During the crisis the public sector remains largely unscathed, while the impact on the private sector is painful. Even within the private sector, the impact on sub-sectors is particularly strong, making the case for well-targeted mitigation efforts.

Employment Impact

The impact of COVID-19 on employment is shown in Figure 4 indicating both level of jobs and the annual changes. There is an implied total loss of 716 jobs over FY2020 and FY2021, which ranges across a series of sectors. If a job loss of this size transpires it would be the largest employment reduction in RMI since the civil service retrenchment program, which was required at the time of the FY1997 second stepdown in the initial Compact funding period.

It should be noted that the loss in jobs should be understood as a reduction to full-time-equivalent (FTE) positions rather than a specific loss in employed persons. Firms are likely to institute reduced hours for employees before terminating their jobs. The biggest impact is likely to come from the loining plant which is estimated to lose as many as 175 jobs in FY2020, but regain 116 of these jobs in FY2021. This impact is due to the reduction of material to the plant and transportation issues.

The hotel and restaurant sector is projected to lose 258 jobs given the near absence of commercial flights into the RMI. A loss of 202 jobs across transport, port services, airport ground handing and in the retail/wholesale trade is further expected. On the positive side, an increase in 60 jobs in construction is anticipated to meet additional demand in FY2020. The job market is unlikely to improve in FY2021 despite the rehiring of 116 people at the loining plant, as fish prices hold firm and the local fishing industry partially recovers. On the other hand, the boost to construction is likely to falter with logistical and transport issues, and 91 jobs are lost with other sectors contracting even further.

> *The hotel and restaurant sector is projected to lose 258 jobs given the near absence of commercial flights into the RMI.*

Fiscal Impact

The fiscal outturn is shown in Figure 5. The RMI suffers from a weak fiscal position in FY2019

Figure 4 ***Projected employment level and growth***

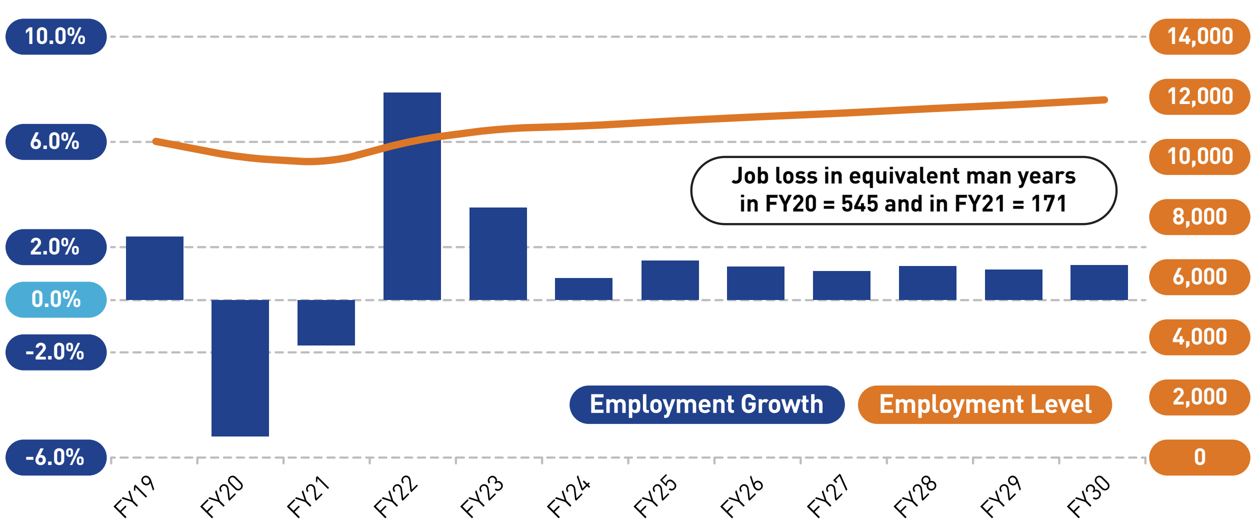
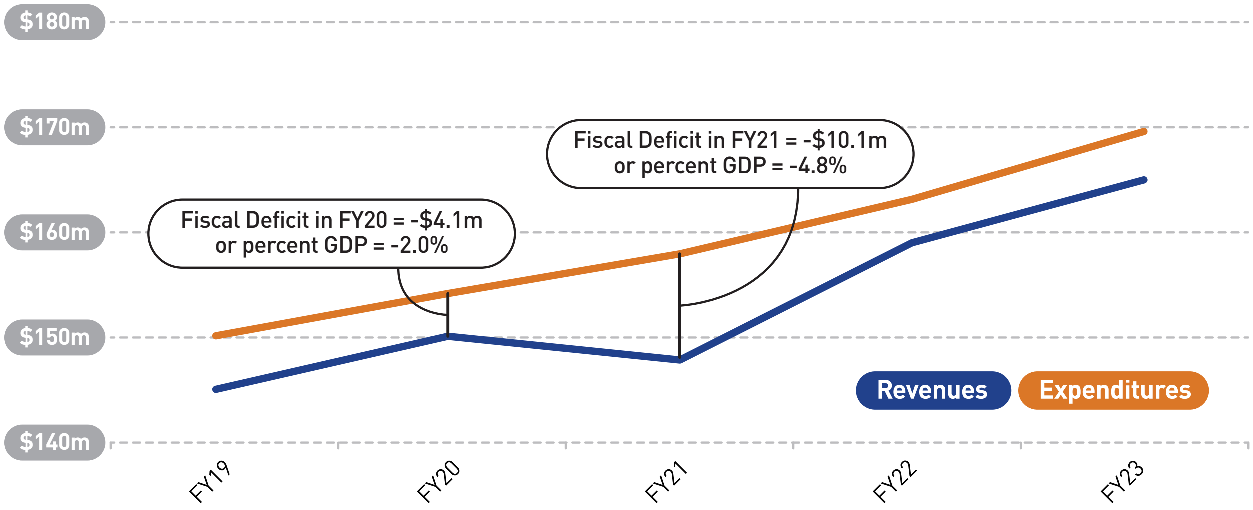


