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Development Finance Assessment for Republic of The Marshall Islands

Leveraging finance for sustainable development





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Asia Pacific Development Effectiveness Facility (AP-DEF) AP-DEF is a country-led regional platform, chaired by the Government of Bangladesh, which supports countries to implement their national agendas on Development Finance and Cooperation. The Facility is a platform for regional dialogue, cooperation, and sharing of country knowledge and experiences. It is responding to the growing demand from countries in Asia and the Pacific to establish evidence and analysis, and introduce policy and institutional reforms for managing the increasing complexity of domestic and international sources of finance for development. AP-DEF has its Secretariat at the UNDP Bangkok Regional Hub.

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Foreword

On behalf of the Republic of the Marshall Islands' Government and as the Minister of Finance, I am pleased to present the RMI's completed Development Finance Assessment. It is the Government's intention that this tool will further inform the ongoing efforts in improving and completing its National Strategic Plan and Integrated National Financial Framework (INFF) or locally referred to as the Medium-Term Budget Investment Framework (MTBIF).

The Republic of the Marshall Islands faces numerous development challenges including having finite resources – natural, financial, and human resources. Financial assistance under the Compact Agreement as Amended with the United States will cease in four years. Additionally, the Republic of the Marshall Islands faces existential threat with the ongoing effects of climate change. As identified in the assessment, RMI relies heavily on aid for its development. Economic growth over the past seventeen years has been moderate but any growth is mainly due to growth in public sector and aid.

Development in the RMI means ensuring resilience in all areas including human, financial and economic security and development. Numerous efforts and reforms are already ongoing to strengthen systems within the government and improve and/or provide an enabling environment for private sector growth. Human capital development is vital in ensuring that all development at all fronts are, not just successful but sustainable.

Some of the ongoing improvement efforts include Public Financial Management reforms focusing in the areas of accounting, budgeting, human resources, tax and revenue collection and projections, aid coordination, state owned enterprise reform and many more.

The ultimate goal for the government remains as creating an enabling environment for a growing and strengthened economy and continuous investment in our major resources, including our Human Capital. I, therefore, am very pleased to present the RMI Development Financial Assessment.

Kommol Tata!
Minister of Finance
Brenson S. Wase

Content

AcknowledgementsII
Foreword	III
Content	IV
List of Abbreviations	VIII
Executive summary1
1. Introduction10
1.1 Overview	10
1.2 Purpose and objectives of Development Finance Assessment	13
1.3 Conceptual framework for the Integrated National Financing Framework	14
1.4 Structure of the Report	16
2. Social and economic context17
2.1 Economic performance	17
2.2 Social development and environmental sustainability	24
3. Development finance landscape in RMI27
3.1 Public domestic sources	28
3.2 Public development assistance	36
3.3 Public sector external borrowing: Debt-creating financial flows	44
3.4 Private sources: domestic and foreign	46
4. The building blocks of RMI's INFF54
4.1 Block 1: Leadership and institutional coherence	55
4.2 Block 2: Vision for Results: RMI's long- and medium-term planning	57
4.3 Block 3: Overarching financing strategy	60
4.4 Block 4: Financing policies for specific flows	61
4.5 Block 5: Robust and efficient monitoring, evaluation and learning systems	63
4.6 Block 6: An enabling environment for accountability and dialogue	65
5. Improving the public financial management system to mobilize domestic resources67
5.1 Annual budget planning and appropriation	67
5.2 Public expenditure: financing for social services and recurrent operating expenditures	70
5.3 Sources of public finance: Reliance on foreign aid	72
5.4 Public revenue vs expenditure: slow-rising revenue and a balanced budget	75
5.5 Inefficient public expenditure	76

5.6 Weak Public Financial Management System	77
5.7 Improving public finance management	79
6. Safeguarding the Compact Trust Fund	82
6.1 Performance of the Compact Trust Fund	82
6.2 Prospects of the Compact Trust Fund	84
7. Improving SOE performance	87
7.1 SOE's drain on public finance	87
7.2 Promoting market-oriented SOE reforms	89
8. Promoting “blue growth” and private sector development	92
8.1 Promoting blue growth	92
8.2 Promoting private sector development	93
9. Prospective analysis of development finance flows	95
9.1 Prospective analysis of development flows	95
9.2 Scenario analysis of development finance	96
10. Recommendations: Developing the current system to address sustainable development challenges	99
10.1 Ensuring leadership and institutional coherence	99
10.2 Developing a new long-term development strategy and updating the medium-term NSP to establish a new vision for the result	100
10.3 Establishing an overarching financing policy	101
10.4 Strengthening the M&E system to monitor and provide evidence-based support for financing for development	102
10.5 Building an enabling environment for accountability and dialogue	102
11. Roadmap for key actions	104
References	107

Figures

Figure 1: Map of the Marshall Islands	10
Figure 2: Scope of finance flows to be reviewed in the DFA	14
Figure 3: Building blocks of an INFF	15
Figure 4: GDP trend in RMI, 2000–2017 (Index, 2000=100)	18

Figure 5: GDP trend in RMI, 2000–2023 (Index, 2000=100)	19
Figure 6: Structure of RMI's economy (% of GDP), 2015	19
Figure 7: Investment (% of GDP), 2004–2015	21
Figure 8: Average investment (% of GDP), 2004–2015	22
Figure 9: Trade openness (Trade as % of GDP), 2000–2016	22
Figure 10: External debt position, 2000–2017	23
Figure 11: Rankings on Doing Business topics – RMI	24
Figure 12: Development finance in RMI (% of GDP), 2004–2017	28
Figure 13: Domestic public income (% of GDP), 2004–2017	28
Figure 14: Tax revenue, 2004–2017	30
Figure 15: Tax burden (tax revenue as % of GDP) in the Pacific Island Small States, 2015	30
Figure 16: Tax revenue by sources (% of tax revenue), 2017	32
Figure 17: Tax revenue by sources (US\$ million), 2004–2017	32
Figure 18: Tax revenue by sources (% of GDP), 2004–2017	33
Figure 19: Non-tax revenue, 2004–2017	33
Figure 20: Non-tax revenue by sources (US\$ million), 2004–2017	34
Figure 21: Non-tax revenue by sources (% of GDP), 2004–2017	34
Figure 22: Public foreign sources (% of GDP), 2004–2015	36
Figure 23: Scheduled Compact Grants (US\$ million inflation-adjusted), 2004–2023	37
Figure 24: Total awarded Compact Grants (US\$ million), 2004–2017	38
Figure 25: Disbursed Compact Sector Grants, 2004–2017	38
Figure 26: ODA received (current US\$ million) from non-US DAC countries and ODA as a share of GDP, 2000–2017	39
Figure 27: Sectoral distribution of ODA received from non-US DAC countries (% of total ODA from non-US DAC countries), 2002–2017	40
Figure 28: External debt in RMI, 2000–2017	45
Figure 29: External debt service in RMI, 2000–2017	45
Figure 30: Private sources (% of GDP), 2004–2017	47
Figure 31: Gross Domestic Savings (% of GDP) in 2015	47
Figure 32: Remittance received per capita (US\$) and remittance received as a share of GDP in Pacific Island Countries, 2017	48
Figure 33: Remittance received (US\$ million and as % of GDP), 2005–2017	49
Figure 34: Remittance paid (US\$ million and as % of GDP), 2005–2016	50
Figure 35: Net FDI inflow to RMI, 2000–2017	51
Figure 36: Net FDI inflow as a share of GDP (average), 2010–2017	51

Figure 37: RMI's Integrated National Financing Framework	54
Figure 38: Annual budgeting process in RMI	68
Figure 39: Actual capital vs current expenditure (% of total public expenditure), 2000–2016.	70
Figure 40: Compensation to employees (% of Total Public Expenditure), 2004–2017.	70
Figure 41: Distribution (%) of public expenditure by sectors in 2017	71
Figure 42: Distribution (%) of public expenditure (budget) by sectors from 2007–2017	72
Figure 43: Sources of public revenue (% of GDP), 2000–2017.	73
Figure 44: Self-reliance ratio (domestically collected revenue as % of public expenditure), 2000–2017 . .	74
Figure 45: Compact Base Grant (% of public revenue), 2004–2017	74
Figure 46: Public revenue, expenditure and deficit (US\$ million), 2000–2017.	75
Figure 47: Health expenditure per capita versus the under-5 mortality rate in Pacific Island Small States .	76
Figure 48: Compact Trust Fund Assets (current US\$ million), 2004–2017.	83
Figure 49: Compact Trust Fund investment return on assets (%), 2005–2017	83
Figure 50: Scenarios for the CTF up to 2050	85
Figure 51: SOE losses (US\$ million), 2004–2017.	88
Figure 52: Subsidies and transfers to SOEs, 2004–2017	88
Figure 53: Mobile subscription rate (% of population) in 2015	89
Figure 54: Baseline analysis of public finance in RMI (US\$ Million), 2017–2050	97
Figure 55: Public finance in RMI (US\$ Million) with SOE Reforms, 2017–2050	98

Tables

Table 1: Main social and economic indicators	12
Table 2: Taxes in the Republic of the Marshall Islands	29
Table 3: ODA to RMI by sources, 2002–2017.	40
Table 4: India's development assistance to RMI, 2005–2017.	42
Table 5: RMI Agenda 2020 Framework	60
Table 6: NSP Core Indicator Matrix	64
Table 7: Sources of central government public revenues (current US\$ million), selected years.	72
Table 8: Sequencing of PFM Roadmap by PFM reform area	78
Table 9: Key action areas identified	104

List of Abbreviations

ADB	Asian Development Bank
BCC	Budget Co-ordinating Committee
CAP	Comprehensive Adjustment Program
CTF	Compact Trust Fund
DAC	Development Assistance Committee
DFA	Development Finance Assessment
EPPSO	Economic Policy, Planning and Statistics Office
FDI	Foreign Direct Investment
FMA	Financial Management Act
GAO	US Government Accountability Organization
GEF	Global Environment Facility
ILO	International Labour Organization
INFF	Integrated National Financing Framework
JEMFAC	Joint Economic Management and Financial Accountability Committee
MIDB	Marshall Islands Development Bank
MIMRA	Marshall Islands Marine Resources Authority
MISSA	Marshall Islands Social Security System
MOF	Ministry of Finance
MTBIF	Medium-Term Budget and Investment Framework
NGO	Non-Governmental Organization
NSP	National Strategic Plan
PEFA	Public Expenditure and Financial Accountability
PFMPR	Public Financial Management Performance Report
PFTAC	Pacific Financial Technical Assistance Centre
PNA	Parties to the Nauru Agreement
PSIDS	Pacific Small Island Developing States
OEPPC	Office of Environmental Planning and Policy Coordination
ODA	Official Development Assistance
OOF	Other Official Finance
RMI	Republic of the Marshall Islands

SDGs	Sustainable Development Goals
SMEs	Small and Medium Enterprises
SOEs	State-Owned Enterprises
SSC	South–South Cooperation



Executive summary

The Republic of the Marshall Islands (RMI) faces significant challenges of sustainable development as a small island state and as a middle-income developing economy, at the forefront of climate change and heavily reliant on foreign aid. These challenges include how to grow an economy that is self-reliant, preparing for the post-2023 transition after the end of the compact of free association with the US, adapting to climate change and reducing disaster risks, and in general improving the quality of life of its people.

This Development Finance Assessment (DFA) has found that RMI has already incorporated many of the sustainable development principles into its national development strategic framework since early 2000. In its Vision 2018, RMI has stated that RMI's development vision is "in our own hands is our future," which has been further articulated as "continuing to build a resilient, productive and self-supportive RMI."

However, for the past 17 years, RMI has only made moderate progress in both its social and economic performance. Between 2000 and 2017, its economy only increased by 37 percent, mainly driven by the growth of the public sector funded by foreign aid. In social development, RMI only achieved two of the eight Millennium Development Goals (MDGs) by 2015, and more than one-third of its population are still living in poverty.

In 2015, the RMI government endorsed the 2030 Agenda for Sustainable Development and made a commitment to achieve the Sustainable Development Goals (SDGs) by 2030. Currently, it is aiming to integrate key SDG targets and indicators into its forthcoming National Strategic Plan (NSP). To achieve the SDGs by 2030, RMI faces significant challenges in financing, especially because of the end of the Compact Agreement with the United States by 2023.

The primary purpose of this DFA is to assist the RMI government in establishing an integrated national financing framework (INFF) for the achievement of their development visions and goals, in the context of the 2030 Agenda and the SDGs, and the expiration of the Compact Agreement by 2023. The DFA, therefore, serves as a comprehensive tool to map past, current and future sources of development finance, reviewing a broad range of development finance flows from domestic and external, public and private sources. It is expected that this report will identify opportunities to develop an INFF that can address the financial challenges for achieving the SDGs and RMI's national development goals.

The development finance landscape in RMI

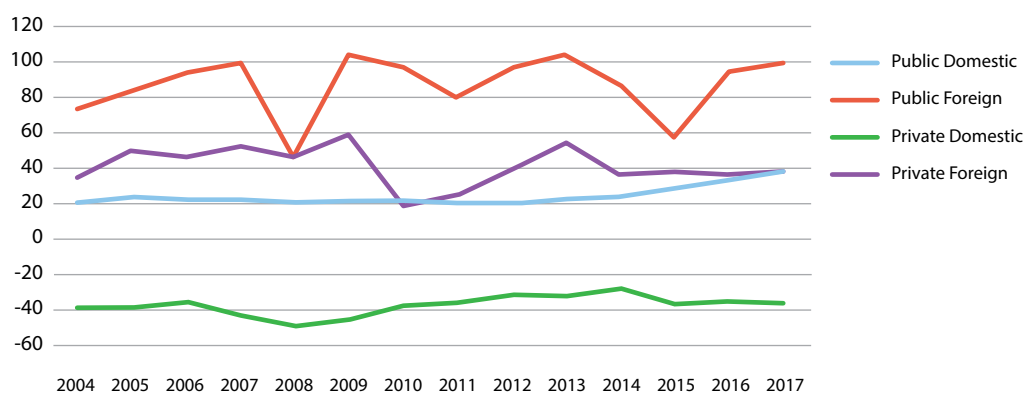
RMI's current and future development finance will broadly come from four sources:

- Domestic-public: tax revenues and non-tax revenue
- Domestic-private: domestic gross saving, together with remittance and net factor transfers from abroad, which are then mobilized for consumption and investment
- International-private: remittance, net factor income from abroad, FDI and portfolio investment, and philanthropic giving
- International public: ODA (Official Development Assistance), OOF (Other Official Flows), South–South Cooperation (SSC), Compact Trust Fund (CTF) investment income, and loans from external public entities.

The figure below shows the landscape of development finance in RMI, which displays the following characteristics:

- The levels of domestic finance flows from public sources, measured as a share of GDP, increased from around 20 percent in 2004 to 38.4 percent in 2017.
- Financial flows from abroad account for the majority of development finance in RMI. The levels of both public finance and private finance from foreign sources, as a share of GDP, have been relatively stable since 2004.
- Gross domestic saving in RMI is low and negative, suggesting that domestic consumption is greater than gross domestic production and has to be financed by external financial sources.

Development finance in the Marshall Islands (% of GDP), 2004–2017



Sources: Asian Development Bank (ADB) Key Indicators (2017), WDI and EPPSO.

RMI's public domestic revenue comprises of tax revenue and non-tax revenue. Between 2004 and 2017, RMI's public domestic revenue increased from around 20 percent of its GDP in 2004 to 38.6 percent in 2017. This increase is mainly due to the increase in non-tax revenue. Between 2004 and 2017, non-tax revenue increased from 3.6 percent of the GDP in 2004 to 24.3 percent of the GDP in 2017, while tax revenue declined from 16.6 percent of the GDP in 2004 to 13.3 percent in 2014, and started to increase until, in 2017, tax revenue had increased to 14.3 percent of the GDP.

RMI's public development assistance mainly comes in three categories: Official Development Assistance (ODA) from the United States in the forms of Compact Grants and federal grants, ODA from non-US Development Assistance Committee (DAC) countries and multilateral development partners, and South–South Cooperation. Between 2004 and 2017, RMI's public development assistance averaged around 85 percent of its GDP. Compact Grants account for the majority of RMI's public development assistance. However, Compact Grants will expire by 2023 and be replaced with investment income from the Compact Trust Fund, which will subject the government of RMI to the challenges of maintaining fiscal stability.

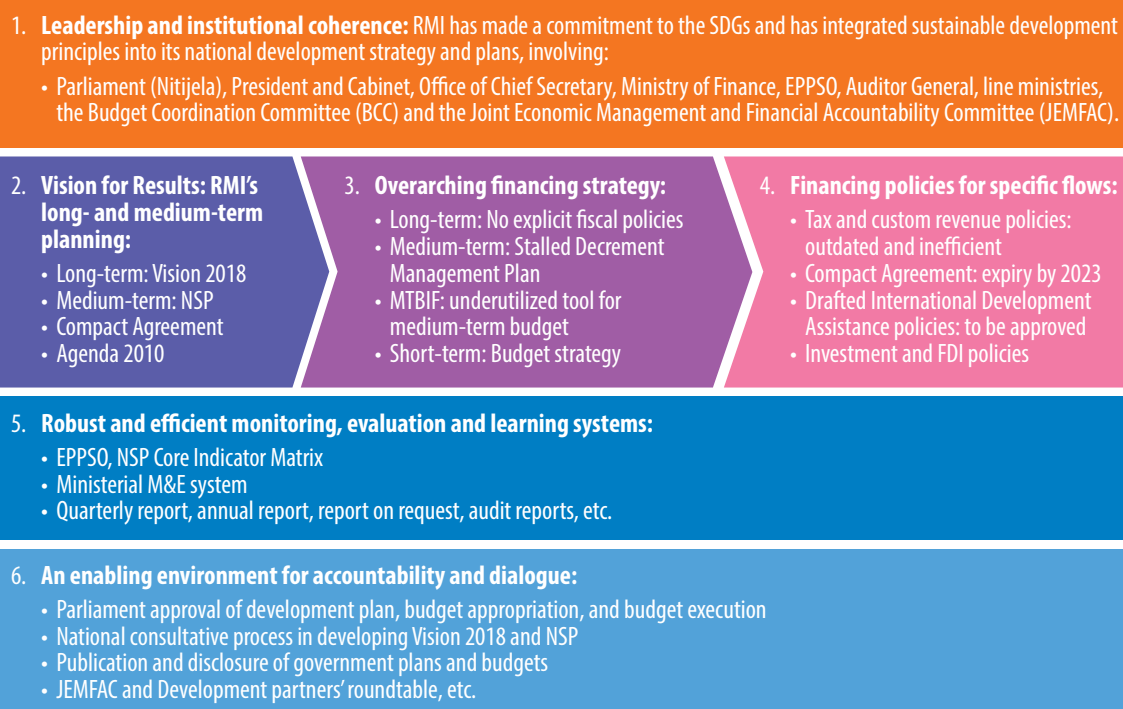
Private finance. There are four sources of RMI's private finance: domestic savings, private remittance from abroad, factor income from abroad to RMI's citizens and companies, and foreign direct investment (FDI). RMI has a negative gross domestic saving rate. As a result, domestic consumption and investment has to be financed by remittance, net factor income from abroad, and FDI. While remittances have significantly increased between 2004 and 2017, both net factor from abroad and FDI have experienced some decline, in particular FDI. FDI to RMI has been hampered by a weak business environment, compounded by RMI's limited physical and digital connectivity.

