Republic of the Marshall Islands

2023

RMI ECONOMIC REVIEW

Republic of the Marshall Islands

March 2024

Graduate School USA

EconMAP
ECONOMIC MONITORING & ANALYSIS PROGRAM

Abbreviations

CURRENCY EQUIVALENTS

Currency unit: United States dollar (US$)

ABBREVIATIONS

ADB — Asian Development Bank
AMI — Air Marshall Islands
AML — Anti-Money Laundering
BCom — Banking Commission
BIF — Budget and Investment Framework
BOMI — Bank of the Marshall Islands
CARES — Coronavirus aid, Relief, and Economic Security Act
CBDC — Central Bank Digital Currencies
CBR — Correspondent Bank Relationship
CDC — Centers for Disease Control and Prevention
CFT — Combatting the Financing of Terrorism
CMI — College of the Marshall Islands
COFA — Compact of Free Association
COVID — Coronavirus Disease
CPI — Consumer Price Index
CPRO — Coronavirus Pandemic Relief Option
CSO — Community Service Obligations
CTF — Compact Trust Fund
DAEF — Disaster Assistance Emergency Fund
DAO — Decentralized Autonomous Organizations
DBS — Doing Business Survey (World Bank)
DEZRA — Digital Economic Zone Rongelap Atoll
DRP — Disaster Resilience Program
DSA — Debt Sustainability Analysis
EPPSO — Economic Policy Planning and Statistics Office
FAS — Freely Associated States
FDI — Foreign Direct Investment
FDIC — Federal Deposit Insurance Corporation
FMIS — Financial Management Information System
FPUC — Federal Pandemic Unemployment Compensation
FRDMA — Fiscal Responsibility and Debt Management Act
FSM — Federated States of Micronesia
GAO — Government Accountability Office
GASB — Governmental Accounting Standards Board
GDP — Gross Domestic Product
GFS — Government Finance Statistics
GRT — Gross Receipts Tax
GSUSA — Graduate School USA
HIES — Household Income and Expenditure Survey
IDP — Infrastructure Development Plan
ICO — Initial Coin Offering
IMF — International Monetary Fund
JEMFAC — Joint Economic Management and Fiscal Accountability Committee
KBE — Kili, Bikini, and Ejit
KYC — Know Your Customer

LRA — Land Registration Authority
MEC — Marshalls Energy Company
MIDAO — Marshall Islands DAO
MIFV — Marshall Islands Fishing Venture
MIMRA — Marshall Islands Marine Resources Authority
MISC — Marshall Islands Shipping Corporation
MISSA — Marshall Islands Social Security Administration
MOF — Ministry of Finance
MSC — Marine Stewardship Council
MTBIF — Medium-Term Budget and Investment Framework
MTEF — Medium-Term Expenditure Framework
NDC — National Disaster Committee
NTA — National Telecommunication Authority
OIA — Office of Insular Affairs
PCRAFI — Pacific Catastrophe Risk Assessment and Financing Initiative
PEFA — Public Expenditure and Financial Accountability
PFM — Public Financial Management
PFMRR — Public Financial Management Reform Roadmap
PFTAC — Pacific Financial Technical Assistance Center
PITP — Pacific Island Tuna Provisions
PNA — Parties to the Nauru Agreement
PSDI — Private Sector Development Initiative
PUA — Pandemic Unemployment Assistance
RFP — Request for Proposals
RMI — Republic of the Marshall Islands
RoP — Republic of Palau
RoC — Republic of China (Taiwan)
RUS — Rural Utilities Service
SAFER — Sustainability Accountability for Enhanced Resilience
SCI — Statement of Corporate Intent
SEG — Supplemental Education Grant
SOE — State-Owned Enterprise
SOEMU — State-Owned Enterprise Management Unit
SOV — Sovereign (Crypto Currency)
SPC — The Pacific Community
TCMI — Trust Company of the Marshall Islands
TCPA — Tobolar Copra Processing Authority
TNC — The Nature Conservancy
TRAM — Tax and Revenue Reform and Modernization Commission
VAT — Value Added Tax
VDS — Vessel Day Scheme

NOTE:

1. The RMI government fiscal year (FY) ends on September 30.
2. Figures in the report are subject to rounding

Table of Contents

List of Figures and Tables

Disclaimer

The views, thoughts, and opinions expressed in this economic review are those of the authors and represent an independent assessment of the economic performance of the Republic of the Marshall Islands. This document does not necessarily represent the views of the government of the Marshall Islands, the Graduate School USA, the US Department of the Interior, or any other organization, committee, sponsor, group, or individual.

Foreword

This review has been developed to assist the Republic of the Marshall Islands (RMI) in implementing the terms of economic assistance under the 2023 Compact Amendment. This review has also been designed to assist the RMI in overall policy and economic management. It has been developed under contract with the US Department of the Interior's Office of Insular Affairs (OIA) and administered through the Graduate School USA's Pacific Islands Training Initiative. The review is intended to assess the RMI's economic performance and policy environment and to present a comprehensive set of economic statistics.

This Review was prepared late 2023 with preliminary economic data covering FY22, and fiscal accounts through FY23. Figures for FY23 were prepared using a combination of actual outcomes and forecasts.

On behalf of Graduate School USA and EconMAP (Economic Monitoring and Analysis Program), the review was authored by Mark Sturton; Glenn McKinlay compiled the statistical data sheet. Additional input was received from Emil Friberg, Kevin O'Keefe, and Jason Aubuchon. Special thanks are extended to: Hon. Brenson Wase, Minister of Finance; Fred DeBrum, Director of the Economic Policy, Planning and Statistics Office; Junior Peter and Disa Nani Bukida also of EPPSO; and the many civil servants and business operators from the RMI who supported the preparation of this review and its statistical tables.

A digital copy of this review is available online at **http://www.econmap.org**.

Key Features in the Review

The overall economic impact of COVID-19 is estimated to have been far less than originally projected. Initial estimates of the impact of COVID-19 had projected an overall decline of 5.5 percent of GDP. However, the economy is estimated to have contracted by 2.4 percent during FY19-FY22, similar to normal year-to-year fluctuations. If the volatile impact of the fishing sector is subtracted from this total, the overall impact of COVID-19 falls to a very modest reduction of 0.2 percent during FY19-FY22. Given the collapse of the KBE local government, high inflation, and reduced COVID-19 related stimulus, the economy is projected to have contract by 0.6 percent in FY23.

Contrary to expectation employment expanded during COVID-19 by 1.9 percent. However, the impact was uneven. While the private sector experienced a loss of 404 jobs or 9 percent of private sector employment, this was more than compensated for by a gain of 645 jobs or 12 percent in the public sector. Much of the private sector loss was incurred in the commercial fisheries sector, where there was a loss of 341 jobs, with 222 employees being laid off from the Pan Pacific Foods loining plant. In FY23 employment contracted by 5.3 percent. This was almost entirely due to public sector jobs being cut by 15 percent, which reflected the collapse of the KBE government and the reduction in national government employees after services returned to normal when the COVID-19 stimulus money ran out.

After a period of modest inflation during COVID-19, inflation rose by 7.4 percent in FY23. Inflation was relatively modest during the COVID-19 period and prices rose by 4.4 percent in FY19-FY22. The high rates of global inflation experienced after the Ukraine war were not immediately felt in the RMI; reflecting the low weight of transport prices in the CPI and MEC, the utility, froze tariffs during the spike in fuel prices. In FY23 inflation rose by 7.4 percent with food and additional taxes being the main contributors.

During COVID-19 the RMI experienced a large fiscal stimulus accompanied by major support for health and unemployment. The RMI benefitted from an available $82-million donor response to COVID-19, primarily from the United States ($40 million), and Asian Development Bank ($30 million). The US CARES Act unemployment benefits supported affected RMI workers with $8 million of disbursed benefits. Household incomes in FY21 were projected to be 4.3 percent higher than they would have been without the mitigation programs and unemployment benefits.

Fiscal policy in the RMI has been driven by available revenue, with expenditures adjusting virtually automatically to rises in revenues. At the start of the amended Compact through the first 10 years to FY14, revenues averaged 50 percent of GDP with expense averaging 51 percent. From FY14 onward, sovereign rents, fishing fees, and fees from the ship and corporation's registry expanded rapidly, and revenues had risen to an average of 64 percent of GDP by FY21-FY23. Expense largely mirrored this growth and averaged 62 percent in the same period. Although some of the expansion is due to COVID-19, the rapid growth reflects the observed operation of a fiscal policy in the RMI in which expense adjusts rapidly to the revenue ceiling.

The new Fiscal Responsibility and Debt Management law requires review

and modification. In late 2019 a Fiscal Responsibility and Debt Management Act (FRDMA) modeled on the Cook Islands was drafted, and in May 2021 became a law for which accompanying regulations were issued. The adoption of the FRDMA-related regulations was a trigger for both a World Bank Development Policy Operation (budgetary support), and the ADB's Performance and Policy Actions (PPA), required for continued grant support. However, due to COVID-19 and the need to qualify for grant support, there was limited debate. As a result, the law is not as good a fit with the RMI's circumstances as would be desirable. Specifically, the FRDMA neither restrains growth in expenditures within the medium-term revenue envelope nor in relation to the size of the economy. There is thus a need to revisit the structure of the existing law; so that rather than validating existing fiscal practices, it provides an environment for the conduct of responsible fiscal operations.

Due to the favorable provisions of the 2023 Amended Compact and re-evaluation of the IMF's DSA, the RMI is likely to lose its grant only status. External debt has fallen sharply to sustainable levels as a result of being accorded "grant only" status. This requirement has inhibited the surge of debt that occurred during the original Compact period and during the early stages of the amended Compact. However, with the favorable outcome of the 2023 Compact negotiations with continued US grant support, the next update of the DSA is likely to result in a loss of the RMI's grant only status. The RMI will surely seek a delay in such a policy change based on its status as a remote and fragile nation subject to climate impacts of large magnitude; however, the RMI does not qualify for any pre-existing "vulnerability" waivers and could only benefit if eligibility is broadened. Given the RMI's experience with incurrence of debt, the FRDMA needs to be carefully reviewed to ensure that adequate provisions exist to ensure new debt is both financially and economically sensible.

At the time of independence RMI inherited an outmoded, distortionary, and inefficient tax regime from Trust Territory days. From an average of 17.3 percent of GDP during the first three years of the amended Compact, the ratio has fallen to 13.6 percent in the last three years. A tax reform process was initiated back in 2012, a legislative package was drafted, and an implementation program was prepared. Unfortunately, the package failed to garner support and was neither taken up by the Nitijela nor passed into law. Both the ADB and PFTAC have supported improvements in administration and compliance, but the regime has remained essentially unchanged. As the 2023 Amended Compact initiates a new era with the potential for improved outcomes, and a new reformed-minded administration takes office, the RMI may wish to implement the previous tax reform package and follow the successful tax reform example of Palau.

The RMI has considered and implemented a series of digital fintech initiatives that come with high risks to the integrity of the financial system. In February of 2018, the RMI passed legislation to issue a cryptocurrency, known as the SOV, to be used in conjunction with the US dollar. As with other cryptocurrencies, the SOV would be subject to a high degree of price volatility, AML and CTF risk, and potential loss of correspondent banking relationships and access to international financial institutions. Implementation of the SOV went on hold and legislation to repeal the SOV was drafted but not passed. In addition to the SOV, the RMI considered the creation of a Digital Economic Zone in Rongelap Atoll, which would have been subject to all the same risks to the financial system. However, the legislation lost support, but it is yet to be removed from the legislative agenda before the Nitijela. Another project, to issue a stablecoin has been proposed, but currently only a pilot project is under consideration. Finally, the RMI passed legislation to permit the establishment of DAOs (Decentralized Autonomous Organizations), a structure that is largely unregulated and also presents high risk to the financial system. In its recent Article IV mission, the IMF recommended that (i) the SOV legislation should be repealed, (ii) DEZRA should be taken off the legislative agenda, (iii) the stablecoin should be introduced, and (iv) DAO project should be suspended until the RMI has the regulatory capacity to manage the risks entailed.

RMI is considering the establishment of a Monetary Authority. Since the RMI uses the US dollar as the currency of legal tender, most of the key functions of a central bank would not be available in the RMI, such as the issue of currency, conduct of monetary or exchange rate policies, or lender of last resort to the government. However, many important functions would remain including (i) management of the RMI's international reserves and operation of an account at the Fed, (ii) provision of banking services to the government, (iii) management of the local payments system, and (iv) enhancement of its regulatory capacity and ability to provide financial and economic advice to the government. The IMF has been providing Technical Assistance to the RMI for the establishment of the MA and has drafted legislation.

The SOE sector has underperformed and poses significant costs and fiscal risks. The RMI's SOE sector has underperformed for many years, operating at an average annual loss of up to 6.9 percent of GDP and incurring average subsidies of 5.9 percent over the last three years, FY20-FY22. In response to these concerns, in 2015 the government introduced an SOE Act that was designed to focus public enterprises on achieving commercial viability as well as strengthening governance structures and accountability. In 2018 an SOE Management Unit (SOEMU) was created with support from the ADB with the mandate to assist the RMI in implementation of the Act. SOEs prepared Statements of Corporate Intent for submission to the Nitijela and developed business plans. After initial success, momentum slowed with COVID-19, changes in staff, and lack of resourcing. Recent reviews of the sector indicate a lack of management and financial capacity to operate a well-run and efficient sector. Development of community service obligations required to replace subsidies on a contractual basis has not been successful. While the problems seem insurmountable, and solutions will clearly be long-term, greater resources are needed if solutions to the problems are to improve things.

The 2023 Amended Compact agreement comes with more resources but a significant amount of reporting. The agreement of the 2023 Amended Compact with the US in October 2023 was a milestone in the RMI's history and will introduce a new era with a significant expansion in available resources. The annual sector grants will increase from the current level of $35 million (including the Supplemental Education Grant) to $50 million. In addition, there is $8 million a year for supplemental health and a series of other onetime grants. Federal grants and services will continue as will the Joint Economic Management and Financial Accountability Committee. The role of JEMFAC has been expanded but the focus has shifted from ex-ante grant approval to ex-post monitoring. There are a host of annual reporting requirements including the (i) budget and investment framework, (ii) infrastructure development plan, (iii) implementation plan, (iv) financial reports, including annual and quarterly reports, and (v) performance report. The date of enactment of the 2023 Amended U.S.-RMI Compact is March 9, 2024, for all three FAS, while the date of entry-into-force will follow shortly thereafter, likely on different dates for each FAS.

A significant change in the 2023 Amended Compact is the repurposing of the Trust Fund. The funds from the existing trust fund, that was intended to form the basis of a perpetual fund to eventually replace annual sector grants, will set up in "Account 1," which will be repurposed for current use to support additional sector grants or for individual income support. Up to 4 percent of the funds may be withdrawn in any one year. An Account 2 will be established with a series of grants totaling $700 million over the first four years and can be withdrawn at rates up to 5 percent for extraordinary needs of the outer atolls. Finally, carryover funds from previous years will be deposited in Account 3 and be available for use in the sectors. The "D" account, now Account 4, funded by the RMI, Taiwan and, potentially, other donors, will be available for unanticipated shortfalls.

A major issue for the RMI has been the income support for the outer atolls. Outer atoll income support has been implemented through the Copra subsidy paid to outer atoll copra producers, an industry that gives the RMI no comparative advantage and has largely disappeared in the Pacific Island region. The repurposed trust fund, either Account 1 or 2, would provide a means to replace the copra subsidy with a more efficient means of income support. The basis for use of Account 1 funds for income support is that it must be on an equal per capita basis for eligible participants. Eligibility is to be decided by both the US and RMI. In the case of the Extraordinary Needs fund the RMI can determine the use of funds for programs without the need for consultation with the US.

Perpetual vs Repurposed. A major policy issue confronting the RMI is whether to follow the approach adopted in the 2023 Amended Compact, that is, to draw on the CTF for operational purposes or consumption, or to allow the funds to accumulate to achieve perpetual status as originally intended in the 2003 Amended Compact. It would seem that Account 2 for Extraordinary Needs programs would be better suited for use as a basis for a Universal Income Support mechanism for outer atoll residents. This would leave Account 1, the original trust fund, for use as either a fund for operational purposes or the achievement of perpetual status. A further principle that might be written into a reformed fiscal responsibility law would be to allow withdrawals provided there was no loss in net national wealth. Thus funds could be withdrawn for capital projects with a higher rate of return than might be achieved from investments in global financial markets.

1. Recent Economic Performance

Performance

Economic growth in the RMI was modest during the pre-COVID-19 amended Compact, averaging 1.5 percent annually[1] but with high volatility. The RMI's low average growth during FY04-FY19 reflects periods of high volatility with periods of strong growth versus periods of substantial contraction, see Figure 1. The main drivers of growth during the amended Compact period have been dominated by fisheries, with finance and public sector services playing an important but lesser role, see Figure 2. In the public sector, administration, education, and health have all been forces of growth supported by disbursement of the Compact sector grants in education and health and more recently by booming sovereign rents (fishing royalties and fees from the shipping registry).

1 Log linear growth estimate

Figure 1: Real GDP level and annual growth, FY15 prices, percent
Economic growth has been volatile but was displaying signs of sustained growth before COVID-19.

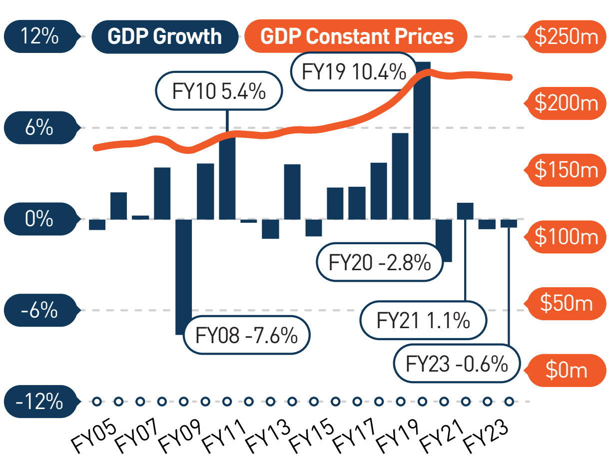
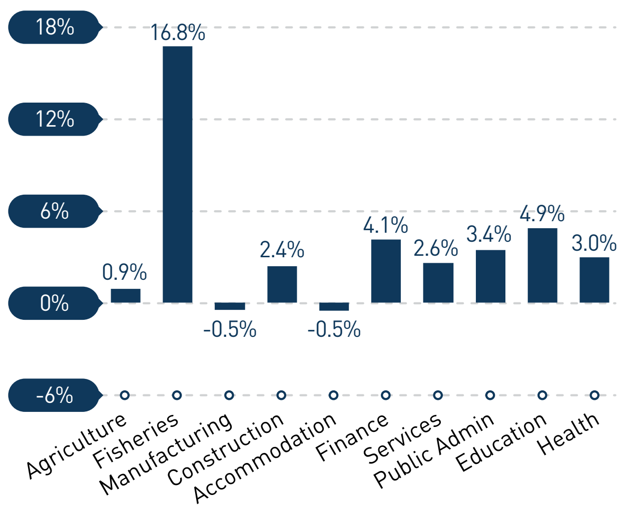


Figure 2: Contribution to economic growth by industry, FY04-FY21
Fisheries has been the main contributor to economic growth.



