resource use, and the quality of public administration.³² Thus, further interventions in the FSM will be anchored on lessons from ADB's ongoing regional TA supporting effective and sustainable delivery of development results in fragile situations in the Pacific.³³ ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

27. **Social and poverty impact.** The government's comprehensive and targeted schemes for poor households and vulnerable groups will prevent poverty exacerbation. A cumulative increase in real per capita incomes of 10.8% during FY2014–FY2019 is estimated to have reduced poverty incidence to 32.3% just before the COVID-19 crisis, but the projected 6.9% contraction in incomes has the potential to push poverty back to 36.8% of the population by the end of FY2021.³⁴ Unconditional cash relief targeted at low-income households and those outside the formal economy will provide supplementary income and avoid negative coping mechanisms such as selling assets and incurring debts to support basic needs. These households are likely to have more children, be female-headed, have lower education attainment levels, and be without a reliable source of income. The risks of heightened vulnerability of persons with disabilities, children, and the elderly from lack of access to services and adequate food supply will be addressed through additional cash assistance, utility subsidies, and medical waivers. A targeted approach will prevent their welfare from being compromised during the COVID-19 pandemic.

28. **Gender.** The program is classified *effective gender mainstreaming*.³⁵ The program includes proactive measures to reduce key negative impacts of the COVID-19 pandemic and support women and girls' health and economic empowerment. Schemes supporting women employees and women-owned businesses include (i) support to tourism-related businesses to maintain employees and pay salaries, including 418 female employees (out of 863 employees); (ii) support to 14 women-owned tourism businesses (out of 186 total businesses); and (iii) support to women migrant workers in the tourism industry who have become unemployed because of COVID-19. In addition, grants and loans will be offered to micro and small enterprises, with a target of 100 women-owned enterprises. Several schemes support low-income households and female-headed households, including (i) a one-off cash transfer scheme for 4,500 households with additional payments for those with caring responsibilities, such as children and the elderly; and (ii) a utility subsidy allowance for at least 2000 households. Actions to prevent and respond to GBV include (i) provision for the clinical management of rape and intimate partner violence in eight health clinics across all states; (ii) medical waivers for survivors of GBV; and (iii) measures to establish GBV services and referral pathways. Women's health is further supported by ringfencing budget for maternal, child, and reproductive health services; and investing in providing quality decentralized services so that women and girls do not need to travel to a hospital and put themselves at increased risk of COVID-19 infection. Finally, the community-based COVID-19 preparedness scheme supports women's organizations, and all proposals will be assessed on gender equality criteria.

29. **Safeguards.** Following ADB's Safeguard Policy Statement (2009), the program is classified *category C* for environment, involuntary resettlement, and indigenous peoples, as the

³² ADB. 2019. [Annual Report on the 2018 Country Performance Assessment Exercise](#). Manila.

³³ ADB. 2018. [Technical Assistance Towards Effective and Sustainable Delivery of Development Results in Fragile Situations in the Pacific](#). Manila.

³⁴ Based on an assumed growth elasticity of poverty of between –1.5 to –2.0, or toward the lower end of the observed developing country range of –1.5 to 5.0 for conservative results.

³⁵ Gender Monitoring Matrix (accessible from the list of linked documents in Appendix 2).

program component activities are not expected to have adverse environmental or social safeguards impacts.³⁶ Budget expenditure categories financed by ADB will not lead to involuntary resettlement, or negatively affect indigenous peoples or the environment, as defined in the Safeguard Policy Statement.

30. **Risks and mitigating measures.** Major risks and mitigating measures are summarized in Table 6 and described in detail in the risk assessment and risk management plan.³⁷

Table 6: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
A COVID-19 outbreak may lead to realignment of resources away from social assistance to fund additional expenditures on containment of public health impacts.	The government is building the health system's capacity to respond to any potential outbreak, including through the preparation of quarantine and isolation facilities across all four states and expanding COVID-19 testing capacities.
Disasters caused by other external shocks undermine the Federated States of Micronesia's fiscal position.	The government is looking to identify additional disaster risk financing options and all four states have adopted joint state action plans for climate change. ADB is also preparing a program to improve disaster risk management and provide quick-disbursing funds in the event of a disaster.
Lack of capacity leads to poor execution and monitoring of the program.	The Economic Stimulus Package and social protection programs use existing mechanisms, where available. These mechanisms are assessed as adequate, with functional structures, processes, and staffing. The government will employ temporary staff to assist during implementation. ADB will support the implementation, including monitoring gender activities and collecting sex-disaggregated data, through ongoing technical assistance in the Pacific. ^a

ADB = Asian Development Bank, COVID-19 = coronavirus disease.

^a ADB. 2020. [Technical Assistance for Strengthening Social Protection in the Pacific](#). Manila; and ADB. 2020. [Technical Assistance for Strengthening Gender Outcomes in Pacific COVID-19 Response and Recovery](#). Manila.

