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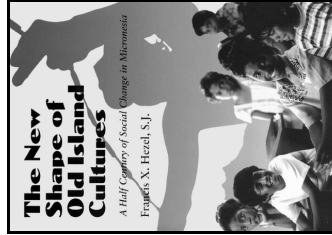


*US Assistance for the Next Two Years
and the Compact Funding Outlook*

By Francis X. Hezel, SJ

The New Shape of Old Island Cultures

The new book by Francis X. Hezel, SJ



The Years since World War II have brought unprecedented social change to Micronesia. Now, drawing on more than four decades of experience living and working in the region, Francis X. Hezel assesses the most striking changes to have swept over the islands in the past fifty years. The broad range of topics covered includes family structure, land, gender roles, cultural treatment of life events (birth, death and marriage), sexuality, political authority, demography and migration.

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Then Pharaoh said to Joseph: "Behold, in my dream I was standing on the banks of the Nile; and seven cows, fat and sleek, came out of the Nile and fed in the grass; and seven other cows came up after them, poor and very gaunt and thin. And the thin and gaunt cows ate up the first seven fat cows."

Joseph explained to Pharaoh that the seven fat cows represented seven years of plenty for the land, and the seven thin cows stood for the seven years of famine that would follow. Joseph counseled the Pharaoh to store food during the years of plenty that could help the people of Egypt avert the effects of the famine to follow.

The secular wisdom in this famous biblical passage is obvious: what we do with our surplus bounty will determine how hard the lean times, if they do occur, are on all of us. If we resist the impulse to consume recklessly, to use the surplus in parties, to satisfy our immediate appetites at the expense of our long-term interests, we will all be a lot better off when the tap is turned off. This is a timely bit of advice for the Federated States of Micronesia as the nation prepares to make some adjustments to the flow of funds after the first fifteen years of the Compact of Free Association.

The Feast: 2002 and 2003

We all know that negotiations are in progress for those parts of the Compact that expire this year. If these negotiations are not concluded by the end of the fifteenth year of the Compact—that is, November 3, 2001—the Compact allows for an additional two years to complete the negotiations. "During this additional period of negotiations," the Compact stipulates, the US "shall continue its assistance...at a level which is the average of the amounts granted." Under the Compact, US funding decreased in three nearly equal steps from the implementation of the Compact in 1986 to the present. Thus, for the next two years of continuing negotiations, FSM can expect to receive from the US the same amount of yearly assistance adjusted for inflation as it was receiving during 1992-1996, before the last funding step-down in 1996.



Despite the best efforts of those who directed them, these fishing industries remain a major financial burden on the state. There is a biblical parable about a vineyard that is unproductive even after being fertilized and watered and pruned one year after another. The passage closes with the warning that if the plants do not produce fruit they will be cut down and the vineyard closed. Yet, the state government today seems no closer to cutting their losses and closing down these businesses than they ever were. Fortunately, this waste of resources is far from common in the nation.

An Eye on Tomorrow

The FSM may not have wasted the money, but the nation is still open to criticism if it fails to provide for the times of scarcity that are sure to come. The German colonial government, in the first decade of the 20th century, clamped down on dancing in the outer islands of Chuuk because the people were harvesting all their breadfruit and consuming it during the month-long celebrations that accompanied the dances. The Germans, who always had an eye on tomorrow, felt that it was imprudent for islanders to use all their produce in a few weeks and save none for future needs. The people of those outer islands, we can be sure, simply wanted to enjoy the day and let tomorrow take care of itself. That spirit of healthy hedonism has always been one of the charms of the Pacific. But that spirit was suited to a simpler day, before the people had to find ways to support a police force, school teachers, doctors and nurses, accountants, and everyone else who is needed to make the modern government system work.

FSM has it within its power to convince the US, its partner in negotiations over future funding, of the serious commitment it is making to creating a future in which it will no longer rely on US support to maintain its own government. By setting aside surplus funds over the next two years for a trust fund, it is taking a major first step in investing in its future and encouraging the US to follow suit.

