Republic of the Marshall Islands

EconMAP Technical Note

May 8, 2020

Assessing the Impact of COVID-19 on the Marshall Islands Economy

Economic Monitoring and Analysis Program (EconMAP) Technical Notes are intended to provide concise and timely analysis of important issues for decision-makers in the Republic of the Marshall Islands. Technical notes utilize currently available data sets and macroeconomic tools developed in close collaboration with the RMI government. The EconMAP program is managed by the Graduate School USA's Pacific and Virgin Islands Training Initiatives (PITI-VITI) with funding support from the Department of the Interior's Office of Insular Affairs. Comments, questions or requests for further detail may be directed to info@econmap.org.

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Assessing the Impact of COVID-19 on the Marshall Islands Economy

Introduction

The global emergence of coronavirus disease 2019 (COVID-19) continues to have an extraordinary impact on Pacific island economies and across the globe. The Republic of the Marshall Islands (RMI) has been spared any confirmed cases of COVID-19 and has taken strong proactive measures—perhaps some of the strongest in the world—to protect the health of the nation. The structure of the RMI economy is heavily dependent on the public sector but also substantially dependent on fisheries activity and rent receipts. The economy relies very little on tourism and visitor arrivals; nevertheless, the projected economic consequences of the COVID-19 pandemic are significant.

Of course, if the tourism sector played a greater role in the RMI economy or if accommodations were not being made to try to allow for continued fisheries activity in the RMI, the projected negative impact of COVID-19 would be stronger than projected in this Technical Report. The longer COVID-19 threatens the people and the fragile health system of the RMI, the greater the indirect effects on the government's fiscal position and on the fisheries sector. More ominously, if the RMI is afflicted with actual COVID-19 cases and community transmission, the negative economic impact will be much worse. In this Technical Note, it is assumed public health restrictions on arrivals will remain through FY2021 and a return to normal access and post-pandemic economic activity begins in October 2021.

The government of the RMI entered the current fiscal year, FY2020, in a weak fiscal position with limited reserves to draw upon. While revenues have grown rapidly in recent years with the boom in Vessel Day Scheme (VDS) fisheries receipts, these have been matched by a rising level of expenditures. There thus remains little fiscal space to mitigate the impact of the current crisis. The projected impact on tax revenues, employment and job loss coupled with potential significant reductions in fisheries revenues may result in a sizeable fiscal shock, larger than previous shocks experienced by the RMI. A fiscal response will need to be designed and implemented on an urgent basis. The RMI will need significant assistance from its donor partners to mitigate the projected negative impacts on the economy as a whole and to avoid a dangerous deterioration of its fiscal position.

The challenge will be to balance the need to provide some forms of counter-cyclical stimulus or compensation to affected individuals and businesses while also limiting the negative fiscal impact of this cyclical shock. This EconMAP Technical Note utilizes current statistical data and macroeconomic modeling to project the impact of COVID-19 and to outline a range of fiscal measures for government consideration.

It should be noted that the modeling techniques used for this study do not account for potential

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behavioral changes by the RMI's domestic consumers. It is possible that domestic demand will be further depressed than our model indicates if, despite the dominance of government wages and spending in the economy, the consumption behavior of individuals is markedly reduced due to fear of worsening impacts from COVID-19 or due to changes in economic activity in response to public health restrictions placed on social gathering. If such behavioral changes do occur, we will see them after the fact, and they would lead to increased saving during the COVID-19 pandemic and potentially increased demand when restrictions are removed.

Basic Assumptions Used in the Analysis[1]

Fisheries

The fisheries industry in the RMI comprises a set of activities: household subsistence, aquarium fish exports, the tuna loining plant and Pan Pacific purse seine operations, shore-based support (MIFV) to the longline industry and the operations of the Marshall Islands Marine Resources Authority (MIMRA). While household fishing is not projected to decline and may well increase, export of aquarium fish is currently reported to be down 50 percent. Pan Pacific has indicated both the loining plant and purse seiners are expected to be down by 30 percent in FY2020. While both are expected to improve in FY2021, they are still likely to remain 10 percent below the FY2019 level. The shore-based transshipment service for export of sashimi grade tuna is also projected to be down by 50 percent. The value added of MIMRA is projected to decline by 10 percent in both FY2020 and FY2021 reflecting the temporary closure of the observer program which monitors the fish catch of the purse seine fleet.