Source: Asian Development Bank.

IV. ASSURANCES

31. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the grant agreement.

V. RECOMMENDATION

32. I am satisfied that the proposed grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$14,000,000 to the Federated States of Micronesia from ADB's Special Funds resources (Asian Development Fund) for the Health Expenditure and Livelihoods Support Program, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Masatsugu Asakawa
President

5 November 2020

³⁶ ADB. [Safeguards Categories](#).

³⁷ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Country's Overarching Development Objectives Effective health preparedness and mitigation to COVID-19 ensured Economic activities in FSM restored, with adverse impacts of COVID-19 to vulnerable segments mitigated (State of the Nation Address by President David W. Panuelo) ^a			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Effect of the Program Adverse effects of COVID-19 on citizens and businesses reduced ^b	By 30 September 2021: a. At least 4 quarantine facilities operational (FY2019 baseline: 0) b. At least 200 registered-businesses that received economic stimulus remain in operation (FY2019 baseline: 0) c. At least 4,500 low-income households (including female-headed households) benefiting from temporary financial and welfare assistance during the crisis (FY2019 baseline: 0)	a. National task force on COVID-19 reports b. Government's economic update reports; tracking using sex-disaggregated data c. PSC report; tracking using sex-disaggregated data	Worsening economic conditions as a result of COVID-19 External shocks, such as disasters, triggered by natural hazards and epidemics
Outputs 1. Measures to combat the entry and spread of COVID-19 in the FSM delivered	1.1. By January 2021, at least 265 first responders (i.e., Chuuk: 90; Kosrae: 50; Pohnpei: 80; Yap: 45) improved capacity on COVID-19 contact tracing and infection prevention control (with at least 50% being women) (August 2020 baseline: Chuuk: 40; Kosrae: 25; Pohnpei: 40; Yap: 20) 1.2. By December 2020, at least 55 isolation beds (i.e., Chuuk, 20; Kosrae, 10; Pohnpei, 15; Yap, 10) identified and set up for clinical management of suspected and confirmed patients (August 2020 baseline: Chuuk: 12, Kosrae: 2, Pohnpei: 4, Yap: 2) 1.3. By March 2021, simulation exercise at ports of entry for admitting persons under investigation at local hospital for isolation in each state completed (FY2020 baseline:	1.1. National task force on COVID-19 reports; subcommittee reports for infection prevention control 1.2. National task force on COVID-19 reports 1.3. National task force on COVID-19 reports	Poor execution by the government of the COVID-19 Health Action Plan

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	simulation exercise conducted in Pohnpei state)		
2. Measures to provide economic stimulus relief to businesses implemented	<p>2.1. By September 2021, at least 186 affected tourism businesses^c received stimulus checks under the TMF (FY2019 baseline: 0)</p> <p>2.2. By September 2021, at least 56 businesses (including 14 women-owned businesses) received debt relief under the TMF (FY2019 baseline: 0)</p> <p>2.3. By September 2021, 200 small and micro enterprises received loans and grants under the ESP (at least 100 are women-owned enterprises) (FY2020 baseline: 0)</p>	<p>2.1. TMF committee report; tracking using sex-disaggregated data</p> <p>2.2. TMF committee report; tracking using sex-disaggregated data</p> <p>2.3. FSMDB quarterly and annual reports</p>	Poor execution of the ESP
3. Measures to provide social protection to poor and vulnerable groups enhanced	<p>3.1. By September 2021, at least 4,500 low-income households (including all eligible female-headed households)^c received a one-time cash payout as supplementary assistance to meet basic needs (FY2020 baseline: 0)</p> <p>3.2. By September 2021, at least 40 community-based COVID-19 proposals (e.g., awareness, sanitation, GBV) funded to strengthen gender-responsive COVID-19 preparedness in the communities (FY2020 baseline: 0)</p> <p>3.3. By September 2021, at least 2,000 low-income households received utility subsidy (FY2020 baseline: 0)</p> <p>3.4. By September 2021, at least 5,000 households provided solar lamps in the outer islands (FY2020 baseline: 0)</p>	<p>3.1. DFA monthly monitoring report; tracking using sex-disaggregated data</p> <p>3.2. DHSA monthly report; implementing progress report</p> <p>3.3. DHSA monthly report; tracking using sex-disaggregated data</p> <p>3.4. DHSA monthly report; tracking using sex-disaggregated data</p>	<p>Poor execution of the social protection program</p> <p>Diversion of funding from the social protection program in the event of an outbreak</p>

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	<p>3.5. By September 2021, all four states provided medical waiver to vulnerable groups such as the elderly and persons with disabilities on health services that are not covered under the Compact Fund (FY2020 baseline: 0)</p> <p>3.6. By September 2021, requirements for clinical management of rape and intimate partner violence^d in place in eight health clinics (FY2020 baseline: 0)</p>	<p>3.5. DHSA monthly report; tracking using sex-disaggregated data</p> <p>3.6. DHSA biannual report against WHO checklist</p>	

Budget Support

ADB: \$14,000,000 (grant)

ADB = Asian Development Bank, COVID-19 = coronavirus disease, DFA = Department of Finance and Administration, DHSA = Department of Health and Social Affairs, ESP = Economic Stimulus Package, FSM = Federated States of Micronesia, FSMDB = Federated States of Micronesia Development Bank, FY = fiscal year, GBV = gender-based violence, PSC = program steering committee, TMF = Tourism Mitigation Fund, WHO = World Health Organization.