Years of plenty, years of want. How do we respond? A lot is hinging on this question.



will put a bit more in their pay envelope each week. On the other hand, they face a greater disappointment when, after two years of relative prosperity, the state government is forced to cut salaries once again as the budget plunges. Chuuk has in recent years exercised commendable restraint in checking expenses and cutting the costs of government. This windfall of nearly \$13 million over the next two years will allow the state to do some capital improvement that it has not had the funds to undertake for most of the last decade. On the other hand, Chuuk State is looking at a loss of about \$4 million yearly under the funding that US is proposing to give for the next funding period. Investment of its windfall of \$13 million would help in making up the difference, and it could help persuade the US to loosen its own purse strings in contributing to the trust fund.

Waste or What?

Now and then articles and reports charge that Micronesians are wasting US money. These reports point to the failure of FSM, after fifteen years of Compact funding, to turn around its economy and find a way to support itself in the future. If Micronesia had been able to take a major step towards becoming self-supporting in that period of time, it would have done something that virtually no other nation has accomplished—except for the lucky few that have found they were sitting upon oil deposits or valuable minerals. FSM shouldn't be faulted for failing to achieve miracles.

FSM need not accept the argument that the financial assistance the US has provided over the years has been wasted. Most of this aid has been used to good effect, I would guess, although perhaps not always as carefully as many of us might have wished. The priorities for projects have been determined by the local governments, as is only fitting for a nation that has come of age and is learning how to use power and money for the benefit of its people.

There are glaring exceptions, however. For several years now Pohnpei State, for example, has subsidized fishing companies that have drained a total of about \$12 million from the government.



TABLE 1: COMPACT FUNDS: 2001-2003

	FY 2001	FY 2002	FY 2003	Additional Funds
National Govt	11,209,800	13,320,400	13,416,100	4,316,900
Chuuk State	29,047,400	35,345,900	35,615,600	12,866,800
Kosrae State	8,250,600	9,983,200	10,060,300	3,542,200
Pohnpei State	19,446,100	23,541,600	23,718,200	8,367,500
Yap State	12,290,900	14,906,100	15,019,500	5,343,800
Total	\$ 80,244,800	\$ 97,097,200	\$ 97,829,700	\$ 34,437,200

Source: FSM Department of Economic Affairs

The table above shows what this windfall will mean to FSM during the next two years. The nation as a whole, which is receiving \$80 million in US assistance this current year, can expect to receive \$97 million annually during the next two years. This means an increase of over \$34 million over the two-year extension period. After FSM has endured a public sector reform program forced upon it by Compact funding step-downs, this extra \$34 million can easily conjure up images of fat cattle and rich wheat fields. Yet, the season of plenty is destined to last for only two years rather than the seven that Egypt enjoyed.

The extra money is welcome relief after a period of belt-tightening that has included cuts in government staff, voluntary early retirement for former government employees, and smaller take-home pay for those still working for the government due to the elimination of automatic annual step increases in salaries and the reduction in work hours forced by budget cuts. This is not even to mention the slow pace of growth in the private sector, which has been touted as the salvation of the economy in an age of government cost reduction. The failure of every major attempt to develop a fishing industry despite massive investments of Compact funds was bad enough, but tourism has been a no-growth industry since the



Asian economic setback and no other industries have emerged to pick up the slack. For the last few years it's been one woeful story after another. How much dieting can the body take? It's time for a real party.

So, the governments are licking their lips thinking of the feast that is in the making for the next two years. Kosrae, which has had to cut back its government employees first to 32 hours, and then to 28, would finally have the funds to offer employees a 32-hour work week. Pohnpei, which has been engaged in a marathon road-paving project over the last 20 years, now sees a chance to finish paving the road around the island. The executive branch of Pohnpei State government hopes to use the capital account to complete this project, although it has expressed a willingness to set its operational funds aside. Chuuk wants to build new schools to replace some of the dilapidated classroom buildings that now blight the villages. It could use the rest of the money to pay off landowners for some of the land that the government wants to buy outright to save the huge lease payments that have crippled it in the past.