Figure 5 Projected revenues and expenditures



with a deficit[3] of $5.1 million, reflecting the large subsidy paid to copra producers, transfers to MISSA and contributions to the Compact Trust Fund. In FY2020 a reduced fiscal deficit of $4.1 million or 2 percent of GDP is projected. FY2020 projections are consistent with the FY2020 appropriations bill. While a similarly large transfer to copra producers of $9 million is forecasted, the FY2020 budget includes reductions in transfers to MISSA and to the Compact Trust Fund.

The FY2020 budget has thus reduced contributions that in prior budgets were designed to maintain the value of financial assets or national wealth, but in FY2020 were redirected to reduce the deficit and support a weak fiscal position. Current projections indicate tax collections will fall by 4.1 percent or 2.0 percent of GDP. While reductions in collections of the wages and salaries tax and of import taxes are small, there is a large projected reduction in collection of the Gross Revenue Tax of 12 percent.

In FY2021 the gap widens even further, and the RMI deficit rises to $10.1 million or 4.8 percent of GDP. This result reflects weak tax collections while Compact sector grants and other donor grants remain constant in nominal terms. Expenditures are projected to rise without a change in policy stance and with continued subsidies to SOEs, including the large copra subsidy. However, transfers from MIMRA are assumed to fall by $4 million reflecting a lowering of the VDS daily rate to the reserve price of $8,000 a day for sales of bilateral days. The overall result is an unsustainable fiscal deficit, which requires adjustments. The need to implement mitigation measures to support the incomes of the rising level of unemployed individuals in the private sector, coupled with measures to support severely affected businesses, will also add to fiscal pressures.

Financing

Without adjustment or additional donor support, current projections indicate a total deficit of $14.2 million from FY2020 through the end of FY2021. Coupled with this is the need to service existing loan obligations of $3.2 million annually. The total financing need over the next 18 months could thus approach $20 million depending on VDS sales. Unlike the RMI's two sister Freely Associated States, the nation does not have a pool of reserves to draw upon. The financing gap must thus be addressed either through revenue measures, expenditure reductions or donor assistance through budgetary support.

[3] On a Government Finance Statistics (GFS) basis

Without adjustment or additional donor support, current projections indicate a total deficit of $14.2 million from FY2020 through the end of FY2021.