^a H.E. David W. Panuelo, President of the Federated States of Micronesia. 2020. [State of the Nation Address](#). Pohnpei.

^b Because of uncertainties in how the outbreak will unfold, its economic effects, the need for government responses to be flexible as the situation evolves, and because new data collection and reporting systems to monitor the crisis are being developed and evolving, it is not yet possible to set more specific and realistic effects of the program targets than those presented in the design and monitoring framework. Additional indicators to measure the effects will be identified later and used to report on the program's effectiveness as comprehensively as possible in the project completion report.

^c Support to tourism-related businesses to maintain employees and pay salaries, including 418 female employees (out of 863 employees). Women-owned tourism businesses are defined as businesses with women as sole or co-owners).

^d Households with annual income of \$3,600 (based on the minimum wage) or less. Following WHO 2020 guidelines. WHO, United Nations Population Fund, and United Nations High Commissioner for Refugees. 2020. [Clinical Management of Rape and Intimate Partner Violence Survivors: Developing Protocols for Use in Humanitarian Settings](#). Geneva: WHO.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=54309-001-2>

1. Grant Agreement
2. Development Coordination
3. Country Economic Indicators
4. International Monetary Fund Assessment Letter
5. Summary Poverty Reduction and Social Strategy
6. Risk Assessment and Risk Management Plan
7. List of Ineligible Items
8. Debt Sustainability Analysis

Supplementary Documents

9. Gender Monitoring Matrix
10. Summary of Economic and Social Protection Measures in Government's COVID-19 Response Package
11. COVID-19 Government's Response Package for Economic Stimulus and Social Protection Measures Allocation Across Four States
12. Safeguards Assessment Matrix

DEVELOPMENT POLICY LETTER



Secretary of Finance
&
Administration

GOVERNMENT OF THE FEDERATED STATES OF MICRONESIA

Department of Finance and Administration

P.O. Box PS 158

Palikir, Pohnpei FM 96941

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September 24, 2020

Masatsugu Asakawa
President
Asian Development Bank
6 ADB Avenue
Mandaluyong
Metro Manila 1550
Philippines

Health Expenditure and Livelihoods Support Program

Dear President Asakawa:

On behalf of the Federated States of Micronesia (FSM), I take this opportunity to thank the Asian Development Bank for its continued support to our nation's development agenda and in particular its assistance during this COVID-19 pandemic crisis. In particular, it has been pleasing with the pace ADB has been able to process and deliver financial support. This development policy letter conveys our interest in obtaining a grant of US\$14 million under the COVID-19 Pandemic Response Option, through the Health Expenditure and Livelihoods Support (HEALS) Program.

The FSM, like many small island states, has a very fragile economy and COVID-19 is presenting significant health and economic risks. Although the country has not experienced any COVID-19 cases this has been at the cost of needing to shut down the country to almost all outside contact. This was necessary as none of the four State health systems were prepared to deal with a pandemic. This is resulting in a deeper and most likely longer economic impact to the country.

On January 30, 2020 the FSM President declared a Health Emergency and imposed restrictions on travelers' originating in COVID-19 affected countries which in turn affected FSM citizens who were travelling abroad as well as the flow of tourists and business travelers. Further to the Health Emergency, on March 25 FSM completely shut down its borders in each State to eliminate the risk of COVID-19 from entering.

The Government and Congress reacted swiftly to the COVID-19 crisis and has been able to source \$29 million for health sector needs, with over 50% of this being made available directly to the States while the majority of the rest is being used for joint procurement at the state-level. It should be noted that these funds relate to the cost for readiness but in the event of an outbreak the cost could escalate over three times this amount.

FSM, like many small island states, has a very fragile economy and the impact of COVID-19 along with prolonged domestic containment measures come with high economic costs to our population and businesses.

Although tourism is not a significant component of the economy it employs over 1,000 directly and many more indirectly as downstream workers. For the 9 months to June 2020 tourism sector revenue is down 23.7 percent on the same period for 2019 while the transport sector revenue is down by 32.2 percent for the same period. Over 50% of workers have been laid off in the tourism sector and of the remaining almost all are on reduced hours. Approximately 800 of the 1,200 tourism workers have applied for Pandemic Unemployment Assistance.