During FY14-FY19 economic growth picked up to an average of 4.8 percent before COVID-19 struck. Most of this result was due to growth in the public sector. During the first half of the amended Compact, through FY14, economic growth was weak, averaging 0.7 percent per annum, and without fisheries was largely stagnant, growing by a mere 0.2 percent. During the later pre-COVID-19 years, FY14-FY19, the economy grew more rapidly with an annual average growth rate of 4.8 percent. During this period, the fisheries sector and non-fisheries private sector contributed 2.2 and 1.4 percent, respectively, while the public sector made only a modest contribution of 0.6 percent.

The overall economic impact of COVID-19 is now estimated to have been far less than originally projected. The economy is estimated to have declined by 2.8 percent in FY20 at the start of COVID-19, grown by 1.1 percent in FY21, and fallen by 0.7 percent

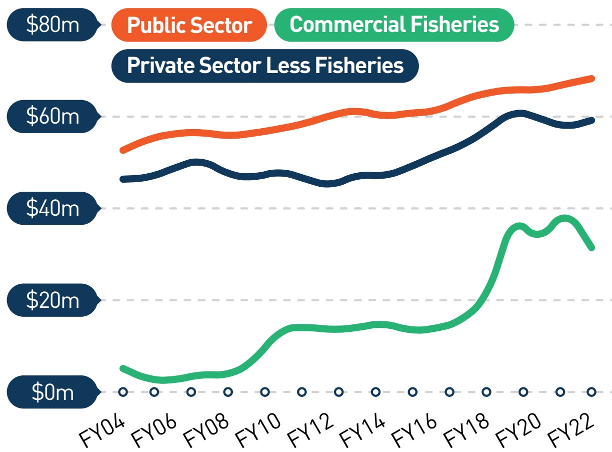
The economy is projected to have fallen by 2.4 percent during COVID-19, FY19-FY22, and by 0.2 percent if the volatile impact of the fisheries sector is excluded.

in FY22, bringing the total impact of the pandemic to a 2.4 percent decline over the three years.[2] If the volatile impact of Pan Pacific fishing (-2.2 percent) is excluded from this total,[3] the overall impact of COVID-19 during the FY19-FY22 period is a mere -0.2 percent. Initial estimates of the impact of COVID-19 had projected an overall decline[4] of 5.5 percent of GDP, but as events transpired they were similar to the normal annual fluctuations in the economy.

During the pandemic the public sector maintained and supported the economy while both the commercial fisheries and the non-fisheries private sector contracted. Figure 3 indicates the growth in commercial fisheries,[5] and non-fisheries (private and public) sectors during the FY04-FY22 amended Compact. The figure clearly reveals the significant growth in commercial fisheries during the period. There was a surge in commercial fishing in FY10 when Pan Pacific commenced operations and again in FY19 when it added 3 new purse seiners to its fleet,[6] During the FY19-FY22 COVID-19 period, commercial

Figure 3: RMI constant price GDP: commercial fisheries, private (less fisheries) and public sectors, FY15 prices

Public sector value added grows consistently with significant volatility in the private and commercial fisheries sectors.



fishing contracted by 15.5 percent and was responsible for the majority, 2.6 percent, of the overall contraction in the economy. The remaining private sector contracted by 2.8 percent and was responsible for 0.8 percent of the overall result. The public sector played a significant role throughout the amended Compact period growing consistently. During COVID-19, it grew by 3.6 percent and contributed 1.0 percent to the overall outturn, mitigating the impact of the non-fisheries private sector.

At the industry level, COVID-19 had a mixed impact with some positive effects in unanticipated sectors. The closure of the loining plant[7] due to health concerns had a negative impact on GDP and was responsible for -0.6 percent of the overall contraction. Reflecting the reduction of fisheries-related activities and restrictions on shipping entering RMI's borders, port activities also contracted and made a negative contribution of 0.8 percent. However, increased domestic operations of AMI and MISC led to an increase of 1.0 percent in GDP reflecting

2 The data presented in this report through FY22 is based on provisional economic statistics, while the data for FY23 is based on projections derived from a hybrid of actual data and the GSUSA economic model for the RMI.

3 Double deflation of Pan Pacific foods value added led to a significant reduction in GDP

4 Graduate School USA, September 2021, Economic Brief, Honolulu.

5 Includes domestic nearshore fishing, Pan Pacific fishing and loining (manufacturing), MIFV (manufacturing), and Koos (transshipment).

6 In FY19 Pan Pacific withdrew 2 leased vessels that had not been included in GDP and replaced them with new vessels that were included in GDP.

7 The fish loining plant is treated as part of the manufacturing sector in GDP.

additional support to the outer atolls during the pandemic. It had also been feared that the construction sector would suffer a major decline. However, the recorded impact was minor, and the sector made a small positive contribution of 0.3 percent. Despite the negative impact of travel restrictions on key skilled personnel, the construction industry avoided any large cutbacks. Finally, while there were other offsetting impacts, the education sector is estimated to have supported the economy by contributing a positive 1.0 percent to GDP growth.

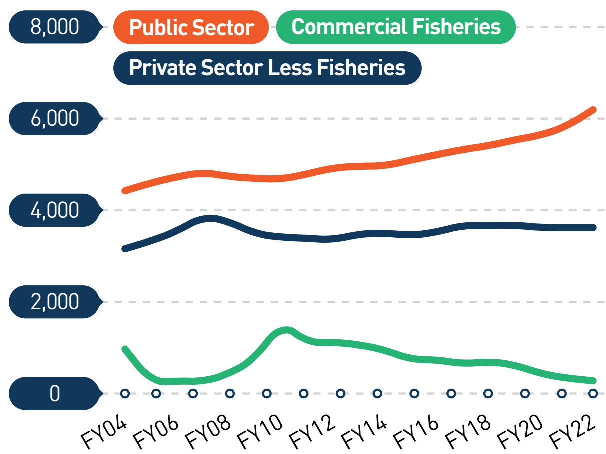
The overall result for FY23 was weak with GDP projected to fall by 0.6 percent. While the economic recovery was well underway in FY23, it was not complete, with the first six months still experiencing the aftereffects of COVID-19. Inflation is estimated to be high, at 7.9 percent for the year, depressing demand with an estimated impact on GDP of -0.6 percent. The cessation of payments from KBE (Kili, Bikini, Ejit) local government had further large macroeconomic implications. Transfers to households fell dramatically by $4 million with termination of transfers from the resettlement fund, and employment by the local government is estimated to have fallen by 350 jobs (albeit at low wages). This may well have had a negative impact on the banking sector as loans secured against payroll went into default. Construction is projected to have improved slightly with COVID-19 restrictions lifted and supply constraints alleviated, but there remains a significant lag in restarting infrastructure projects.

Employment

Before COVID-19, public sector jobs grew steadily, but in the non-fisheries private sector, employment growth has been anemic. Figure 4 indicates the growth in employment in the commercial fisheries, non-fisheries private and public sectors since the start of the amended Compact. The pattern in

Figure 4: RMI employment in commercial fisheries, private (less fisheries) and public sector

After FY10 public sector employment has grown steadily as private sector (less fisheries) employment stagnated.



the public sector during FY04-FY19 mirrors that sector's contribution to GDP with little volatility. During the early years FY04-FY13 growth was modest at 0.9 percent per annum reflecting the tight fiscal conditions. With the increase in sovereign rents since FY14, the RMI's fiscal envelope grew significantly, which enabled expansion of the civil service by an average of 2.1 percent. In the commercial fisheries sectors, the pattern largely reflects the operation of the fish loining plant. In FY04, the former owners of the plant ceased operations and employment in the sector declined. In FY09 the plant reopened under new management, Pan Pacific, and employment peaked in FY10. However, beset by labor shortages, employment levels fell through FY19. In the remaining non-fisheries private sector, employment growth was anemic growing by an annual average of just 0.4 percent during the amended pre-COVID-19, FY04-FY19 period.

During the COVID-19 period, FY19-FY22, a gain of 214 jobs or growth of 1.9 percent of the work force was experienced despite the impact of the pandemic. While a loss of 404 jobs was experienced in the private sector, this was more than compensated for by a gain of 645 jobs (12 percent) in the public sector. In the commercial fisheries sector, there was a loss of 341 jobs, with 222 employees being laid off in the Pan Pacific loining plant, 67 at the MIFV shore base for longliners, with the remainder in other domestic fishing operations, including purse seining. In the early stages of the pandemic fishing operations were restricted due to travel and port regulations. Under the US Cares Act, plant workers at the loining plant were able to increase their income through higher unemployment compensation, while at the same time Pan Pacific was able to cut back on loining operations and reduce costs. In the non-fisheries private sector, a loss of 62 jobs was recorded, with the major sectors impacted being wholesaling and retailing with a loss of 40 jobs, and the hotel/restaurant sector with 26 jobs lost. Despite the earlier indication of a large loss in construction the result was a gain of 21 jobs. Clearly, the overall impact of the pandemic was far less than originally feared as the government significantly increased job opportunities, which more than compensated for the reduction of jobs in the private sector.

Inflation

Inflation has been moderate since the global financial crisis but started to rise in FY22. After the initial part of the amended Compact and the rapid price increases of the global financial crisis, inflation lessened and the overall price level at the end of FY19 was slightly below that of FY12, see **Figure 5**. Inflation continued to be modest at the start of the pandemic and fell by 0.7 percent in FY20. In FY21 prices started to rise and CPI recorded an increase of 2.2 percent, reflecting mainly increases in food prices. In FY22 the inflation rose by 2.8 percent but remained lower than other regional economies such as Palau, which had recorded 13.2 percent over the same period. In the RMI the major driver of inflation in FY22 was increases in

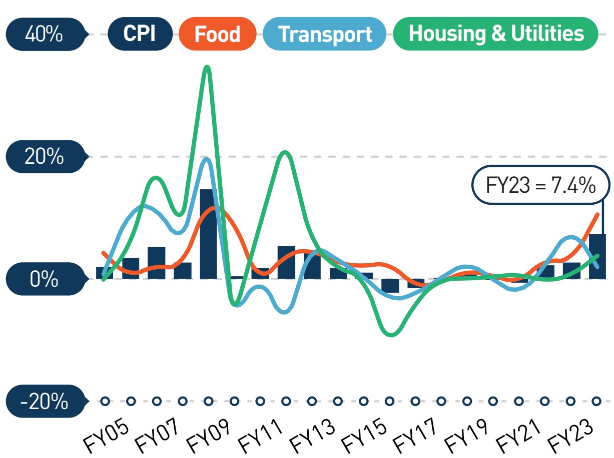
Inflation during COVID-19 was modest but rose to 7.9 percent in FY23.

the international oil price, which reflected the impact of the Ukraine war, causing the transport section of the CPI to rise by 8.9 percent. While food price increases had moderated, the housing and utility section (including electricity) rose by only 1.1 percent. By September the MEC recorded a doubling of fuel costs, but, without any increase in tariffs, the utility was running a large deficit and cash reserves were close to exhaustion.

In FY23 inflation rose by a significant 7.4 percent and it looked like global price increases were finally impacting the RMI. In FY23 inflation shot up reflecting a large increase in food prices of close to 11 percent, contributing 3.6 percent to the overall result. In addition to the increases in food prices, the increase in taxes on tobacco by MalGov contributed another 3.5 percent to inflation. With the fortuitous decline in oil prices, transport costs moderated, but the housing and utility section, which includes electricity prices, rose by 3.8 percent. An increase in

Figure 5: Change in CPI by selected major commodity groups, annual percent change

Inflation jumps in FY23 to 7.9 percent, mostly reflecting large rises in food prices.



utility tariffs at the end of 2022 was requested by the MEC Board, and Cabinet approved increases for businesses and government while rates for residential customers remained unchanged. With the fall in oil prices at the start of FY23 the increase in tariffs reverted to prior levels. However, the resurgence toward the close of FY23 will have resumed pressure on MEC cash reserves.

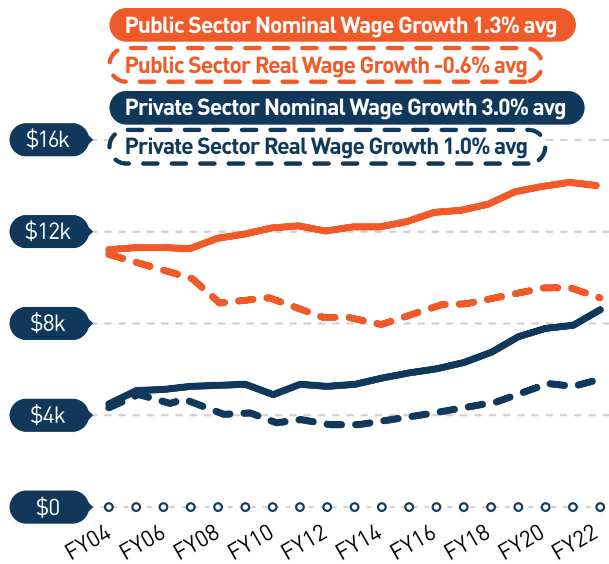
Wages

Between FY14 and FY22 real wages have grown as financial conditions improved and inflation remained low. Nominal wages have grown modestly in the RMI by 3.0 percent and 1.3 percent per annum in the private and public sectors, respectively, during the amended Compact period, see Figure 6. However, once inflation has been taken into account, real wages grew modestly by 1.1 percent per annum in the private sector and fell by 0.6 percent in the public sector per annum. These long-term trends mask two distinct phases: first, there was an early phase (FY04-FY14) when financial conditions were adverse and nominal wages struggled to remain positive and real wages declined; second, (FY14-FY22) as financial conditions in the economy eased and inflation was only 1.3 percent for the entire period, both nominal and real wages rose in both the private and public sectors.

Labor market conditions tightened in FY14-FY22, reflecting labor shortages and out-migration. During this period public sector real wages rose by 1.8 percent, while real wages in the private sector rose far more rapidly, (5.4 percent). The large increase in private sector wages reflects tightening in the labor market as large numbers of Marshallese migrated to the US. However, with the rapid rise in inflation in FY23 these trends are likely to be reversed, at least temporarily, and real wages would have fallen significantly. The wage differential between the private and

Figure 6: Nominal and real wage rates by major institutional sector

Real wages have risen since FY13; but wage differential between the sectors remains large.



public sectors has been large throughout the amended Compact although the different skill mix between the two sectors would explain much of the difference. While the wage-differential remained largely constant through FY04-FY15, it has fallen significantly since FY16 as labor market conditions tightened in the private sector and the ratio fell from 2.5 in FY16 to 1.7 in FY22.

2. COVID-19 Mitigation Programs and Donor Assistance

Analysis of the response of both the public sector and donors to the pandemic can be usefully divided into several major components:

- The RMI Coronavirus (COVID-19) Preparedness and Response Plan
- US CARES Act and unemployment assistance.
- ADB assistance including the COVID-19 Pandemic Relief Option.
- Other donor health assistance programs

RMI Preparedness and Response Plan sets framework for COVID-19 mitigation. In early 2020 in response to the COVID-19 pandemic the National Disaster Committee (NDC), chaired by Chief Secretary, was tasked with the primary responsibility for the development of the COVID-19 Preparedness and Response Plan. The National Disaster Management Office along with various Cluster groups (i.e., WASH, Health, Logistics, Infrastructure, and other relevant agencies) were tasked to provide the technical support to the NDC for the implementation of the Plan. In June 2020 the government of the RMI released the original version of the Plan with an estimated financing need of $42.3 million. This was subsequently extended several times and at the time of preparation of the Review a total available funding level of $81.9 million had been allocated of which $55.5 million had been spent or encumbered by the RMI government. Allocating this funding by broad functional categories provides the following allocations:

- Health mitigation, $37.7 million,
- Household mitigation programs, $15.7 million (CARES Act support, ADB funded hot lunch program, and atoll support programs),
- Private sector business support, $6.9 million, and
- General budgetary support, $21.4 million.

Donor Health Assistance Programs

RMI was the beneficiary of a large donor response to support the Preparedness and Response Plan: The major benefactor to support the Plan has been the US government with $40.5 million. US resources include support under the CARES Act unemployment benefits of $10.9 million, and $29.6 million of health-related funding disbursed through CDC, OIA, and various other Federal Programs. The ADB was the second largest donor and contributed $29.6 million, largely through budgetary support, of which $0.7 million was off budget. Additional health-related funding was available from the World Bank $2.5 million, the European Union $2.7 million (off-budget), Australia $1.7 million, ROC (Taiwan) with $1.8 million, and a further $0.3 million (off-budget) from Japan. Finally, the RMI allocated $2.8 million of its own internal funds.

ADB COVID-19 Pandemic Relief Option

ADB played a major role in funding the mitigation effort. A lead donor for the mitigation program has been the ADB with a program totaling $29.6 million, of which two tranches of $6 million each was funded

> *The RMI benefited from $82 million of donor-assisted COVID-19 mitigation programs.*

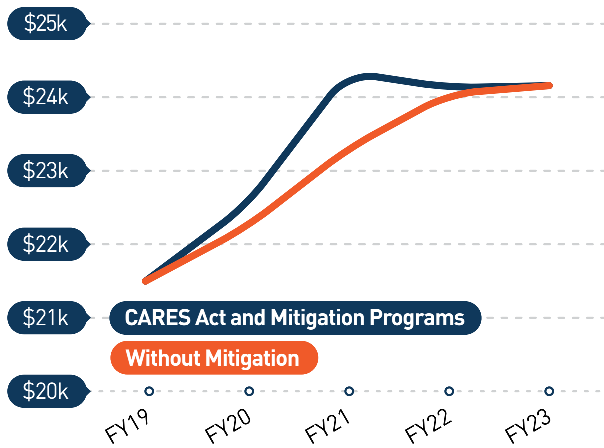
through the Disaster Resilience Program (DRP), $16 million through the COVID-19 Pandemic Response Option (CPRO), $1 million in grants under the Asia Pacific Disaster Response Fund, and off-budget support of $0.7 million in health-related technical assistance. The DRP and CPRO funds provided budgetary support to cover funding shortfalls in the financing of COVID-19 impact mitigation projects and programs specified under the Preparedness Plan. Of this amount $3.3 million was earmarked for the government's hot lunch program.