Yap is the only state firmly committed to depositing the money in a special account that can be invested to generate funds during the lean years ahead. The President of FSM has proposed in his national budget that the national government do the same thing and set aside its share of the budget for the next two years. At the same time, however, he has introduced for congressional consideration a pension plan that has a first year price tag of over \$1 million above current personnel expenditures. This plan will provide lifetime security for a few long-serving employees at the future cost of younger employees who will foot the bill.

Anyone who has witnessed the governments struggle with their balance sheet over the past five years has to be sympathetic to the state and national leaders. It's only natural to want to ease up on the pressure of stringent controls for a year or two. Moreover, leaders are not proposing to spend the money in entirely silly ways. Each of the plans to dispose of these extra funds is a response to real needs and has solid merits. But there is still the specter of those gaunt, thin cows facing us in the future—not for seven years, but for fifteen years and beyond. The thought of those fifteen years of hard times should give us pause, as it did Pharaoh.



To throw a party with the surplus funds that are coming this way for the next two years might be a very human response after the dieting of the past five years, but it would only convince those in Washington, beginning with the Government Auditor's Office (GAO), who believe that FSM (and the Marshalls) are spendthrifts with little concern about results, how correct their biases were in the first place. One can almost hear the critics gloating: "See, we were right after all. These people just don't know how to save. They're just like the other banana republics that we throw money at for political reasons. They spend when they have it without a thought about what they might need tomorrow. And when tomorrow comes, they ask us to set up and fund for them a trust fund that they should have begun themselves."

Why Is a Trust Fund So Important?

The concept of a trust fund, investment of a certain sum of money into a fund that is allowed to grow for a time so that its interest or dividends might provide support in future years, is a critical one for the nation's future economic stability. FSM originally proposed the idea of a trust fund into which the US would pay \$20 million a year, so that by the end of the proposed twenty-year funding period FSM would be able to support itself. In its response, the US supported the idea of such a trust fund, but offered a smaller figure than would be needed to fund it fully—\$13 million rather than \$20 million. The US asked that other funding sources be found to contribute to the trust fund, but it also encouraged FSM to set aside the extra funds for the next two years for deposit in this trust fund. This gesture, in the view of the US negotiating team, would be a clear and unmistakable commitment by national and state governments here to meeting their own needs in the future. It is a mark of providence that foresees and tries to provide for the shortfalls of years to come—like putting away grain in a time of abundance to live off in the years of famine.

The alternatives are tempting, of course. An increase in the number of hours in the work week of Kosrae government employees, whose patience with the system has surely been taxed,



TABLE 3: FURTHER COMPARISON OF US AND FSM PROPOSALS

Sector	FSM Proposal	US Response	Difference
Education	\$25 million	\$23 million	8% cut
Health	\$17 million	\$15 million	12% cut
Infrastructure/Maintenance	\$25 million	\$10 million	60% cut
Governance/Capacity-Building	\$9 million	\$4 million	56% cut
Private Sector Development	\$3 million	\$2 million	33% cut
Transportation	\$3 million	--	100% cut
Environment	\$2 million	\$2 million	--
Macroeconomic Performance Incentive	--	\$5 million	--
TOTAL	\$84 million	\$61 million	27% cut

Source: FSM Department of Economic Affairs

The fall off from the present funding level of \$80 million to \$61 million two years from now is bad enough for a nation struggling to find the resources to maintain its public services, but the drop from \$61 million to \$25 million in fifteen years would be nothing short of catastrophic. Here is where the cows begin to appear thin and gaunt and where the ears of grain start to wither. This is the period of famine that Joseph urged Pharaoh to prepare his country against.