The transport sector has been significantly impacted with international flights reduced to 2 flights per month and only outbound traffic permitted. The cargo airline that picks up fresh fish from Pohnpei and Kosrae now provides a cargo service 3 days a week that has allowed continued imports by air of critical medical equipment supplies. Construction has slowed down considerably with some major projects stalled with key management/engineers stranded offshore.

The wholesale/retail sector is holding up to date. If imports can continue to flow and stores remain stocked the retail sector will be boosted for the remainder of the year through the Pandemic Unemployment Assistance program. The Secretary of Finance signed an agreement with the US Department of Labor on April 3 for the country to benefit from this unemployment program and this will inject around \$36 million into the economy in 2020.

Even though FSM does not have a positive case, and therefore not yet deploying containment measures of the kind seen in places experiencing outbreaks, the significant downward revision to the FY2020 growth projection to -5.4% reflects large anticipated domestic disruptions to economic activity from COVID-19. With it being very unlikely the borders will be open this year, the outlook for FY2021 is a further 1.8% decline in GDP.

The FSM Congress passed two supplemental budgets whereby cuts have been made to government operational expenditures (approximately \$1 million), in particular travel, and redirected these funds to assist the health response. However, all states are reporting cash flow issues and even though they have access to Compact grant funds, much of it is based upon reimbursement of expenditure and this is proving very difficult for States to finance.

In response, the Government has approved a total stimulus package of \$58.7 million —\$28.6 million for FY2020 and a \$30.1 million for FY2021—comprising of:

- 1. COVID-19 Health Action Plan (\$29.0 million).** As part of the 'whole-of-government' COVID-19 Health Action Plan (C-HAP), the government approved in April 2020 a \$20 million COVID-19 Response Framework for health sector strengthening. This framework is an action plan that guides all four state governments' efforts on COVID-19 preparedness and response, which include preparations for building quarantine and isolation facilities across the country; providing infection prevention control training for first responders; increasing local laboratories' testing capacity; provision of essential medical equipment and supplies, including personal protective equipment, ventilators and COVID-19 test machines for each state; and strengthening local surveillance capacities for routine reporting at the national and regional level. It also includes a risk communication plan that guides the mitigation interventions in the event of community transmission. As the pandemic shows no signs of abating, the government is increasing the health

stimulus by another \$9 million as part of the FY2021 budget to include a mitigation plan to decentralize clinical services, establish remote consultation options, and provision of 2–3 months of maintenance medications for our elderly and citizens with pre-existing comorbidities and those that are mentally ill.

2. Economic Stimulus Package (\$18.4 million). In March 2020, the FSM Congress passed Public Law 21-104 setting up the Tourism Mitigation Fund, appropriating an initial \$1,000,000 of financial assistance to the tourism sector which is heavily affected by travel restrictions and border closures. On 22 April 2020, the government passed Public Law 21-105, which temporarily diverts funding from fishing access fees and from revenue derived from major corporations to the country's ESP, which otherwise would have been diverted to the FSM Trust Fund. The ESP includes: (a) financial support to tourism businesses that have been heavily hit by the pandemic through provision of wage subsidies, interest payment relief on business loans, as well as social security and gross revenue tax rebates to help cushion the impact on economic activity and protect job losses. Assistance will also be expanded to other business sectors affected by the pandemic and proposal has already been submitted for Congress approval; (b) concessional credit line through the FSM Development Bank for providing loans to micro-and-small enterprises, with up to 50% of the loan amount to be allocated to women-owned businesses; and (c) temporary unemployment assistance to support our migrant workers who have lost their jobs as a result of the COVID-19 pandemic.

3. Social Protection Program (\$11.3 million). To protect the poor and vulnerable segments of our population, including the elderly, persons with disabilities and survivors of gender-based violence (GBV), our stimulus response will ensure for social protection programs of: (a) cash transfer grants to support low-income households and provide temporary cash relief for affected informal workers to help meet the immediate cash needs in the absence of any income replacement; (b) a food security program for community groups and low-income households to enhance food production through subsistence livelihood training and distribution of seeds, planting and fishing materials at no cost; (c) COVID-19 community-based small grants working with nongovernment organizations and civil society organizations to strengthen community awareness on COVID-19. The government is working with development partners and NGOs on community outreach program but will need further support on education on handwashing and social distancing, distribution of soaps, masks and information materials to remote areas and outlying islands, and adapting service provision for survivors of GBV; (d) financial assistance to the poor and vulnerable groups through temporary waiver of medical expenses; electricity subsidy for low-income households with disabled dependents; distribution of solar lamps to all households on the outer islands which are not connected to the grid; and provision of clinical management of rape and intimate partner violence kits and consultation options in our community health centers; and one-off cash assistance to our citizens and students abroad as repatriation is being planned.