US CARES Act and Unemployment Assistance

CARES Act unemployment benefits generated significant benefits to affected RMI workers: As in the other Freely Associated States, RMI citizens were made eligible for unemployment support from the US government under the US CARES Act. The program provided two forms of benefits: the Federal Pandemic Unemployment Compensation (FPUC) and Pandemic Unemployment Assistance (PUA). The FPUC was initially awarded at $600 a week for four months (April-July 2020). A second phase of the FPUC was awarded from January 2021 through early September 2021 at $300 a week. The PUA was available continuously from July 2020 and expired in September 2021. A benefit of $262 a week was awarded during the period. Total funding of $10.9 million was awarded of which $8.0 million was disbursed with $3.5 under the PUA, $3.8 million under FPUC, and the remaining funds for other CARES Act purposes.

Figure 7: Household real incomes with and without mitigation, FY15 prices

Household incomes were 8.7 percent higher in FY21 with mitigation.



Mitigation programs had large beneficial impacts on household incomes. Without the various mitigation programs and CARES unemployment benefits, household incomes were originally projected[8] to fall by 4.9 percent in FY21, which would have resulted in rising levels of distress in the workforce. However, as events transpired, household incomes were on a rising trend during COVID-19 even without mitigation, see Figure 7. In FY21 incomes rose by a total of 7.9 percent on the prior year and were 4.3 percent above the level that would have prevailed without mitigation.[9] However, the benefits were targeted at specific groups: the unemployed, hot lunch program, and food baskets for the outer atolls; thus, the needs of other COVID-19 affected households may not have been as well addressed. By FY22 the benefits of the mitigation programs were tapering off and coupled with the slowing economy, real household incomes are estimated to have fallen by 0.8 percent. In FY23 the ADB allocated a further $6 million in COVID-19 mitigation due to a period of rapid community spread at the start of the fiscal period. This helped offset the impact of inflation and the loss of jobs at the KBE local government. As a

8 Graduate School USA, Economic Brief, October 2021, Honolulu.

9 Simulated using the Graduate School MTEF-Mod.

result of these forces, household incomes are projected to have fallen a further 0.4 percent. The overall experience has thus been that the donor support and mitigation programs had a beneficial impact during COVID-19, but once the crisis was over household incomes have at best stagnated.

3. Fisheries Developments and Policy

Loining plant resumes operations at the start of 2023. In FY20 the largest negative impact of COVID-19 was on the loining plant. The plant was originally anticipated to rebound in FY21. However, access to the US CARES Act provided incentives for keeping the plant closed and for individuals to remain unemployed. Workers who lost their jobs received higher compensation than those working at the plant. From the loining plant's perspective a similar incentive existed to remain closed and reduce the loss normally incurred from operations.[10] By delaying the rehiring of employees, the business reduced losses until the provisions of the CARES Act expired at the end of FY21. While a small staff was retained by PPF during COVID-19, rehiring did not restart until the beginning of 2023.

FSM Arrangement provides discounts to domestically flagged vessels at substantially reduced rates. A particular issue of concern for the PNA region is the operation of the FSM Arrangement (FSMa). The FSMa was established to encourage the development of domestic fishing fleets and to permit access to fishing resources of other Parties' fleets. Fishing operators are accorded domestic fishing fleet status under the FSMa and pay a reduced daily rate, which is considerably less than the current bilateral market rate of $11,500 per day. The issue of concern

10 Pan Pacific's fishing operations qualify for VDS discounts under the FSM arrangement in exchange for running the loining plant and creating jobs. The loining plant normally runs at a loss and is cross subsidized from purse seine operations.

The FSM arrangement leads to distortions in the management of the Vessel Day Scheme and potential loss of revenues.

is whether the reduced fishing fee and concurrent loss in revenue will be offset by increases in benefits to the PNA economies. In the RMI case, domestically flagged operators include Koo's Fishing Company, which operates 4 purse seiners, and two other boats under a joint equity venture with the government. Pan Pacific operates 5 boats, with an anticipated sixth boat joining the fleet shortly. The loining plant operates at a significant loss in order to take advantage of the reduced domestic fee rate.

FSMa is an economically inefficient regime that misallocates sovereign rents. A recent study[11] of the fisheries sector conducted by the GSUSA suggests that the additional economic benefit to RMI from each domestic vessel compared with bilateral vessels is about $500 per day. Discounts to domestic vessels that exceed $500 per day would thus represent a loss to the economy. Under the FSMa, fish caught by RMI-flagged vessels pay a transfer fee of $4,000 a day when fish are caught in other FSMa jurisdictions. Discounts to locally flagged vessels caught outside RMI waters must therefore at least match the $4,000 to enable fishing operators to cover the cost of the transfer fee. However, the FSMa entails a loss of sovereign rents when fish are caught in RMI waters, and the benefit of the discount accrues to the locally flagged operators. Based on the economic benefit of domestic fishing fleets of $500 per day, plus the transfer fee of $4,000, it's estimated that the annual loss to the RMI economy could be as much as $7.6 million depending on where the fish are caught. In the case of the RMI, fish are frequently caught outside domestic waters and the loss to the economy will be less. The FSMa is inherently inefficient and incurs a loss in sovereign rents to participating nations. It needs replacement with a more efficient approach in which fishing fleets are rewarded in amounts more closely related to the value added and contributions made to the local economy.

Creation of a new joint venture between MIMRA and the TNC and entry into the tuna global supply chain provides a valid means to create value. The RMI has instigated two important initiatives to diversify the local fisheries industry and create more domestic valued added.[12] The first involves the creation of a joint venture, known as Pacific Island Tuna Provisions (PITP), between MIMRA and The Nature Conservancy (TNC). At the start of 2022, PITP supplied its first batch of Marine Stewardship Council (MSC) certified free school caught skipjack and yellowfin to Walmart. A key part of the process relates to the operations of the VDS, which supports a monitoring and control program to promote sustainability in the fishery. Elements of this system — independent verification and a rigorous chain of custody — has enabled MSC certification of free school caught skipjack and yellowfin fisheries in the PNA region for the last 10 years. The creation of PITP and the associated provisions of the PNA through the MSC process enabled the RMI to supply Walmart and break into the value chain with a supply of 11 million cans of tuna in 2022. This new enterprise, if it can build on its success so far and avoid countermeasures from established global suppliers, represents a potentially important means of enhancing the value of the fisheries sector to the RMI.

Measures are underway for the RMI to create a Competent Authority recognized by the EU for the export of fish products. The second area pursued by MIMRA, to enhance local fisheries value added, is the establishment of a Competent Authority for export of tuna to the EU. The nascent RMI Competent Authority is the agency that oversees quality assurance and compliance of local fish

11 Graduate School USA, ***Unpublished analysis of the fishing industry in the North Pacific, 2019, Honolulu.***

12 MIMRA, MIMRA Annual Report, 2022, Majuro.

processing facilities with EU rules for fish handling and prevention of illegal, unreported, and unregulated fishing. A missing link for recognition of the Competent Authority has been its lack of an adequate laboratory to sample and test fish products. To remedy this requirement MIMRA is currently expanding its new building to create a new facility that will fulfill a key requirement for EU recognition. A second key element required for recognition is that local fish processors will need to significantly upgrade their infrastructure, facilities, and processing systems.

MIMRA has generated a significant pool of underutilized reserves: In September 2016 the Nitijela passed a law, the Marshall Islands Marine Resources Authority Surplus Funds Amendment Act, designed to enable "surplus" funds, defined as resources in addition to those approved by the Board as part of the annual budget, to be transferable to the government. The provision arose due to the large accumulation of unused revenues in the MIMRA account, which had reached over $30 million by the end of FY16. In FY17 approximately $14 million of the surplus reserves were drawn on and used to fund additional expenditures. However, the remaining reserves are substantial and by the end of FY21 had once again exceeded $30 million. The reserves are held either as cash or TCDs.

Revisions to the Fiscal Responsibility and Debt Management Act would provide a sound basis to guide the use of any available reserves: The use of any additional funds (such as what occurred in FY16 to inflate general fund expenditures) does not reflect responsible fiscal management. The current legislative framework for the identification and use of surplus funds is not well formulated. It reflects Article VIII of the Constitution which enables surplus funds to be treated as "unanticipated revenues." Unanticipated revenues can be apportioned by the cabinet of the day without the need for appropriation by the Nitijela. Revision of the

> *MIMRA undertakes new initiatives to increase retention of valued added.*

Fiscal Responsibility and Debt Management Act, discussed in the next section, would provide an appropriate institutional structure to guide responsible use and investment of the reserves, including possible transfer to accumulation in the proposed cyclical and/or climate reserve funds. The adoption of well-defined principles in the FRDMA to guide the use of any surplus funds could then establish a sound basis for resource management without the risks of fiscal indiscipline inherent in current practices and law.

4. Fiscal Performance and Policy

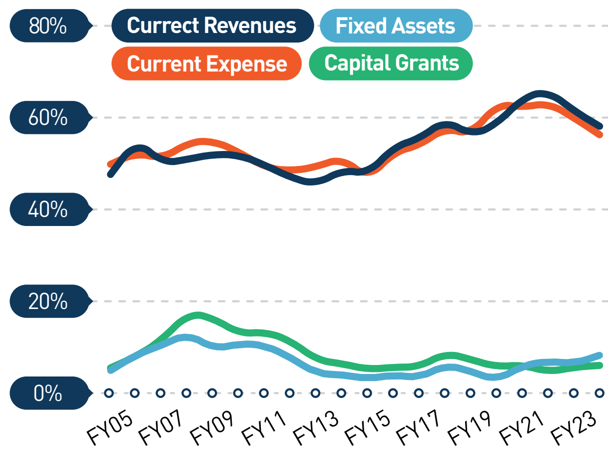
Long-Term Fiscal Trends[13]

Revenues fell as a share of the economy in the first ten years of the amended Compact but then rose rapidly with the growth in sovereign rents. Figure 8 indicates recent trends in fiscal performance, that is, current revenues and expenses, together with capital grants and fixed assets, as a share of the economy. During the first ten years of the amended Compact through FY14, revenues declined as a percent of GDP. This decline reflects the inelastic and outmoded tax regime and the static nature of Compact and other current grants in nominal terms, see Figure 9. The FY14-FY19 period reflected growth in a new form of revenue, sovereign rents: comprising both fishing royalties arising out of the VDS from the PNA and increases in earnings from the TCMI, resulting in an 11 percent increase in the ratio of revenues to GDP. During the COVID-19 period, FY20-FY22, the upward momentum in revenues was sustained through the large receipt of grants for protecting the health of the nation and for budgetary support to mitigate the impact of the pandemic.

Payroll has declined as a share of GDP, but expenses on subsidies and transfers have doubled. The decline in the revenues-to-GDP ratio prior to FY14 led to a tight fiscal period of constrained expenditures. However, as the revenue base expanded with the increase

Figure 8: RMI consolidated revenues and expenditures, percent of GDP

RMI executes expansionary budgets during FY15-FY21 with overall fiscal surplus averaging 1.9 percent of GDP



in sovereign rents, expenses also grew. The rapid increase in grants during the COVID-19 period financed matching health- and mitigation-related expenses. Within current expenses, payroll declined in relation to GDP through FY14 by 4 percent and then stabilized at 22 percent of GDP through FY22, see Figure 10. The use of goods and services remained stable until the outbreak of COVID-19, when it expanded rapidly, but is anticipated to fall back as the economy emerges from the pandemic. The main area of expansion has been in subsidies to the large SOE sector, grants to other levels of government, and transfers to NGOs and households, which has nearly doubled from 11 percent to 20 percent of GDP. On the capital side, expenditures have been primarily covered by grants, which, as with current expenses, have risen and fallen in tandem.

Fiscal policy in the RMI has been driven by revenue availability. During the initial period through FY14, budget expenses were forcibly constrained and the RMI ran an average fiscal surplus of 1.2 percent of GDP.[14] Thereafter,

13 Fiscal trends are based on audits through FY21, the old 4Gov IDC/Dilog FMIS in FY21 and FY22 and the new Bisan FMIS for FY23.

14 In essence the fiscal balance in the RMI is reflected in the difference between current revenues and expenses since investment in fixed assets is financed through capital grants.

Figure 9: RMI revenues by source, percent of GDP
Tax revenues are an inelastic source of revenues while sovereign rents have boomed.

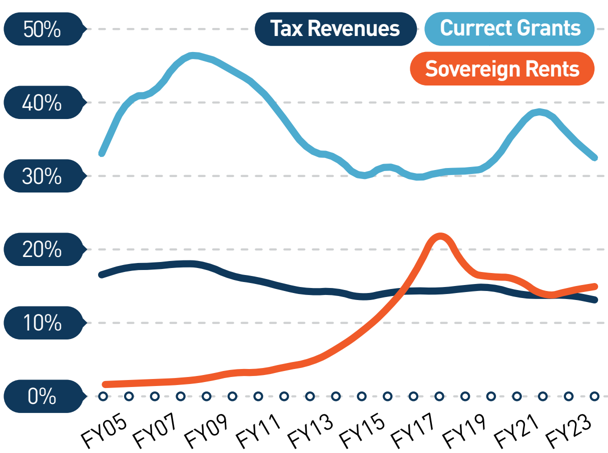
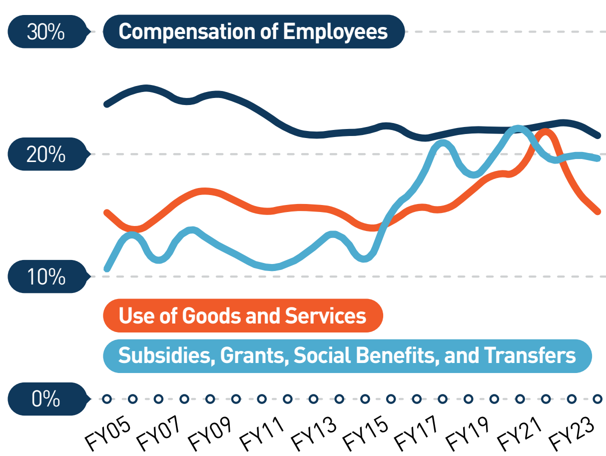


Figure 10: Expense by economic category, percent of GDP
Subsidies and transfers have grown rapidly since FY2014.



with the boom in sovereign rents through FY19 and before COVID-19, expenses were less constrained. Thus, the fiscal outturn remained favorable, and the average surplus grew to 2.4 percent of GDP. During the COVID-19 period, the strong growth in grants covered the expenses for additional needs and helped the nation to avoid running into a deficit. However, the overall position deteriorated and recorded an average surplus of 0.9 percent during FY20-FY23. Throughout the amended Compact period fiscal policy has been operated on the basis of utilizing all available resources with little consideration given to the stage of the economic cycle or future financing needs on the downside.

Fiscal Performance During the COVID-19 Period

Introduction

Fiscal policy during COVID-19 was designed to (i) support the health needs of the nation, (ii) support the private sector, and (iii) mitigate the social impact of the pandemic. In March of 2020, as the consequences of the COVID-19 global pandemic were becoming

> *Payroll expenses have declined as a share of GDP while expenses on subsidies and transfers have doubled.*

understood, the government designed a set of policy actions to support the economy and mitigate the negative consequences. The first objective was to protect the health needs of the nation and deal with a potential outbreak of COVID-19, which fortuitously did not take place until the nation was close to fully immunized. Given the dependency of the economy on the Compact and activities unaffected by COVID-19, the impact of the pandemic was restricted to a narrow range of industries, namely construction, transportation, port activities, transshipment, and tourism. The second policy objective was thus to provide targeted support to the affected private sector firms through a series of subsidies. The third objective of fiscal policy was to enact a series of programs to mitigate the social consequences of the pandemic on individuals and households, including the hot lunch program, food baskets to the outer atolls, and unemployment support to workers

The Proposed Fiscal Responsibility and Debt Management Act fails to place a hold on runaway expenditures and requires reform.

laid off or working reduced hours. These programs were financed under the ADB CPRO program and US CARES Act.

Revenue Effort

Revenues grew strongly to a record level of $181 million in FY21, $33 million or 22 percent above pre- COVID-19 levels. While the initial expectation at the onset of the pandemic was a sharp fall in revenues, the opposite was in fact the case. Government revenues grew strongly, reflecting the infusion of funds, as grants rose to record levels, see Figure 9. At the start of COVID-19, FY20, the tax base contracted by 3.9 percent with the reduction in economic activity. While wage tax collections and import duties held their ground, there was an 11 percent fall in the gross receipts tax reflecting the decline of business activity. In FY21 there was a rebound in all categories of taxation with the GRT improving significantly, and total collections grew by 5.7 percent. By FY23 with the recovery underway, tax revenues had returned to their pre-pandemic level.

While tax revenues held their ground, the onset of COVID-19 was associated with a large increase in grants. In FY20, grants increased by 24 percent ($17.0 million) reflecting support from the US for health and unemployment benefits with additional resources from the ADB under the Disaster Resilience Program. In FY21 a reduction in health funding was compensated for by continued resource transfers through the US CARES Act and the large CPRO grant from the ADB ($16 million for general budget support). By FY23, COVID-related support grants were largely exhausted except for a further $6 million under the ADB Disaster Resilience Program to support the Marshall Islands during the outbreak and community spread of COVID-19. In FY23, overall grants remained $14 million above pre-COVID-19 levels, largely reflecting increased spending on World Bank projects.

Sovereign rents were largely stable during COVID-19 although transfers from MIMRA declined. MIMRA receipts remained largely stable during COVID-19. However, transfers to the government fell by $5 million in FY21 to $26 million and remained at the same level in FY22, before regaining some of the lost ground in FY23 with a transfer of $28 million. It appears that government transfer levels are determined during the budget process, when the actual outturn has not yet been determined. Pessimistic forecasts are often contradicted by events when the final outturn turns out to be more favorable than predicted. This leads to a degree of volatility in budget formulation that could be avoided given the large volume of savings retained by MIMRA that could be used to smooth transfers. Receipts from the Trust Company of the Marshall Islands (TCMI), a mix of sovereign rents earned from shipping and corporate registration fees, grew during the COVID-19 period, offsetting the reduced transfers received from MIMRA in FY22.

Expense Control

During COVID-19, government expenses grew strongly in FY20 through FY21, fell in FY22, and reverted to pre-COVID-19 levels in FY23. During the COVID-19 period through FY23 payroll costs grew by an average annual rate of 2.9 percent, slightly above the long-term average of 2.5 percent. There was a significant increase in FY21 reflecting the large infusions of budgetary support arising from the ADB CPRO. However, by FY23 payroll expenses had stabilized and reverted to a level consistent with the long-term average, see Figure 10. Expenses on goods and services were largely unchanged in FY20 as additional COVID-19-related expenses were offset by a reduction in items such as travel, which fell due to the travel restrictions. In FY21 there was a 30 percent increase in goods and services, reflecting growth in food items due to the grant funding of such items as the outer atoll food baskets together with a large increase in professional services. In FY22 use of goods and services reverted to trend with large reductions in areas such as food, utilities, and repairs and maintenance, suggesting fiscal restraint although use of professional services remained high. In FY23 use of goods and services fell by 9 percent again, reflecting fiscal restraint as the fiscal envelope tightened although the use of goods and services continued to be well above pre-pandemic levels.