The building blocks of RMI's integrated national financing framework

The methodology of the Development Finance Assessment is intended to support the development of a more integrated approach to raising and allocating finance in support of national development ambitions. To this end, findings and recommendations are structured around a conceptual integrated national financing framework (INFF), which is made up of six blocks.

RMI has already explicitly or implicitly put in place all six blocks of the INFF. However, there is scope for RMI to strengthen all six building blocks of the system. Establishing an INFF to mobilize all sources of financial resources (public and private, domestic and external) and to support the implementation of complex, cross-sector strategies, remains a challenge for RMI. The figure below maps existing structures and processes in RMI to the INFF blocks.

RMI's Integrated National Financing Framework



Source: DFA.

The key findings from the DFA on the progress of RMI in relation to the INFF blocks are:

- **Block 1: Leadership and institutional coherence.** RMI has made a commitment to sustainable development and has already integrated the principle of sustainable development into its national development strategies and plans. Currently, it is aiming to integrate key SDG targets and indicators into its forthcoming revised National Strategic Plan.

The main leadership and institutions governing financing for achieving national development goals and the SDGs include the Parliament (Nitijela), the President and Cabinet, the Office of Chief Secretary, the Ministry of Finance (MOF), the Auditor General, and line ministries.

A number of check-and-balance and coordinating mechanisms have been established to ensure institutional coherence. Coordinating mechanisms include specialized committees, task forces, steering groups and specialized advisory groups or similar entities, tasked with coordinating economic and financial decision-making.

However, the DFA recommendations identify a number of practical ways in which these coordinating efforts can be further strengthened to improve development results.

- **Block 2: Vision for results.** RMI has put in place both a long-term and medium-term national planning framework. The long-term (Vision 2018), medium-term development strategy and plan (NSP) and action plans (RMI Agenda 2020) serve as the composite vision for achieving results for financing development in RMI.

While the majority of the issues addressed in Vision 2018 are still relevant today, RMI is facing new challenges, including the coming expiry of the Compact Agreement by 2023 and how to finance

the SDGs. The RMI government has recognized that a new national Vision may have to be developed, at least for the period after 2023, to address the new challenges RMI is and will be facing in the next 10 to 20 years.

- **Block 3: Overarching financing strategy.** RMI's overarching financing vision is of a "resilient, productive and self-supportive RMI" laid out in Vision 2018 and the National Strategic Plan. However, RMI does not have a set of concrete long-term social and economic targets, which are conducive to this vision, and without such a set of targets, it is lacking an explicit long-term fiscal policy focusing on financing activities towards achieving the vision.

The Medium Term Budget and Investment Framework (MTBIF) has played a central role in providing overarching operational guidance for the government of RMI to mobilize all forms of public financial flows in the medium term. However, the MTBIF has not been fully utilized, due to the lack of local capacity to operate it.

- **Block 4: Financing policies for specific flows.** RMI has put in place a legal framework for public financial management and budgeting, which are supported by a set of complementary financial regulations, instructions and manuals of standard operating procedures.

RMI has also put in place a number of policies, although in many cases not explicit enough, governing the mobilization and use of different types of finance, including tax and customs revenue policies, expenditure policies, agreements and policies governing the Compact Grants, and investment policy for both domestic and foreign investment. The assessment has, however, identified a number of issues with the policies governing some of the major financial flows, including:

Tax revenue: The current tax and customs system is generally considered to be outdated and inefficient, with a narrow tax base and low compliance. Tax reform has been proposed since 2009. However, the draft tax bills are still pending with Parliament for review.

Non-tax revenue: Although non-tax revenue accounts for a significant proportion of public finance, there is no policy on how to best utilize non-tax revenue and on how to make non-tax revenue income sustainable.

Development assistance: RMI does not have a development assistance policy covering all form of development assistance flows. The development assistance dialogue platform has not been formalized.

Foreign Direct Investment (FDI). FDI in RMI has been hindered by a weak business environment, including both a weak policy and regulatory environment and weak physical infrastructure. RMI does not have a strategic framework for FDI promotion.

Public expenditure. RMI's current budget strategy does not fully align with its national development strategy. Public expenditure focuses on recurrent operating expenditure rather than capital expenditure, and on social expenditure, including health and education, rather than economic and infrastructure expenditure; has no fiscal buffer for disasters and post-2023 transition; and subsidizes chronically loss-making SOEs.

External debt. Currently, RMI does not have a national debt management policy, and does not have a centralized debt management unit responsible for implementing the national debt policy.

- **Block 5: Robust and efficient monitoring, evaluation and learning systems.** RMI has a two-tiered monitoring and evaluation (M&E) system, with the NSP Core Indicator Matrix representing the overarching M&E framework used in RMI to monitor and evaluate programme or intervention progress, outcome and impacts against intended development objectives.

However, still missing from the framework are a set of targets and baseline values for all the indicators to monitor the government's efforts in mobilizing necessary resources, and the outputs and impacts to which those financial flows contribute. Regular updating of this matrix is needed to track progress towards national development targets.

- **Block 6: An enabling environment for accountability and dialogue.** In RMI, accountability and dialogue have been facilitated mainly through dialogue between government and the general public, government and private sector participants, and government and development partners. However, effective accountability and dialogue has been hampered by limited disclosure of reliable information and insufficient coordination.

Public finance management

Public finance management, the process through which the government of RMI raises funds from domestic and foreign sources and allocates the funds for economically and socially productive investments, will be critical for RMI to achieve its national development goals and the SDGs, especially after the expiry of the Compact Grants in 2023. However, due to its small and less diversified economy, with a narrower resource base and relatively limited types of economic activities, RMI has particular constraints in domestic resource mobilization.

This assessment has found that RMI's public revenue has been rising gradually since 2004. While foreign aid, in particular Compact Grants, represents the most important source of RMI's public finance, the increase in public revenue is mainly driven by the increase in non-tax revenue. As a result of the increase in domestically collected public revenue, RMI have improved its ability to finance its own expenditure.

However, the **allocation of public finance does not fully align with national development objectives**, in that RMI's allocation of public expenditure focuses mainly on current and recurrent government expenditure and focuses less on capital expenditure. Meanwhile, the share of capital expenditure in public expenditure has been declining. **The quality of public finance management system is weak. There are a number of sources of inefficiency in RMI's public expenditure**, including the ever-increasing subsidies to loss-making SOEs and increased spending on an inefficient public sector, which are not conducive to sustainable development.

Recommendations and roadmap of key actions for developing the current system to address sustainable development challenges

This DFA has identified several opportunities for improving the development of main financial flows and for managing them to support RMI to achieve its national development goals and the SDGs.

Most of these opportunities are related to improvements to the implicit integrated national financing framework that governs each financial flow as well as the overarching financing policy. Some of the main opportunities include: developing a long-term development strategy for achieving the SDGs and facilitating RMI's transition to a self-reliant economy that is sustainable, improving the public finance management system, improving SOE performance and reducing subsidies to SOEs through SOE reform, and transforming the economy that is currently led by the public sector to a private-sector-led "blue economy", i.e. an economy based on sustainable use of marine resources. As RMI is also facing the challenges of post-2023 transition, it will be critical to safeguard the value of the Compact Trust Fund, the investment return from which is expected to replace the Compact Grant post-2023, and to manage fiscal stability issues associated with market volatility.

RMI's National Strategic Plan and the Agenda 2020 have already identified many of the steps that could improve resource utilization and development performance. The main message from this assessment is to recommend their prioritization. The summary of the main actions recommended in the assessment is presented in the table below.

Key action areas identified

Recommendations		Key activities
To ensure leadership and institutional coherence	1.1	To establish a strong champion both in terms of individual and institutional leadership in driving forward policy initiatives for national development and the SDGs.
	1.2	To strengthen RMI's policy coordination mechanisms in both policy setting and policy implementation
	1.3	To establish an effective M&E system and an effective results-based public sector performance management system.
To develop a new long-term development strategy and update the medium-term NSP to establish a new vision for the result	2.1	To establish a new long-term development strategy and update the medium-term NSP, taking into account the current social, economic and environmental challenges facing RMI and integrating SDG targets and indicators.
	2.2	To include the cost estimations for achieving development goals, consider the affordability and financial resources needed to achieve the development goals, and prioritize the implementation of these development goals in the newly updated development visions and strategic plans.
	2.3	To develop sector strategies that integrate and operationalize the targets and goals proposed in national development visions and strategic plans.
	2.4	To develop an industrial transformation strategy with the objective: <ul style="list-style-type: none"> To transform RMI from a service-based and public-sector-driven economy into an economy led by the "blue" and private sector To reposition RMI's economy on a market segment with global comparative advantage, taking advantage of emerging "blue economy" activities

Recommendations		Key activities
To establish an overarching financing strategy	3.1	To develop an overall financing strategy with clearly articulated goals, targets and priority development programmes, as well as the potential role of different actors in contributing to specific development priorities
	3.2	To strengthen macroeconomic modelling capacity to improve public revenue forecast capacity and to fully utilize the functions of MTBIF.
	3.3	To strengthen the capacity of line ministries to cost policies and to develop integrated sector strategies that are clearly linked to the national MTBIF.
To implement public finance management reform and to improve the quality of public finance management	4.1	<p>To reform the tax system and enhance tax administration, including:</p> <ul style="list-style-type: none"> • To review, update if necessary, approve and implement the proposed tax reforms as soon as possible • To develop for each tax stream the supplementary guidelines, standard of procedures and other key documents, consistent with international best practices and standards. • To enhance tax and customs administration • To improve tax and customs administration capacity through automating the tax and customs administration system
	4.2	To develop a policy on how to best utilize non-tax revenue and balance the needs for current public expenditure, public expenditure post-2023.
	4.3	<p>To prioritize financing for infrastructure investment and economic activities towards growing a self-reliant economy:</p> <ul style="list-style-type: none"> • Ensuring the allocation of public expenditure to be guided by a comprehensive and coherent financing policy, and to be aligned with the national development priorities • Considering leveraging public finance for the involvement of private sector for infrastructure investment • Promoting the delivery of public services by the private sector and improving public sector efficiency
To safeguard the value of CTF and to manage the fiscal instability associated with the volatility	5.1	<p>This will involve:</p> <ul style="list-style-type: none"> • Setting up an appropriate investment strategy for CTF investment • Setting up rules and regulations, and procedures for drawing-out investment returns • Setting up a mechanism to deal with the volatility of investment returns arising from market volatility • Exploring the feasibility and mechanisms for attracting contributions from beyond the United States, Taiwan Province of China, RMI and CTF investment • Exploring the feasibility of utilizing CTF as a buffer for macroeconomic stability and for large domestic infrastructure projects
To promote market-oriented SOE reforms	6.1	<p>This will involve:</p> <ul style="list-style-type: none"> • Developing a comprehensive economy-wide SOE reform strategy • Building up the mandates for SOE reforms, establish task forces to champion the SOEs reforms • Prioritizing reforms to those SOEs that pose the highest fiscal risk over the short to medium term • Selecting the most feasible and appropriate forms of reform (including corporatization, separating social and economic responsibilities, partial or full privatization, and public-private partnerships (PPPs)) • Implementing SOE reform • Establishing appropriate state asset management mechanisms and appropriate corporate governance mechanism for SOEs • Accompanying SOE reforms with market liberalization, such as price reform, opening the markets formerly dominated by SOEs, encouraging the entry of private sector players, and generating competition • Developing an appropriate policy and regulatory framework to ensure fair competition

Recommendations		Key activities
To develop robust and efficient monitoring, evaluation and learning systems	7.1	To develop an M&E system, incorporating SDG targets and indicators with: <ul style="list-style-type: none"> • Clearly defined roles and responsibilities of various agencies • A proper feedback and lesson learning mechanism • An information disseminating mechanism
	7.2	To conduct a data mapping exercise to: <ul style="list-style-type: none"> • Identify the current available data sources and institutional setting and identify any data and institutional gaps for establishing baselines and monitoring national development
	7.3	To develop a strategy to address the gaps and to ensure the implementation of monitoring and evaluation based on the Core Indicator Matrix at both the national level and the linked sector level
To develop an enabling environment for accountability and dialogue	8.1	To strengthen accountability mechanisms that support transparent and open dialogue between government, private sector and the voluntary sector, through: <ul style="list-style-type: none"> • Transparent and credible information dissemination • Participatory and inclusive decision-making, policy dialogue, effective M&E and lesson learning, effective reviews and independent audits.

Source: DFA team

The actions listed above may require systemic reforms and involve a wide variety of areas, from public administration to good governance and the strengthening of the management capacity of the central government and line ministries.

Implementing them all at once will be a big challenge for RMI. Therefore, the government should consider the prioritization of these policy areas and develop a realistic roadmap of interventions based on the outcomes of this assessment and other government priorities. The implementation of the prioritized agenda will require leadership and coordination from the highest levels of the government.



1. Introduction

1.1 Overview

The Republic of the Marshall Islands is a Pacific Small Island Developing State, located in the tropics of the North Pacific Ocean, and is one of the world's smallest, most isolated and vulnerable nations. It has 1,225 islands and islets grouped in 29 coral atolls, with a total land area of 180 km² and an exclusive economic zone extending to some 2 million km². Of its land area, 43.8 percent is low lying area with an elevation under 5 metres, which makes RMI more vulnerable to the impacts of climate changes, such as rising sea level, high tides, storm surges, tsunamis, coastal erosion, pollution of the marine environment, ecosystem degradation and food security problems.

Figure 1: Map of the Marshall Islands



Source: UNOCHA Pacific

Disclaimer: The designations employed and the presentation of material on this map do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations or UNDP concerning the legal status of any country, territory, city or area or its authorities, or concerning the delimitation of its frontiers or boundaries.

RMI had an estimated population of 52,993 in 2015.¹ The majority (74 percent according to the 2011 RMI Census²) reside in two main urban centres, Majuro and Ebeye. This high level of urbanization has put pressure on land use and the provision of basic social services such as clean water and sanitation, housing and health facilities. Ebeye, in particular, with a land area of 0.36 km² and a population of about 15,000,³ is one of the world's most densely populated areas, which brings significant social and economic challenges to the government.

RMI is also a young nation, with young people aged below 25 accounting for 53 percent of its population,⁴ posing a big policy challenge for the government in generating enough employment opportunities for young people entering the job market.

Politically, the Republic of the Marshall Islands is a sovereign nation that has agreed a “Compact of Free Association” with the United States. The first Compact of Free Association was signed in 1983 and continued in force through 2003. The second Compact of Free Association, as Amended, entered into force on 1 May 2004, and is in effect through 2023. Under the Compact of Free Association agreement,⁵ which provides a reciprocal obligatory relationship between RMI and the United States:

- The United States has full authority and responsibility for security and defence of the Marshall Islands.
- The United States is allowed use of parts of the lagoon and several islands on Kwajalein Atoll, and continued use of the US Army Kwajalein Atoll missile test range until 2066, with an option until 2086.
- The United States provides the Marshall Islands with approximately \$70 million of assistance annually through FY2023, including contributions to a jointly managed Compact Trust Fund (CTF) and financial assistance from other US federal grants.
- Marshallese citizens are allowed to work and study in the United States without a visa, and serve in the US military, and are allowed to access many US programmes and services.

The Republic of the Marshall Islands is a self-governing democracy. Its legislative body consists of a 33-member Nitijela (Parliament), who elects the President by majority vote. From the Nitijela, the President appoints their 10-member Cabinet. Additionally, an 11-member Council of Iroij (Chiefs) presides over traditional and customary matters.

1 World Bank Development Indicators, 2017.

2 EPPSO (2012). The RMI 2011 Census of Population and Housing: Summary and Highlights Only, available at: <https://www.doi.gov/sites/doi.gov/files/migrated/oia/reports/upload/RMI-2011-Census-Summary-Report-on-Population-and-Housing.pdf>

3 Smith, O. (2017). The world's 10 most overcrowded islands. The Telegraph. Available at: <https://www.telegraph.co.uk/travel/lists/most-overcrowded-islands-in-the-world/>

4 CIA (2017). the World Factbook, available at: <https://www.cia.gov/library/publications/the-world-factbook/fields/2010.html>

5 Compact of Free Association Agreement, available at: <https://www.state.gov/documents/organization/173999.pdf>

The Republic of the Marshall Islands has a relatively high level of economic development. It has been classified by the World Bank as an upper-middle income country.⁶ In 2016, its GDP was estimated at US\$194.5 million, and GDP per capita at US\$3,592.⁷

However, RMI's performance in social development has fallen short of expectations. During the period of the Millennium Development Goals (MDGs), it only achieved two of seven MDGs between 2000 and 2015 – Millennium Development Goal 4 of reducing child mortality and Millennium Development Goal 5 of improving maternal health.