Weather Control: Another Strategy

But there's another twist to the story of the feast and famine. Suppose the weatherman is watching us to see how the seasons of plenty are used so that, on the basis of our response to the abundance, he can determine the gravity of the famine. That's the situation we face today. Negotiations are still in progress, so the US funding is not yet determined. Americans, who may suspect that the \$2 billion they have given to FSM over the past fifteen years has been largely wasted, could be confirmed in their suspicions or have them challenged, depending on the way in which FSM decides to deal with the present surplus.



The Famine: New Compact Funding

How bad will those fifteen years be? We don't know for sure just yet, but to judge from the preliminary results of the negotiations between FSM and US on future funding, the time of want could be severe. Public briefings, interviews, and formal papers provide enough information to compare the funding level contained in the FSM proposal with the US counter-proposal.

In reply to FSM's proposal for an \$84 million annual grant in addition to \$20 million a year to build up a trust fund over a twenty-year period, US responded with a counter offer of \$61 million yearly, divided among seven sectors, and \$13 million each year for the trust fund over a fifteen-year period. The total package offered by US is \$0.65 billion, compared with the \$1.2 billion that FSM is seeking. All this translates into a revenue stream starting in November 2003—just two years from now—where the US is prepared to give only 55 percent, a little over half, of what FSM is seeking in aid.

TABLE 2: COMPARISON BETWEEN FSM AND US PROPOSALS

	FSM Proposal	US Response	Difference
Year US Assistance	\$84 million	\$61 million	27% cut
Yearly Trust Fund contribution	\$20 million	\$13 million	35% cut
Final year: US Assistance (year 20, FSM; year 15, US)	\$70 million	\$40 million	43% cut
Initial Year of Trust Fund (year 21, FSM; year 16, US)	\$70 million	\$25 million	64% cut
Net value of total package	\$1.17 billion	\$0.65 billion	45% cut

Source: FSM Department of Economic Affairs



If the US funding plan is implemented, the average annual Gross Domestic Product will immediately fall from about \$1,827 a year to about \$1,600. That's not so bad, we might think; it's only a drop of \$200, or about 12 percent. But a 12 percent drop is twice the magnitude of the step-down in 1996 that sent shockwaves through the FSM. Besides, the 12 percent decline is only the beginning of a descent that gets steeper and steeper as the fifteen years go on. The \$61 million a year in aid that the US is offering barely allows the government to scrape by—even allowing for local revenues, fishing license fees, and other such independent sources of income. Worse still, the US counter-proposal would eliminate any adjustment for inflation, a provision that FSM has greatly benefitted from during the past Compact period. (If it hadn't been for the inflation adjustment clause, FSM would be receiving only \$40 million instead of \$80 million this year.) With the declining value of the dollar due to inflation, the \$61 million that US wants to give FSM yearly will have effectively shrunk to about \$40 million by the end of the next fifteen-year period in 2017.

Let's look at what the funding level proposed by US for the next fifteen years would mean for Pohnpei State. It would mean an immediate reduction of the state's operational budget by \$2 million a year, bringing the annual assistance from US down from \$19 million to \$17 million a year. But that's only the start of the downward spiral. By the time other losses, including the estimated reduction in tax revenues due to decline in economic activity, are counted, Pohnpei State government will lose an estimated \$4 million a year. That represents a cut of about 15 percent in its annual budget.

But it is the reduced trust fund figures in the US counter-proposal that will really determine the course of the future. If the US is not persuaded to contribute any more than \$13 million for a fifteen-year period to the trust fund, the interest from the fund will be generating only \$25 million a year by 2019 at the end of this period. Thus, under the US proposal, FSM's yearly operating income would drop from \$61 million at the start of the next 15-year period, to \$40 million during the final year of the next fifteen-year funding period (2018), to \$25 million the following year (2019) when US casts FSM loose from its funding for the first time in 75 years.

Level of US Assistance According to the FSM and US Proposals