Subsidies to the SOE sector fell during COVID-19 but were matched by payment of subsidies to the private sector for COVID-19 mitigation. After a period of rapid increases in subsidies to SOEs, subsidies fell in FY21 due to more favorable world prices of coconut oil and remained stable though FY23. With the onset of COVID-19, the government introduced a private sector subsidy program to support businesses adversely affected by the pandemic. Subsidies to the private sector of $3.9 million and $2.7 million were recorded in FY21 and FY22, respectively and were financed through the ADB CPRO program. By FY23 the economy had reopened obviating the need for further support. With a stable level of SOE subsidies, the reduction in private sector support led to an overall reduction in subsidies in FY23.

US pays compensation to the RMI for the loss of the trade and investment provisions of the original Compact on the condition that the funds were deposited into the CTF. During FY20-FY23 the government deposited $5 million annually into the Compact Trust Fund reflecting the payment of a matching amount by the US for compensation for the loss of the trade and investment provisions of the original Compact. A total compensation of $20 million was agreed on with the condition that the funds were deposited into the CTF. As a result of COVID-19 and the US CARES Act provisions for unemployment benefits, the fiscal account recorded the payments of $1.6 million in social benefits in FY20, $5.4 million in FY21, and $0.5 million in FY22, when the program was terminated. Grants to government entities remained largely unaffected by COVID, although the annual transfer to MISSA had been reduced reflecting the improved performance of the Social Security Fund. Finally, expenses on "other" items rose rapidly from $16 million in FY19 to $23 million in FY23 reflecting increases in transfers to households, nonprofits, and schools (including expenditures on the hot lunch program).

Capital expense

Public investment grew during COVID-19 despite fears of contraction. Despite the impact of COVID-19 on the economy and the fear of reduced investment due to skill shortages in the construction industry, there was a large increase in expenditures on nonfinancial assets and in particular sizeable increases in investment in health-related equipment.

Financing

RMI runs a fiscal surplus in FY20 through FY22, but a deficit is estimated for FY23 as the pre-COVID-19 structural deficit reasserts itself. In FY19 the RMI recorded a fiscal deficit of 1.8 percent of GDP, which reflected the emergence of a structural deficit as rising expenditures outstripped revenues. In FY20, fiscal balance was restored, and a 2.5 percent surplus was recorded as the rapid increase in grants led to a buildup in deposits with the accumulation of unused funds. In FY21 the fiscal surplus fell to 0.2 percent of GDP as capacity limitations were overcome and cash balances were drawn down. For FY22 an improved surplus of 0.7 percent deficit was achieved, but in FY23 a preliminary estimate of a 0.4 percent deficit is estimated as the large increases in COVID-19-related grants were no longer available, and the underlying structural deficit that had existed before COVID-19 reasserted itself.

Fiscal Responsibility

Passage of a Fiscal Responsibility and Debt Management Bill was a key trigger for both World Bank and ADB support. The above analysis of recent fiscal trends indicates rapidly rising expenditures, which are growing to absorb the increasing level of revenues. Fiscal discipline to restrict the growth in expenditures, and thereby to build a reserve to accommodate downturns in the business cycle, has been absent. Rather, expenditures have raced to catch up with the expanding funding envelope. In 2019 a committee was formed, chaired by the RMI Chief Secretary, to design a fiscal strategy and to consider a fiscal responsibility framework. As a result, in late 2019 a Fiscal Responsibility and Debt Management Act (FRDMA) was drafted, and in early 2020 it was adopted by the cabinet and submitted to the Nitijela. In May 2021, the bill became a law and accompanying regulations were issued. The adoption of the FRDMA-related regulations was a trigger for a World Bank Development Policy Operation (budgetary support) and for ADB's Performance and Policy Actions (PPA), which are required for continued grant support at planned program levels.

Proposed modifications to FRDMA would better enable it to address the unique needs of the RMI. The sudden appearance of COVID-19 in early 2020 left the development of the FRDMA with an incomplete level of technical review; however, the new law would benefit from the addition of several key, RMI-specific elements that would make the law a better fit for the RMI's unique circumstances and fiscal risks. Perhaps most importantly, the FRDMA neither restrains growth in expenditures within the medium-term revenue envelope nor in relation to the size of the economy. At the present time with a new and reform-minded administration taking office, an opportunity exists to modify the FRDMA to reflect the key principles identified in the RMI-vetted fiscal strategy and to better reflect the budgetary cycle within the Marshall Islands. It is hoped the FRDMA will be revised to reflect these principles and create an environment for the conduct of responsible fiscal operations as was intended in the World Bank's and ADB's respective PPAs.

Tax Reform

The RMI tax regime is inherently inelastic relative to economic growth and in need of modernizing reforms. The RMI, along with its two sister Freely Associated States (FAS) of Palau and the FSM, inherited a tax regime from the Trust Territory days. Palau has now replaced the old anachronistic regime with a modern system, but in the Marshall Islands the regime remains unchanged, outdated, distortionary, and in need of reform. Figure 9 indicates the decline in the tax/GDP ratio and inherently inelastic nature of the current batch of taxes: wage withholding tax, the gross receipts tax, and import tax. From an average of 17.3 percent of GDP during the first three years of the amended Compact, the ratio has fallen to 13.6 percent in the last three years. A tax reform process was initiated back in 2012, a legislative package was drafted, and an implementation program was prepared. Unfortunately, the package failed to garner support and was neither taken up by the Nitijela nor passed into law. The major focus of opposition was from the business community, which resisted the introduction

> *Following agreement with the US on the terms of the 2023 Amended Compact, the RMI will likely lose its favored "Grant- Only Status".*

of a Value-Added Tax (VAT), even though the incidence of tax would fall on consumers.

As the RMI enters a new era with a new administration and the start of the 2023 Amended Compact, a good opportunity exists to reignite the tax reform initiative. Since the tax reform efforts of the early 2010s following shortly after the financial crisis and tight fiscal envelope of the time, reform of the tax regime has not been seriously reconsidered. The donor perspective has been that without commitment to reform of the tax regime, donor support should focus on administrative strengthening. The Pacific Technical Assistance Center (PFTAC) has continued to provide support and in 2020 the ADB launched a TA under the Public Financial Management (PFM) project to provide administrative support in compliance, improved tax collections, internal processes, and risk management. The ADB TA resulted in one major recommendation to improve IT systems to enhance efficiency. However, while such efforts are highly desirable and will result in increased revenue collections in the short term, they will not overcome the inherent weaknesses, inefficiencies, and lack of buoyancy of the existing regime. In other words, tax collections will fail to keep up with the growth in the economy. The tax reform initiative in Palau and introduction of a VAT (Palau Goods and Services Tax) and Business Profits Tax (BPT) has been a significant success[15] and provides a path for the other FAS to adopt.

15 The exception to the success of the Palau reform was a spike in inflation as business owners took advantage of the new system to increase margins. The inflationary spike only happened once, and hopefully, prices will adjust as competitive forces assert themselves.

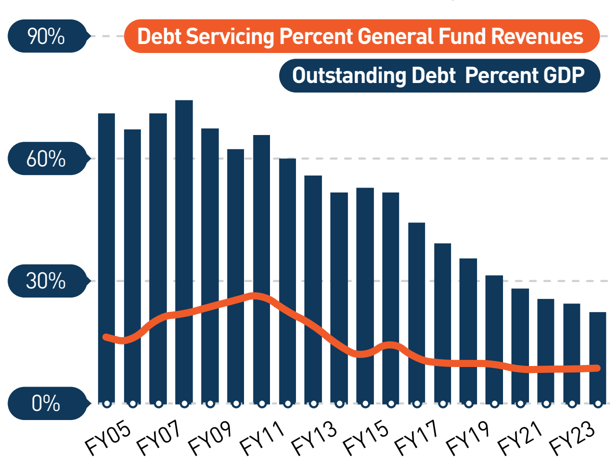
External Debt Management

External debt and debt service fall to low levels. As a result of the IMF/World Bank's Debt Sustainability Analysis (DSA) indicating the nation as being at high risk of debt distress, the RMI was designated as a "grant only" recipient, making the RMI no longer eligible for loan financing from multilateral donors. The high-risk assessment was based on two major factors: (i) the historically high ratio of debt to GDP and the (ii) potential shortfalls in resources in an adverse scenario after the end of the 2003 Amended Compact period. External debt stress had posed significant risk to the RMI fiscal position during the early years under the 2003 Amended Compact, including periods of delinquency in the late 2000s. However, the current position has improved significantly, and external debt has fallen from 71 to 22 percent of GDP (see **Figure 11**). Debt service as a ratio of payments to general fund revenues has also fallen significantly from over 20 percent at the height of the global financial crisis, when the RMI was in a state of default, to just 7 percent in FY21.

The designation of "grant-only" status served the RMI well but under the 2023 Amended

Figure 11: RMI external debt (percent of GDP) and debt service (percent of general fund revenues)

External debt has been falling rapidly with adoption of grant-only status.



Compact is likely to terminate. External debt has fallen sharply to sustainable levels as a result of being accorded "grant- only" status. This status is accorded on the proviso that the RMI does not incur debt from third parties at non-concessional rates. This requirement has inhibited the surge of debt that occurred during the original Compact period and during the early stages of the 2003 Amended Compact. However, while grant-only status has inhibited borrowing, this is not to say that pressure to incur new debt has disappeared. So far, the DSA provision and analysis has imposed a useful brake on any reemergence of the past debt-financing trends. However, with the favorable outcome of the 2023 Amended Compact agreements, the FSM is already undergoing reclassification to "eligible for both grants and loans" and thus will lose its "grant-only" status. At the time of the next IMF Article IV consultations, likely in the first half of 2025, the RMI is also likely to be reassessed. The RMI will surely seek a delay in such a policy change based on its status as a remote and fragile nation subject to climate impacts of large magnitude; however, the RMI does not qualify for any pre-existing "vulnerability" waivers and could only benefit if eligibility is broadened. The current proposal to implement a well-specified FRDMA reflecting the needs of the RMI is thus viewed as essential for providing guidelines on the proper management of debt at sustainable levels and for well-vetted purposes.

Countercyclical Policy, Fiscal Buffers, and Climate Events Management

The RMI has a need for countercyclical fiscal buffers and reserves that could be established and maintained through the use of MIMRA surplus funds. The fiscal policies adopted during the 2003 Amended Compact have resulted in periods of substantial cash-flow shortfalls and led to fiscal and economic instability. This was seen in both the failure to service accounts payable and the temporary default on external debt repayments during the late 2000s. The RMI, unlike more financially developed nations, has no access to capital markets. Further, the adoption of the US dollar and the lack of a central bank removes the availability of a domestic source of funds for cash-flow management. Under these circumstances the RMI needs to build a pool of savings for funding government operations during cyclical downturns and periods of illiquidity. In the previous section and the discussion of the management of the MIMRA surplus funds, it was suggested that transfer of the surplus to a cyclical reserve would provide a more efficient means of investment and principled approach to their use.

Target levels of cyclical reserve funds may be set in relation to domestic revenues. Many Pacific Island Countries (PICs) with their own currencies, fixed exchange rates, and central banks operate on the principle of maintaining foreign reserves at a defined level of imports. In the RMI's case, this objective would translate into maintaining a minimum level of resources equivalent to a target number of months of domestic revenues. This could be determined with reference to historical periods of cyclical volatility. One source of funds to establish a cyclical reserve as discussed above is the MIMRA reserve, but it could be augmented on a matching basis with donor funding. Once established, the fund would need periodic augmentation to ensure the reserve target was met and a mechanism to replenish the fund after it had been drawn upon was identified. Clear rules would need to be adopted to specify the conditions under which the reserve funds could be accessed.

A Climate Resilience Fund is likely to become increasingly necessary. In the case of periodic climate events and natural disasters, the RMI could establish a climate resilience fund to help mitigate adverse impacts. While the RMI does have access to climate event insurance funds from the World Bank and ADB, there may be events and circumstances for which these funds may either be unavailable or just not available on a timely basis. Contributions from domestic revenues and from donor partners could be set aside into a resilience fund until a target amount is reached. The exact target amount might be based on the World Bank's Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI). In the RMI's case the risk and cost of an annual climate event has been estimated at about 2.0 percent of GDP. The target for the fund might be set in relation to this risk and the availability of other donor contributions. Withdrawal of funds would be permissible once the president declares a state of national emergency. Commitment costs of the World Bank's and ADB's disaster funds, or premium costs for any other such insurance facility, could be drawn from the climate resilience fund.

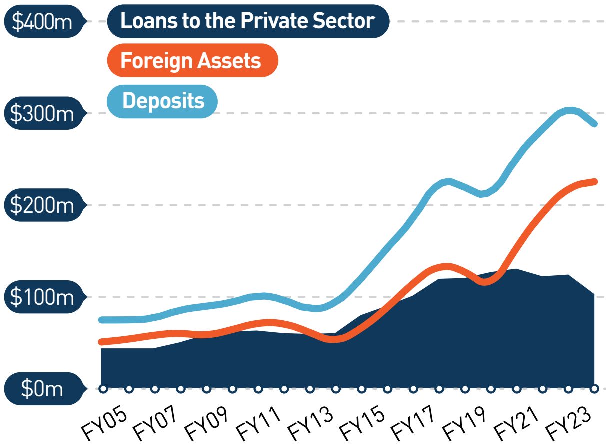
5. The Financial Sector

Banking

The RMI banking sector operates a more proactive lending policy than its sister Freely Associated States (FAS). Commercial bank lending in the RMI is more active than in the sister FAS states of the FSM and Palau and achieved a loans-to-deposits ratio of 36 percent, as compared to ratios of 13 percent in FSM and 11 percent in Palau (see Figure 12). The greater lending performance reflects the more active lending policy of the local bank: the Bank of the Marshall Islands (BOMI), which is not FDIC-insured and comes only under local supervision. However, greater financial intermediation has been limited by the inability

Figure 12: Commercial bank deposits, lending, and foreign assets

Commercial bank lending remains weak, funds invested offshore



Households remain at risk of high debt stress due to large indebtedness to the commercial banks.

of businesses to prepare meaningful business plans and financial statements; lack of collateral; and the limited ability to use land as security. However, the introduction of secure-transactions legislation and property registry has enabled lending against moveable chattels (personal property). With limited opportunities in RMI, commercial banks have preferred to invest their assets offshore in less risky and more secure markets.

The RMI banking sector remains at risk due to the possible loss of BOMI's correspondent banking relationship. A particular issue for the RMI has been the worldwide phenomena of "de-risking" by international financial institutions. In order to reduce exposure to money laundering, the financing of terrorism, or the stiff penalties imposed by regulatory authorities, international banks have limited Correspondent Banking Relationships (CBR). BOMI has been under threat of loss of its correspondent bank, First Hawaiian Bank. It is understood that First Hawaiian has been satisfied with recent progress at BOMI in tightening Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) procedures, but a permanent CBR solution is needed. While the de-risking issue has receded, the financial system in the RMI remains at risk until a permanent solution is found.

Households are at risk of high-debt stress due to large indebtedness to commercial banks. A further issue relating to banking is the high ratio of consumer debt to household income. Consumer debt represents 30 percent of GDP and 50 percent of compensation of employees. Consumer debt attracts high rates of interest (11.1 percent in FY23) and is largely secured against the payroll of public sector employees through direct allotment, which guarantees repayment. Analysis of government payroll indicates allotments for debt repayment average 47 percent of total wages, which leaves the net take-home after-tax pay of employees at an average of 15 percent of gross wages. More than 25 percent of employees take home less than 3 percent of their gross wages. As a result, government employees are reported to be at high risk of debt stress. Many national government employees have such low levels of net take-home pay that they are unable to meet their basic family needs.

To reduce risks to both households and the financial system, policymakers need to focus attention on a range of policy responses. As noted in a 2019 policy paper prepared by the Chief Secretary's Office, the government has been presented with a series of potential actions to consider. It was recommended that the government: (i) address the growing consumer debt problem through review of banking practices, laws and regulations, and the role of the Banking Commission and its oversight; (ii) strengthen consumer education and financial literacy programs; and (iii) establish a new Consumer Protection law to strengthen governance over this and related consumer issues. Such a program of action undertaken with private sector and civil society collaboration can be expected to improve fairness in the consumer lending sector and reduce the risk of potentially disruptive levels of stress on the financial sector. The Banking Commission has reported that it will be issuing regulations to address this issue and to reduce household debt stress through placing a limit on debt-service obligations.

Social Security Sustainability Management

An actuarial study in 2011 projected collapse of the Social Security System in 2023, motivating a series of important reforms.

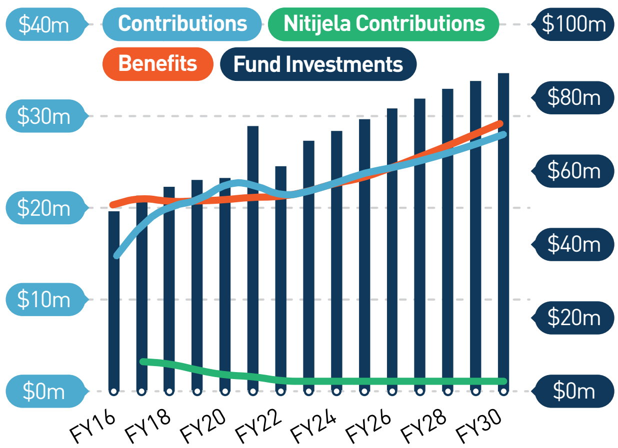
The financial position of the Marshall Islands Social Security Administration (MISSA) was a long-standing issue. MISSA had been identified as being at significant risk and in need of reform. In 2011 an actuarial study projected the threats to the system and the exhaustion of its reserve investments by 2023. As a result of these dire predictions, a series of reforms were proposed in 2013 but were not acted upon by the Nitijela. However, given the imminent collapse of the system, a revised version of the reforms was enacted in 2017. Compared with the original reform list, it was recognized that these reforms would likely be insufficient to restore long-term sustainability. The Nitijela acted to provide annual transfers of $3.6 million in FY17, but these transfers have been gradually reduced to $1.0 million in FY23.

Recent financial data indicates MISSA contributions now match benefits. The impact of reforms and cash transfers appears to have been significantly greater than originally projected. Since FY18 contributions have closely matched or exceeded benefits, suggesting a sustainable financial position. This will allow the fund to accumulate from both the excess contributions and annual earnings on investments. Based on the current financial position of the fund, projected contributions (based on recent economic work conducted by GSUSA), and projections of benefit streams from prior actuarial assessments, the outlook for MISSA appears favorable.