Of critical importance to the RMI has been the rapidly growing source of funds from the Vessel Day Scheme of the Parties to the Nauru Agreement. At the current time, the RMI has been allocated about 3,000 fishing days of Party Allowable Effort under the PNA. Of this, about 800 days remain unsold for calendar year 2020. The low prices of tuna experienced at the beginning of the year coupled with travel restrictions have reduced demand for vessel days and there is significant risk that some of these days may remain unsold by year end, or that recent prices of around $11,000 a day will need to fall.

> *The fishing fee revenue available to the RMI government is projected to decline from $30 million in FY2020 to $26 million in FY2021.*

MIMRA has indicated that it will be able to meet its obligations to government throughout FY2020 with a budgeted transfer of $30 million, perhaps requiring a drawdown of accumulated MIMRA reserves. For FY2021 this Technical Note assumes that the VDS rate will drop to the floor price of $8,000 for those days that are sold on a bilateral basis. This would result in a reduction in MIMRA revenues of about $4 million. An estimated loss of a further $1 million from the temporary closure of the observer program will further impact the reserves. Reflecting these changes, the fishing fee revenue available to the RMI government is projected to decline from $30 million in FY2020 to $26 million in FY2021.

Tourism

Tourism is not large in the RMI and the hotel and restaurant sector accounts for only 2.3 percent of Gross Domestic Product (GDP). The two main hotels are now running virtually empty and output is thus close to zero. Current GDP estimates indicate that 50 percent of the restaurant sector is dependent on visitors, with

[1] The assumptions made are as of 5/6/2020, and will be revised as further information arises.

no current demand from this component. Local restaurant demand reflects the level of demand in the economy. With the termination of most flights into the Marshall Islands, Mobil wholesale fuel operations has also been projected to drop by 45 percent, reflecting the loss of nearly all of its aviation fuel sales.

Private sector operators indicate that output is growing, and the COVID-19 pandemic will not immediately affect construction.

Construction

Construction represents an average of 5 percent of GDP in the RMI. The sector is currently experiencing a boom period in donor projects from both the Asian Development Bank and World Bank. Private sector construction operators indicate that output is growing, and the COVID-19 pandemic will not immediately affect construction. A 7.5 percent growth in construction in FY2020 is currently projected, followed by a 10 percent fall in FY2021. Current travel restrictions constrain travel to the RMI of specialist engineers and project personnel, although it is understood that much can be accomplished by virtual means. Current travel restrictions are also beginning to hinder the supply of goods into the RMI.

Transshipment

Majuro acts as a mid-Pacific entrepot (transshipment center) for the trade of goods and services in support of the purse seine industry. This has been growing in recent years with increased shore-based activities like net repair and containerization of fish. Based on information provided to the Graduate School USA, reflecting the strict travel restrictions that boats must be at sea for 14 days after leaving a COVID-19 infected jurisdiction, significant declines are projected in the activity of local transport companies and the Marshall Islands Ports Authority. It is projected that vessels may be required to transship at sea rather than in port. This results in a modest decline in aggregate demand.

Public Sector

No change in the current levels of government operations or in public expenditures or programs has been assumed. However, as a result of reduction in tax revenues and loss of fishing fee revenues, the government may be required to initiate a COVID-19 fiscal response program, and changes in expenditures to reduce costs in some areas and to pay for mitigation efforts will surely be required. It is understood there are significant increases in the health budget, but that the majority of these will be donor financed. Once these figures are known the projections will be updated; however, they currently appear unlikely to affect the overall fiscal position.