The COVID-19 Task Force, chaired by the Secretary to Health and Social Affairs, is made up of a wide variety of stakeholders, coordinates the health preparedness and response to COVID-19. Day-to-day coordination is undertaken by the Department of Health and Social Affairs. The implementation of the Health Action Plan will be reported through this Task Force.

Under of a “whole-of-country response”, both our national and state governments are working together to ensure the implementation of our stimulus program. A Program Steering Committee (PSC) comprising of senior representatives from both national and state governments has been established to oversee the implementation and monitoring our response program. The PSC will

be co-chaired by the Secretary of Finance and the Secretary of Health and Social Affairs and will provide a monthly update to the FSM President on the activities, disbursements, and overall progress and outcomes of the program.

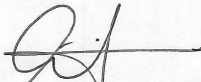
The Department of Finance and Administration (DoFA) will be the executing agency for the program. The implementing agencies will include (i) the DoFA, (ii) the Department of Health and Social Affairs, (iii) the Department of Resource and Development, and (iv) the FSM Development. The implementation of our Health Action Plan will be reported through the existing National COVID-19 Taskforce. Our implementing agencies will also coordinate with our municipal governments, nongovernmental organizations, or civil society organizations to provide welfare services to the poor and vulnerable.

As can be seen above, much has been done, but much more is needed to prepare for the inevitable day that COVID-19 crosses our shores. The Government is committed to the effective implementation of our \$58.7 million countercyclical expenditure program. The HEALS Program will help finance the anticipated deficit from the pandemic response and countercyclical support expenditures needs as well as the decline in expected revenue collections.

We would like to thank ADB for working closely with the FSM Government in developing this program. We look forward to a favorable consideration of the program.

Thank you.

Sincerely,

A handwritten signature in black ink, appearing to read 'E. Amor', with a long horizontal stroke extending to the right.

Eugene Amor

Secretary, Department of Finance & Administration

ASSESSMENT OF COMPLIANCE WITH ACCESS CRITERIA FOR THE COUNTERCYCLICAL SUPPORT FACILITY AND COVID-19 PANDEMIC RESPONSE OPTION ACCESS CRITERIA

Access Criteria	ADB Assessment																																																																								
1. Adverse impact of exogenous shock	<p>The FSM economy is projected to contract by 5.4% in FY2020 (ends 30 September 2020) and by a further 1.8% in FY2021 (Figure 1). This reflects adverse impacts of ongoing border closures and social-distancing measures on agriculture and fisheries, trade, transportation, and tourism-related services sectors, as well as on the implementation of infrastructure projects. The temporary closure of the fisheries observer program which monitors the fish catch of the purse seine fleet and reduced demand for vessel days result in loss of revenues.</p> <p>The economic contraction, can result in the loss of 1,975 full-time formal sector jobs by FY2021, representing a 12% drop from FY2019 levels.^a With losses concentrated in hotels and restaurant (671); transport, storage, and communications (585); public administration, education, and health (476); and wholesale and retail trade (132). Up to 70% of those who are expected to lose their jobs are women (around 1,400). While some women would move to the subsistence sector, more are expected to withdraw from the labor market leading to greater vulnerability.</p> <p>Per capita income is seen to fall by 3.6% from \$3,427 in FY2019 to \$3,305 in FY2021 (Table 1). An additional 4,500 people can be pushed below the poverty line with poverty rates rising from 32.3% in FY2019 to 36.8% in FY2021 (Figure 2). Female-headed households, accounting for 20% of total, are expected to be more severely affected with poverty rates at 50%, compared to 39% for male-headed households.^b</p> <p style="text-align: center;">Table 1: Pre- and adjusted for COVID-19 Macroeconomic Indicators</p> <table><tr><th>Macroeconomic Indicator</th><th>FY2019</th><th colspan="2">FY 2020</th><th colspan="2">FY 2021</th></tr><tr><th></th><th></th><th>Pre-COVID-19</th><th>with COVID-19</th><th>Pre-COVID-19</th><th>with COVID-19</th></tr><tr><td>GDP Growth (%)</td><td>1.2</td><td>0.8</td><td>(5.4)</td><td>0.7</td><td>(1.8)</td></tr><tr><td>GDP per capita (\$)</td><td>3,427</td><td>3,817</td><td>3,308</td><td>3,928</td><td>3,305</td></tr><tr><td>Inflation (%)</td><td>-1.0</td><td>2.0</td><td>1.6</td><td>2.0</td><td>1.9</td></tr><tr><td>Total revenue and grants (% of GDP)</td><td>79.8</td><td>72.4</td><td>74.4</td><td>71.2</td><td>69.7</td></tr><tr><td>Taxes (% of GDP)</td><td>29.1</td><td>13.1</td><td>11.4</td><td>13.1</td><td>11.1</td></tr><tr><td>Fishing license fees (% of GDP)</td><td>20.6</td><td>18.5</td><td>18.0</td><td>18.0</td><td>16.2</td></tr><tr><td>Grants (% of GDP)</td><td>29.9</td><td>36.7</td><td>41.0</td><td>36.0</td><td>38.4</td></tr><tr><td>Total expenditure (% of GDP)</td><td>62.2</td><td>65.7</td><td>79.3</td><td>64.8</td><td>79.6</td></tr><tr><td>Fiscal balance (% of GDP)</td><td>17.6</td><td>6.7</td><td>(4.9)</td><td>6.4</td><td>(9.9)</td></tr><tr><td>Current account balance (% of GDP)</td><td>24.8</td><td>2.6</td><td>21.7</td><td>2.4</td><td>15.1</td></tr></table> <p>(-) = negative, ADB = Asian Development Bank, COVID-19 = coronavirus disease, FY = fiscal year, GDP = gross domestic product. Sources: International Monetary Fund 2019 Article IV Consultation Staff Report (pre-COVID-19) and ADB estimates based on data provided by the FSM Department of Finance and Administration (with COVID-19).</p>	Macroeconomic Indicator	FY2019	FY 2020		FY 2021				Pre-COVID-19	with COVID-19	Pre-COVID-19	with COVID-19	GDP Growth (%)	1.2	0.8	(5.4)	0.7	(1.8)	GDP per capita (\$)	3,427	3,817	3,308	3,928	3,305	Inflation (%)	-1.0	2.0	1.6	2.0	1.9	Total revenue and grants (% of GDP)	79.8	72.4	74.4	71.2	69.7	Taxes (% of GDP)	29.1	13.1	11.4	13.1	11.1	Fishing license fees (% of GDP)	20.6	18.5	18.0	18.0	16.2	Grants (% of GDP)	29.9	36.7	41.0	36.0	38.4	Total expenditure (% of GDP)	62.2	65.7	79.3	64.8	79.6	Fiscal balance (% of GDP)	17.6	6.7	(4.9)	6.4	(9.9)	Current account balance (% of GDP)	24.8	2.6	21.7	2.4	15.1
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2. Countercyclical development expenditure	<p>To address the emergency and immediate financing requirements caused by the COVID-19 pandemic, the government has approved a total package of \$28.6 million in FY2020 (8.4% of GDP) and \$30.1 million in FY2021 (8.9% of GDP). Key components of these development expenditures, include (i) a health action plan (\$29 million) on COVID-19 preparedness and mitigation response; (ii) an economic stimulus package (\$18.4 million) which</p>																																																																								