Collateral Issues Add to the Fiscal Challenge

While the national government budget will come under pressure there are also important parallel threats to the Marshall Islands Social Security Administration. After the reforms enacted by the Nitijela and support from the RMI government with an annual transfer of $3 million, the outlook for the Social Security system looked favorable with a growing level of reserves projected. However, the current downturn in payroll projected at 3 percent on FY2020 and a flat projection for FY2021, coupled with a significant drop in the value of market assets and growing levels of benefits, suggests the need for a fresh evaluation of the viability of the system. Current projections indicate that with the current level of $0.7 million annual transfer from the government, the level of reserves will peak in FY2023 at a lower level of about $59 million, and then commence a gradual decline. Given the importance of MISSA benefit transfers to the elderly and vulnerable, careful monitoring of the system is required and warrants continued government support, possibly through policy reform and direct grant support typical of a policy-based, donor supported program.

Fiscal policy and the compelling need for an adjustment program

The above analysis is based on the EconMAP economic model. The projections indicate a need for a significant adjustment in the remainder of FY2020 and through FY2021. The RMI thus needs to start preparing budget revisions and a set of policies to respond to the projected economic downturn. In any fiscal adjustment program, there are three areas of policy action: expenditure adjustments, revenue enhancements, and access to financing. The optimal balance between these policy actions and the nature of adjustments—temporary or permanent—depend on the assessed nature of the fiscal shock.

Permanent adjustments with minimal use of financing are required in the case of structural deficits. The RMI entered this period of COVID-19 impact with a weak fiscal position and an emerging structural deficit. Given that the RMI is clearly facing both a structural deficit and a cyclical shock as a result of COVID-19, the government will likely need to consider a balanced approach of fiscal adjustment and financing through budgetary support. The RMI would thus emerge from the current crisis with a more robust fiscal position and without the need to seek further budgetary support to finance its fiscal operations.

Revenue Measures

Given the structure of the RMI's revenues with only 23 percent of total revenues derived in FY2018 from taxation and other grant and resource rents largely independent of COVID-19, the RMI fiscal account is somewhat insulated from the current massive downturn in the world economy. However, reported reductions by the RMI treasury in GRT collections are larger in the first quarter of 2020 than have been projected and indicate a possible lack of filing by businesses or perhaps under-reporting. The focus on revenue and tax measures should thus be to strictly maintain compliance and collections.

The RMI government should avoid the use of the tax system to provide relief, especially generalized relief, to the private sector and to individuals. Rather, relief and mitigation efforts should be targeted as directly as possible to businesses and individuals directly impacted by the COVID-19 crisis. Of course, tax and MISSA data may be used as valuable data sources for estimating—and later documenting—incremental changes in business turnover and individual incomes.

Expenditure Measures

The rapid growth in fishing fee revenues emerged in FY2013 and enabled a matching increase in government expenditures. While increases in payroll—both number of jobs and remuneration rates—have been modest at 4.6 percent per annum, use of goods and services has expanded at an annual rate of 9.8 percent. Subsidies to the SOE sector have grown by 22 percent per annum while grants and "other" expense have grown by 12 and 18 percent, respectively.

The most rapid increase has been in subsidies to copra growers which have grown from $1.7 million in FY2015 to $9 million in FY2019, or a quadrupling from 1 percent to 4 percent of GDP. While support to lower income and disadvantaged groups in the outer islands is an admirable priority, current subsidy levels clearly exceed the ability of the nation to sustain such a large transfer program in the current fiscal and economic climate. The above analysis thus suggests the need to craft a program that adjusts some of the recent rapid growth in specific areas of expenditures.

Donor support for mitigation of lost jobs and, where applicable, to support affected businesses, might include policy measures to support medium-term fiscal sustainability beyond this period of crisis. A clear priority should be given to acceleration of grant-funded infrastructure programs where travel restrictions permit as the funds injected into the RMI economy can play an important role in maintaining economic activity and job creation.

Financing

The analysis suggests that the RMI should embark on a program of fiscal adjustment and mitigation to affected individuals and businesses while ensuring the fiscal position of the RMI does not further deteriorate. The analysis further suggests that the RMI adjust to the recent emergence of a structural fiscal deficit amid the impact of COVID-19. Such a program, through grant-funded budgetary support, might involve commitments to, and adoption of, policies by the RMI government to redress the structural deficit, coupled with donor resourcing to fund mitigation efforts and to protect the vulnerable and disadvantaged.