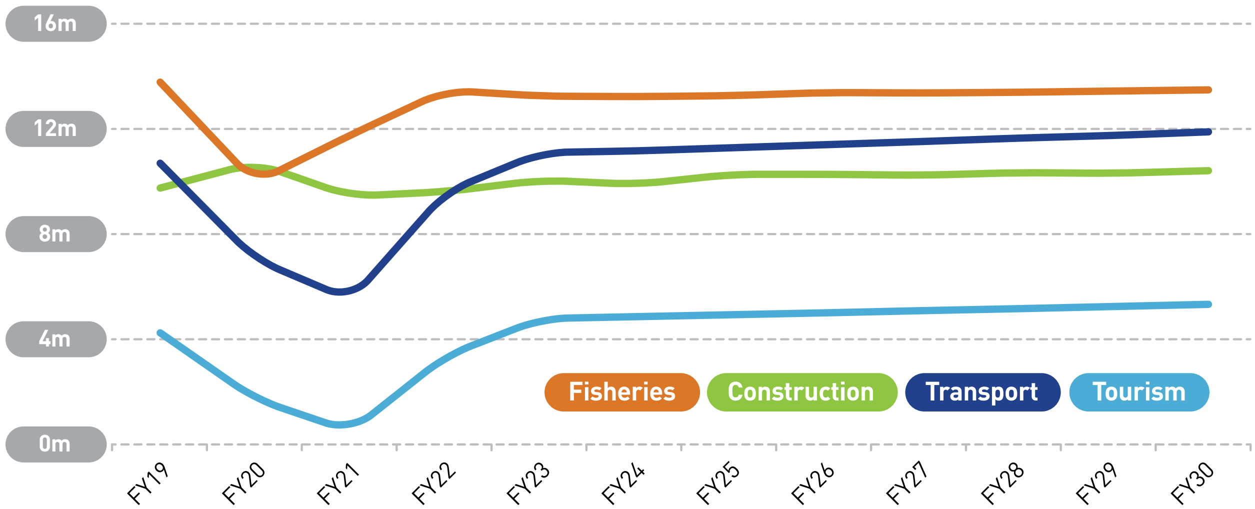
Kwajalein Military Base

The Kwajalein Military base is treated as outside of the RMI economic territory and is thus not part of RMI GDP. However, the base employs a significant number of Marshallese workers, most of whom live nearby on Ebeye and commute to work daily. Earnings by these workers constitute 16% of all RMI employee income. Currently the base operations continue as normal, but any shift in security alert level that results in reduced employment would have significant economic and welfare impacts on Ebeye and flow-through to income and social security tax collections.

Major industries affected by the Pandemic

Figure 1 provides a graphical picture of the major industries that are affected by the pandemic. Fisheries drops in FY2020 but recovers in FY2021. Additional impacted sectors include the small tourism sector and transshipment and fuel

Figure 1 Major industries affected by the pandemic: value added constant prices



services. Construction helps maintain the level of activity and is projected to grow in FY2020 and drop back in FY2021 reflecting supply and capacity issues.

COVID-19 Donor Assistance

The economic and fiscal projections undertaken in this Technical Note do not take into account additional donor assistance which is very likely to be made available to the RMI from its major bi-lateral and multi-lateral partners. While the primary purpose of this document is to assist the government of the Marshall Islands in developing its own fiscal response policies, it is hoped the analysis provided will be beneficial to the ongoing dialogue the RMI undertakes with its donor partners. Further, it is hoped that the analysis will assist the donors in designing their programs at a time when missions cannot be sent to complete in-country review and due diligence.

Economic and Fiscal Impact

Economic Impact

The economic impact of COVID-19 on the RMI economy is shown in Figure 2. This Technical Note projects a 5.5 percent drop in GDP in FY2020 and a further 1.4 percent reduction in FY2021. The major contributing factors to this reduction are led by the fisheries sector, which is responsible for 1.6 percent of the decline. The reduction in the hotel and restaurant sector also imparts a negative 1.2 percent hit on GDP, as does the wholesale and retail trade sector reflecting reductions in flights and reduced demand in the economy. The transport sector, impacted by the loss of transshipment, is responsible for a 1.1 percent fall. Given the large public sector which, including State-Owned Enterprises, represents 45 percent of GDP, the economy has been somewhat insulated from impact of the COVID-19 crisis. Nevertheless, the shock to the economy is substantial and similar in magnitude to GDP reduction in FY2008 when GDP fell by 6.0 percent during the Global Financial Crisis.

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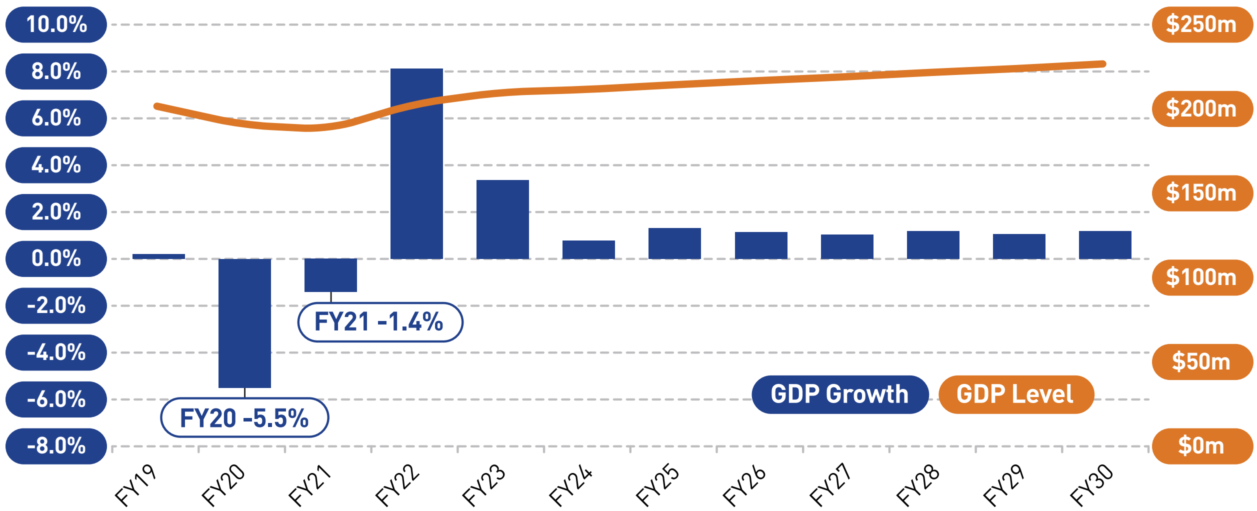
Figure 2 *Projected GDP level and growth*