Despite progress in development, poverty persists – especially on the outer islands. According to the 2011 Census and the newly defined national poverty line,⁸ 37 percent of the RMI population lives in poverty,⁹ among the highest in the Pacific region. On the outer islands, this figure is even higher, with 60 percent of the outer island population living in poverty.

RMI has a limited range of natural resources and a narrow production base, with the economy based on two major sectors: an agriculture sector, including activities such as fishing, farming (banana, pandanus, taro and breadfruit), and a modern service sector focusing on banking, wholesale and retail. Handicrafts and copra production are important sources of income for the outer islands of the Marshall Islands. In 2016, the service sector accounted for 70 percent of its GDP, while agriculture and industry accounted for 16 percent and 14 percent respectively.¹⁰

Like many Pacific Island States, **trade plays a major role in the economy given the limited domestic markets and production,**¹¹ in particular RMI relies on imports for food, consumer goods, machinery and petroleum products. In 2016, RMI's exports were the equivalent of US\$53.6 million, or 27.6 percent of its GDP; imports were US\$163.2 million, or 83.9 percent of its GDP.¹²

Table 1: Main social and economic indicators

Main indicators	Main indicators
Population in 2016	54,153
Land Areas (km ²)	180
% of land areas with elevation under 5m	43.8
GDP (Current US\$ million) in 2016	194.5
GDP per capita (US\$) in 2016	3,592
Export (Current US\$ million) in 2016	53.6
Export (% of GDP) in 2016	27.6

6 See <https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups>

7 RMI Economic Statistics (2016). Available at: http://www.pitiviti.org/news/wp-content/uploads/downloads/2017/08/RMI_EconStat_tabs_FY16_Pub2.pdf

8 In the past, the US poverty line was used rather than a national poverty line in a domestic and Pacific region context.

9 Please note that this figure is based on ADB's report, *Assessing Vulnerability in the Marshall Islands*. However, this report has not been endorsed by the RMI Government.

10 EPPSO (2016). Fiscal Year Economic Review 2015.

11 World Development Indicators.

12 ADB Key Indicators (2017).

Main indicators	Main indicators
Import (Current US\$ million) in 2016	163.2
Import (% of GDP) in 2016	83.9
Poverty rate (% of population under National Poverty Line) in 2011	37
DBR ranking in 2018	149 th of 190

Sources: EPPSO Economic Statistics 2016, WDI 2017, DBR 2018 and ADB Key Indicators compiled by the DFA team.

RMI's public finance relies heavily on external aid. Financial assistance from the United States under the Compact of Free Association and financial assistance from other US federal grants have provided for more than 50 percent of RMI's public expenditure. However, the financial assistance under the Compact of Free Association will come to an end by 2023. The resulted fiscal gap will have to be met by the investment returns from the Compact Trust Fund (see section 6), complemented by generating extra domestic revenue.

Given the coming expiration of the Compact Grants, **RMI faces the challenge of developing a self-reliant economy.** However, **the growth of the domestic economy, in particular private sector development, is only modest**, due to its small size, remoteness from major traffic routes and markets, dispersion over a vast ocean area, and weaknesses in the business environment.

At the same time, RMI, along with other Pacific Island countries, **is at the forefront in facing the impacts of global climate change.** These include rising sea levels, more frequent floods, and extreme and unpredictable weather events such as droughts. It also faces the unsustainable exploitation of marine resources, and the environmental impact of urbanization, together with the changing disease patterns associated with climate change, all of which can undermine people's quality of life.

1.2 Purpose and objectives of Development Finance Assessment

The primary purpose of all Development Finance Assessments (DFAs) is to assist governments in establishing an integrated approach to make the best possible use of available resources for the achievement of their development visions and objectives, in the context of the Sustainable Development Goals. The DFA, therefore, serves as a comprehensive tool to map past, current and future sources of development finance, reviewing a broad range of development finance flows from domestic and external, public and private sources as shown in Figure 2 below.

The specific objectives of this assessment include:

- To provide a snapshot assessment of the financing landscape in RMI and the challenges and opportunities it presents for achieving the objectives of the National Strategic Plan, focusing particularly on post-Compact scenarios and opportunities.
- To assess the institutional structures and strategies that the government has in place for mobilizing and channelling finance to contribute to the goals of the National Strategic Plan, using the INFF concept.

- To assess policy options in specific areas, such as private sector development, customs and tax system reform, public finance management reform, and emerging partnership opportunities, for leveraging the post-Compact transition.
- Building on these assessments, to develop recommendations for consideration by senior government policymakers, and to develop possible next steps for the roadmap towards and after 2023.

This assessment will examine the financing flows and financing framework that RMI has in place or is developing, using the concept of the INFF, with the objectives to develop an INFF for RMI. The scope of finance flows to be reviewed is shown in Figure 2. The conceptual framework of an INFF will be discussed in section 1.3.

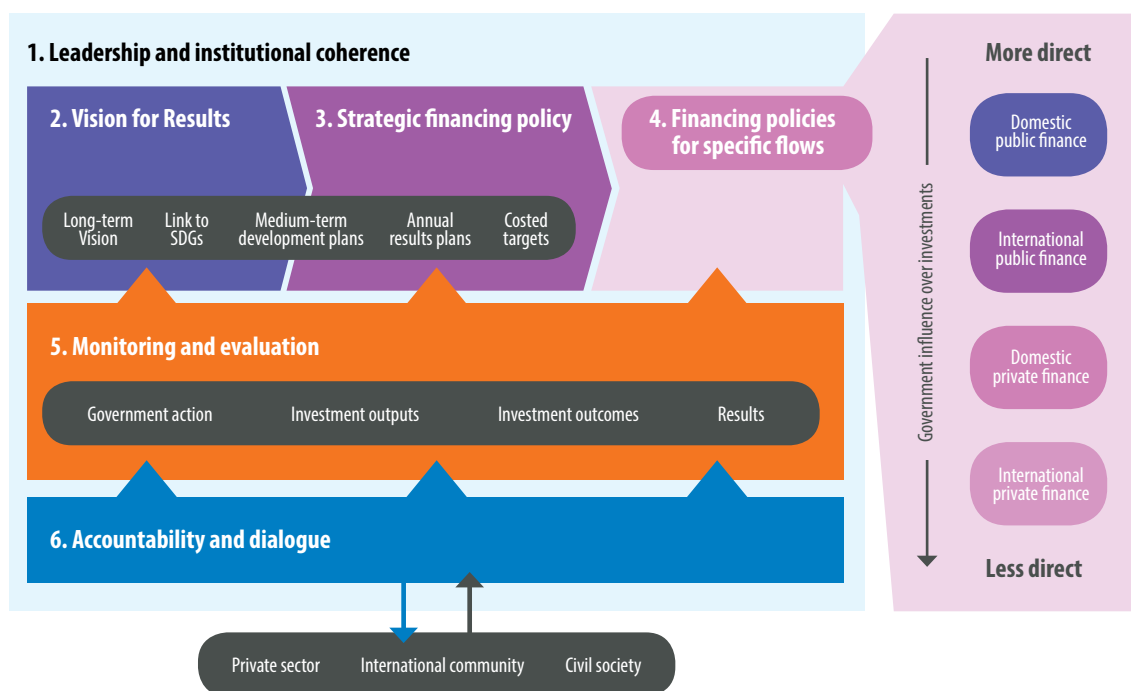
Figure 2: Scope of finance flows to be reviewed in the DFA

External	<ul style="list-style-type: none"> • ODA grants and loans • Public borrowing from K-markets • South–south and triangular cooperation • INGO donations (in-budget) • Vertical funds (GFATM and GAVI) • Other Official Flows (OOFs) 	<ul style="list-style-type: none"> • Foreign Direct Investment (FDI) • Overseas remittances • INGO donations (off-budget) • Private borrowing from K-markets
Domestic	<ul style="list-style-type: none"> • Tax revenues • Non-tax revenues • Public-private partnerships • Mineral-related taxation • Public domestic borrowing • Sovereign wealth funds 	<ul style="list-style-type: none"> • Private borrowing • Inclusive business finance • Domestic philanthropy and NGOs • CSR linked to development
	Public	Private

1.3 Conceptual framework for the Integrated National Financing Framework

An Integrated National Financing Framework (INFF) is a system of policies and institutional structures that can help governments to develop and deliver a strategic, holistic approach toward managing financing for nationally owned sustainable development strategies. It can help articulate a complex and holistic financing structure of private and public sources – both domestic and international. It provides insights on developing targeted, evidence-based policies, sound institutions to deliver them, and good governance at all levels. A DFA is a practical tool in helping governments develop an INFF.

Figure 3: Building blocks of an INFF



The INFF has the following six building blocks:

- **Leadership that facilitates strategic and institutional coherence.** Leadership that provides direction and facilitates institutional coherence is essential to bring a government together and establish mechanisms for aligning policy around a shared vision.
- **A clear vision for results.** A clear vision for the development path that a country wants to follow is the foundation of an efficient, results-driven financing framework.
- **A strategic financing policy.** Developing an overarching strategic financing policy that estimates costs and the scale and types of financing needed to achieve results can be a foundation for clearer objectives in relation to each type of finance.
- **Financing policies to mobilize each type of finance.** Building on a strategic financing policy, policies for each type of financing can guide the way resources are mobilized and harnessed to achieve results.
- **A robust and efficient monitoring, evaluation and learning system.** A robust system for monitoring, evaluation and learning can ensure that financing policies are effectively managed to achieve desired results.
- **An enabling environment for accountability and dialogue.**

This assessment will examine the financing flows and financing framework that RMI has in place or is developing, using the concept of INFF, with the objectives to develop an integrated national financing framework for RMI.

1.4 Structure of the Report

This DFA was commissioned by the Government of the Marshall Islands with support from UNDP. The contents of the assessment are organized in the following sections:

- Section 1 is this introduction, presenting the background and structure of the report
- Section 2 outlines RMI's socio-economic context and key development challenges
- Section 3 looks at the development finance landscape in RMI
- Section 4 looks at the building blocks of RMI's existing INFF
- Section 5 examines how public finance and domestic finance are mobilized for development in RMI
- Section 6 focuses on analysing the Compact Trust Fund's current performance and future prospects
- Section 7 looks into the performance of state-owned enterprises in RMI
- Section 8 looks at promoting "blue growth" and private sector development
- Section 9 proposes a prospective framework to analyse the future development of finance flows, analysing the different processes that RMI will face in the near future
- Section 10 outlines the initial conclusions and the main actions emerging from the DFA Report
- Section 11 presents a roadmap for key actions



2. Social and economic context

As identified in Agenda 2020, an action plan put forward by the then newly elected government in 2017, RMI is facing a number of key challenges in realising overall development ambitions:

- Growing its economy;
- Preparing for the post-2023 Compact transition; Improving Majuro Hospital and basic health services;
- Supporting education, youth and vulnerable groups;
- Adapting to climate change and reducing disaster risks;
- Strengthening water, energy and food security;
- Improving the quality of life in Ebeye and other Kwajalein communities;
- Improving the welfare of outer islands communities;
- Tackling consumer debt and strengthening consumer protection; and
- Strengthening laws, justice, and public safety and management.

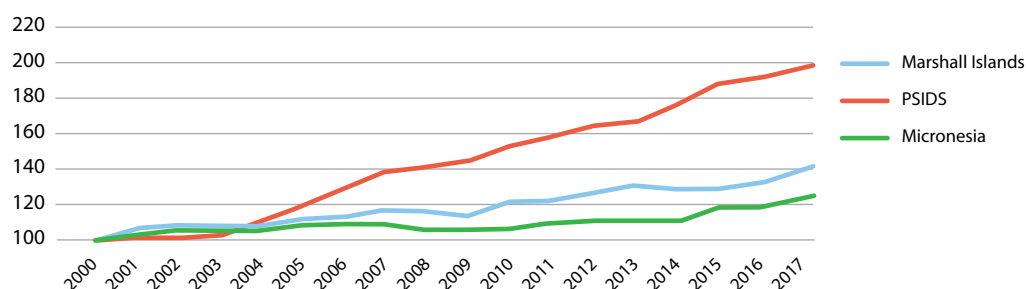
This section describes the social and economic situation in RMI, and puts the DFA analysis in context.

2.1 Economic performance

2.1.1 Modest economic growth

RMI's economic performance in the last two decades has been modest, although it is the fastest-growing economy among Micronesian countries (including the Federated States of Micronesia (FSM), Kiribati, the Marshall Islands, Nauru and Palau).¹³ Between 2000 and 2017, RMI's GDP has only increased by 34 percent, with an annual growth rate of 1.9 percent. For the same period, GDP in the Pacific Small Island States as a whole has increased by 93 percent, with an annual growth rate of 4 percent. However, RMI has performed relatively better than neighbours in the region – Kiribati, FSM and Palau, which had an annual GDP growth of 1.5 percent, 0.1 percent and 1.1 percent respectively.

13 The GDP growth data for Nauru is incomplete, so it is not included for comparison.

Figure 4: GDP trend in RMI, 2000–2017 (Index, 2000=100)

Source: WDI (2018) compiled by the DFA team.

This low growth rate can be attributed to a number of factors, including: (i) a small domestic market, remoteness from major markets, and a long distance from major transport hubs; (ii) limited resource endowments and an undiversified economy; (iii) underutilized human capital, (iv) low level of investment, and (iv) frequent natural disasters. These disadvantages are compounded by an unfavourable environment for enabling business (see section 2.1.5) and weak institutional capacities, which make it difficult for the private sector to do business in RMI. In fact, World Bank has classified the Marshall Islands as suffering from a fragile situation due to its limited public sector capacity.¹⁴ These same factors also create higher costs and complexity in providing public services. In 2015, health expenditure accounted for 22 percent of RMI's GDP, nearly four times the Pacific Island Small States average.¹⁵

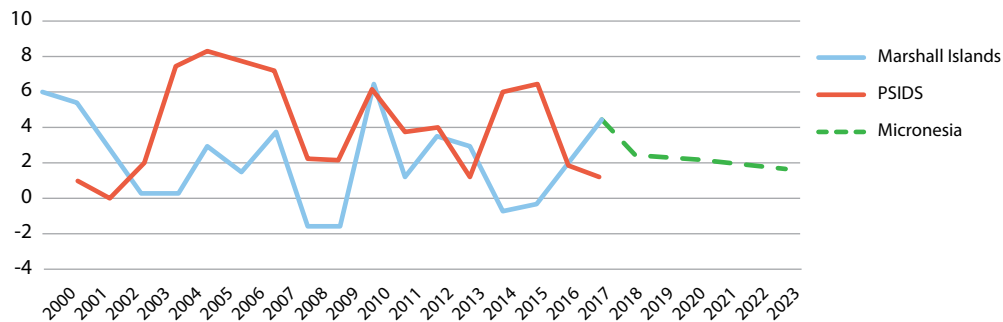
Growth in RMI is also volatile. For example, GDP growth rates in 2000 and 2010 were 5.6 percent and 6.4 percent respectively, while GDP declined by around -1.6 percent in 2008 and 2009. The high volatility is to a large degree due to the high dependence on a **limited number of economic sectors**, such as fishery and construction, and exposure to extreme weather events and external economic shocks. The high level of volatility in GDP leads to high volatility in domestic revenue.

The more recent growth trend is encouraging; however, the medium-term growth prospect is only modest, and the long-term growth prospect is uncertain. Figure 5 shows the economy has started to pick up since 2015, after five years of deceleration since 2010, and increased by 1.9 percent and 2.5 percent respectively in 2016 and 2017, mainly driven by infrastructure investment. However, **the growth prospect is only modest.** The IMF forecasts that annual GDP growth for the years up to 2023 will be less than 2.5 percent.¹⁶ Moreover, the expiry of the Compact Grant by 2023 could dampen growth prospects after 2023, as demonstrated by the extended period of contraction in the late 1990s resulting from the reduction in Compact Grants to fund government operations, which resulted in a 20 percent contraction in GDP in a period of 6 years.

14 World Bank (2017). Harmonized List of Fragile Situations FY18, available at: <http://pubdocs.worldbank.org/en/189701503418416651/FY18FCSLIST-Final-July-2017.pdf>

15 WDI (2018).

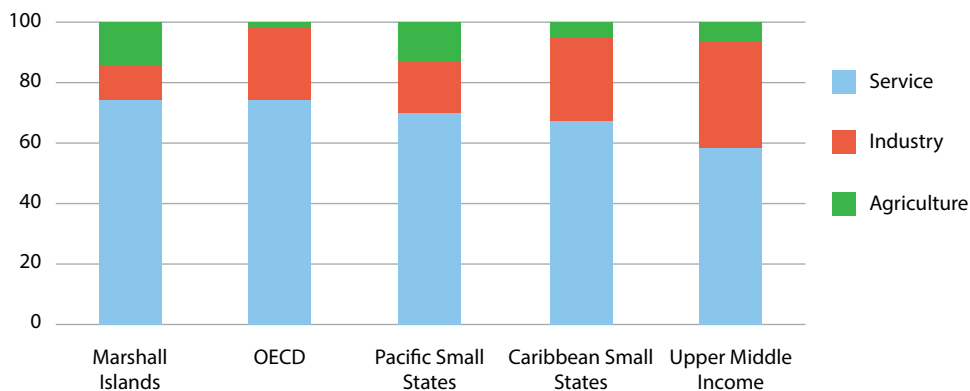
16 IMF (2016). Article IV Consultation Report; IMF (2018).

Figure 5: GDP trend in RMI, 2000–2023 (Index, 2000=100)

Sources: WDI, IMF Article IV, compiled by the DFA team.

2.1.2 A service-oriented economic structure

RMI has developed an economy with a high level of service components, a large proportion of agricultural production, in particular fishery, and a relatively small industrial sector.

Figure 6: Structure of RMI's economy (% of GDP), 2015

Note: The industrial structure data from WDI 2018 may have problems, so the 2015 data from WDI 2017 are used.

Sources: WDI (2017), RMI Economic Statistics 2016, compiled by the DFA team.

In 2015, the service sector accounted for 74.4 percent of RMI's GDP, which is similar to those of other Pacific Small Island countries and is on par with those of developed countries. The wholesale and retail trade sector leads the service sector, accounting for 13.8 percent of GDP in 2015, followed by the public-sector-dominated education sector (13.6% of GDP), public administration and defence (13.1% of GDP), and transportation and storage (10.1% of GDP)¹⁷.