Projections indicate MISSA's financial position has improved significantly but requires careful monitoring. Figure 13 suggests that contributions will exceed benefits for some years but with a narrowing of the balance as benefit growth exceeds that of contributions. The projections (which are based on a 4.5 percent return on invested assets, the rate assumed in the 2017 actuarial assessment, but including the current transfer from government of $1 million) indicate that reserves will continue to rise and attain a value of close to $87 million by FY30, that is, an increase of $25 million on the current fund balances. Without government transfers, fund balances continue to rise but by FY30 the system begins to peak and suggests government should maintain the current level of transfers to maintain long-term financial sustainability. The results indicate that the financial position of MISSA is out of the danger zone. However, the benefit projections presented here are based on earlier actuarial studies. There remains a need for reevaluation and regular monitoring of the system.

Figure 13: MISSA benefits, contributions, fund investments, and Nitijela contributions

Social Security Funds now projected to rise after recent reforms



Earlier reforms to the Social Security system have improved financial sustainability.

Corporate and Shipping Registry

The IMF indicates the nonresident corporate sector is not subject to the AML/CFT framework. In recent IMF Article IV consultations,[16] the Fund indicates that financial integrity risks remain in the nonresident corporate registration sector. Under a long-standing and confidential agreement, the operation of these registries has been delegated to the Trust Company of the Marshall Islands (TCMI), which is a subsidiary of a US company, International Registries Inc. TCMI is subject to limited oversight by the Banking Commission or other government agencies. The Fund indicates that corporate services provided (by TCMI) to foreign entities registered in the RMI are not subject to the AML/CFT framework, undermining the authorities' ability to properly understand and oversee the sector, obtain accurate information, and combat illicit activity linked to offshore activities.

EU places the RMI on its blacklist in February of 2023 only to withdraw it in October. The EU placed the RMI on its blacklist of "non-cooperative jurisdictions for tax purposes" in March 2019 only to remove it in October 2019. Again in 2023, it went through a similar process indicating in February that the *Marshall Islands facilitates offshore structures and arrangements aimed at attracting profits without real economic substance by failing to take all necessary actions to ensure the effective implementation of substance requirements under criterion*.[17] By October the EU had changed its mind and withdrew the RMI from the blacklist.

A transparent evaluation of the costs and benefits of the Corporate and Shipping Registry remains needed to assure that the RMI is receiving its fair share of royalties. In addition to the financial integrity risks associated with TCMI, there is concern regarding the distribution of sovereign rents accruing from the activity. At the start of the amended Compact the RMI government received $1 million annually from the registry; $8.2 was received in FY21 and FY22; and in FY22 had risen to $11.4 million. However, there is a general lack of transparency and publicly available financial information on TCMI operations. As a result, the question arises whether or not the RMI receives its fair share of the royalties. However, it is known that in similar jurisdictions the host nations receive a far higher return. There is thus a need for a transparent evaluation of TCMI in light of perceived unfairness and possible underpayment of royalties that are due to the RMI. It is understood that the government commissioned a study some time back to evaluate this issue and to recommend a range of actions, but these are also not publicly available.

16 IMF, Republic of the Marshall Islands: 2021 and 2023 Article IV Consultation, IMF, Washington DC, October 2021, and 2023.

17 Council of the European Union, *The Council conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes, 6121/23 FISC 24 ECOFIN 128 + COR 1 + COR 2, Brussels, February 2023.*

Fintech Initiatives

The SOV

RMI announced intention to issue a digital currency, the SOV, in the RMI as legal currency. In late February of 2018 the RMI passed legislation to issue a digital currency based on block-chain technology to be known as the SOV, which would act as legal currency in the RMI in addition to the use of the US dollar. An "appointed organizer," named by the cabinet, would be responsible for the Initial Currency Offering (ICO) as well as the development of the block-chain technology and software for transacting in the currency in the RMI. The Ministry of Finance would be responsible for regulation of the SOV, and the banking commissioner would be responsible for compliance with anti-money laundering and combating financing of terrorism (AML/CTF) requirements and standard Know Your Customer (KYC) procedures.

The passage of the law to issue the SOV as legal tender resulted in widespread concern. Many countries in the world have been considering issuing a Central Bank Digital

Currency (CBDC); and a few including the Bahamas, Jamaica, and Nigeria have already made the move. However, in the RMI's case the intention was not that the SOV would be backed by the country's main currency, the US dollar, but rather would be similar to other cryptocurrencies, which are subject to high price/value volatility. Such volatility could prove highly destabilizing, undermine of balance sheet integrity, and disrupt payments. Further, anonymity of transactions has been one of the major concerns, especially with regard to the facilitation that cryptos afford to both money laundering and the financing of terrorism (AML and CFT).

Creation of SOV would threaten the RMI's correspondent banking relationship (CBR). Another concern has been the risk to the CBR relationship of the Bank of Marshall Islands with First Hawaiian Bank. Clearly, AML and CFT risks associated with cryptocurrencies may adversely affect BOMI's CBR with First Hawaiian or other international banks. It is also not clear what the position of the FDIC might be regarding the acceptance and holding of SOVs by the other bank in the RMI, the Bank of Guam. It has been made clear that the BoG would not accept or conduct transactions in the SOV.

IMF encourages government to expeditiously repeal the SOV legislation. In March of 2020 under a new government, a bill was introduced to repeal the SOV legislation. It is known that the initial intent was not to repeal the legislation but to put the process on hold while the then-new administration had time to commission a comprehensive study on whether to proceed with implementation of the law. Since that time, no further action has been taken, there has been a further election, and a new administration came into office in early 2024. In their recent Article IV staff report,[18] the IMF "strongly encouraged" the government to complete the repeal of the SOV legislation, something the new administration may wish to fulfill.

> *Fintech initiatives pose high risk to financial integrity and threaten BOMI's correspondent banking relationship.*

DEZRA

Creation of a Digital Economic Zone in Rongelap Atoll poses additional risks to financial stability. Subsequent to the slow process in implementation of the SOV, a bill was introduced into the Nitijela for the creation of the Digital Economic Zone in Rongelap Atoll (DEZRA). Rongelap Atoll is a former site of nuclear testing. DEZRA is intended to generate foreign investment through the creation of a virtual means of exchange, including assets based on block-chain technology, coupled with the creation of a tax-free zone. Many of the same criticisms of the SOV also apply to DEZRA. The IMF points out[19] that the benefits to the RMI are likely to be limited while the new zone is likely to generate a host of new risks. In a jurisdiction with limited regulatory capacity, DEZRA would be subject to the same AML and CFT risks and concerns as the SOV and would further compound the issues of maintaining BOMI's CBR with First Hawaiian. The bill lost support in the Nitijela and was not taken up for the third and final reading.[20] With a new administration and the Nitijela taking office in January 2024, it is presumed the DEZRA legislation has now lapsed.

Issue of a Stablecoin

RMI considers issuance of a stablecoin and proposes to undertake a limited pilot

18 IMF, Republic of the Marshall Islands: 2023 Article IV Consultation, IMF, Washington DC, October 2023.

19 Republic of the Marshall Islands: 2021 Article IV Consultation, IMF, Washington DC, May 2021

20 Ibid, Marshall Islands Journal

> *RMI prepares for the establishment of a Monetary Authority with IMF support.*

study. In addition to the earlier attempts to branch into digital assets, the RMI is also considering issuing a stablecoin. The intent is to address the cost of cash management and distribution, and lack of penetration of banking services in the outer atolls. While the issue of a stablecoin would not be subject to the same price/value volatility as crypto or the SOV, it would carry many of the same AML/CFT risks and possible loss of BOMI's CBR. At the present time the plan is to undertake a limited pilot project to assess viability and risks. In Palau a similar venture is underway, and a pilot project has been undertaken. However, the local banking community does not support the initiative and would refrain from making transactions in stablecoin or providing exchange facilities. In Palau these functions would need to be fulfilled by the national Treasury something the country does not have the capacity for. In the RMI the intent is to contract a private service provider to manage the stablecoin, which might entail loss of macroeconomic stability and financial integrity. Again, the IMF stresses the need for a cautious approach, that is, the authorities would need to assess AML/CFT risks and develop appropriate mitigating measures prior to its launch.

Decentralized Autonomous Organization (DAO)

The Nitijela passed the DAO Act, but the new initiative is largely unregulated and subject to loss of financial integrity. In 2022 the Nitijela passed the "Decentralized Autonomous Organization Act". Investopedia defines a DAO as "an emerging form of legal structure that has no central governing body and whose members share a common goal to act in the best interest of the entity. Popularized through cryptocurrency enthusiasts and block-chain technology, DAOs are used to make decisions in a bottom-up management approach."[21] A subsidiary of a Delaware-incorporated entity (MIDAO Directory Services) acts as the DAO registrar under the oversight of the Attorney General. To date, 50 DAOs have applied for registration of which 25 nonprofits have been registered although regulations for the DAO sector are still under development.[22] While the government intends to have access to a portal maintained by MIDAO, this has not yet happened. While the government intends to have access to a portal maintained by MIDAO, this has not yet happened. While MIDAO applications are subject to criminal record checks by a third party vendor and the Financial Intelligence Unit (FIU) undertakes a due diligence check on initial members, the government has little information on the sector. As in the case of the other fintech initiatives, the IMF recommends caution and that a moratorium should be imposed on new registrations until needed oversight can be implemented.

Establishment of an RMI Monetary Authority

RMI considers establishment of a Monetary Authority to maintain financial integrity. As a result of the myriad of crypto and digital initiatives and concerns over financial stability and loss of CBRs, the RMI has been considering the establishment of a Monetary Authority (MA). Since the RMI uses the US dollar as the currency of legal tender, most of the key functions of a central bank would not be available in the RMI, such as, the issue of currency, conduct of monetary or exchange rate policies, or lender of last resort to the government. However, many important functions would remain.

- The MA could be given the mandate to manage the RMI's international reserves. A key feature would be the establishment

21 See, https://www.investopedia.com/tech/what-dao/

22 See IMF Article IV report, October 2023

of a bank account within the US Federal Reserve System and IMF.

- The MA could act as a lender of last resort to the government in a limited capacity by drawing on international reserves or credit lines.
- The MA could take over the oversight and the payments and settlements infrastructure between local financial institutions. At present this function is carried out informally among the domestic banks.
- The MA could provide banking services to the government. It could also provide investment services. For example, should the RMI establish either Cyclical or Climate Reserve Funds, it could take on management of MIMRA reserves, which are in essence part of the RMI's international reserves.

Establishment of the MA would need a clear mandate and independence to achieve its objectives. It would take time to build capacity and the assurance that this would not lead to reduction in capacity in other government agencies, especially the Ministry of Finance. However, as in the case of MIMRA, the creation of an independent body with sufficient resources to fulfill its mandate could lead to an excellent means of providing quality economic and financial advice to the government. The IMF has been providing Technical Assistance to the RMI for the establishment of the MA and has draft legislation.

6. Public Financial Management (PFM)

Public Expenditure and Financial Accountability (PEFA)

The RMI has developed a PFM Reform Roadmap, but progress has been slow. In December 2011, the RMI underwent an external PEFA assessment, and the cabinet adopted the report and directed the government to request PFTAC to compile a PFM Reform Roadmap (PFMRR). In collaboration with the government, PFTAC prepared the PFMRR in 2014. An observed weakness at the time of the first PFMRR review in 2015 was the lack of prioritization of the adopted components and activities and the allocation of insufficient resources for implementation of the reform efforts. Progress was slow and many of the components had yielded no actions. However, since then, prioritization has been implicitly expressed through donor-assisted resourcing of the reform effort.

ADB technical assistance (TA) to support the PFMRR has been underway since 2018 and has played an important role in enhancing PFM in the Ministry of Finance. As part of the ADB's 2018-2020 project cycle a $2 million PFM project was initiated with additional financing in 2019 and again in 2021 to support the Ministry of Finance with the PFMRR by providing the focus of the reforms. The major initiative has been in strengthening the Ministry of Finance with improved staffing levels and providing a focus upon financial management, accounting, and controls. An additional focus has been the establishment of the SOE monitoring unit that is part of the ADB PFM project. The initial project was considered largely successfully completed, and a 2-year phase 2 will start in 2024 with potential for a third phase in 2026.

Financial Management Information Systems (FMIS)

With World Bank support a new FMIS was identified, and the new system went live at the start of FY23. The original FMIS, which had been utilized throughout the amended Compact, had reached the end of its effective life. The responsible software company was no longer operational, and support was unavailable. With $9 million in donor grant support from the World Bank for budget execution and financial reporting systems, an RFP for a new financial management information system was issued. While initial proposals were deemed unacceptable, a revised RFP was issued, and a vendor, Bisan, identified. Implementation started in early 2022 and after user acceptance testing and training, the new system went live at the start of fiscal year FY23.

The Bisan system is up and running but compliance with US audit requirements will only be ascertained following issuance of the FY23 single audit. Notably, old system transactions and fund balances were not brought over to Bisan at the time of implementation, but will be required for audit and compliance with US federal programs. The software company selected is based out of the Middle East with a client base of largely private sector Middle Eastern enterprises and has never dealt with the requirements of either US government fund accounting or GASB. It is understood the PFM team allocated significant time and effort to develop the system and make it "fit for purpose." Currently, Bisan is providing reports sufficient for day-to-day operations. The GFS fiscal account included in this report is based on a journal listing generated from the Bisan system and appears to provide a data set consistent with the prior series. However, full testing of the new system to ensure conformity with generally-accepted U.S. accounting principles is yet to be undertaken.

Public Sector Payroll

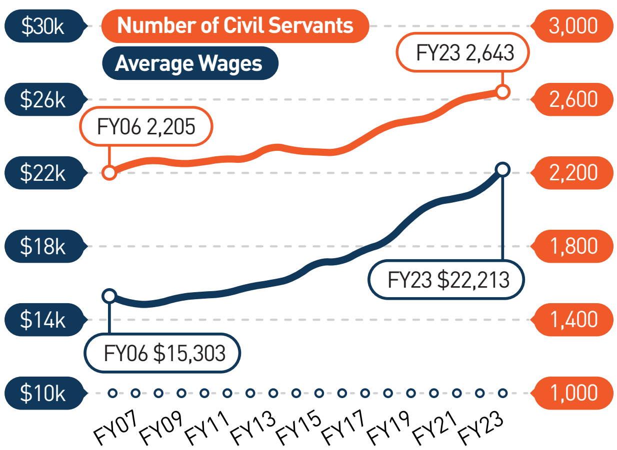
Civil services wages were repressed during the early years of the amended Compact but matched inflation with the rise in sovereign rents since FY14. The FY06-FY23 period after adjustment to the amended Compact in FY04-FY06[23] can be divided between the financially repressed period (FY06-FY14) and an expansionary period based on rising sovereign rents (FY14-FY23). Between FY06 and FY14 there was a small increase in employment of 117 jobs at an annual rate of increase of 0.6 percent that reflected the imposition of a wage and hiring freeze during much of the period, see Figure 14. However, since that time the public service has expanded at a faster rate, adding an extra 321 jobs at an annual rate of 1.7 percent average growth. Wage rates reflected similar forces growing by 1.0 percent per annum in the initial period and rising to 3.4 percent from FY14 through FY23.

Government payroll declined as a share of GDP during the initial years of the amended Compact. Two important conclusions may be drawn from the above analysis. First, payroll costs as a percent of GDP fell from 25 percent in FY06 to 21 percent in FY14 and then stabilized. Payroll has not been the driving force behind the recent growth in the share of public expense in GDP, see Figure 10. Second, average wages have grown throughout the period despite the imposition of a wage

23 At the start of the amended Compact there was an exceptional increase in 380 public servants or 20 percent in the first two years. This was in response to the depressed levels of public employment after the reforms of the late 1990s and the incorporation of Head Start into government.

Figure 14: Government wage bill and share of wages in GDP

Numbers of civil servants and wage rates remain stable in early Compact but then accelerated as the fiscal envelope eases.



freeze. Wage drift, due to annual increments imbedded in civil service hiring conditions, imparts a gradual increase in cost despite attempts to control expenditures.

State-Owned Enterprise (SOE) Reform

The SOE sector, comprising a dozen public enterprises, has underperformed and poses significant costs and fiscal risks. Given the challenges posed by remoteness, small size, and dispersion, SOEs remain active in numerous crucial sectors of the RMI economy. While in some circumstances there are legitimate reasons for the state to subsidize the provision of key public services, the RMI's SOE sector has underperformed for many years, operating at an average annual loss of up to 6.9 percent of GDP and incurring average subsidies of 5.9 percent over the last three years, FY20-FY22. Figure 15 indicates virtually all of the RMI SOEs required significant support over the same period. Furthermore, rates of return on assets and on equity over the period FY19–FY21 were

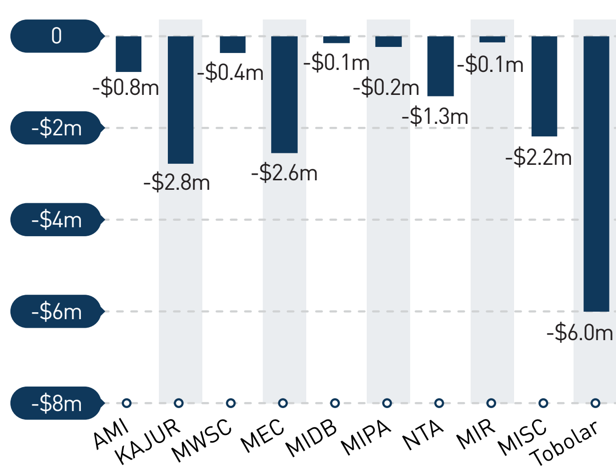
Reforms to the weakly performing SOEs sector got off to a good start but were constrained during COVID-19 and are suffering from lack of resources.

–10 percent and –16 percent, indicating both poor performance and a negative return on government investments.

The government of the RMI enacted the SOE Act, but it was almost immediately amended to reverse the restriction on the participation of government ministers and officials on boards. In response to these concerns, in 2015 the government introduced an SOE Act that was designed to focus public enterprises on achieving commercial viability as well as strengthening governance structures and accountability. The Act included the requirements of the annual Statement of Corporate Intent (SCI), Business Plans (BP), and the introduction of Community Service Obligation (CSO) agreements. Unfortunately, the law was almost immediately amended to reverse those reforms that had restricted the participation of government ministers and

Figure 15: State-owned enterprises subsidies and capital transfers, average FY19–FY21

Subsidies and capital transfers to ailing SOE sector are a persistent drain on fiscal resources.



officials on SOE boards. The law was again amended in 2020 with further provisions concerning the appointment of public officials requiring at least one, but no more than three, such appointments. In 2022 the law was again amended removing both the Ports Authority and NTA from the list of entities covered by the SOE Act. These entities with majority public sector ownership are functionally SOEs and their removal from the SOE list was inappropriate.