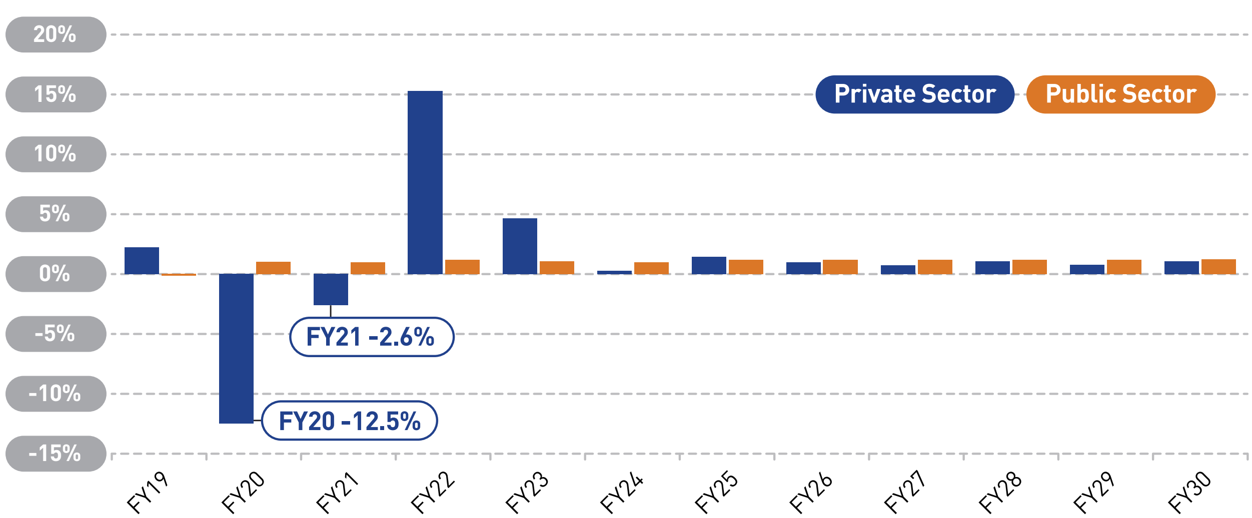


During that period the transport sector was responsible for 3.0 percent of the decline.[2]

Figure 3 indicates the impact of the pandemic on the private and public sectors. While the public sector is projected to grow at 1 percent reflecting recent trends in payrolls, which are assumed to remain unchanged, the brunt of the COVID-19 impact will be felt in the private sector. In FY2020, a large reduction of 12.5 percent is indicated, in part reflecting reductions in the loining plant, and in FY2021 a smaller reduction of 2.6 is projected. Overall a very sizeable loss in output of 15 percent has been projected for the private sector. While the overall impact of the pandemic on the economy may appear "conservative", when the structure of the economy is taken into full account it is seen that the economic impact is highly uneven.

[2] About 30 percent of the economy is classified as non-traded industries whose output is driven by the level of domestic demand. Our projections project that domestic demand will fall by 3.5 percent in FY2020 and 2.0 percent in FY2021.