Access Criteria	ADB Assessment
	includes a Tourism Mitigation Fund, pandemic unemployment assistance, and for concessional loans to micro and small enterprises, with mandatory allocation of 50% of the total loan amount supporting women-owned enterprises; and (iii) social protection programs (\$11.3 million) for the poor and vulnerable groups, including women, elderly, persons with disabilities, and victims of gender-based violence and sexual abuse. These are mainly funded through development partner grants, with the rest through realignment of domestic expenditures and funds, including intended contributions to the FSM Trust Fund.
3. Pre-shock record of generally sound macroeconomic management	After contracting by an average of 2.6% of GDP annually in FY2012–FY2014, the economy grew by an average of 1.9% annually in FY2015–FY2019. Main contributors were in the services sector: wholesale and retail trade, real estate, and financial intermediation. Transport and communications, public administration, and agriculture and fisheries also contributed to the growth. The FSM had been running annual fiscal surpluses since FY2009, except for a small deficit (1.8% of GDP) incurred in FY2011. Total grants and revenues—mainly from fishing license fees and corporate income tax from offshore companies reached 74.6% of GDP in FY2015–FY2019, while total expenditure was only 59.9% of GDP—mainly due to restraint on the public sector wage bill. Fiscal surpluses rose sharply in FY2015–FY2019, averaging 14.1% of GDP (Figure 3). These fiscal surpluses were used mainly to build up the FSM Trust Fund, which increased from \$22 million in FY2014 to \$270 million by FY2019 (the trust fund can only be drawn upon after FY2023 when the economic provisions under the Compact Agreement with the US expire). The surplus was also used to reduce external debt from \$81.1 million in FY2014 to \$71.1million in FY2019 (from 28.1% of GDP to 20.2%).
4. Structural reforms	<p>In preparation of a potential reduction in revenues with the expiration of the economic provisions of the US Compact in 2023, the government unveiled in 2014 the 2023 Action Plan. Aimed to enhance economic and financial stability, the plan set goals in terms of revenue enhancement, expenditure management, and overall economic reform. In FY2015, pay structure and staff grading of national government were reviewed and revised, restraining increases in the public wage bill. Annual contributions to the FSM Trust Fund was increased through a series of laws mandating mandatory percentages from fishing license fees and corporate income taxes. The share of state governments from the Compact Fund was also increased, providing additional resources for states for social spending. Since 2017, tax collection methods have been enhanced with further improvements expected as the new automated Revenue Management System is implemented in FY2020. In FY2019, the Financial Management Act and related internal procedures were also updated.</p> <p>Both the national and state governments took early and pre-emptive actions to contain the threat of the pandemic outside FSM borders. Interventions include the declaration of National Public Health Emergency which remains in effect; closure of borders for all international arrivals; mandatory health screenings of interstate travelers; and school closures. The government, with technical support from WHO and UN, has developed a COVID-19 Response Framework, which is the platform of the country's COVID-19 Health Action Plan (C-HAP) to strengthen the health system's capacity for surveillance and early detection of diseases, infection prevention control, quarantine, isolation, contact tracing, clinical case management, and laboratory for local testing. Risk communication and community outreach are also being implemented, in coordination with development partners,</p>