Unlike some other Pacific Island States, such as Fiji, where tourism plays an important role in the service sector, **tourism in RMI is still at a nascent stage**. In 2015, receipts from international tourism only amounted to 3 percent of the GDP, compared with 24 percent of GDP in Fiji.¹⁸ Tourism has many

¹⁷ EPPSO (2016). Fiscal Year Economic Review 2015, Statistics.

¹⁸ World Development Indicators, 2017.

linkages with other economic sectors, and when properly managed can contribute to growth in other critically important sectors such as agriculture, fisheries, services and transportation. The tourism sector could also be a major sector for employment creation and in some Pacific Island Small States is already a major employer. In Fiji, tourism contributed to 35 percent of total employment directly and indirectly in 2015; in Vanuatu, the figure was 45 percent.¹⁹ The South Pacific Tourism Organization estimates that employment in tourism amounts to 18 percent and 15 percent of total employment in Samoa and Tonga respectively.²⁰

Agriculture is also an important economic sector in RMI. In 2017, the agriculture sector, including fisheries, contributed close to 16.5 percent of RMI's GDP. Fishery alone contributed 12.9 percent to RMI's GDP in 2017, and 6.3 percent of the total employment. Onshore and oceanic fishing industries also represent an important source of jobs and revenue for RMI, including revenues from the issuance of fishing licences to other countries. It is estimated that fishing fees accounted for nearly 27.5 percent of the government's revenue (including grants) in 2017, while the revenue from ship registry accounted for around 5 percent of RMI's public revenue.²¹ The agriculture sector can also have strong linkages with the rest of the economy, for example providing inputs for the light manufacturing industry such as food processing.

RMI has a weaker industry sector compared to other middle-income countries and other Pacific Island Small States. In 2015, RMI's industry sector accounted for 10.9 percent of its GDP,²² which is lower than the Pacific Island Small States average of 16.6 percent and the upper-middle-income country average of 34 percent. RMI has a particularly small mining and manufacturing sector, which accounted for only 1.8 percent of its GDP in 2017. The industrial sector is typically one of the main engines for economic growth. Manufacturing, in particular, can produce tradable goods, which can add value to domestically produced input materials, be exported globally, and satisfy local demands by replacing imported goods.

Economic activities in RMI are dominated by the public sector. The public sector, including public enterprises and government, contributed to 41 percent of the GDP and accounted for 48 percent of total employment in 2017.²³ However, the public sector could be more efficient and effective. At the same time, private sector development is limited. In 2017, the private sector (excluding private households that contributed around 20 percent of the GDP) contributed to 32 percent of the GDP, and accounted for 39 percent of total waged and salaried employment. Private businesses dominate in the sectors of wholesale/retail trade, general business service, commercial fisheries, construction, tourism and light manufacturing.

19 World Travel and Tourism Council (WTTTC) (2016), Economic Impact Reports, available at: <http://www.wttc.org/research/economic-research/economic-impact-analysis/>

20 World Bank (2017). Pacific Possible: Long-term Economic Opportunities and Challenges for Pacific Island Countries. Available at: <http://www.worldbank.org/en/country/pacificislands/brief/pacific-possible>

21 EPPSO (2016).

22 In 2017, industry, including manufacturing, electricity and water supply, and construction, contributed to 13.6 percent of GDP.

23 EPPSO Economic Statistics.

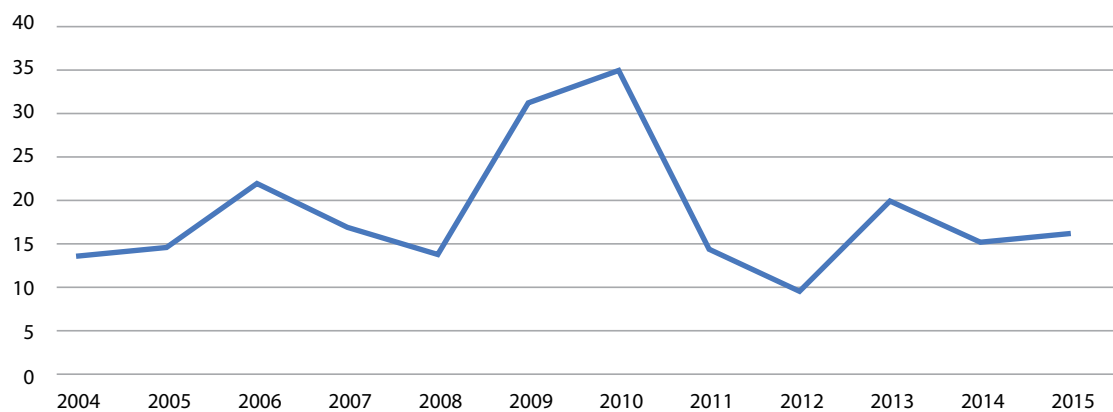
RMI's economy relies heavily on foreign aid, especially Compact Grants from the United States. In 2017, development assistance, including contribution to the Compact Trust Fund and Compact Kwajalein Impact payment, flowed to RMI totalled more than US\$100 million, equivalent to around 50 percent of its GDP. Development assistance to the government in the form of budget grants accounted for 44 percent of the government's total public revenue in 2017. **Foreign aid, in particular Compact Grants from the United States, provided financial assistance to the government for the expenditure on health, education and infrastructure.** However, Compact Grants will terminate by 2023.

2.1.3 Trade and investment

Promoting trade and investment, in particular promoting private sector investment, has been defined as a national objective in both Vision 2018 and the National Strategic Plan. Vision 2018 and the National Strategic Plan have recognized private sector development as the driving force for development in RMI and have identified creating a favourable investment climate as a strategy to promote the development of the private sector and to achieve its goal of self-reliance. Agenda 2020, put forward by the newly elected government, has also identified priority actions for promoting investment.

RMI's investment has been relatively low. Historically, RMI's investment level has fluctuated at around 15 percent of its GDP (see Figure 7), except in 2009 and 2010 when investments reached 31.4 percent and 35.1 percent of GDP respectively due to investment in undersea cable, aircraft and ships.²⁴

Figure 7: Investment (% of GDP), 2004–2015

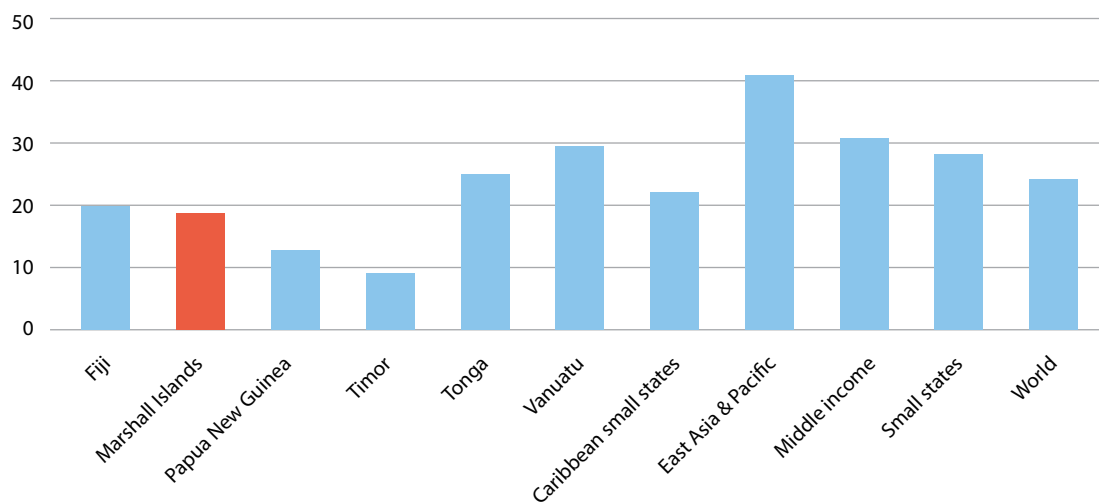


Source: ADB Key Indicators (2017).

Compared internationally (see Figure 8), RMI's average investment rate for the period between 2004 and 2015 is lower than the world average (24.3% of GDP) and the average of middle income countries (31.5% of GDP in 2014), much lower than the average in Asia and Pacific developing countries (40.7% of GDP in 2014), and is only higher than those in PNG (12.9% of GDP) and Timor-Leste (9.1% of GDP).

²⁴ EPPSO.

Figure 8: Average investment (% of GDP), 2004–2015

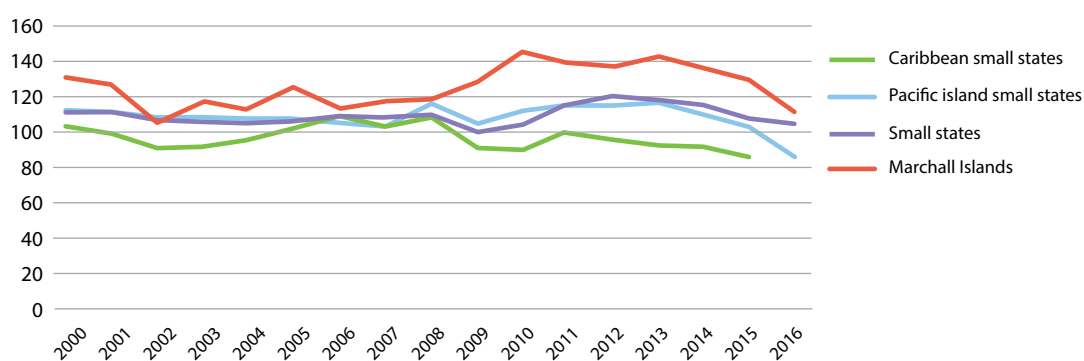


Sources: ADB Key Indicators (2017) and WDI (2017), compiled by DFA.

RMI has been more integrated into the world economy than many of its Pacific counterparts.

One measure of this integration is the trade openness indicator, measured as trade as a percentage of GDP. Between 2000 and 2016, RMI’s trade openness measure was consistently higher than the averages of Pacific Small Island States, Caribbean small states, and small states in general. In fact, between 2002 and 2013, trade openness in RMI increased from 105 percent of GDP in 2003 to 142 percent of GDP in 2013. However, in the past few years, RMI has witnessed a decline in this indicator, from 142 percent of GDP in 2013 to 111.5 percent of GDP in 2016.

Figure 9: Trade openness (Trade as % of GDP), 2000–2016



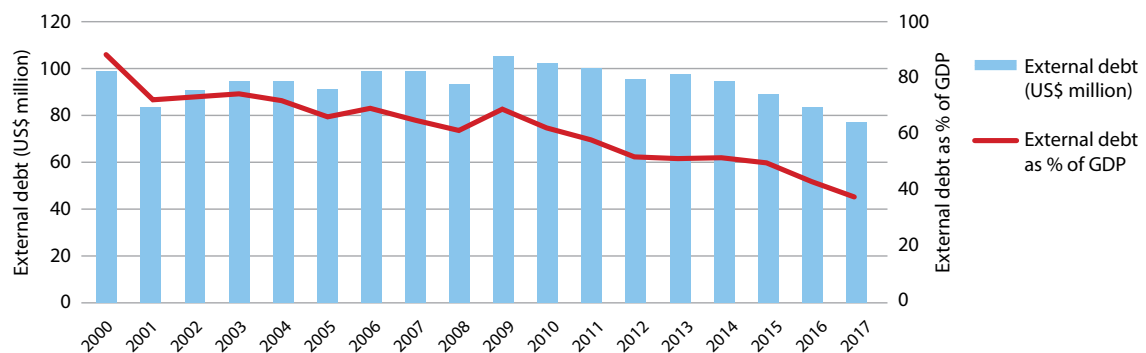
Sources: WDI (2018) and RMI Economics Statistics 2016.

RMI has been party to various regional multilateral trade agreements, including the Pacific Island Countries Trade Agreement (PICTA) and the South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA).

2.1.4 Macroeconomic stability

As a small country with a less diversified economy, at the forefront of climate change, and heavily relying on external financial assistance, RMI is susceptible to both climate-related shocks and economic shocks. During the past 10 years, RMI has maintained a relative stable economy through maintaining a balanced budget and putting on hold new external borrowing. The macroeconomic stability during this period has also been enabled through stable external funding and increased public revenue sourced from increased income from shipping registry fees and fishing licences. As a result, RMI's external debt level has been reduced from 88.6 percent of its GDP in 2000 to 37.5 percent of its GDP in 2017.

Figure 10: External debt position, 2000–2017



Source: RMI Economic Statistics (2017).

However, in the next 10 to 15 years, RMI will face the challenge of coping with the reduction in Compact Grants from the United States after 2023, volatility associated with Compact Trust Fund investment returns, climate change, and limited private sector growth. Consequently, the RMI government will have to maintain prudent monetary and public finance management, and ensure sustainable fiscal deficits and debt levels to maintain macroeconomic stability.

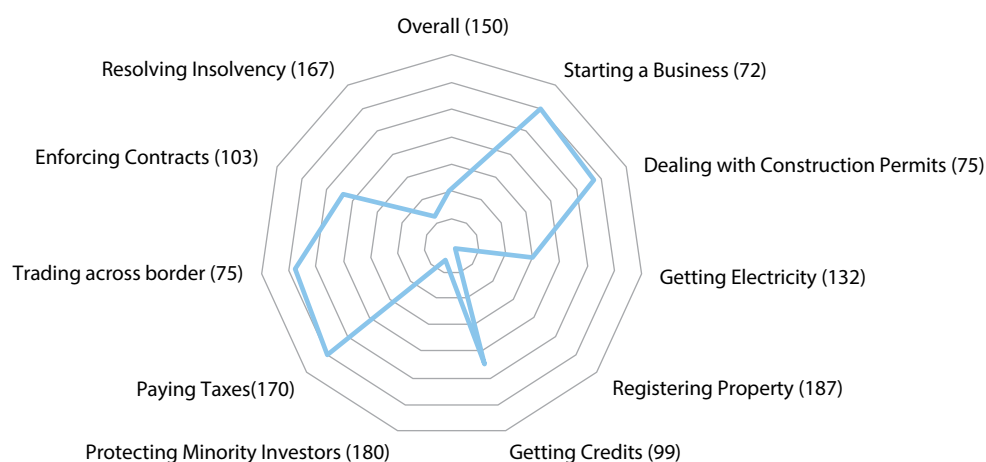
2.1.5 Business environment

Business environment is an interplay of policy, legal, institutional and regulatory conditions that govern business activities. Business environment impacts on economic development through affecting the cost of doing business (transaction costs) and consequently influencing the incentives of enterprise to invest, and affecting their survival and expansion thereafter. A good business environment enables entrepreneurs to start new businesses and expand their activities, and creates incentives for them to formalize their businesses, leading to higher levels of decent employment, trade, investment and growth.

RMI's business environment is challenging. According to IFC's Doing Business Report 2019, RMI ranked 150th out of 190 countries in the overall easiness of doing business ranking, which is below the average ranking of the Pacific Island countries and compares favourably only with the Federated States of Micronesia (158th), Kiribati (160th) and Timor-Leste (178th). Of the 10 dimensions measuring the ease of doing business (see Figure 11), registering property (187th), protecting minority investors (180th), and resolving insolvency (167th) are the three lowest ranking factors constraining RMI's easiness of doing business.

Figure 11: Rankings on Doing Business topics – RMI

(Scale: Rank 190 = centre, Rank 1 = outer edge)



Source: IFC Doing Business 2019.

Moreover, RMI's rankings in the Doing Business Report have been declining since 2012. Since 2011, RMI's Doing Business ranking has declined by 25 positions. According to World Bank's Doing Business Database, RMI has not implemented any business-enabling reforms since 2011.

2.2 Social development and environmental sustainability

RMI's performance in social development has been relative weak, with particular challenges associated with ensuring development gains are spread to remote outer islands. During the MDG period, it only achieved two of the seven Millennium Development Goals between 2000 and 2015 – Millennium Development Goal 4 of reducing child mortality and Millennium Development Goal 5 of improving maternal health – and is now facing the challenge of achieving the SDGs.

The proportion of people living in poverty is still high. According to RMI's 2011 census and the newly defined national poverty line, which is comparable across Pacific Islands States, the Marshall Islands has the second highest poverty rate among Pacific Island Small States. In 2011, 37 percent of the RMI population lives in poverty, second only to Timor-Leste. This figure is even higher for the outer islands, where 60 percent of the population lives in poverty.²⁵

²⁵ Marshall Islands Journal, "ADB report: Poverty rate high in Marshall Islands", 19 Aug 2016.

RMI still has to achieve the goal of achieving universal primary education. RMI has had mixed progress in achieving Millennium Development Goal 2 of achieving universal primary education. In recent years, both the net enrolment rate and completion rate in primary education have declined.²⁶

RMI has a high level of human capital development, yet human capital in RMI is underutilized.

RMI has a high literacy rate, with 92 percent of adults having at least some secondary education, higher than the average of those countries with very high levels of human development. 43 percent of the tertiary education aged population are enrolled in tertiary education. However, this human capital is underutilized, with 60 percent of the working age population economically inactive. Moreover, many of the most qualified choose to pursue employment opportunities overseas. RMI has made progress in achieving gender equality. It has achieved gender equality in education and has also increased women's participation in political life. The number of seats in parliament held by women has increased to three, accounting for 9 percent of the total seats. However, this is still short of the international target of 20 percent. Women's participation in the labour force is still low.

RMI has a low prevalence of HIV. However, RMI has witnessed a significant increase in TB incidence and prevalence. WHO considers the situation of TB in RMI severe. Furthermore, non-communicable diseases have become the leading health concern in RMI, with the percentage of population living with them among the highest in the world.

RMI is facing the challenge of environmental sustainability. As a small island country located in the middle of the Pacific Ocean, with 43.8 percent of its land area low lying with an elevation under 5 metres, RMI is vulnerable to the impacts of climate changes, such as rising sea level, high tides, storm surges and tsunamis. At the same time, RMI is also facing the challenges of coastal erosion, pollution of the marine environment, ecosystem degradation and food insecurity, resulting from both human activities and climate change.

Climate-change-related disasters have brought about significant losses to RMI people.