SOE monitoring unit was created to implement the law and drive the reform process. In 2018 an SOE Monitoring Unit (SOEMU) was created as part of the ADB PFMRR. The unit started with the training of Ministry of Finance (MOF) officials and SOE key officials in the contents and implications of the SOE law. Once internal systems and templates were established to fulfill the unit's monitoring mandate, the SOEMU's consultant and 3 staff members began work on capacity building within each SOE. In FY19 and FY20 virtually all SOEs had completed SCIs for review by the Nitijela and prepared BPs as required by the SOE law. With the onset of COVID-19 in 2020, the work program of the SOEMU was adversely impacted, and momentum slowed. In 2022 the work program got underway again.

SOE diagnostic report paints a dismal picture of SOE management capacity. In June 2023 an SOE diagnostic report was prepared under the ADB PFM TA.24 The report provides a lengthy study of 9 of the listed SOEs. It focuses on financial management capacity, asset management, and identification of noncommercial activities. The report paints a largely dismal picture of both financial and asset management capacity. The report shows the absence of financial information from CFOs, which is required by boards for management of the business and for driving performance. The Ministry of Finance (MoF) has issued instructions for timely presentation of financial information. However, when boards fail to demand the material, there are few consequences of noncompliance, and the MoF instructions have been ignored. Asset management is also described as weak with few SOEs maintaining plans. In the absence of asset management, capital is depleted, which will in time compromise service delivery.

Progress on development of CSOs has not been successful. Another report on CSO Agreements was prepared in May 202325 by the SOEMU and elaborates further on the development of a CSO structure. Most SOEs engage in noncommercial activities that reflect government policy and pricing. This places the SOE in financial distress and in need of support. However, identification of noncommercial activities, associated costs of delivery, and establishment of appropriate pricing for preparation of CSOs requires a degree of management capacity largely beyond the scope of many SOEs. At the early stages of the project three SOEs were selected for development of a CSO structure: Air Marshall Islands (AMI), Marshall Islands Shipping Corporation (MISC), and Tobolar Copra Processing Authority (TCPA). The exercise established that distinguishing commercial from non-commercial activity was subjective given the range of policy and operational constraints. Further accounting systems were inadequate to accurately identify costs. The report concludes that *"there has been no progress on CSO initiatives between late 2019 and mid-2022 and little evidence of real efforts by SOEs to cost and identify non-commercial activity"*.

Solutions to the SOE problem are long-term but only with sustained support will the sector achieve improvements. After a positive start in 2018, a difficult period during COVID-19, and renewed effort in 2022, the SOEMU reports its performance has stagnated. Further, the lack of resources allocated to the project has

24 SOEMU, *State-Owned Enterprise Reform – SOE Diagnostic Study Report Draft, Grant: 0795-RMI, June 2023*

25 SOEMU, *CSO Agreement Report, Grant: 0795-RMI, May 2023*

constrained progress26. The SOE sector has long presented the government of the RMI with significant fiscal risk and continues to do so. The lack of capacity in financial and corporate management seriously undermines the objective of developing an effective and efficient SOE sector. Solution to the problem is clearly long-term, but without sustained government and donor support the sector will continue to be a significant drain on public resources.

26 Ibid

7. Private Sector Developments[27]

The World Bank's "Doing Business" Survey

Although the World Bank's "Doing Business" survey has been discontinued it painted a discouraging view of the environment for private sector growth in the RMI. The World Bank's ease-of-doing-business survey has now been discontinued due to certain irregularities in the conduct of the survey[28]. However, the survey provided a useful broad indicator and yardstick on the attractiveness of the business environment. From the 2020 DBS survey out of 190 countries the RMI ranked 153, 81 percent down the list, indicating that there was much room for improvement. The RMI fared worse than Palau but better than the FSM, which were ranked 145 and 158 respectively. This is substantially below most South Pacific nations. Samoa was ranked 98, Tonga 103, Vanuatu 107, Fiji 102, and Papua New Guinea 120. Overall, the RMI's scores were weak. For example, their scores in the areas of registering property and protecting investors fell in the bottom decile of countries, while scores for providing electricity and resolving insolvency were also very weak. The discontinuation of the doing business survey was unfortunate but it is understood that the survey will be replaced with a new

27 This section is largely similar to that in the 2022 Economic Brief, but the material remains relevant and is repeated in the current Review.

28 *"The World Bank's Doing Business Report", Congressional Research Service, October 29, 2021, Washington D.C.*

World Bank's, now defunct, "Doing Business" survey 2020, places the RMI in the lowest 20 percent and indicates that the environment for private sector development is weak and needs reform.

survey entitled B-READY, intended to measure the business and investment climate of 180 countries annually. A replacement survey will enable the RMI to benchmark its performance against its peers and form the basis of a roadmap for future private sector reforms.

Private Sector Registration and Licensing

Online upgraded business registration is needed for transparent identification of business ownership. An assessment of the private sector[29] for the RMI provides a useful analysis of the regulatory environment for the private sector. Many areas need reform. In the RMI, corporate business registration is conducted through the Attorney General's office. The existing system relies on manual processes that are slow and time consuming. A modern computerized business registration system in the public domain would allow businesses to be legally identified for commercial transactions. The RMI lacks a national business licensing law; however, local governments do have the power to issue licenses and collect fees under the Local Government Act. This has led to a lack of transparency as well as discretionary decision making at the local level. Reforms could combine registration and licensing into a single process, but local governments would need to be compensated for their lost revenue due to such a change.

29 Pacific Private Sector Development Initiative, *Republic of the Marshall Islands, Private Sector Assessment, Draft: July 15, 2016*

Foreign Direct Investment (FDI)

The environment in the RMI for FDI is antiquated, overly bureaucratic, and in need of replacement with a modern system. FDI is implemented under the Foreign Investment Licensing Act 2005 but appears to have failed to simplify the process as the act was intended to do. FDI permitting is done manually and licenses take weeks or months to process. FDI licenses are only issued after all other regulatory requirements, such as corporate registration, local government licensing, foreign work permits, Social Security registration, and others have been fulfilled. To reduce uncertainty, an automated process is needed to allow other legal requirements to be fulfilled on a parallel timeline, as is required for any domestic enterprise. There is a substantial list of restricted activities, which appears not to be enforced. This lack of enforcement encourages "front" businesses, which hide illicit economic activity. In a modern FDI regime, businesses are only required to submit information required for statistical and monitoring procedures, and licenses are issued in just a matter of days.

Land Tenure

The Land Registration Authority (LRA) was introduced to support voluntary registration, but start-up has been slow and needs reinvigoration. In the RMI, as in many Pacific Island economies, land is largely owned by customary groups with complex governance structures. Banks are reluctant to take customary land (either owned or leased) for collateral. Non-Marshallese are not allowed to own land, and even transactions between Marshallese are rare. A key objective of economic development is to improve tenure security (i.e., protection against eviction) for both landowners and leaseholders by accurately defining and protecting land rights. In 2004 (with ADB support) a Land Recording and Registration Act was introduced as a means for custom owners to voluntarily register land via an accessible registry of land transactions. The Land Registration Authority (LRA) was introduced to implement the new legislation, but use of the LRA has been minimal. Despite the slow start, the 2004 legislation and LRA are generally considered to provide a sound basis for land administration. The process of improving public awareness, with both government and private sector backing, needs a restart so that secure registration and leasing of land can support its critical role toward business and financial development.

8. Compact Issues

Background

The terms and conditions of the 2023 Amended Compact (C-23) were agreed upon by the US and the RMI in October 2023 and became law on March 9, 2024. The original Compact of Free Association between the US and the RMI was signed by the parties in 1983. A plebiscite was held in the same year and a majority of the RMI confirmed the desire to enter into the Compact of Free Association. The original Compact, which became effective in 1986, was for a 15-year period with a two-year extension through the end of FY03. In FY04 the Compact was extended for a further 20 years through FY23 known as the 2003 Amended Compact (C-03). C-03 contained funding for a series of annual sector grants; supplemental education grants; and support for audits, Kwajalein atoll, infrastructure, disaster assistance, and funds for a Compact Trust Fund (CTF). In January of 2023 an agreement detailing the basic financial assistance to be granted the RMI was agreed upon between the US Special Presidential Envoy for Compact Negotiation and the RMI Chief Negotiator. This agreement was not acceptable to various parties in the RMI and the RMI withdrew from negotiations. A period of uncertainty followed that necessitated that the RMI withdraw funding from the CTF in order to maintain government services. However, an eventual agreement was achieved internally in the RMI to accept the January offer and the negotiations were concluded in October 2023. The agreement awaited

2023 Amended Compact comes with a significant increase in grants for an extended range of sectors.

passage by both houses of the US Congress. Owing to delays in the US Congress, two continuing resolutions (CR) were passed enabling the US government to stay open, the second of which included temporary funding for the RMI through March 8, 2024. Fortunately, on March 6 the US House passed bill H.R. 4366 including mandatory funding for all three FAS Compact amendments. The US Senate passed the same bill on March 8 and the US president signed the bill into law on March 9, 2024. With the law enacted, a period of rapid mobilization involving both the US and RMI governments begins to achieve "entry-into-force" in a timely manner. Notably, the temporary funding for the period from October 1, 2023 – March 8, 2024 will be deducted from the grants to be provided under the new arrangements. Still, the increase in funding will be large and will need to be carefully managed.

The 2023 Amended Compact

There are a series of important instruments that outline the new agreement between the US and the RMI: changes in the Compact law, the Fiscal Procedures Agreement (FPA), and Compact Trust Fund agreements. These documents are interrelated and lengthy, thus, the implications are still being worked out. The following discussion describes the main features of C-23 as negotiated, but changes may be introduced in the US Congress.

Direct Economic Assistance

Sector grants

C-23 provides an annual grant for 20 years of $50 million for sector grants with an annual 2 percent adjustor in lieu of inflation indexation. The sectors, see section 261(a), include the original list with some additions and modifications:

- Education: including those services previously undertaken under the Supplemental Education Grant (SEG). It also includes an allowance for partial inflation between FY04 and FY23 of $22 million, omitted during all but the final two years of C-2003, referred to as Additional Education Assistance.
- Health
- Private Sector Development
- Capacity Building
- Environment
- Public Infrastructure with the continuing proviso that priority is to be accorded to the social sectors with second priority accorded to economic projects. A minimum of 30 percent and maximum of 50 percent of the total value of the sector grant total is to be awarded to infrastructure.
- Enhanced Reporting and Accountability: This shall be no more than 2.5 percent of the total sector grants awarded.
- Enewetak Development: This grant shall constitute 4.8 percent of total sector grants awarded.

US Supplemental Health Fund and Joint Health Dialogue

In FY24 the US will provide $20 million for deposit into the Supplemental Health Fund to support efforts to improve health outcomes. A Joint Health Dialogue is to be established and funds may only be used for programs recommended by the Dialogue. The US will also provide an annual grant for 20 years of $8 million to be deposited into the Supplemental Health Fund for health programs that are agreed upon mutually and may have been recommended by the Dialogue. The funds will be provided on a matching basis and are not subject to the annual 2 percent adjustor.

Climate Fund and Working Group

The US will provide $20 million for deposit into a new Climate Fund to obtain additional assistance to better enable the RMI to cope with challenges from climate impacts, including sea-level rise and other environmental challenges that could threaten the existence of the RMI. A Working Group will be established to obtain additional assistance for climate needs. The Climate fund may only be used to obtain additional assistance for climate needs that are identified by this working group.

Environmental assistance

The US will provide $30 million for additional sector grants for the environment, $20 million of which will be used for environmental feasibility studies and technical assistance and $10 million will be used for future environmental programs.

Kwajalein Development Plan Fund

The US will provide $132 million for deposit into the Kwajalein Development Plan Fund for projects described in the plan adopted in March 2022 by the Government of the RMI to facilitate resilience and healthy communities throughout Kwajalein Atoll.

Nuclear Testing Transparency and Museum

The US will provide $10 million in grants to improve the accessibility of documents and information previously provided to the Government of the RMI relating to the US nuclear testing program, including the subject of waste disposal. A further $5 million will be made available to the College of the Marshall Islands (CMI), to establish a museum and research facility related to the US nuclear testing program.

Infrastructure Maintenance

The government of the RMI will use local funds to make contributions to an infrastructure maintenance fund of $2.5 million in FY24 and adjusted annually by 2 percent through FY43. The US will match the funds contributed by the RMI from the annual $50 million sector grant. The funds may only be used to repair or maintain infrastructure provided by the US.

Annual Audit

Under C-03 the US provided a grant of $0.5 million for the conduct of the annual single audit. In C-23 the costs of the audit will be borne by the RMI from the $50 million sector grant.

Kwajalein Atoll – non-expiring provisions

The non-expiring provisions of the C-03 agreement for Kwajalein will continue as originally agreed. As of FY23 these grants amounted to $9.3 million, which is two-thirds adjusted for inflation as per the C-03 agreement. The grants address the special needs of the communities in Ebeye and Kwajalein. Part of these funds will be used to assist those Kwajalein landowners most affected by the US presence on Kwajalein.

Disaster Assistance Emergency Fund

The DAEF was initiated in C-03 with a fixed annual grant of $200,000. The fund continues under C-23, but funding is to be provided from the $50 million sector grant.

Federal Programs and Services

The US government will continue to provide access to US Federal Programs and Services as agreed upon in the original Compact. Federal services included but are not limited to:

- US Weather Service;
- US Postal Service;
- US Federal Aviation Administration;
- US Department of Transportation;
- Federal Deposit Insurance Corporation; and
- Federal Emergency Management Agency

Joint Economic Management and Financial Accountability Committee - JEMFAC

The nature and powers of JEMFAC have been modified since it was originally specified in C-03. In its current form JEMFAC is composed of a US chairperson, one other US member, and two members from the RMI. The FPA indicates that decisions shall be made by consensus. If consensus cannot be reached, decisions are to be made by majority vote, and in the event of a tie, the US chair will cast the deciding vote.

The major duties of JEMFAC are to review the:

- Budget and Investment Framework (BIF);
- Infrastructure Development Plan (IDP);
- Annual Implementation Plan (AIP);
- Annual Financial Report;
- Annual Performance Report;
- Annual Financial Audit;and
- Annual Trust Fund Investment Reports

Provided the RMI has satisfactorily submitted the BIF, IDP, and AIP in the format and detail required, with conforming sector allocations, JEMFAC is required to review and concur. It can only reject proposals if they do not meet the conditions specified in the FPA. The role of JEMFAC has thus changed from *ex-ante* approval to a greater focus upon ex-post review of the annual financial and performance reports as discussed below.

Pre-award Requirements

Budget and Investment Framework

The Government of the RMI is required to prepare and maintain an annual (Medium-Term) Budget and Investment Framework (BIF). The BIF is intended to be strategic in nature and be continuously reviewed and updated through the annual budget process. In the FPA it further states that the BIF will include:

- The goals and broad strategies of the RMI to promote economic advancement, macro-economic goals, budgetary self-reliance, and economic self-reliance;
- Multi-year objectives for each of the grants included in C-23, and
- The BIF is to be formally adopted by the government of the RMI.

The process in the RMI departs from that normally adopted and included in the respective Compacts for the FSM and Palau. In the FSM and Palau, the two countries are required to prepare a Strategic Development Plan and a National Development Plan. respectively, which provide the long-term framework and directions of the nation. In the RMI this function is to be repeated annually in the BIF. The BIF thus falls somewhere

Compact 2023 comes with a significant increase in pre- and post-reporting requirements including performance monitoring.

in between the standard development plan and a standard Medium-Term Expenditure Framework (MTEF). In C-03 the MTBIF was not widely integrated into the planning process, was frequently not compiled, and was not formally adopted by the government.

Infrastructure Development Plan

The IDP is to provide a list of infrastructure projects that will be used to guide the selection and use of the infrastructure grant. The IDP is required to be consistent with the goals specified in the BIF.

Annual Implementation Plan

The RMI is required to provide by July 15 of each year an annual implementation plan (AIP or budget) to JEMFAC that compiles and details proposed uses of grant expenditures. The AIP is required to indicate:

- Proposed sector allocations;
- Actual expenditures in the most recently completed fiscal year;
- Appropriated grants in the current fiscal year;
- Proposed expenditures for the upcoming fiscal year by program and ministry portfolio, including a detailed breakdown of object classes, and
- Objectives, specific performance indicators, and assessment methods

The AIP, essentially the annual Compact budget, does not align with the standard PFM Medium-Term Expenditure Framework and as scored in the RMI PEFA. The Medium-Term framework is found in a combination of the BIF and the AIP.

Post-Award Requirements

Financial Reports

Quarterly and annual financial reports are required to provide:

- Statement of revenues and expenditures by fund types with a comparison of budget and actual expenditures by function and fund types;
- A report for all operational grants by function and major offices, cost centers, and budget activities, and
- A fund status report on the Health Care and Climate Funds that shows deposits, disbursements, and fund balances.

Monitoring and Performance Reports

A new feature of C-23 is the requirement for the RMI to monitor and provide performance reports. Ongoing monitoring is required to ensure program execution is in accord with achievement of the performance goals. The annual performance report is required to provide a comparison of actual accomplishments with the objectives and indicators established in the implementation plan. C-23 requires that budget execution is undertaken on a performance basis. However, the FPA fails to distinguish between outcomes/results and program outputs/deliverables. The same issue failed to be addressed adequately during C-03 with US wishing to focus upon outcomes and the FAS focusing to a limited extent upon project outputs or deliverables.

Compact Trust Fund is "repurposed" to allow for annual drawdowns and for individual income support.

Third party assistance

Recognizing the weakness in the RMI to compile the required financial and performance reports, the US has required the RMI to retain a qualified third party to assist. However, choice of the third party requires consultation with the US. The responsibilities of the third party will be to:

- Assist in collection of the necessary material;
- Assist in analysis;
- Draft the reports, and
- Provide training and capacity building.

The FPA does indicate that in many cases material will not exist or be available to provide the information necessary to prepare the performance reports. In these cases, it will be necessary to develop data systems to provide the information that can best be used for monitoring and performance assessment.

Compact Trust Fund

The CTF agreement has undergone a total overhaul. The original objective was to provide a source of funds to replace the sector grants at a level consistent with the value of the sector grants at the end of C-03. Under C-23 the CTF has been "repurposed" to augment the revenue available to the RMI immediately rather than only after FY2043. The rate of withdrawal at 4 or 5 percent is below average market rates of return on a balanced portfolio, which in many projected cases will support a growth in the real value of the *corpus*. In a significant number of cases the CTF would, however, be liable significant declines in the real value of the *corpus*.

The Trust Fund Committee serves as Trustee of the Fund in accordance with the provisions of the CTF Agreement. The CTF Committee is comprised of three US members, one of whom is the chair. Two members are selected by the RMI and one from Taiwan. The Trust Fund Committee decisions are made by majority vote and in the case of a tie the chair gets the deciding vote.