The US, through the CARES act, is likely to provide funding for emerging unemployment of Marshallese citizens. This Technical Note will be updated when the precise amounts and conditions of such funding is fully understood. The ADB and World Bank have greatly increased their programs of grant support to the RMI, and they are believed to be considering use of some of these resources in the form of budgetary support. A coordinated and well-crafted program with donor collaboration is clearly needed. It is important at this time that the donors find ways to design, approve and implement projects even while the RMI maintains strong public health controls that eliminate the ability to field missions. Bilateral donors such as Japan and Taiwan may well provide additional valuable partnership in the endeavor to support the RMI through the COVID-19 pandemic.

Potential Components of a Fiscal Response

Working with the RMI's donor partners the government may consider a COVID-19 response and mitigation program that includes the following categories, among others:

1. First and foremost, a health sector strengthening program to address the threat of the COVID-19 pandemic and to improve the RMI's ability to provide sustained, high quality health services to its population.
2. An unemployment relief program administered through the Social Security Administration for groups that are not supported through the CARES act, including informal workers and foreign nationals employed in the RMI.

3. A business relief program that provides:
   - Subject to financing availability: direct support to businesses in directly impacted sectors—with priority to small businesses, perhaps measured as (presumptive) loss of gross revenues—to be confirmed through subsequent BGRT filings; and
   - Government guaranteed loans through the Marshall Islands Development Bank and/or commercial banks to businesses in directly impacted sectors to cover (i) fixed costs to maintain lease payments and physical plant and equipment through the downturn; and, perhaps, to finance physical improvements that will allow construction and rehabilitation during the downturn.
4. A public sector expenditure control program that provides fiscal space to support relief programs and allows for "burden-sharing" to enable the RMI to exit the current crisis in a position of relative strength. Elements of such a program might include reductions in the use of goods and services including travel, reductions in subsidies and alternative measures to fund outer island incomes, measures to reduce transfers such as the rapidly growing transfer to high income groups including the transfer to Majuro landowners for utility easement rights and recent growth in a series of project-related expenses.
5. Acceleration of public investment projects funded with donor grant or loan support, including necessary attention to minimizing bottlenecks to project design, planning, engineering and labor needs.

The five outlined components of an overall Fiscal Response are provided in general form for consideration of the RMI leadership. It is important that the depth and breadth of the eventual response be sized and timed to reflect support from RMI's donor partners.

Conclusion

The economic and fiscal impacts projected in this note are based on an economic model of the RMI economy. The impacts, of course, are driven by the structure of the economy. While developments will take their course, the size of the projected outcome, given the assumptions relating to the various sectors in the economy, is reasonable and of the right order of magnitude. These can be modified as more information comes to light. Notably, a first draft shared with government officials and key sources of timely information and insights into the observable impacts of the COVID-19 pandemic resulted in significant data adjustments. For their efforts to improve our model inputs we thank those individuals and entities.

Importantly, the analysis indicates the compelling need to prepare a response and mitigation program to maintain stability and to open channels with the RMI's partners for potential financing sources. Optimistically, the application of targeted donor assistance to offset health sector investments, to improve the resilience of the health system, to provide budgetary resources to offset revenue losses due to the projected decline in economic activity, and to provide direct support to affected individuals and businesses, will be sufficient to offset much of the projected threat to the RMI economy and to its fiscal position going forward.

About EconMAP

The Economic Monitoring and Analysis Program (EconMAP) provides professional expertise to support statistical development and economic analysis in the three Freely Associated States (FAS) of the Republic of the Marshall Islands (RMI), the Federated States of Micronesia (FSM) and the Republic of Palau (ROP). Annual program outputs for each FAS include the development of economic statistics, the publication of Economic Reviews, and the delivery of economic presentations. Occasional topical reports and technical notes are also published occasionally.

The EconMAP program is supported by the Department of the Interior's Office of Insular Affairs, and managed by the Graduate School USA's Pacific & Virgin Islands Training Initiatives. Additional information is available online at http://www.pitiviti.org.

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