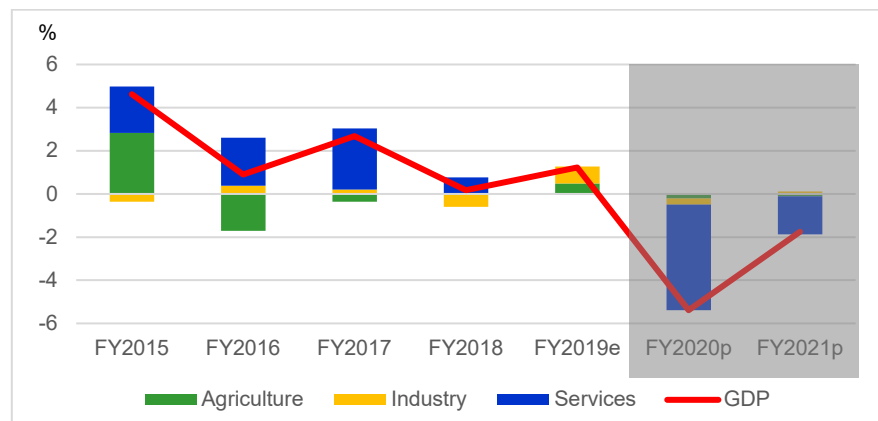
Access Criteria	ADB Assessment
	to create public awareness on COVID-19. This framework also guides the mitigation interventions at both national and state levels, and across five scenarios based on the number of confirmed COVID-19 cases with an operational budget disaggregated by sector and across the four states. The country has made progress in strengthening health screening and surveillance at point-of-entry in airports and seaports, procuring essential medical supplies and equipment. The framework also provides for separate plans for vulnerable populations through decentralized clinical services.
5. Debt sustainability	Although the FSM's public debt stock is relatively low, equivalent to 20.2% of GDP as of FY2019, the IMF rates the country's risk of debt distress as "high" in view of a reduction in revenues after FY2023 (Figure 4). Debt sustainability analysis by ADB and the IMF (through a June 2020 assessment letter) maintains the high risk of debt distress rating but concludes that the FSM's public debt remains sustainable. The COVID-19 crisis is projected to reverse the fiscal position to a deficit at least in FY2020, but the impact on debt is expected to be moderate if financing needs continue to be financed by grant assistance from the FSM's development partners. The IMF recommends the development of a comprehensive fiscal adjustment strategy that accounts for the potential near-term impacts of the pandemic, the medium-term implications of the fiscal cliff, and the long-term impacts of disasters to safeguard debt sustainability. Tax and tax administration reforms, along with steady improvements in public financial management, will be crucial elements of such a fiscal adjustment strategy.
6. IMF Coordination	ADB has been closely coordinating with the IMF and has built strong relationships through active participation during Article IV missions and staff visits to FSM. In an Assessment Letter (dated 25 June 2020), the IMF expressed its support for the proposed CPRO and expressed agreement with ADB's views on: (i) FSM's pre-shock record of generally sound macroeconomic management, as reflected primarily by the achievement of annual fiscal surpluses over a sustained period; and (ii) public debt remains sustainable, though the risk of debt distress is high mainly due to uncertainties pertaining to the renewal of the economic provisions of the Compact Agreement with the US (currently under negotiations) expiring in 2023.

ADB = Asian Development Bank, COVID-19 = coronavirus disease, CPRO = COVID-19 Pandemic Response Option, FSM = Federated States of Micronesia, FY = fiscal year, GDP = gross domestic product, IMF = International Monetary Fund, US = United States.