Between 1988 and 2008, 18 natural disasters affected around 12,700 people in the Marshall Islands. The estimated direct cost of these events was US\$317 million.²⁷ In the future, the Marshall Islands is expected to incur, on average over the long term, annual losses of US\$3 million due to earthquakes and tropical cyclones. In the next 50 years, RMI has a 50 percent chance of experiencing a loss exceeding US\$53 million, and a 10 percent chance of experiencing a loss exceeding US\$160 million.²⁸

RMI has made some progress in mainstreaming sustainable development principles and practices into planning and development processes. RMI has built environmental sustainability into its long-term development plan – Vision 2018 – and has developed a National Climate Change Policy Framework, a Joint National Action Plan for Climate Change Adaptation & Disaster Risk Management and a National Conservation Area Plan.

RMI has a high level of access to improved drinking water sources; however, water quantity and quality are big concerns for some areas. By 2015, 95 percent of the national population is estimated to have secured access to improved drinking water sources. However, there are serious concerns over water quantity and quality, especially in Ebeye. In 2014, only 78 percent of households

²⁶ WDI (2018) and Pacific Regional MDG Tracking Report (2015).

²⁷ PCRAFI (2015). Disaster Risk Financing and Insurance, Country Profile, Marshall Islands.

²⁸ Ibid.

in Ebeye were connected to the freshwater distribution system, and each individual on average could only access up to 26 litres of fresh water per day.²⁹

Access to clean sanitation is also an issue, especially in rural areas and in Ebeye. In 2015, there was still 23 percent of population without access to improved sanitation facilities and 44 percent of the rural population without access.³⁰ None of the sewage in Ebeye is treated to the minimum treatment standards.

29 ADB (2015). Ebeye Water Supply and Sanitation Project: Final Report, available at: <https://www.adb.org/projects/documents/ebeye-water-supply-and-sanitation-project-final-report-tacr>

30 World Development Indicators 2017.



3. Development finance landscape in RMI

To achieve the SDG ambitions by 2030, countries face significant challenges to mobilize the necessary finance. This is particularly true for RMI, a small island middle-income developing economy at the forefront of climate change, facing significant challenges of sustainable development.

It is estimated that **a total of US\$1.4 trillion incremental financing is needed annually across all low-income and lower-middle income countries to achieve the SDGs by 2030. However, no national estimates are available for RMI.**

RMI's current and future financial resources available to meet RMI's financial demand for achieving its development goals and the SDG goals will come broadly from four sources:

- Domestic-public: tax revenues and non-tax revenue.
- Domestic-private: domestic gross saving, together with remittance and net factor transfers from abroad, which are then mobilized for consumption and investment.
- International-private: remittance, net factor income from abroad, FDI and portfolio investment, and philanthropic giving.
- International public: ODA (Official Development Assistance), OOF (Other Official Flows), South–South Cooperation, Compact Trust Fund investment income, and loans from external public entities.

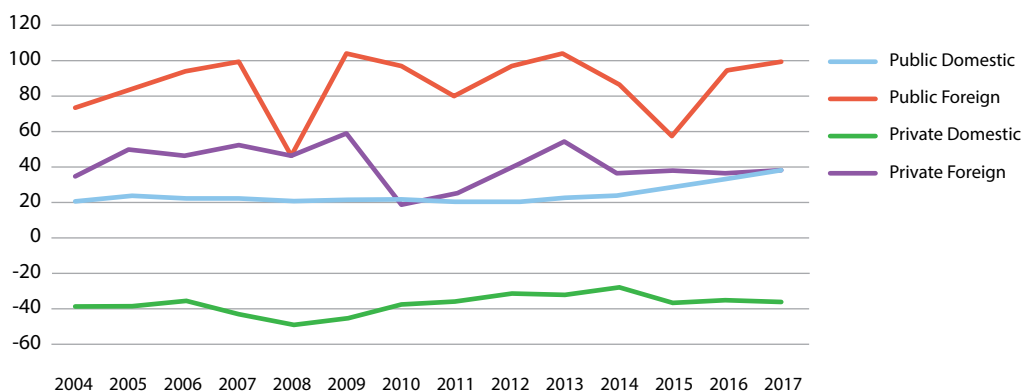
Figure 12 shows the landscape of development finance in RMI. The development finance landscape in RMI has shown the following characteristics:

- Financial flows from abroad account for the majority of development finance in RMI.
- As a share of GDP, the levels of public finance from foreign sources have remained relatively stable at around 90 percent of GDP.
- Private finance from external sources has only declined slightly. In 2017, private finance from foreign sources added up to 36.4 percent of GDP.
- At the same time, the level of domestic finance flows from public sources, measured as a share of GDP, has been increasing from around 20 percent in 2004 to 38 percent in 2017. This increase is

mainly driven by the rapid increase of non-tax revenue in recent years, in particular the rapid increase in fishing licence fees.

- RMI has a very low saving rate. In fact, gross domestic saving is still negative, suggesting that domestic consumption is greater than gross domestic production and has to be financed by external financial sources.

Figure 12: Development finance in RMI (% of GDP), 2004–2017

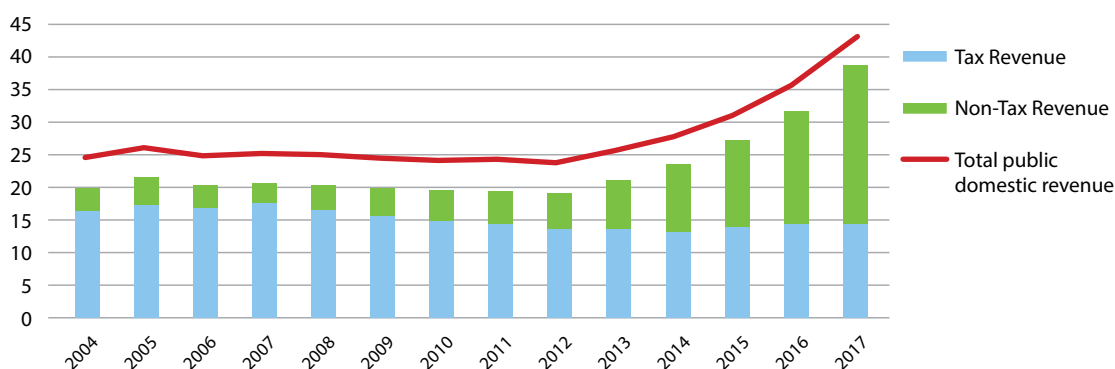


Sources: ADB Key Indicators (2017), WDI and EPPSO.

3.1 Public domestic sources

RMI’s public domestic revenue comprises of tax revenue and non-tax revenue. RMI’s public domestic revenue has increased from around 20 to 22 percent of GDP in the early 2000s to 38.6 percent in 2017. This increase is mainly due to the increase in non-tax revenue. Between 2004 and 2017, non-tax revenue increased from 3.6 percent of GDP in 2004 to 24.3 percent of GDP in 2017, while tax revenue declined from 18.2 percent of GDP in 2003 to 13.1 percent of GDP in 2014, and gradually recovered to 14.3 percent of GDP in 2017 (see Figure 13).

Figure 13: Domestic public income (% of GDP), 2004–2017



Sources: ADB Key Indicators (2017) and EPPSO (2017).

3.1.1 Tax revenue

RMI's tax revenues can broadly be divided into the following tax categories: income tax, capital tax, consumption tax, and custom and excise. Table 2 shows the current taxes and tax rates in RMI. A number of persons, entities and businesses are exempt from these taxes, including the RMI government, public utility companies, state-owned air transport services, the state-owned copra processing corporation and non-resident domestic businesses.³¹

Table 2: Taxes in the Republic of the Marshall Islands

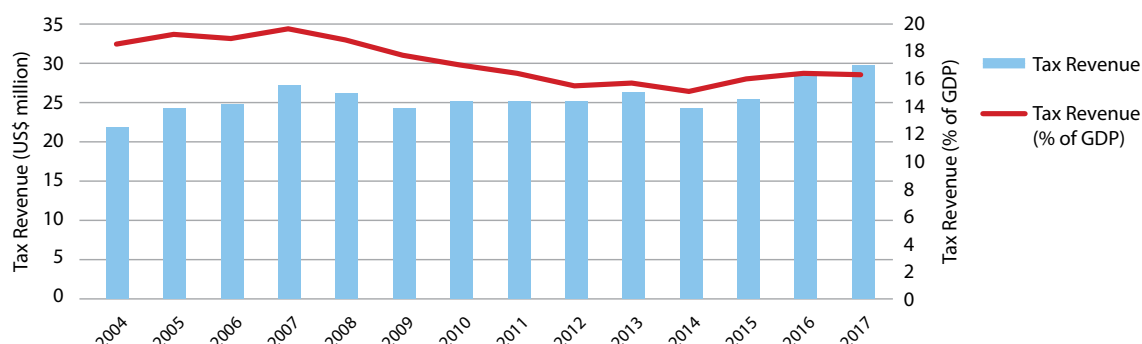
Categories	Tax in RMI	Tax rate	Income in 2017 (US\$ million)
Income tax	Wages and salaries tax	8% upon first \$10,400 and 12% for any amount over. Exemptions given for the first \$1,560 of income for those earning no more than \$5,200.	14.78
	Non-resident gross income tax	10% on the gross income earned by non-resident.	
	Social responsibility contribution	8% to the Marshall Islands Social Security Administration, and 3.5% to health fund	
Capital tax	Immovable property tax	3% on gross income or rent from property leased	0.68
Gross revenue tax (GRT)	Gross revenue tax (GRT)	\$80 tax on amount not exceeding \$10,000 per year; and 3% on gross revenue exceeding that	5.69
Consumption tax	Hotel and resort tax	8% on daily room rate on hotel and resort facilities	
	Local government sales tax	General sales tax on goods at 4% in Majuro local government; sales tax of 10% at the wholesale level in Kwajalein Atoll local government.	
Custom and excise	Import duties	8% on most imported goods, with a lower rate of 5% on foodstuff. A selected number of goods (including cars, tobacco products, and alcoholic and carbonated beverages) are subject to an excise tax levied at ad valorem or specific rates that range from 2% to 150%.	6.52
	Fuel tax	Tax on gasoline is at 25 cents per gallon; diesel at 8 cents per gallon	0.61
	CMI Tax		1.33

Sources: MoF, EPPSO and IMF (2008).

RMI's tax revenue has stagnated in recent years. After a relatively rapid increase from US\$21.8 million in 2004 to US\$27.2 million in 2007, RMI's tax revenue stagnated at around US\$25 million up to 2015. In 2017, tax revenue increased to US\$29.7 million. As a percentage of GDP, after a gradual increase from 16.7 percent of GDP in 2004 to 18 percent of GDP in 2007 (see Figure 14), RMI's tax revenue declined to 13.3 percent of GDP in 2013, and has stabilized around 14.1 percent of GDP in 2015 and 14.3 percent in 2017.

31 Income Tax Act 1989, available at: http://rmi-parliament.org/cms/images/LEGISLATION/PRINCIPAL/1989/1989-0050/IncomeTaxAct1989_1.pdf

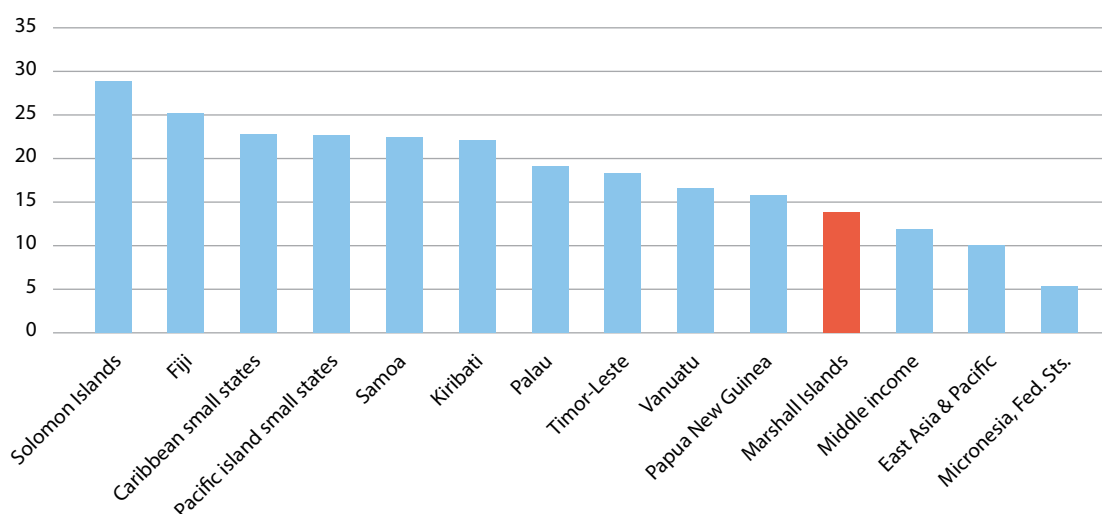
Figure 14: Tax revenue, 2004–2017



Source: Compiled based on EPPSO.

Compared internationally, **RMI’s tax revenue to GDP ratio (or tax burden) is relative low** (see Figure 15). This figure may underestimate the actual tax burden faced by households and businesses in RMI, as the current tax revenue data cover only central government tax revenue, and exclude local government tax revenue.³² Nevertheless, the magnitude of the difference between RMI and regional comparators suggests that the overall tax take is genuinely low. In 2015, when the relevant comparable international data were available, RMI’s tax burden was shown as one of the lowest among Pacific Island Small States, half of that in Solomon Islands (29.2%), around 10 percentage points lower than that in Fiji (25.5%) and nearly 9 percentage points lower than that in Samoa (22.7%). Tax burden in RMI is slightly lower than the world average of 14.5 percent, but higher than the average of 10.4 percent in Asia and Pacific developing countries.

Figure 15: Tax burden (tax revenue as % of GDP) in the Pacific Island Small States, 2015



Source: WDI (2017) and EPPSO.

³² Local governments in RMI do impose local government sales taxes, with general sales tax on goods at 4 percent in Majuro and sales tax of 10 percent at the wholesale level in Kwajalein Atoll.

On one hand, the low tax revenue to GDP ratio may indicate that RMI's tax base is narrow and there is space for RMI to raise its overall tax rate further. Indeed, the tax base under the current tax regime is low. There is no corporate tax, and the actual coverage of the Gross Receipt Tax is low.

On the other hand, it may indicate a high level of non-compliance, especially when there are no major changes in taxation and the tax revenue to GDP ratio has been declining. In fact, non-compliance is significant in RMI. An IMF Pacific Financial Technical Assistance Centre estimate in 2008 puts the non-compliance rate at between 25 percent and 50 percent. The resulted loss of tax revenue could be around 25 percent of tax revenue (equal to 4 to 5 percent of GDP in 2007), assuming a 35 percent non-compliance rate and non-compliers' income being 30 to 40 percent lower than compliers. Government officials also acknowledged that there was "significant tax avoidance".³³ The declining tax revenue to GDP ratio since 2007 may indicate that the non-compliance rate has also been increasing.

The limited enforcement and dispute settlement capacity of the current tax and customs administration system and the consequent low costs associated with tax non-compliance provide incentives for non-compliance. Currently, the tax and customs administration is done manually, which on one hand would entail an element of discretion on the part of tax and customs officials, and on the other hand leaves insufficient staff capacity for enforcement activities, which are generally sporadic. Manual operations also make it difficult to compare information from different sources – such as the tax office, the Marshall Islands Social Security Administration (MISSA), customs and wholesalers – for tax and customs monitoring and enforcement. For the limited number of tax dispute settlement cases, the settlement process is generally lengthy.

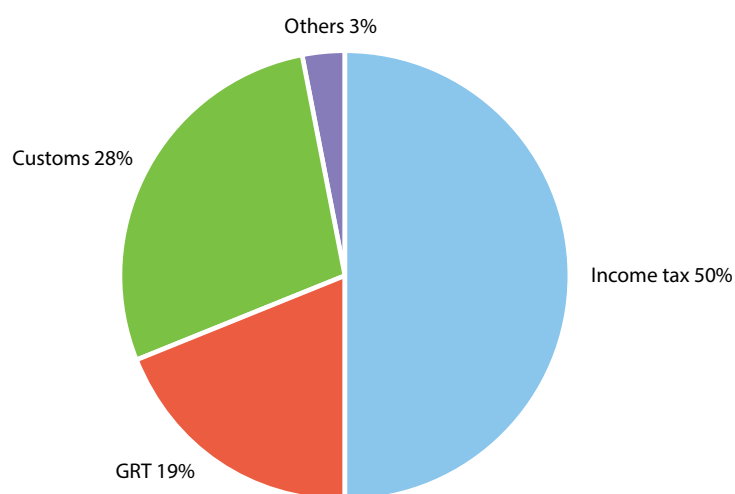
Outdated and inefficient tax design also provide incentives for non-compliance behaviours. The current tax design is perceived as inequitable in that the wage and salary tax does not tax allowances, gross receipt tax favours businesses with low turnover and high profit margin, and import duty is based on units rather than value.³⁴

The largely cash economy and the existence of a relatively large informal economy and shadow economy also facilitate non-compliance behaviour. The shadow economy in RMI is estimated to have accounted for nearly 30 percent of GDP in 2005.³⁵ **RMI's tax base is narrow, with tax revenue mainly originating from tax on wages and salaries, followed by tax on international trade and transactions, and Gross Receipt Tax (GRT).** In 2017, tax on wages and salaries accounted for 50 percent of total tax revenue, while tax on international trade and transactions accounted for 28 percent, and gross receipt tax accounted for 19 percent (Figure 16). However, formal employment only accounts for less than 20 percent of the total population. The fact that the GRT contributed the least to the total tax revenue may indicate a high level of non-compliance in this tax category.