The CTF has been "repurposed" into a series of Accounts:

Account 1 – Sector and Individual Support Fund.

Account 1 will initially consist of the resources in the CTF at the end of C-03, which recorded a value of $682.8 million at the end of FY23. The distribution cap is defined to be the average of the last 3 years of known fund *corpus* values multiplied by the distribution percentage, which is set at 4 percent.

Distributions from the fund can be used for any of the purposes defined under the sector grants or for individual income support. The RMI, in concurrence with the US, will determine who is eligible for income support. Such payments shall be paid on a per capita basis and on at least a quarterly basis.

The Trust Fund Committee is accorded powers to review and approve budgets submitted by the RMI for the use of the funds. In this instance the CTF Committee is accorded a similar function to that of JEMFAC. C-23 thus duplicates the function of review and budget approval between JEMFAC and the CTF Committee. While JEMFAC is established and staffed with the competence to review and approve budgets, the functions of the CTF Committee have to-date been fiduciary and financial in nature and not in budget approval or expenditure review.

Account 2 – Extraordinary Needs Distributions

Account 2 is to be funded through four US contributions in the amounts of $200 million in each of FY24-FY26 and $100m in FY27, providing a total of $700 million. The extraordinary needs account is to be used for exceptional hardships and needs through programs for people in specified atolls including: Ailuk, Aur, Bikini, Enewetak, Likep, Lib, Mejit, Rongelap, Rongerik, Wotje, Wotho, Ujelang and Utrik. The RMI is to determine the programs to be supported.

While the Extraordinary Needs fund covers the four nuclear affected trust funds, it is not provided in recognition of the nuclear compensation claimed by the RMI. Rather, many outer atolls are specified as eligible to participate in the programs chosen by the RMI government.

Trust fund distributions are to be calculated on a similar basis to Account 1 and are subject to the same issues. The Account 2 distribution cap is defined to be the average of the last 3 years of known fund *corpus* values times the distribution percentage set at 5 percent. In the initial years the distribution formula is complicated by the periodic contributions to the fund.

Account 3 - Unspent Economic Assistance Fund

All unused funds provided during C-23 are to be deposited in Account 3. This fund may be used to finance projects and programs permitted under the sector grants and is available at the full value of the fund provided they are in compliance with the CTF Agreement.

Account 4 – the "D" Account

Account 4 is to inherit the former funds in the "D" account of C-03. Contributions to the "D" account may be made by the RMI, Taiwan, or other benefactors and are to be used for unanticipated shortfalls or other purposes.

> *RMI has important choices to make on use of the CTF: "repurposed" or perpetual or creation of Universal Basic Income.*

Issues Relating to the 2023 Amended Compact

Perpetual COFA Fund for Later Use or Source of Revenue for Current Use

An important feature of C-03 was the creation of a Compact Trust Fund. The purpose indicated in the original CTF subsidiary agreement Article 3 stated: *The purpose of the Fund is to contribute to the economic advancement and long-term budgetary self-reliance of the Republic of the Marshall Islands by providing an annual source of revenue*. However, the CTF subsidiary agreement also indicates in Article 16 section 7(a) that the CTF Committee may disburse *in Fiscal Year 2024, an amount equal to the Annual Grant Assistance in Fiscal Year 2023, plus Full Inflation*. The agreement then goes on to say in section 7(b) that in future years beyond FY24 the CTF Committee may disburse similar amounts fully indexed to inflation. In essence C-03 indicated that while the purpose of the CTF was to provide "a source" of funds, the implicit target was to provide a (perpetual) yield equal to the FY23 sector grants plus full indexation.

However, C-23 is based on the assumption that reliance upon a perpetual fund at a later date is no longer needed. The rationale of C-23, which permits drawdowns from the CTF for current operational purposes or basic income support, is at odds with the objective of the (perpetual) fund as it was established in C-03. In essence C-23 permits the RMI to withdraw from its CTF to support current levels of consumption. This was designated during negotiations as a re-purposing of the CTF and is justified on the premise that C-23 now indicates that *"The Signatory Governments may mutually agree to continue the provision of sector grants and federal programs and services beyond fiscal year 2043 at the same levels..."* C-23 thus indicates that the relationship between the US and the RMI will exist in perpetuity and therefore obviates the need to establish a perpetual CTF of sufficient size to replace terminating grant levels. The policy question for the RMI thus arises as to whether the nation wants to maintain the original intent imbedded in C-03 to establish a perpetual fund for future generations or drawdown the available funds for government operations and current consumption. Much consideration will need to be given to the "may mutually agree" portion of the above-quoted text. Of course, mutual agreement requires an Act of the US Congress and passage into law of continued annual appropriations. It may help that, under the current US Senate pay-as-you-go" rule ("PAYGO"), [30] and based on the scoring that the Congressional Budget Office applied to the FSM and RMI 2023 Compact Amendment Agreements and the Palau 2023 Compact Review Agreement, the need to provide and offset for funding post FY2043 will be eliminated as the funding under the current wording of each Agreement would be expected to continue after FY2043 and such funding would—presumably—not be scored as an increase. It was the problem of the "offset" that led to an 8-year delay in finding the Palau 2010 Compact Agreement and, again presumably, to the half-year delay in approving the 2023 Agreements.

30 The Senate pay-as-you-go, or PAYGO, rule prohibits consideration of legislation that is projected to increase on-budget deficits in any of the following four fiscal-year periods: (1) the current year; (2) the budget year; (3) the six years beginning with the current year; and (4) the 11 years also beginning with the current year.

Use of CTF for viable infrastructure projects would maintain value of national net worth. The C-23 Trust Fund agreement states that distributions may be used for purposes identified for the sector grants, which includes infrastructure. Should the RMI adopt the principle that withdrawal of funds from the CTF was permissible if the value of net national wealth was not eroded, this would allow investment in infrastructure projects. This might be further qualified to restrict investment in infrastructure to those projects that attain a rate of return that exceeds the historical financial return achieved on the CTF.

Inflation adjustment

C-23 does not provide any provision for annual inflation adjustment. C-23 incorporates a 2 percent annual adjustor in lieu of actual inflation adjustment. The rationale for this specification would appear to be to shift the risk of the cost of periods of high inflation onto the RMI. Clearly, the US is far better positioned to absorb the cost of inflation than the RMI. In the RMI the impact of a period of high inflation, like that recently experienced, could be very large and could significantly undermine the operation of the government and jeopardize fiscal stability. The RMI's CPI rose on average by 2.6 percent annually between FY00 and FY19 and before the recent spike in international prices. The 2 percent adjustor is below this rate. Thus, the RMI will need to prepare for an annual decrement in the real value of the Compact economic assistance of close to 1 percent per annum as well as possible periodic spikes due to inflation.

Trust Fund Performance

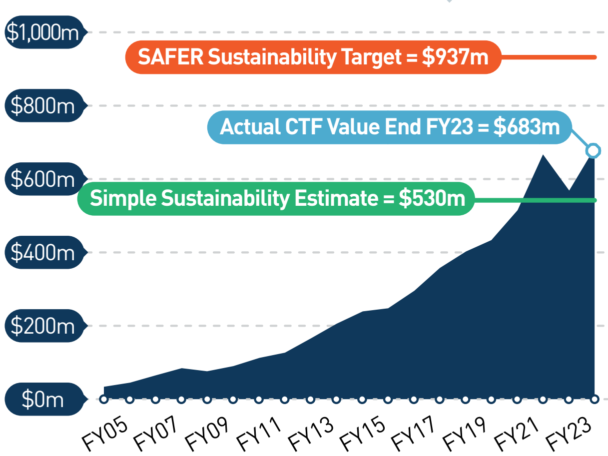
FY23 was a strong year of investment performance resulting in the CTF growing from $567,557,523 at the end of FY22 to $682,256,529 at the end of FY23. The RMI CTF experienced an asset-weighted return of 14.41

percent during FY23; these gains, combined with a scheduled contribution from the US of $22,020,900 at the outset of the fiscal year, plus $5,000,000 as an RMI contribution of tax and trade compensation in March 2023, plus $2.4 million from Taiwan in March of 2023, enabled the fund to achieve its final balance of $682,256,529 on September 30, 2023, see Figure 16. During the period of investment since FY06 (October 1, 2005) and based on the reported dates of deposits from public reports of the RMI CTF, the annualized asset-weighted rate of return through FY23 has been 6.36 percent. The asset-weighted annual rate of return during the period since initial deposits in June 2004 has been 6.17 percent.

Further demonstrating the importance of the endpoints of reported data, as of this writing using the CTF value at the end of September 2022, the rate of return while invested from October 1, 2006, was down to 5.60 percent. As of September 30, 2022, the CTF value had declined to an unaudited value of $567,557,523 despite FY22 contributions of $20,132,800 from the US, $5,000,000 from the RMI's tax and trade compensation, and $2,400,000 from Taiwan. The asset-weighted return for FY22 was an estimated -18.65 percent. The negative

Figure 16: Compact Trust Fund balances through the end of FY23

CTF recaptures lost ground in FY23 but is 27 percent short of achieving the SAFER Sustainability target.



investment return in FY22 was only the fourth year with a negative return since FY04.

Prior GSUSA reports have placed substantial focus on the sustainability of the CTF in achieving a theoretical goal of replacing the inflation-adjusted value of FY23 expiring grants from FY24 onward. That analysis is herein reduced to a basic level given two key factors: first, US inflation spiked in recent years and its path is not being sensibly projected by the Congressional Budget Office, our usual source for such projections; and second, the enactment of the 2023 Amended Compact which calls for the repurposing of the CTF to achieve current objectives--rather than the delayed objective of the notional replacement of the future expiring sector grants.

So, notwithstanding the onset of a new paradigm in the purpose and/or use of the newly "re-purposed" CTF, we briefly note that in order to replace the $28.1 million of expiring FY23 sector grants (only, not including SEG, audit support or disaster assistance) achieving sustainable and perpetual replacement in real terms would imply an RMI CTF size at the end of FY23 of $937 million. Assumptions include a geometric mean (average) real rate of return of 5.3 percent annually and a 95 percent confidence level for sustainability. Clearly, the actual end of FY23 CTF value of $682.3 million is far short of the $937 million level that would have yielded a 95% confidence level for sustainability.

As it turns out, the 2023 Amended Compact is, indeed, a package that represents a new paradigm with respect to the CTF and, if sector funding is believed to be reliably available after FY2043 at the then-prevailing level of $72.8 million per annum, the CTF can be used—as the term "repurposed" implies—for other purposes during the next 20 years. The RMI faces the challenge of establishing a sound fiscal framework at the outset of the 2023 Amended Compact period to achieve desired economic development results while weighing the risks of future fiscal shocks.

9. Other Issues

UBI would allow replacement of the inefficient Copra subsidy and loss of GDP with a more efficient distribution mechanism.

Outer Atoll Support and Universal Basic Income

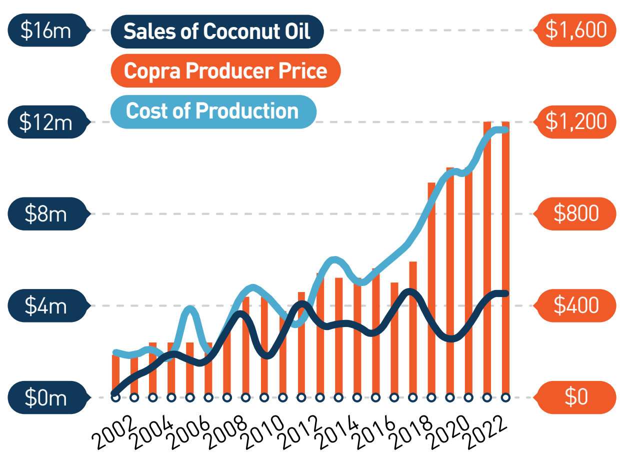
The Copra support Program

Government's income support program to the outer islands has been implemented through price support to copra producers. A major component of the government's income support for the outer atolls has been the Copra price support program paid to producers. The industry is organized through Tobolar, the copra processing plant, an SOE. Tobolar collects copra from producers in the outer atolls at subsidized prices, processes it into coconut oil in Majuro, and exports the product to world markets at prices generally far below the cost of operations, see Figure 17. Initially the program was modest, and the level of subsidy was a minor element of fiscal operations. However, since 2015 (from what was originally intended as a temporary, pre-Christmas bonus), the increase in subsidy has become a permanent feature of the budget and represents a significant additional element of fiscal cost. Subsidies increased from $1.7 million in FY15 to $9.0 million in FY19, and the price paid to growers grew from $563 to $1,200 per short ton during this period.

The copra price support program is an inefficient means of income support in an industry for which the RMI has little comparative advantage. The copra subsidy income support mechanism grew out of a desire to support outer atoll incomes and provided a simple means of delivery. However,

Figure 17: Sales and cost of copra production & producer prices

Producer prices rise rapidly, and Tobolar runs large operating deficits since 2011.



the distribution mechanism encourages production in an area where the RMI does not have a comparative advantage. The copra and coconut industry has virtually disappeared in most Pacific Island nations, due to low international prices, price volatility, and senile tree stocks. In the RMI the high prices encourage continuation of an activity that has negative value added and reduces the level of GDP. The 2021 IMF Article IV31 report argued for development of a more direct and targeted social protection system for outer island income support. The Fund observed that the current system of redistributing income *is inefficient and distortionary. Farmers are subsidized independently of their income level and a high copra price reduces incentives for farmers to change to other, commercially more viable crops*.

31 Ibid

The repurposed CTF would provide an alternative means to establish income support for the outer atolls. C-23 provides two separate means for support to the outer atolls. The repurposed CTF, account 1, permits funds to be drawn from the CTF for income support to eligible individuals provided it is made on an equal per capita basis. The issue of eligibility is to be established by the RMI with the concurrence of the US. One option would be to define eligible individuals as residents of the outer atolls. The recent population census indicates an outer atoll population of 9,789. At 4 percent and current value of the CTF, a total of $27.3 million could be generated for income support. Should the RMI decide to use the repurposed trust fund for an outer atoll UBI, this would provide an income of $16,182 for a household with an average size of 5.8 and be a strong incentive to discourage internal and external migration.

Use of the new fund for extraordinary needs would more closely fit with the objectives of a UBI. Alternatively, the Extraordinary Needs Distribution, account 2, of the CTF to be established from US contributions of $700 million, could be used as a source of support. This resource is specially set up for programs that support residents of the outer atolls to address exceptional unmet hardships and needs and does not require US concurrence. This resource more closely fits the objectives of an outer atoll UBI, and would leave account 1, the original CTF for other purposes. The administration of a UBI for the outer atolls would require development of a new institutional structure, which would take time to establish with appropriate controls. Possibly Tobolar, with its existing structure, could be repurposed for this function. However, whether the funds were withdrawn from the original repurposed trust fund or the extraordinary needs fund, both would entail a significant improvement over the current inefficient Copra support mechanism; either option would further reduce fiscal risk and release funds previously allocated for the copra subsidy for alternative purposes.

> *Large reductions in the RMI population and similar trends in the FSM indicate the emergence of significant regional depopulation.*

Statistical Issues

Data sufficiency

The RMI has significantly improved the nation's economic statistical systems. Since the start of the amended Compact (C-03), the RMI has developed a wide range of statistics to better enable the monitoring of economic performance. The 2023 IMF Article IV staff review found *"Data provision is broadly adequate for surveillance and the authorities willingly share available data, though some shortcomings tend to constrain policy analysis, including limited coverage and timeliness of data releases."*[32] The annual statistical update has been timed to coincide with the release of the government audits and in time for the JEMFAC annual meeting. This implies a final set of estimates would normally be available eleven months after the end of the fiscal year. However, this cycle was disrupted by COVID-19 and by the change in auditors from Deloitte to Ernst & Young. With both disruptions now over, the time sequence should get back to normal. In recent years a preliminary set of statistics has been prepared by the end of April based on FMIS downloads, and before audit availability. This provides a more current set of statistics, supports budget preparation, and facilitates periodic International Monetary Fund (IMF) missions. A set of quarterly indicators has been prepared by EPPSO over the past few years in time for use in the regular session of the Nitijela in January and August.

32 Ibid

Tax data improvements

Weak data systems in Tax and Customs for both trade and the gross revenue taxes has inhibited comprehensiveness and timeliness. Asycuda, a computerized customs management system that covers most foreign trade procedures, is currently under implementation in the RMI. It handles manifests and customs declarations, along with accounting, transit, and suspense procedures. It also generates trade data that can be used for statistical economic analysis. Implementation will dramatically improve the provision of trade statistics and the compilation of many parts of the economic statistical system, that is, the balance of payments and GDP by expenditure. The RMI is also in need of a modern tax administration system that would help with the provision of better data and statistics. However, the introduction of a modern tax IT system is usually deferred until a comprehensive tax reform package has been implemented. The introduction of the new FMIS Bisan has led to recording of GRT payments both directly on items purchased by government and by private sector revenues derived from other institutional sectors. This is a significant improvement, and data from this source has been used in this Review. However, it lacks the controls and integrity checks that would be part of a well-developed tax administration IT system.

Population and Migration

2021 population census indicates a large drop in population. In previous economic reviews and briefs the Graduate School had estimated the 2020 RMI population to be 54,962. This was derived from the 2011 Census's population estimate of 53,138. In September 2021 the most recent Census was conducted and an initial estimate of 39,262 announced. Given the very large and unexpected reduction in population, a substantial amount of additional work has since been undertaken on both enumeration follow-ups and validation comparisons against other data sources. While final Census results have yet to be published, a preliminary population of 41,490 is currently estimated.

The census results were initially unanticipated but given regional trends are now being accepted. A reduction in population of 10,600 or 20 percent compared with 2011 was a remarkable reduction given the earlier projections. It raised serious questions about the validity of the results that showed such a large reduction in population in such a relatively short period of time. There had been an absence of many other potential red flags. For example, employee numbers from Social Security data have been remarkably stable and increased slightly during 2011-2021. However, significant outmigration is known to have occurred although there is no clear way to ascertain the rate of migration from official border control systems for this period. The US Department of Transportation "Net air passenger" data, was not credible for much of the period, but averaged close to 2,000 per annum during 2017-2019 when data improved. During COVID-19 travel was highly restricted through much of 2021, but data for 2020-21 indicated an average of outmigration of close to 1,600 per annum. Neighboring data from the FSM indicates an even greater population reduction than that in the RMI and suggests the emergence of a regional trend. Thus, while the magnitude of the population decline was initially shocking and raised questions about the validity of the census results, these is now largely acceptance of the reality of the numbers.