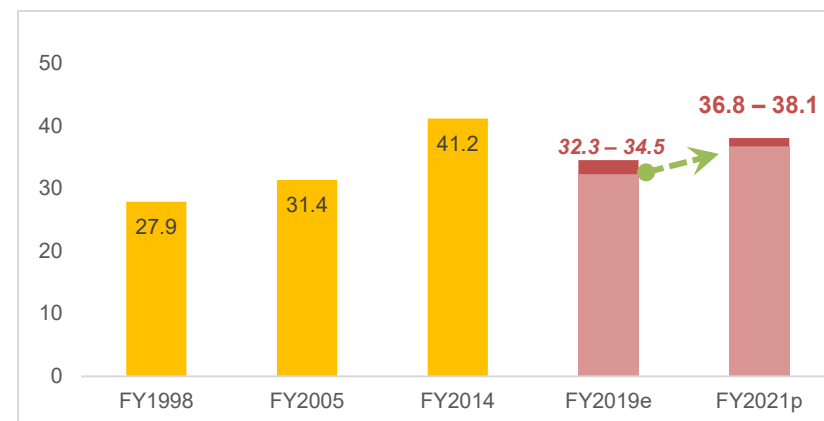
^a ADB estimates; Graduate School USA Pacific Islands Training Initiative. 2020. Assessing the Impact of COVID-19 on the Federated States of Micronesia Economy. Economic Monitoring and Analysis Program Technical Note. 3 June 2020.

^b ADB estimates; FSM Statistics, FSM Poverty Profile (various years) and 2010 Census.

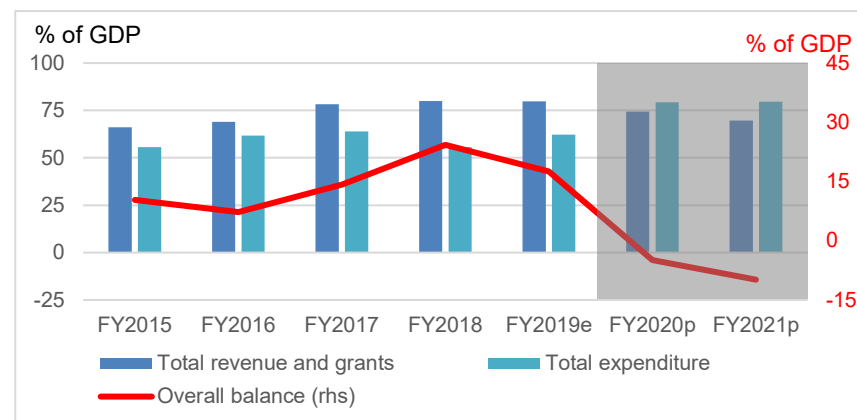
Source: Asian Development Bank estimates; Graduate School USA Pacific Island Training Initiative. Federated States of Micronesia FY2018 Statistical Appendices; FSM Department of Finance and Administration; FSM Statistics Office; and International Monetary Fund.

Figure 1: FSM Contributions to GDP Growth

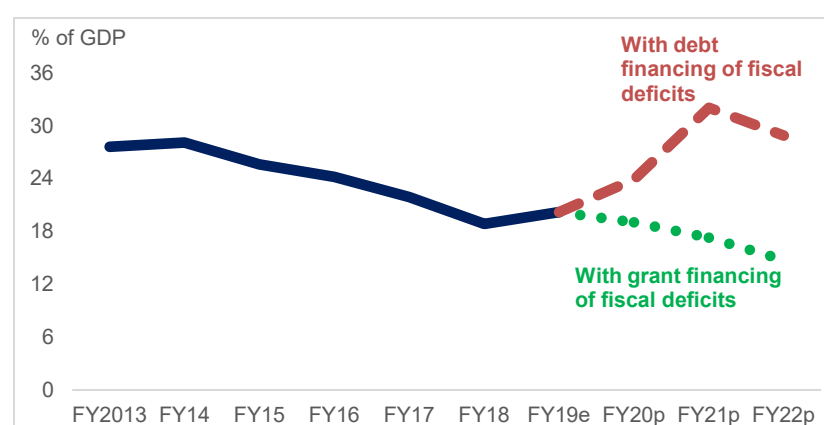
e = estimate, FSM = Federated States of Micronesia, FY = fiscal year, GDP = gross domestic product, p = projection.
Source: ADB estimates; IMF Article IV Consultation Staff Reports; FSM Department of Finance & Administration.

Figure 2: FSM Basic Needs Poverty

e = estimate, FSM = Federated States of Micronesia, p = projection.
Source: FSM 1998, 2005, and 2014 Household Income and Expenditure Survey; ADB estimates.

Figure 3: FSM Fiscal Balance

e = estimate, FSM = Federated States of Micronesia, FY = fiscal year, GDP = gross domestic product, p = projection, rhs = right-hand scale.
Source: ADB estimates; IMF Article IV Consultation Staff Reports; FSM Department of Finance & Administration.

Figure 4: FSM Public Debt

e = estimate, FSM = Federated States of Micronesia, FY = fiscal year, GDP = gross domestic product, p = projection.
Source: ADB estimates; IMF Article IV Consultation Staff Reports; FSM Department of Finance & Administration.