33 New Marshalls Tax Reform Plan Draws Mixed Reactions (2013). *Marshall Islands Journal*, available at: <http://www.pireport.org/articles/2013/03/12/new-marshalls-tax-reform-plan-draws-mixed-reactions>

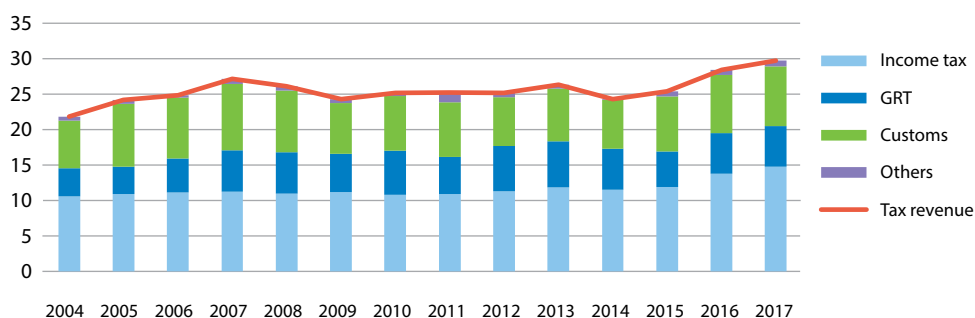
34 Tax and Revenue Reform and Modernization Commission (2010). A Holistic Approach to Reforming the Tax and Revenue System, available at: <http://www.yokwe.net/ydownloads/Info2010/Tax.pdf>

35 Buehn, A. & Schneider, F. (2007). Shadow economies and corruption all over the world: Revised estimates for 120 countries. *Economics: The Open-Access, Open-Assessment E-Journal*, 1(9), pp. 1–66. Available at: http://www.economics-ejournal.org/economics/journalarticles/2007-9/version_1

Figure 16: Tax revenue by sources (% of tax revenue), 2017

Source: EPPSO.

In general, tax revenue has stagnated in recent years. Between 2004 and 2007, all sources of tax revenue experienced some degree of increase. For example, between 2004 and 2007, tax on international trade and transactions increased from US\$6.7 million to US\$9.4 million, while GRT increased from US\$4.0 million to US\$5.9 million, and tax on wages and salaries increased from US\$10.6 million to US\$11.2 million. **However, all sources of tax revenue stagnated between 2007 and 2015**, with the tax on wages and salaries and GRT stagnating at around US\$11 million and US\$6 million respectively, and tax on international trade and transactions declining first and then stagnating at around US\$7.5 million. Since 2016, all sources of tax revenue, in particular income tax, have started to increase.

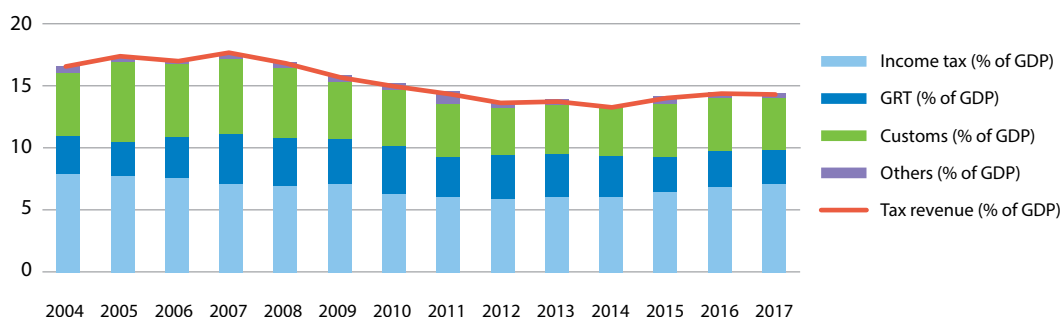
Figure 17: Tax revenue by sources (US\$ million), 2004–2017

Source: EPPSO.

All sources of tax revenues have been growing slower than GDP in recent years. Since 2004, tax on wages and salaries as a share of GDP has been declining, dropping from 8 percent of GDP in 2004 to 6 percent of GDP in 2012. Since then, this ratio has been increasing gradually. By 2017, it had increased to 7.1 percent. More significantly, after the initial increase from 5.1 percent of GDP in 2004

to 6.2 percent in 2007, tax on international trade and transactions, as a share of GDP, has declined, dropping from 6.2 percent of GDP in 2007 to 4.1 percent of GDP in 2017, despite the fact that imports have been growing slightly faster than GDP has been over this period. Gross Receipt Tax, as a share of GDP, has also declined from 3.8 percent of GDP in 2007 to 2.7 percent of GDP in 2017.

Figure 18: Tax revenue by sources (% of GDP), 2004–2017



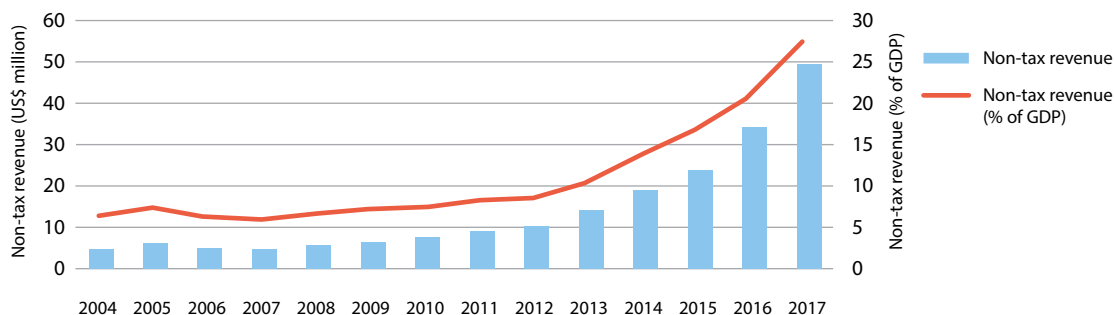
Source: EPPSO.

3.1.2 Non-tax revenue

Non-tax revenue includes: fees, fines and charges, dividends from investments, and sales of goods and services. **Two of the most important types of non-tax revenue sources for RMI are ship registry fees and fishing fees.** Ship registry fees are fees payable for the registration of a vessel in RMI, including both initial registry fees, tonnage taxes, and annual fees. Fishing fees are fees and licences levied on foreign and domestic-based fishing vessels through an access agreement for access to the fishery waters of the Marshall Islands, including activities related to transshipment (the shipment of goods or containers to an intermediate destination, then to another destination).

Non-tax revenue has experienced a significant increase and has become an increasingly important component of RMI's public revenue. Between 2004 and 2017, the volume of non-tax revenue has increased by nearly 10 times, rising from US\$4.7 million in 2004 to US\$50.5 million in 2017. As a share of GDP, non-tax revenue has increased from 3.5 percent of GDP in 2004 to 24.3 percent of GDP in 2017. By 2016, the size of non-tax revenue had overtaken the size of tax revenue.

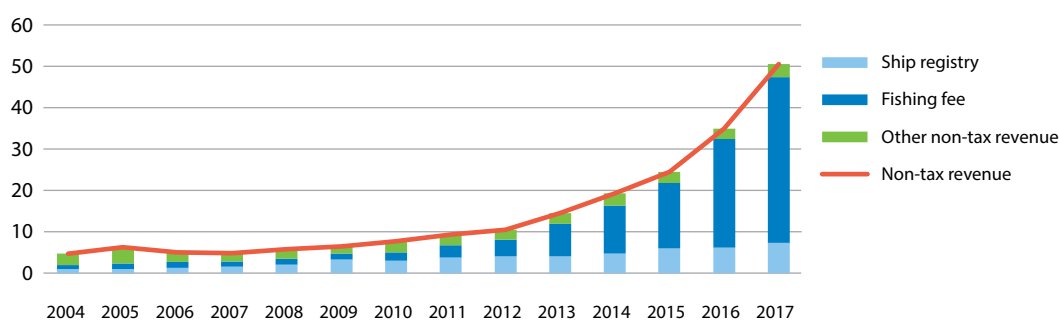
Figure 19: Non-tax revenue, 2004–2017



Source: EPPSO.

This significant increase is mainly driven by the increases in fishing fees and ship registry fees, in particular the increase in fishing fees. Between 2004 and 2017, fishing fees increased from US\$0.9 million in 2004 to US\$40 million in 2017, while ship registry increased from US\$1 million in 2004 to US\$7.3 million in 2017.

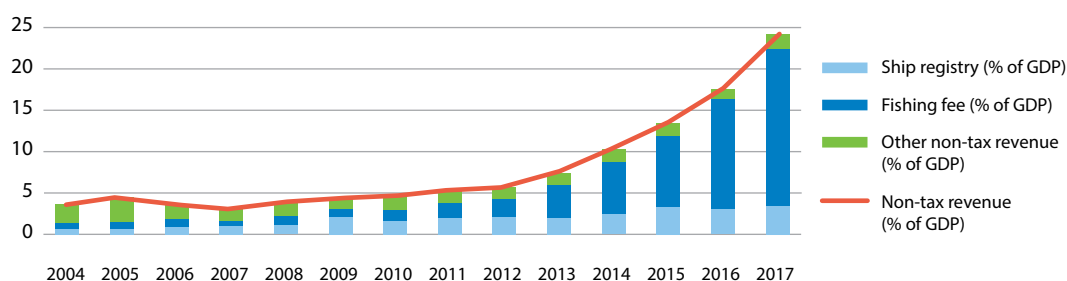
Figure 20: Non-tax revenue by sources (US\$ million), 2004–2017



Source: EPPSO.

As a share of GDP, income from fishing fees increased from 0.7 percent of GDP in 2004 to 9.3 percent of GDP in 2017, and ship registry increased from 0.8 percent of GDP in 2004 to 3.5 percent of GDP in 2017.

Figure 21: Non-tax revenue by sources (% of GDP), 2004–2017



Source: EPPSO.

The sharp increase in fishing licence fees is due to the implementation of the Vessel Day Scheme (VDS) under the Parties to the Nauru Agreement (PNA) since 2010, which raised the benchmark minimum vessel day price from US\$1,500 in 2010 to US\$8,000 in 2015,³⁶ and has seen the fishing revenues accrued to PNA members increase by more than 500 percent between 2010 and 2016. Currently, the VDS is only applied to Purse Seine fishing. An agreement has also been reached to apply VDS to longline fishing,³⁷ which may further increase fishing licence revenue for RMI if implemented.

36 Pacific Islands News Association (2017). Global Fisheries' Sunken Billions, available at: <http://www.pina.com/fj/?p=pacnews&m=read&o=40060244758a3c0086c1a8457e48c6>

37 Five PNA countries ready to implement first VDS for longliners. See <https://www.pnatuna.com/node/177>

However, there are natural limits to growth in this revenue stream even when fish stocks are to be managed sustainably. In recent years, RMI has already witnessed a drop in both catch tonnages and the number of foreign vessels fishing in RMI waters.³⁸ Even after appropriate investments to make fishing sustainable, there is a limit to the increase in fishing licence fees. According to an estimate by the World Bank,³⁹ there is only an extra US\$5 million fishing licence revenue to be generated annually for RMI by 2040. Furthermore, **fishing licence fees are also volatile, depending on where the fish is.** Moreover, there is the ongoing challenge of monitoring vessels and fish catches.

The increase in ship registry is driven by the increase in ship registry fees negotiated with International Registries Inc. (IRI), the company who manage the ship registry for RMI, as well as **the increase in the number of ships registered.** In fact, by 2017, the Marshall Islands had overtaken Liberia to become the world's second largest ship registry.⁴⁰

The Economic Planning, Policy and Statistics Office (EPPSO) annual economic review has noted that the basis of estimation determined by IRI lacks transparency, and RMI should conduct an independent investigation on the ship registration market and estimation of revenue potential from the business.

RMI has also emerged as an offshore centre for non-resident corporate registration. However, the income from offshore corporate registry is still low, and is associated with financial and reputational risks. A particular problem with ship registry and the registry of non-resident corporations relates to international tax evasion. RMI has already attracted scrutiny for its large non-resident corporate registry and flag-of-convenience ship registry⁴¹

An alternative source of revenue currently being pursued by the RMI government is the issuance of the planned 'SOV' **decentralized digital currency.** In February 2018, RMI passed a law to recognise the SOV as a second legal tender, in addition to the US dollar. The RMI government has committed that the SOV would only be issued in compliance with Financial Action Task Force and US regulations, and once its use in transactions in the US financial system is approved. However, in its recent Article IV assessment, the IMF urged caution, noting economic, reputational, money laundering, and governance risks associated with moving into this untested area.⁴²

Non-tax revenue could also originate from dividends received from state-owned assets and the proceeds from disposal of government assets. However, all of the SOEs in RMI are chronically loss-making, and currently there are no dividend receipts from SOEs or if there are any, they are marginal. SOE reform could potentially improve SOE performance in the future and consequently enable the government to reduce subsidies and transfers to SOEs, and potentially even to receive positive dividends. **Disposal of state-owned assets through partial or full privatization of SOEs could be another source of non-tax income.** However, this income stream could only be sustained until the full privatization of SOEs.

38 MIMRA (2013). The benefits of active engagement in tuna fishery, available at: <http://www.mimra.com/index.php/2013-12-30-04-15-09/2013-12-30-06-45-35>

39 World Bank (2017). Pacific Possible: Long-term Economic Opportunities and Challenges for Pacific Island Countries.

40 Marshall Islands becomes the world's second largest ship registry. *Seatrade Maritime News*, 2017, available at: <http://www.seatrade-maritime.com/news/europe/marshall-islands-becomes-the-world-s-second-largest-ship-registry.html>

41 Tom Lansford (2017). Political Handbook of the World, 2016–2017.

42 IMF, Staff Report for the 2018 Article IV Consultation, August 2018

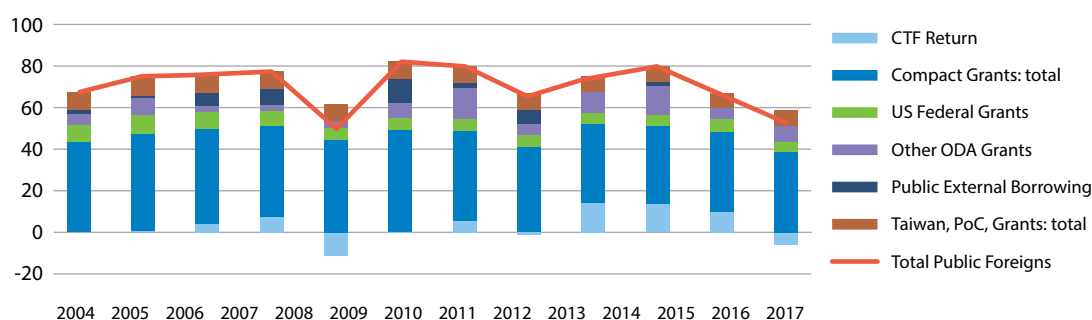
3.2 Public development assistance

RMI's public development assistance comes mainly in three categories: Official Development Assistance (ODA) from the United States in the forms of Compact Grants and federal grants, ODA from non-US DAC countries and multilateral development partners, and South–South Cooperation.

The United States is by far the largest contributor of ODA to RMI, accounting for an average 82 percent of total annual Official Development Assistance. These funds are made up of various Compact Grants and various federal grants. The majority of these funds are directed at supporting health and education, including the construction and refurbishment of health clinics and schools on the outer islands. The United States' public development assistance to RMI also comes in the form of contribution to the Compact Trust Fund, the investment income of which will replace Compact Sector Grants after 2023. ODA to RMI from non-US countries mainly comes from Japan and Australia, which provides about 10 percent and 3.6 percent of total ODA respectively.

Taiwan Province of China is the largest provider of South–South Cooperation to RMI. Between 2002 and 2015, it was responsible for a total of US\$136 million in development assistance, with US\$117.6 million targeting mainly at direct budget support and capital projects, and a US\$18.4 million contribution to the Compact Trust Fund.

Figure 22: Public foreign sources (% of GDP), 2004–2015



Sources: EPPSO, OECD DAC database.

Grants in the form of direct budget support still account for a significant proportion of RMI's public revenue. However, their share of public revenue has been declining since 2007.

Compact Grants accounted for the majority of the grants. However, Compact Grants as a share of GDP has decreased from 48.1 percent in 2009 to 38.2 percent in 2015. Compact Sector Grants, in particular, decreased from 29.9 percent of GDP in 2009 to 18.5 percent in 2015.

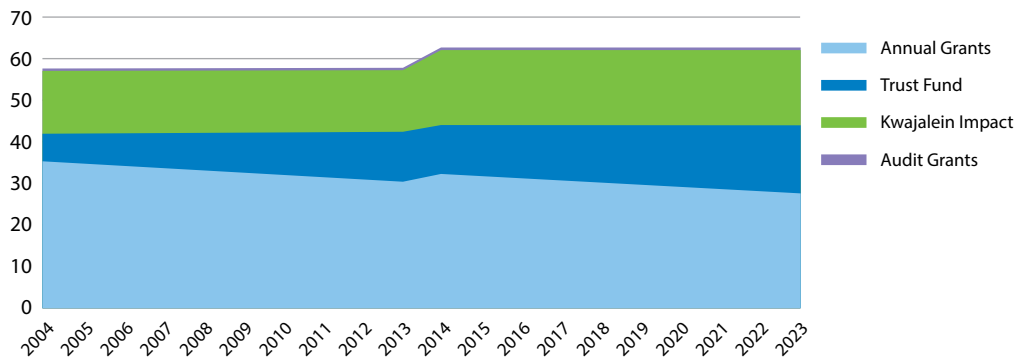
3.2.1 Compact Grants and other federal grants

As part of the agreed Compact of Free Association with the United States, RMI receives substantial development support from the United States. Compact Grants can be broadly divided into three categories: Compact Annual Grants (sector or base), contribution to the Compact Trust Fund, and Compact payments for the US Military's right to operate in Kwajalein Atoll. While the Compact Sector Grants are counted as a source of public revenue, compact payments to Kwajalein are counted as a

source of factor income from abroad for private Marshallese households, and the contribution to the CTF and the investment income from the CTF will provide a future income stream to replace the Compact Base Grants after 2023. By 2023, both Compact Base Grants and Compact contribution to the CTF will expire. Compact Grants for Kwajalein landowners will continue until 2066.

According to the Compact Agreement amended in 2004, the US government would provide a total of US\$57.2 million of assistance to RMI each year between 2004 and 2013, increasing to US\$62.7 million from 2014 onwards. Under the Compact Agreement, each year, the annual recurrent grant declines (referred to as the annual decrement) by US\$0.5 million, with the declines offset by annual increases in the contributions to the Compact Trust Fund. Figure 23 shows the scheduled inflation-adjusted Compact Grant payments from the United States to RMI.