10. The Reform Agenda

Progress with Reform

Progress with the reform agenda has been weak despite numerous commitments. During the amended Compact period, the RMI has entertained numerous reform initiatives that have failed to achieve substantial success. The expenditure proposals of the Comprehensive Adjustment Program (CAP) in 2009 were not implemented. At the same time a Tax and Revenue Reform and Modernization Commission (TRAM) was established but failed to garner momentum to initiate the tax reform proposal. While the SOE Act has become law and progress has been made through the creation of the SOE Monitoring Unit, adoption of "best practices" enshrined in the Act have yet to be well established. In May 2021, a draft of the Fiscal Responsibility and Debt Management Act was passed by the Nitijela into law. Unfortunately, due to the onset of COVID-19 the bill had been inadequately vetted and failed to place constraint on government behavior to budget and spend all available revenues as well as other fiscally prudent and responsible policies. The Act now needs major revisions before it is ready to: (i) be readily and competently implemented by RMI officials; and (ii) act as a framework for the conduct of responsible and transparent fiscal policy.

Outline of a Reform Agenda

Despite the weakness in achieving meaningful reform, the current time presents a unique opportunity to revisit the agenda. The 2023 Compact Amendment with an additional twenty years with significant increases in funding provides a good time for the RMI to evaluate its development objectives and priorities. The assumption of office by a new reform-minded administration is entirely appropriate to lead the nation as it embarks on new programs. The following lists brings together possible reform options that have been outlined in this review and that the new administration may wish to consider:

Fiscal

Fiscal Responsibility and Debt Management. The current FRDMA does not provide an appropriate set of principles for the RMI to guide fiscal policy. The fiscal anchor embedded in the FRDMA, the requirement of a balanced budget, does not constrain the automatic rise in expenditures to match the fiscal envelope and set aside resources for future needs. The framework further does not provide any guidance on the issue of consumption versus capital expenditures and accumulation of net national wealth. Under the new C-23 provisions, guidance is needed on the permissible use of CTF resources. Thus, the timing is right for the RMI to reopen the discussion and reform the FRDMA to fit the RMI's unique current conditions.

Tax reform. The RMI previously considered the adoption of comprehensive tax reform for which legislation was drafted but not enacted. With new directions, policies, and additional resources, the timing is appropriate to reconsider the tax reform initiative. Improvements are being made in the customs area and this reform needs to be extended to the other domestic taxes. The recent generally favorable experience of the tax reform in

Progress with reform in the RMI has been weak, but the beneficial terms of Compact 2023 and an improving economy provide a favorable environment for reinitiation of the reform agenda.

Palau, despite push back from certain quarters, provides an example to follow.

Fiscal Buffers. Given the vulnerability of the RMI to fiscal- and climate-related shocks, the nation would be well served to establish both cyclical and climate funds to deal with unexpected events. MIMRA has built a large source of funds that could well form the seed money for such funds. Both funds could be established in a reformed FRDMA.

Financial

Fintech and Digital assets. This review concurs with the IMF that the existing SOV legislation and DEZRA draft legislation should be repealed in the former case, and removed from the list of pending legislation in the latter, if it has not already lapsed. New initiatives like the stablecoin and DAO should be considered with care and a comprehensive regulatory regime developed before implementation. The IMF recommends the DAO project should be put on hold until an adequate regulatory regime is developed. This review is of the position that fintech initiatives in unsophisticated financial environments like the RMI carry greater risks and costs than the benefits frequently promised.

Creation of a Monetary Authority. The concept of developing a Monetary Authority for the RMI appears to be a good one. While many of the functions of a central bank will not be available to an economy like the RMI, there remain important benefits. The MA would be able to assume the functions of banker to the government, open an account at the Fed, manage the nation's reserves, and become a center of excellence. It could also take on the function of investment of the cyclical and climate reserve funds.

Public Financial Management

Reform Coordination Unit. The PFM unit in the Ministry of Finance supported by the ADB has provided a much-needed function with its support to financial management. Successful implementation of the new FMIS will require continued support from the unit.

State-Owned Enterprises. While the momentum behind the SOEMU slowed during COVID-19, it provides a useful function and should be strengthened. The fiscal risk of the SOE sector is large, and there is no doubt that improved performance will not be immediate. However, abandoning the initiative and the progress it has made should not be an option.

Income support

Income support to outer atolls. The existing program of outer atoll income support effective through the copra subsidy is inefficient though easy to administer. The renewed Compact C-23 provides the opportunity to replace the copra subsidy program with more efficient direct income support to the outer atolls. The new resources available under the extraordinary needs account of the CTF would seem the best option to fund the program leaving the original part of the CTF for other purposes.

Minimum wage. The Minimum Wage Act of 2016 set the minimum wage at $2.50 in 2016 and was to be raised by $0.50 a year until it reached $4.00. However, while the minimum wage was increased to $3.00, no further increases have been implemented. Since that time there have been significant increases in the cost of living that warrant an increase in the minimum wage. However, the timing of any further increases needs to be carefully dovetailed with the entry-into-force of C-23 to avoid adding to fiscal pressures. Furthermore, it needs to be coordinated with initiatives to implement income support or UBI.

Compact Trust Fund

Repurposed or Original Perpetual Intent. The Compact negotiations resulted in repurposing of the CTF, enabling funds to be drawn down for current operating and consumption purposes before the fund had attained a sufficiently large level to carry on after the loss of annual grants from the US at some date in the future. The RMI is confronted with the choice of maintaining the original intent of the CTF to establish a perpetual fund or with the withdrawal of assets as specified for operations and consumption purposes during C-23. The ability to withdraw funds to provide a universal basic income complicates the choice. However, clear principles to guide allocations that could be incorporated into the FRDMA would help ensure windfall gains were not simply consumed to match available resources.

RMI summary economic indicators, FY15-FY22

	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Per Capita Income measures								
GDP current prices, $ million	183.2	200.9	212.9	219.4	232.0	240.8	257.8	258.8
Population	49,931	48,748	47,040	45,418	44,217	44,015	42,500	41,496
GDP per capita $	3,669	4,121	4,527	4,831	5,247	5,470	6,066	6,236
GNI per capita $	**4,842**	**5,221**	**5,535**	**5,886**	**6,370**	**6,501**	**6,652**	**7,146**
GNDI per capita $	5,929	6,303	6,599	7,079	7,766	8,323	8,939	9,050
National accounts								
GDP, at constant FY2015 prices, $ million	**183.2**	**187.2**	**194.1**	**205.1**	**226.4**	**219.9**	**222.4**	**220.9**
% growth	**2.1%**	**2.1%**	**3.7%**	**5.7%**	**10.4%**	**-2.8%**	**1.1%**	**-0.7%**
GDP less fisheries	**175.4**	**178.8**	**183.3**	**189.0**	**193.7**	**189.7**	**186.2**	**193.1**
% growth	**1.5%**	**1.9%**	**2.5%**	**3.1%**	**2.5%**	**-2.1%**	**-1.9%**	**3.7%**
GDP production, $ million	**183.2**	**187.2**	**194.1**	**205.1**	**226.4**	**219.9**	**222.4**	**220.9**
Agriculture and fisheries	22.8	24.5	26.0	31.5	48.6	45.5	50.7	42.9
Manufacturing and utilities	13.9	11.3	10.7	11.8	13.0	12.2	10.9	11.8
Construction	6.9	8.8	9.5	10.0	12.0	11.4	11.2	12.7
Wholesale and retail trade	24.7	24.9	25.0	27.4	28.5	28.0	27.9	28.8
Transport	14.6	14.6	17.4	18.2	16.6	16.2	16.3	17.5
Accomodation & restaurants	4.0	4.5	4.7	4.7	5.2	4.2	3.3	4.2
Public admin, Health and education	63.0	63.6	65.9	66.8	67.1	66.6	67.7	69.3
Other services	26.3	26.5	27.1	27.0	26.3	27.6	26.2	25.1
Taxes less subsidies on products	7.0	8.4	7.9	7.8	9.0	8.2	8.1	8.6
GDP by Expenditure, $ million	**185.4**	**201.0**	**205.6**	**214.8**	**250.2**	**238.7**	**267.1**	**265.9**
Final consumption expenditure, government	103.2	111.9	114.2	124.3	140.3	131.2	134.6	125.6
Final consumption expenditure, households	142.5	147.4	162.0	160.7	170.9	165.5	159.2	165.3
Gross capital formation	31.5	42.3	50.9	52.0	126.8	50.9	52.7	52.3
Gross domestic expenditure	**277.2**	**301.7**	**327.2**	**337.0**	**438.0**	**347.6**	**346.5**	**343.2**
Exports	81.3	71.8	69.7	73.8	82.6	78.7	96.6	90.4
Less Imports	173.1	172.5	191.3	196.0	270.4	187.6	176.0	167.6
Descrepancy % GDP(P)	-1%	-7%	-6%	-5%	-11%	-9%	-20%	-20%
Prices (annual percent change)								
Consumer price index	-2.2%	-1.5%	0.1%	0.8%	-0.1%	-0.7%	2.2%	2.8%
Average wage	2.5%	1.9%	4.4%	4.0%	6.2%	5.3%	3.5%	0.8%
Export price Index	-11.2%	2.6%	17.0%	-1.4%	-11.7%	4.4%	14.5%	6.2%
Import price Index	-7.3%	-6.6%	2.9%	3.7%	0.2%	-6.7%	11.9%	9.0%
Terms of trade	-4.2%	9.9%	13.6%	-4.8%	-11.9%	11.8%	2.3%	-2.6%
Employment and Wages								
Number of employees	**10,741**	**11,056**	**11,281**	**11,413**	**11,430**	**11,246**	**11,373**	**11,644**
% change	-0.9%	2.9%	2.0%	1.2%	0.2%	-1.6%	1.1%	2.4%
Private sector	4,187	4,269	4,329	4,356	4,308	4,059	3,962	3,905
% change	-6.0%	2.0%	1.4%	0.6%	-1.1%	-5.8%	-2.4%	-1.4%
Public sector	5,103	5,207	5,337	5,401	5,544	5,639	5,831	6,189
% change	2.6%	2.0%	2.5%	1.2%	2.7%	1.7%	3.4%	6.1%
Other	1,451	1,580	1,615	1,656	1,578	1,548	1,580	1,551
Average annual wage	**11,917**	**12,146**	**12,679**	**13,192**	**14,010**	**14,749**	**15,265**	**15,381**
% change	2.5%	1.9%	4.4%	4.0%	6.2%	5.3%	3.5%	0.8%
Private sector	7,012	7,228	7,668	8,279	9,332	10,235	10,890	11,402
% change	3.1%	3.1%	6.1%	8.0%	12.7%	9.7%	6.4%	4.7%
Public sector	14,555	14,709	15,280	15,788	16,139	16,353	16,717	16,373
% change	0.1%	1.1%	3.9%	3.3%	2.2%	1.3%	2.2%	-2.1%
Average annual real wage (FY15 prices)	**11,917**	**12,332**	**12,866**	**13,281**	**14,120**	**14,963**	**15,146**	**14,849**
% change	4.9%	3.5%	4.3%	3.2%	6.3%	6.0%	1.2%	-2.0%

RMI summary economic indicators, FY15-FY22 cont'd

	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Government Finance Statistics, ($ million)								
Revenue	**108.6**	**122.4**	**145.5**	**138.6**	**148.4**	**170.1**	**181.2**	**173.4**
Tax revenue	25.9	28.9	30.4	32.1	34.9	33.5	35.4	35.9
Grants	58.7	59.1	65.3	67.3	71.9	88.9	102.3	91.5
Other revenue	23.9	34.4	49.9	39.2	41.5	47.6	43.4	45.9
Expense	**-96.4**	**-108.4**	**-123.2**	**-122.9**	**-146.5**	**-149.7**	**-163.1**	**-155.1**
Compensation of employees	-41.4	-42.4	-45.9	-48.2	-50.8	-52.7	-57.6	-58.7
Use of goods and services	-26.3	-32.0	-32.2	-36.7	-50.0	-43.5	-56.5	-44.5
Interest Payments	-0.7	-0.8	-0.6	-0.6	-0.6	-0.7	-0.6	-0.5
Subsidies	-9.3	-11.2	-11.7	-12.1	-17.3	-19.0	-18.0	-16.5
Grants	-10.0	-15.8	-15.6	-12.1	-11.5	-16.4	-17.3	-16.6
Other expense	-8.8	-6.3	-17.2	-13.3	-16.3	-17.4	-13.2	-18.3
Net Worth and its Changes	**-12.1**	**-14.0**	**-22.3**	**-15.7**	**-1.9**	**-20.4**	**-18.1**	**-17.5**
Nonfinancial assets	-7.0	-6.2	-12.9	-10.1	-6.1	-14.3	-17.6	-16.5
Financial assets	-2.3	-5.8	-10.0	0.0	-2.1	-8.4	-0.5	0.0
Financial liabilities	-2.9	-2.0	0.7	-5.6	6.3	2.3	0.0	-1.1
Overall fiscal balance	**5.2**	**7.8**	**9.4**	**5.6**	**-4.2**	**6.1**	**0.5**	**1.7**
(In percent of GDP)								
Revenue	**59.3%**	**60.9%**	**68.3%**	**63.2%**	**64.0%**	**70.6%**	**70.3%**	**67.0%**
Taxes	14.1%	14.4%	14.3%	14.6%	15.0%	13.9%	13.7%	13.9%
Domestic revenues	32.1%	29.4%	30.7%	30.7%	31.0%	36.9%	39.7%	35.4%
Grants	13.1%	17.1%	23.4%	17.9%	17.9%	19.8%	16.8%	17.7%
Expense	**-52.6%**	**-53.9%**	**-57.9%**	**-56.0%**	**-63.1%**	**-62.2%**	**-63.3%**	**-60.0%**
Compensation of employees	-22.6%	-21.1%	-21.5%	-22.0%	-21.9%	-21.9%	-22.3%	-22.7%
Use of goods and services	-14.3%	-15.9%	-15.1%	-16.7%	-21.5%	-18.1%	-21.9%	-17.2%
Interest Payments	-0.4%	-0.4%	-0.3%	-0.3%	-0.3%	-0.3%	-0.2%	-0.2%
Subsidies	-5.1%	-5.6%	-5.5%	-5.5%	-7.4%	-7.9%	-7.0%	-6.4%
Grants	-5.5%	-7.9%	-7.3%	-5.5%	-4.9%	-6.8%	-6.7%	-6.4%
Other expense	-4.8%	-3.1%	-8.1%	-6.0%	-7.0%	-7.2%	-5.1%	-7.1%
Non Financial Assets	**-3.8%**	**-3.1%**	**-6.1%**	**-4.6%**	**-2.6%**	**-5.9%**	**-6.8%**	**-6.4%**
Overall fiscal balance	**2.8%**	**3.9%**	**4.4%**	**2.6%**	**-1.8%**	**2.5%**	**0.2%**	**0.7%**
Balance of Payments								
Current Account balance	**21.0**	**20.1**	**-1.9**	**-4.5**	**-72.6**	**36.1**	**58.0**	**45.3**
Exports of goods and services	80.2	72.8	82.5	86.4	85.3	85.3	119.7	119.1
Imports of goods and services	172.0	159.1	181.9	192.9	269.3	174.8	183.8	190.5
Primary income balance	58.5	53.6	47.4	47.9	49.7	45.4	24.9	37.8
Secondary income balance	54.3	52.7	50.0	54.2	61.7	80.2	97.2	79.0
Capital account balance	**15.1**	**16.1**	**20.1**	**16.5**	**12.7**	**14.5**	**11.0**	**13.4**
Net lending/Borrowing (Curr + Cap)	**36.0**	**36.2**	**18.2**	**12.0**	**-59.9**	**50.6**	**69.0**	**58.7**
Financial Account balance	**-3.5**	**-8.8**	**-10.7**	**20.9**	**90.9**	**-27.5**	**-32.9**	**-16.0**
Direct investment	4.3	6.1	7.5	8.1	69.5	5.1	10.5	-7.8
Portfolio investment (increase in assets: -)	20.3	17.6	7.9	11.5	11.7	14.2	-0.1	25.3
Other investment (increase in assets: -)	-28.1	-32.5	-26.2	1.2	9.8	-46.9	-43.2	-33.4
Errors and omissions	-32.5	-27.4	-7.4	-32.9	-31.1	-23.0	-36.1	-42.8
Errors and omissions (% goods and services)	*-13%*	*-12%*	*-3%*	*-12%*	*-9%*	*-9%*	*-12%*	*-14%*
External Debt. $ million								
Gross External Debt. total	94.6	89.0	83.5	77.9	72.5	67.5	66.2	63.5
National Government	62.2	59.5	56.6	54.1	51.4	49.2	49.9	48.9
State Owned Enterprises	32.4	29.5	26.9	23.8	21.1	18.3	16.4	14.6
Gross External debt as % of GDP	51.7%	44.3%	39.2%	35.5%	31.3%	28.0%	25.7%	24.5%
Debt Service	3.3	3.1	3.1	3.2	3.9	3.8	4.1	4.5
Debt service as % of national government revenues	3.0%	2.5%	2.2%	2.3%	2.6%	2.3%	2.3%	2.6%
Depositiory Coporations Survey ($ million)								
Net foreign assets	**87.6**	**115.4**	**135.7**	**129.2**	**113.6**	**155.3**	**193.2**	**221.1**
Domestic claims	**87.8**	**96.3**	**109.9**	**110.3**	**118.5**	**112.4**	**108.8**	**111.4**
Net claims on national government	-8.0	-7.5	-11.6	-11.6	-9.1	-18.4	-13.7	-12.8
Claims on other sectors	89.6	101.1	119.7	120.6	126.8	130.2	122.3	124.2
Private non-financial corporations	27.0	35.1	44.7	43.7	51.5	54.5	49.8	48.2
Individuals	62.6	66.0	75.0	76.9	75.4	75.7	72.6	76.0
Broad money liabilities	**145.0**	**175.9**	**215.5**	**207.9**	**199.8**	**235.8**	**270.3**	**297.3**
Demand deposits	62.1	80.7	128.2	120.6	92.8	122.6	134.5	150.2
Other deposits	82.9	95.1	87.3	87.3	107.0	113.2	135.8	147.1
Capital and other accounts	**30.4**	**35.8**	**30.0**	**31.6**	**32.3**	**31.9**	**31.6**	**35.2**
Loans to deposit ratio, %	61.8%	57.5%	55.5%	58.0%	63.5%	55.2%	45.2%	41.8%

RMI ECONOMIC REVIEW 2023

Republic of the Marshall Islands

March 2024

The RMI Economic Review is produced annually to provide an independent assessment of the Republic of the Marshall Islands' economic performance and policy environment, as well as independently verified economic statistics. The Review has been developed to assist the governments of the RMI and the United States to fulfill their respective reporting requirements under RMI's Compact of Free Association with the United States.

The RMI Economic Review has been prepared by the Economic Monitoring and Analysis Program (EconMAP) of the Graduate School USA, with funding assistance from the United States Department of the Interior's Office of Insular Affairs. Additional information is available online at ***www.econmap.org***

Additional information on the EconMAP program, as well as a digital copy of this report, is available online at http://www.econmap.org