Figure 3 *Projected private and public sector growth*



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

Employment Impact

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

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

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

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Fiscal Impact

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

Figure 4 Projected employment level and growth

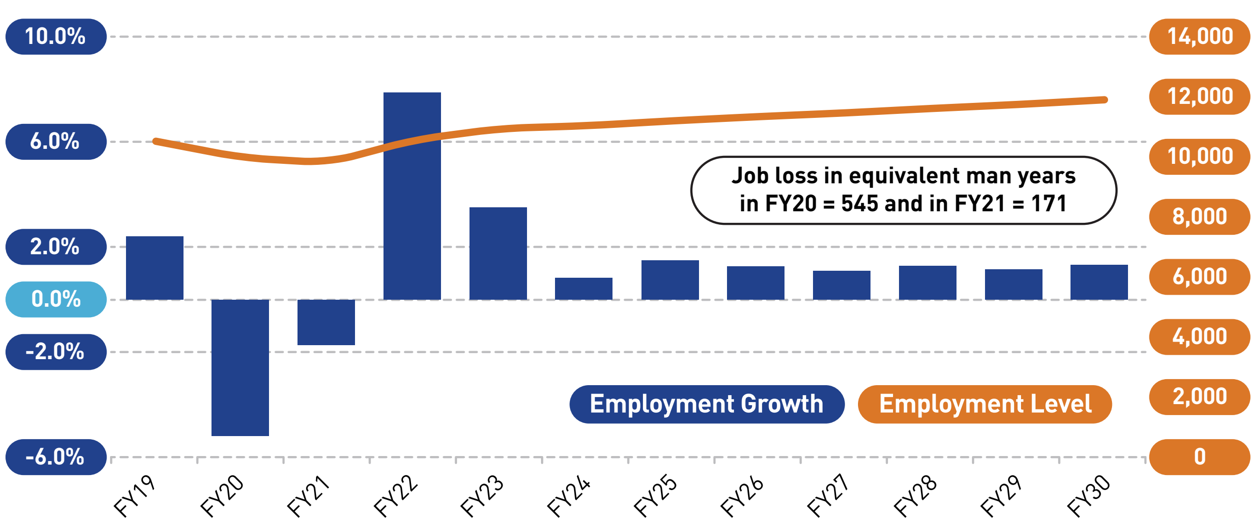
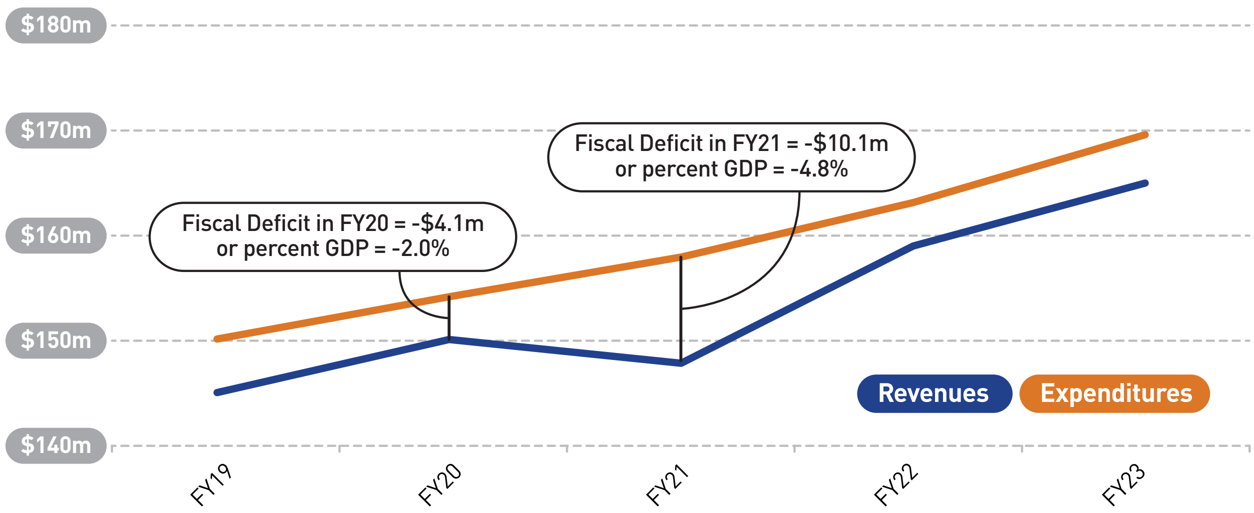


Figure 5 Projected revenues and expenditures



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

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

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

Financing

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

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

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

Collateral Issues Add to the Fiscal Challenge

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

Fiscal policy and the compelling need for an adjustment program

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

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

Revenue Measures

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

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

Expenditure Measures

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

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

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

Financing

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

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

Potential Components of a Fiscal Response

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

1. First and foremost, a health sector strengthening program to address the threat of the COVID-19 pandemic and to improve the RMI's ability to provide sustained, high quality health services to its population.

2. An unemployment relief program administered through the Social Security Administration for groups that are not supported through the CARES act, including informal workers and foreign nationals employed in the RMI.

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

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

Conclusion

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

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

About EconMAP

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

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

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