Figure 23: Scheduled Compact Grants (US\$ million inflation-adjusted), 2004–2023

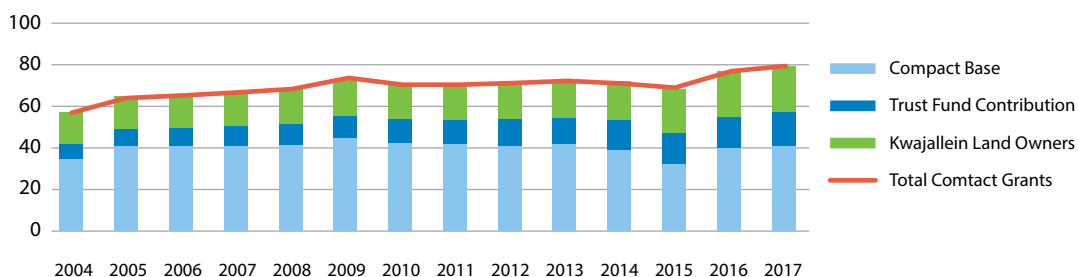


Source: Amended Compact Agreement.

According to the Compact Agreement, **the Compact Base Grant will be used for assistance in education, health care, the environment, public sector capacity-building, and private sector development, or for other areas as mutually agreed, prioritizing the education and health care sectors.** No less than 30 percent and no more than 50 percent of the annual base grants is required to be allocated for public infrastructure. The allocation of Compact Base (or Sector) Grants is made jointly by the governments of both the United States and RMI through the Joint Economic Management and Financial Accountability Committee (JEMFAC), in accordance with the Medium-Term Budget and Investment Framework (MTBIF).

Figure 24 shows the total amount of awarded Compact Grants for the period between 2004 and 2017. It shows that both the contribution to the CTF and payment to Kwajalein landowners have been increasing, while the Base Compact Grant increased initially from US\$35 million in 2004 to US\$45 million in 2009 and has been reduced to US\$40 million in 2016 and US\$42 million in 2017.

Figure 24: Total awarded Compact Grants (US\$ million), 2004–2017



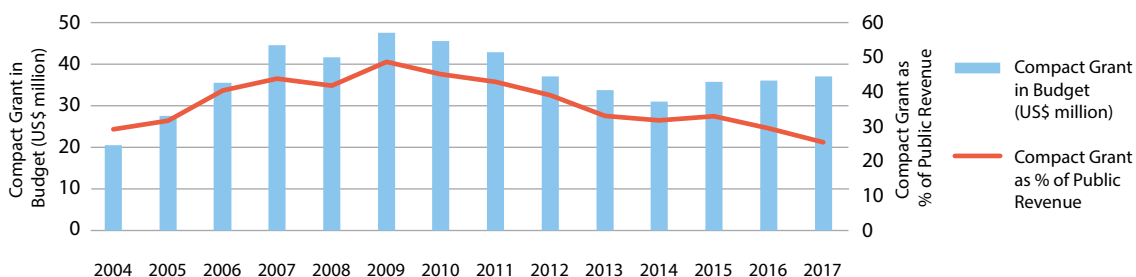
Source: EPPSO.

Not all the awarded Compact Sector Grants are disbursed in the financial year when they are awarded, especially for the grants allocated for infrastructure projects. For example, in 2012, US\$41.3 million of Compact Sector Grants was awarded and US\$37.1 million was disbursed; in 2013, US\$41.4 million was awarded and only US\$33.7 million was disbursed; in 2014, US\$38.8 million was awarded and only US\$31 million was disbursed. In fact, for the period between 2012 and 2015, a moratorium was put on the Compact Infrastructure projects, with most of the grants allocated for infrastructure projects on hold. The moratorium may have also resulted in the reduction in the allocation of Compact Grants for infrastructure projects in 2015 and 2016. The moratorium was due to organizational problems with the Ministry of Public Works’ Project Management Unit. This may reflect limitations in RMI’s capacity in absorbing development assistance.

In addition to Compact Grants, **RMI also has access to a number of US special and federal programmes**, such as the Supplemental Education Grant. RMI also receives development assistance from US aid agencies. For the period between 2004 and 2017, the annual amount of federal grants has been around US\$9 to US\$11 million.

Compact Sector Grants account for a significant proportion of RMI’s public revenue. However, their share in public revenue has been declining in recent years. In 2017, Compact Sector Grants accounted for nearly 25.5 percent of RMI’s public revenue. This, however, represents a 23 percentage point reduction from the peak of 48.7 percent of public revenue in 2009.

Figure 25: Disbursed Compact Sector Grants, 2004–2017



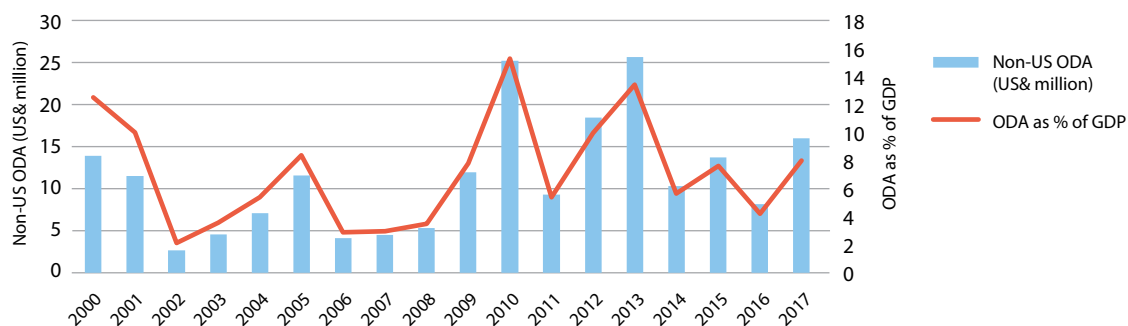
Source: EPPSO.

3.2.2 ODA from non-US DAC countries

RMI's Overseas Development Assistance from non-US Development Assistance Committee countries has been on the rise. Between 2000 and 2017, the volume of ODA that RMI received from non-US DAC countries has been on the rise yet has fluctuated (see Figure 26). The sharp increases in ODA in 2010 and 2013 to US\$25.2 million and US\$25.6 million respectively were due to the US\$10 million grants from the Asian Development Bank in 2010 for a public sector reform project in RMI, and the US\$9.1 million grant from Japan in 2013 for a project for improving Domestic Shipping Service in RMI.

The share of RMI's ODA received from non-US DAC countries as a share of GDP has been on the rise as well. In 2002, the ODA as a share of GDP was only 2.1 percent; by 2017, this figure was 8 percent.

Figure 26: ODA received (current US\$ million) from non-US DAC countries and ODA as a share of GDP, 2000–2017



Source: OECD DAC database.

RMI's ODA received from non-US DAC countries mainly came from Australia, Japan, the ADB, EU institutions, and the World Bank. While Australia, Japan, New Zealand and the European Union are RMI's traditional development partners, recently RMI has also witnessed more ODA coming from ADB and the World Bank. According to the OECD DAC database, between 2002 and 2017, Japan provided a total of US\$97.4 million of ODA, accounting for 10.4 percent of total ODA RMI received; Australia provided a total of US\$41.4 million of ODA, accounting for 4.4 percent of total ODA RMI received; the EU provided a total of US\$6.6 million of ODA, accounting for 0.7 percent of the total ODA. For the same period, ADB provided US\$17.7 million of ODA, accounting for 1.9 percent of total ODA, while World Bank provided US\$5.8 million, accounting for 0.6 percent of total ODA.

Table 3: ODA to RMI by sources, 2002–2017

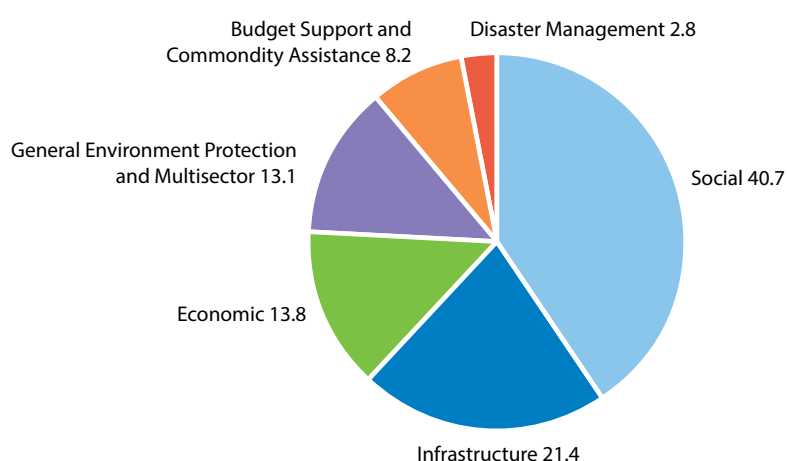
	Total ODA to RMI (US\$ Million)	% of Total ODA
Japan	97.4	10.4
Australia	41.4	4.4
ADB (special funds)	17.7	1.9
EU institutions	6.6	0.7
World Bank (IDA)	5.8	0.6
Total (including ODA from US)	864.77 ⁴³	100

Source: Based on data from OECD DAC and EPPSO, compiled by DFA team.

3.2.3 Sectoral distribution and delivery channel of ODA

ODA in RMI focuses mainly on social services. Under the Compact Agreement, Compact Sector Grants target six areas: education, health care, the environment, the public sector, capacity building, and private sector development. **ODA from non-US DAC countries focused more on social services as well, followed by infrastructure building and economic activities.** Between 2002 and 2017, 40.7 percent of ODA received from non-US DAC countries was allocated for social services, while 21.4 percent was allocated for infrastructure building, and 13.8 percent was allocated for economic activities, and 13.1 percent was allocated for environmental protection and multisector activities. Over time, there has been a tendency for the allocation of non-US ODA to shift gradually away from social services to infrastructure building.

Figure 27: Sectoral distribution of ODA received from non-US DAC countries (% of total ODA from non-US DAC countries), 2002–2017



Source: OECD-DAC Database.

⁴³ The figure for US ODA in 2016 is not consistent with the figures recorded for the previous years and is much smaller in 2016.

Development assistance from Taiwan, Province of China focused on direct budget support, with 27 percent of its development assistance allocated for this purpose, contribution to the Compact Trust Fund (19%), construction projects and the renovation of infrastructure, and agriculture.

There is some complementarity between development assistance from different development partners, with the United States focusing on health and education; Australia focusing on social infrastructure, general environmental protection and multisectoral activities, and water and sanitation; Japan focusing on fishing, transport, commodity assistance, health, education, and energy; and the European Union focusing on renewable energy. **However, this complementarity is achieved mainly through bilateral agreements based on individual development partners' competitive advantage rather than through active coordination.**

ODA is mainly delivered via the RMI government. Both the US Compact Sector Grants and federal grants are typically on the government's budget and are delivered through the government departments of RMI. ODA from non-US DAC countries is also mainly delivered through the government of RMI. According to OECD DAC data, between 2002 and 2017, more than US\$100 million of ODA from non-US DAC countries was delivered through the government of RMI or public sector players, accounting for nearly 60 percent of the total ODA from these countries. The high level of ODA delivered through the government and the public sector suggests a high level of country ownership for ODA in RMI.

Two other important channels for delivering ODA are local and regional NGOs, and donor governments. Between 2002 and 2017, 9 percent of the non-US ODA is delivered through local and regional NGOs, around 7 percent is delivered by the donor government, while nearly 7.5 percent is delivered by various international organizations.

3.2.4 South–South Cooperation

South–South Cooperation (SSC) refers to the exchange of resources, technology, and knowledge between developing countries. Around the globe, South–South Cooperation has increased significantly, in particular with emerging developing countries, such as China and India.

Taiwan, Province of China⁴⁴ is the largest SSC partner for RMI, providing contribution to the Compact Trust Fund, direct budget support grants and project support grants. Since 2004, Taiwan has been contributing to the CTF and has become a key donor. Taiwan contributed US\$5 million to the CTF in 2005 and has pledged to contribute US\$2.5 million per year until 2023. Taiwan is also a sitting member of the Compact Trust Fund Committee.

Apart from contributing to the CTF, **Taiwan Province of China has been providing regular annual grants in the form of direct budget support of US\$3.6 million and capital grants of US\$7.4 million.** Taiwan's capital grants target mainly infrastructure, microfinance, the environment and renewable energy, and outer island development. Some of the most recent projects include the newly completed Ronneppan Beach Park multi-purpose sports facilities, and the US\$4 million Home Energy Efficiency and Renewable Energy project that is currently being implemented.

⁴⁴ Taiwan is considered as an emerging economy according to a number of classifications.

In addition to providing grants, Taiwan, Province of China also provides technical assistance to RMI in the form of Technical Assistance Missions, scholarships to study in Taiwan, on-the-job trainings in Taiwan, and Taiwanese medical professionals coming to work in RMI. The Technical Assistance Mission is established as a local branch of Taiwan's International Cooperation and Development Fund (ICDF), focusing on technical assistance in livestock and horticulture and aiming to recommend crops and livestock suitable for RMI and to train local farmers to manage them. Some of the ongoing projects include a US\$1.25 million horticulture project and a US\$2.3 million livestock project.⁴⁵

India has established long-standing development cooperation with Pacific Small Islands States, in particular Fiji. India has also developed development cooperation with RMI. Some of the development assistance provided by the Indian government to RMI are listed in Table 4. In June 2017, India announced a contribution of US\$1 million towards a Climate Early Warning System project for six Pacific Island countries, including RMI under the newly established India-UN Development Partnership Fund, where India will enter into a triangular partnership with the UN Office for South-South Cooperation.⁴⁶

Table 4: India's development assistance to RMI, 2005–2017

Year	Project name	Sectors	Value (FJD\$ million)
2005	Purchase of solar panels and two-way radio sets for Outer Islands Health Centre for the Ministry of Health.	Health	0.242
2008	Providing solar-powered street lights	Infrastructure	0.1
2013	Two Mini Vans and computer and communication equipment		1.63
2013	Disaster Relief	Disaster relief	0.1
2015	Funding for National Export Strategy	Government	0.1
2015/16	Grants for organizing the Annual Pacific Islands Leader's Summit	Infrastructure (road)	0.15
2016	Atoll Community Coral and Calm Project	Environment	0.2
2016	Disaster Relief and Recovery	Disaster Relief	0.1
2017	Majuro Atoll Local Government for "Solar Refrigeration Project"	Renewable energy	0.2

Source: Indian Embassy in Tokyo.⁴⁷

India has recently substantially increased its financial support to Small Island Developing States (SIDS) and has pledged a sum of US\$500 million in grant-in-aid and US\$1 billion in soft loans over the next three years to SIDS. In the context of cooperation with Pacific Islands countries, India has committed to the establishment of an Institute for Sustainable Coastal and Ocean Research and a network of marine biology research stations; setting up IT laboratories; continuing support for coastal

45 See the Taiwan ICDF website: http://www.icdf.org.tw/Ip.asp?CtNode=30040&CtUnit=172&BaseDSD=100&mp=2&xq_xCat=&xq_xCat2=A

46 UNOSSC (2017). Climate Early Warning Systems Project for Pacific Island States receives India-UN Development Partnership Fund support, available at, <https://www.unsouthsouth.org/2017/06/16/climate-early-warning-systems-project-for-pacific-island-states-receives-india-un-development-partnership-fund-support/>

47 See https://www.indembassy-tokyo.gov.in/India-RMI_Bilateral_Relations.html

surveillance and hydrographic surveys; continuing scholarships for higher education and training; and training in solar energy, among others. RMI could benefit from India's scaling up its development cooperation with the Pacific Island small states.

China is also a significant provider of development cooperation in the Pacific. Between 2006 and 2015, China provided US\$1.78 billion in aid to the nine Pacific small island countries with which it has diplomatic relations.⁴⁸ As a result, China has become the fourth largest donor to the Pacific, only slightly behind New Zealand. Although having no direct diplomatic relation with China, the **RMI has benefited from China's development cooperation with the region.** For example, China has opened its market for tuna exports for Parties to the Nauru Agreement (PNA), of which RMI is a member. China has also offered to cooperate with PNA in market access, domestic development and fishery science.

China is the second largest trade partner for RMI, with a total of US\$3 billion in exports to RMI in 2017.⁴⁹ Chinese firms have already started to invest and make their presence known in RMI. For example, Shanghai Kaichuang Marine International, which is a subsidiary of Shanghai Fisheries Group, China's largest seafood company, has two subsidiary companies registered in RMI: a fishing company, Pan Pacific Fisheries (Marshall Islands) Co. Ltd., and a tuna processing company, Pan Pacific Foods (RMI) Inc., with total assets of US\$56 million.

While China's contribution to South–South Cooperation is expected to rise further in the future, the question of **how to benefit from China's increasing development cooperation will be a task for the government of RMI.** RMI's trade policy⁵⁰ already includes recommendations to work with China to deepen trade, investment and development cooperation with Asia and to seek technical and financial assistance from China and Taiwan, Province of China to implement RMI's trade policy.

3.2.5 Vertical funds and climate financing

Vertical funds represent another opportunity for RMI to access international development assistance. "Vertical funds" are development financing mechanisms devoted to a single development cause with mixed funding sources. Major multilateral global vertical funds include the Global Environment Facility (GEF), the Global Fund to Fight AIDS, Tuberculosis and Malaria (the Global Fund), the Global Alliance for Vaccines and Immunization (GAVI), the Green Climate Fund (GCF), the Climate Investment Fund (CIF), and the Adaptation Fund (AF). There are also a number of bilateral climate funds, including Germany's International Climate Initiative, the United Kingdom's International Climate Fund and Australia's International Forest Carbon Initiative (IFCI).

RMI's usage of vertical funds is low. For the period between 2002 and 2010, RMI received a total of US\$1.79 million grants from GEF, which accounted for less than 0.4 percent of RMI's total ODA received. All the grants from GEF were allocated for general environmental protection. GEF funding was channelled mainly through UNDP. According to OECD DAC records, between 2011 and 2017, RMI received no disbursement from GEF. However, a total of US\$11.5 million has been committed to a number of projects in the Marshall Islands during this period, including the Ridge to Reef projects.

48 Lowy Institute for International Policy (n.d.). Chinese Aid in the Pacific, see <https://www.lowyinstitute.org/chinese-aid-map/>

49 PIFS (2017), Trade Statistics Handbook 2017 between China and Forum Island Countries, available at: <https://pacifictradeinvest.com/media/1587/pacific-islands-statistical-handbook2017.pdf>

50 The Trade Policy for RMI, see https://pafpnet.spc.int/images/articles/policy-bank/Marshall/Trade_Policy_RMI.pdf

RMI's burden of TB is considered severe and RMI is eligible for the Global Fund but has not received funding.

In November 2016, RMI, together with six other Pacific countries, secured funding from the Green Climate Fund (GCF) for a total investment of US\$26 million for a Pacific Island Renewable Energy Program, aiming to assist Pacific Small Island States to shift away from diesel power generation and towards solar, hydropower and wind energy.^{51,52} In June 2018, RMI secured a US\$25 million grant from GCF for the co-financed Pacific Resilience Project Phase II for RMI. RMI is also seeking grants from the Adaptation Fund and GCF through SPREP for a number of projects, including the Coastal and Marine Ecosystem Resilience Programme Project Preparation Facility Grant, GCF readiness, and Climate Resilient Agriculture in RMI.⁵³

To better access vertical funds relating to climate change, RMI has set up an action plan to strengthen systems and capability to access and manage global climate funds, including from the Green Climate Fund, and to attain accreditation status to apply for climate change resources. However, attaining accreditation status for the Green Climate Fund may need significant investment in technical capacity.

A number of factors may have constrained RMI's effort to access vertical funds, in particular climate funds, including: complex eligibility and application requirements that can be difficult to fulfil; limited technical and administrative capacities; co-financing requirements; the lack of high-quality "bankable" projects for investment; the small size of the economy; the lack of expertise and capacity; and the weak public financial management system.

One challenge in making use of vertical funds is how to align vertical funds with national development priorities and integrate vertical funds with national development programmes.

3.3 Public sector external borrowing: Debt-creating financial flows

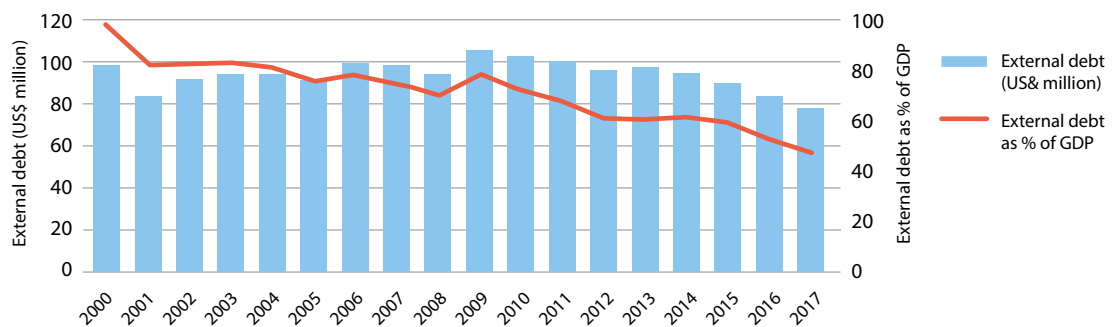
External loans can provide valuable resources to both the public and private sectors in developing countries and stimulate development. However, debt must be managed carefully, especially for small economies vulnerable to external shocks.

RMI maintained a relative high level of external debt in the early 2000s and increased external debts gradually from US\$83.7 million in 2001 to US\$105.5 million in 2009. Since then, **RMI has been improving its external debt position,** and gradually reduced its external debt stock to US\$77.9 million by 2017. As a percentage of GDP, the level of external debt has been declining since 2000, dropping from 72.7 percent of GDP in 2000 to 37.5 percent of GDP in 2017. The **public sector accounts for all the external debt stock.**

51 See <http://www.greenclimate.fund/-/pacific-islands-renewable-energy-investment-program>

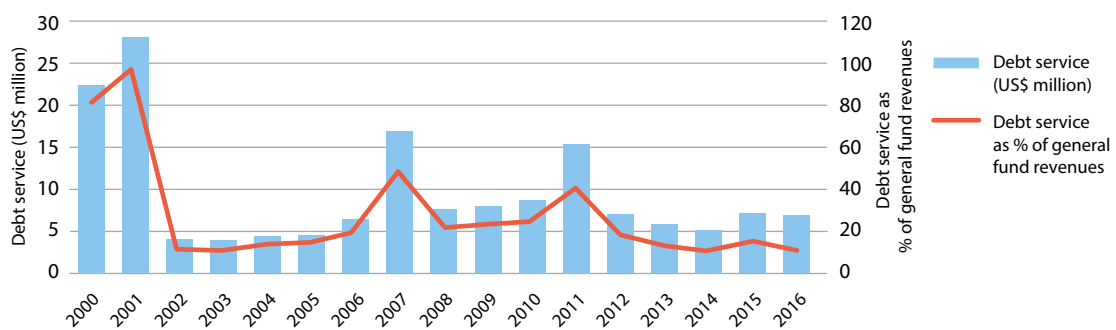
52 The proposal was approved in 2016. However, there has been no disbursement of grants yet.

53 See <https://www.sprep.org/attachments/2017SM28/Officials/English/WP%206.2.Att.1-Access%20to%20Climate%20Finance%20etc.pdf>

Figure 28: External debt in RMI, 2000–2017

Sources: WDI and EPPSO.

A significant proportion of domestically collected revenue has been channelled to service external debts. In 2000 and 2001, debt servicing amounted to 81 percent and 97 percent of RMI's general fund revenues, the public revenues collected domestically. In 2007 and 2011, debt services amounted for 49 percent and 41 percent of RMI's general fund revenues. Since 2012, the debt services have fluctuated at around US\$7 million.

Figure 29: External debt service in RMI, 2000–2017

Source: EPPSO.

All of RMI's current outstanding external loans as of September 2017 were either from ADB or the US Rural Utility Service. Debt from ADB,⁵⁴ which is all concessional, accounted for the majority of RMI's outstanding external debts. As of September 2017, outstanding debt from ADB stood at US\$54 million. Debt from the US Rural Utility Services was US\$23.8 million.

High levels of external debt puts stress on financial stability and limits RMI's ability to borrow again. The recent IMF Debt Sustainability Analysis suggested that RMI is still at a "high risk of debt distress".⁵⁵ Due to RMI's high level of external debt, in 2014, ADB put RMI into the "grant only" category, meaning that RMI can't borrow from ADB and can only receive grants.

54 According to data from EPPSO, there were four loans from ADB in 2001 and 2003, valued at US\$27.5 million. However, only three of them, valued at US\$20 million, are recorded in the OECD DAC database and were recorded only as commitments.

55 RMI (2018). ARTICLE IV CONSULTATION.

As RMI has gradually improved its external debt position and eased its external debt stress⁵⁶ since 2009, there is a resurgence of interest from development partners to provide loans to RMI. For example, a US\$10 million non-concessional loan has been approved by the International Renewable Energy Agency (IRENA) in January 2017 to finance the installation of a hybrid micro-grid project using solar PV and advanced lithium batteries in Ebeye, Wotje, Jabor and Rongrong. RMI has also signed an agreement with the Taiwan International Cooperation Development Fund in November 2016 for concessional loans of US\$4 million for purchasing home solar units for residents of Majuro and Ebeye.

However, more loans may increase RMI debt burdens in the future and subject RMI to financial stress,⁵⁷ if not managed properly. **Consequently, careful debt management and strengthened debt management capacities in RMI will be critical.**

Currently, RMI does not have a policy on the maximum level of external debt RMI could assume to ensure financial stability. It does not have a centralized debt management unit either, one that is tasked with identifying lending agencies, evaluating financial risks, securing loans by negotiation, documenting loan agreements, monitoring and reporting on the various aspects on the loan, and servicing all obligations of the loan on the due date. The securing of external loans is conducted through ministries or SOEs individually. The soliciting and disbursing of external finance needs to be integrated into the national planning and budgeting cycle.

3.4 Private sources: domestic and foreign

Domestic revenue and official external finance are both critical in supporting RMI to achieve the SDGs. However, these sources alone will be insufficient. More private finance – from both domestic and external sources – will need to be mobilized over the coming years, especially after 2023.

RMI's private finance comes from four sources: domestic saving, private remittance from abroad, and factor income from abroad to RMI's citizens and companies, and Foreign Direct Investment.

Gross Domestic Saving: RMI's gross domestic saving rate is negative, indicating that aggregate consumption in RMI is greater than production and has to be financed from income or transfers from outside the country. While government consumption is supported by ODA, private consumption is supported by ODA plus remittances received, and net factor income from abroad. Domestic investments are also supported by income and transfers from abroad, together with FDI.

Remittance: Both remittance inflows and outflows have been increasing in volume. However, as a share of GDP, remittance inflow declined from 18 percent of GDP in 2006 to 12.6 percent in 2012, and then rose to 15 percent of GDP by 2017. Remittance outflow has experienced a significant increase, rising from 2.5 percent of GDP in 2005 to 13 percent of GDP in 2014, and has dropped to around 10 percent of GDP recently.

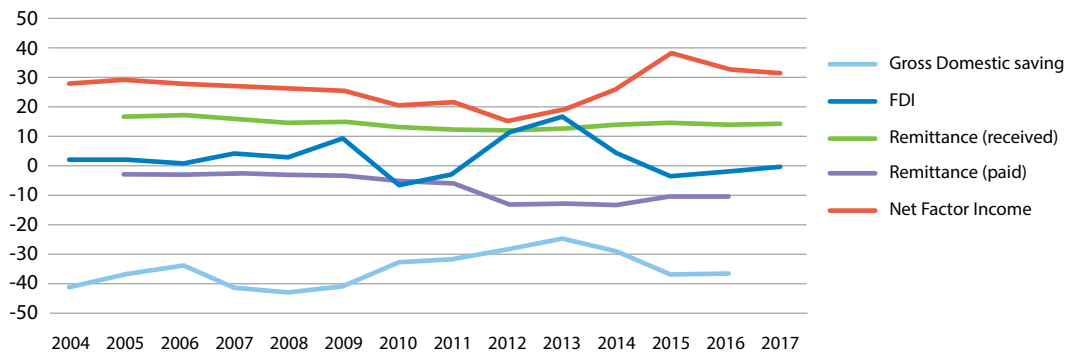
Net factor income from abroad: Net factor income from abroad declined from 33.5 percent of GDP in 2000 to 15.8 percent of GDP in 2012, followed by a sharp rise to more than 30 percent of GDP since 2015.

⁵⁶ RMI's ratio of external debt to GDP has been declining since the early 2000s, and external debt service stabilized at around US\$5 million since 2011.

⁵⁷ IMF (2018). Republic of the Marshall Islands: 2018 Article IV Consultation Report: Debt Sustainability Analysis.

FDI to RMI experienced significant decline in the early 2000s, and has remained low and volatile since 2004. A number of factors have been identified as contributing to reducing RMI's attractiveness to FDI, including rigid regulations on foreign investments, weaker investment climate, and issues of land accessibility, which are compounded by the limited connectivity, both physical and digital, to major markets.

Figure 30: Private sources (% of GDP), 2004–2017



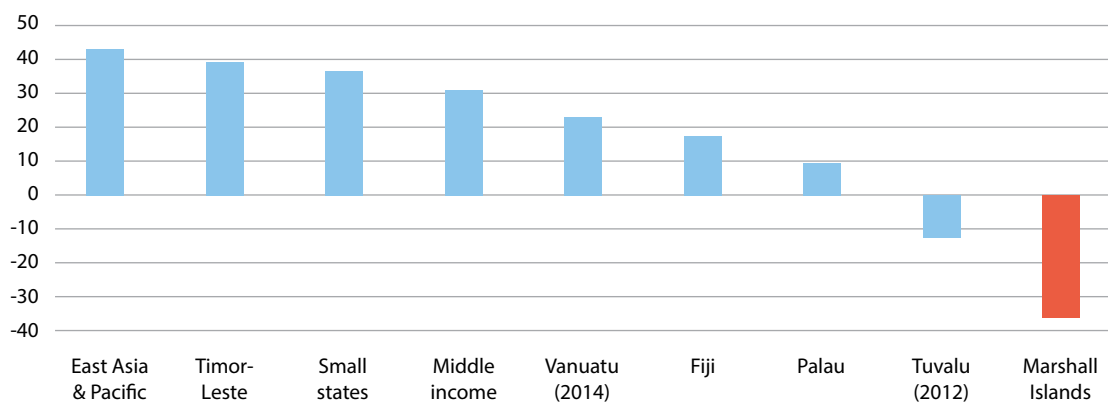
Sources: ADB Key Indicators (2017), EPPSO (2017) and WDI (2018).

3.4.1 Gross domestic savings

Gross domestic savings is the difference between gross domestic product (GDP) and the final domestic consumption expenditure, including final public sector consumption and household final consumption expenditure.

Compared globally, the gross domestic saving rate in RMI is low. In 2015 when comparable data were available, RMI's gross domestic saving was -36.4 percent of GDP, very much lower than the world average of 24.6 percent of GDP. RMI's level of Gross Domestic Saving is also lower than those in fellow Pacific Small Island States, which was 39.6 percent in Timor-Leste, 23.4 percent of GDP in Vanuatu in 2014, 17.8 percent of GDP in Fiji, 9.6 percent of GDP in Palau, and -12.6 percent of GDP in Tonga in 2012.

Figure 31: Gross Domestic Savings (% of GDP) in 2015



Sources: EPPSO and WDI.

In fact, RMI's gross domestic saving rate has been negative for an extended period, suggesting that domestic consumption expenditure has been greater than gross domestic product. This reflects governments' and households' dependence on external sources of finance for consumption, including ODA, remittance, and factor income from abroad. While government's final consumption is supported by ODA grants, household consumption is supported by ODA, remittance and factor income from abroad.

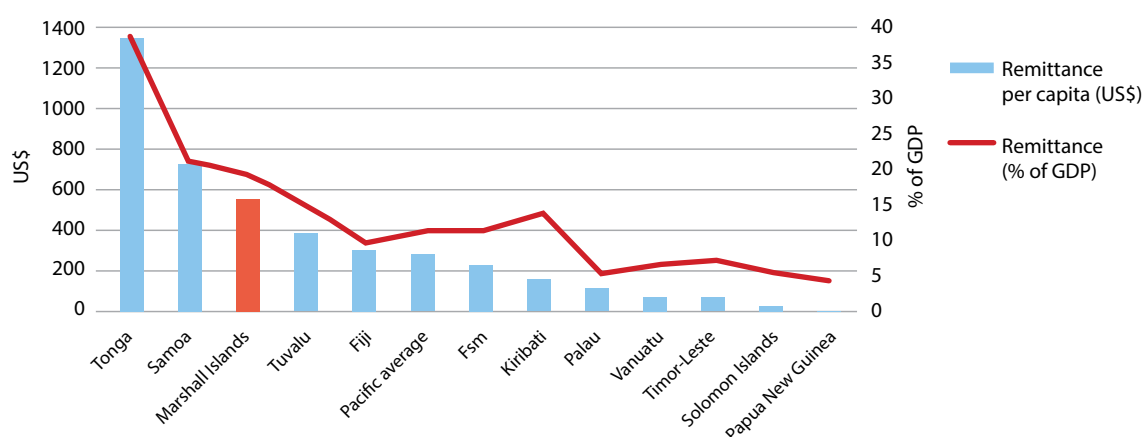
While domestic savings provides an essential source of fund for investment, the low level of saving leads to limited availability of investable funds, and consequently low investment and low growth. This in turn results in low savings. It is of particular concern for private businesses who may find it difficult to access finance to boost investment.

3.4.2 Remittance in RMI

Remittance has played an important role in many Pacific Island countries in elevating people out of poverty or keeping people from falling into poverty, especially when the economy is not performing well.

The volume of remittance received from abroad to RMI is significant, even compared with other Pacific Island countries. In 2017, remittance received in RMI stood at US\$29.4 million, equal to nearly 15 percent of RMI's GDP, and remittance received per capita stood at US\$554, lower only than those in Tonga and Samoa, two of the top remittance receiving countries in the world. In fact, RMI are also ranked high on the World Bank's top remittance-receiving country list, ranked 30th by remittance received as a share of GDP.⁵⁸

Figure 32: Remittance received per capita (US\$) and remittance received as a share of GDP in Pacific Island Countries, 2017



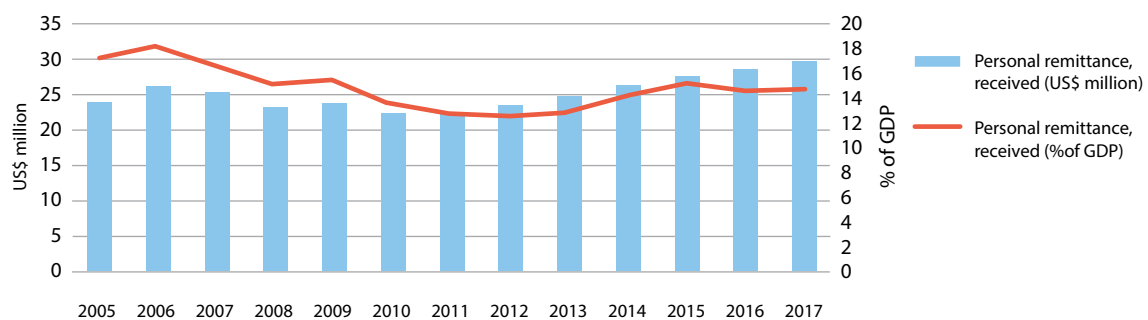
Source: WDI.

Remittance to RMI may be even higher than the official estimates due to the fact that RMI uses the US dollar, which makes it easier to transfer remittances through informal channels, such as hand-delivery. Consequently, a proportion of the remittance received may have not been recorded.

⁵⁸ World Bank (2016). Migration and Remittances Factbook 2016, available at <https://openknowledge.worldbank.org/bitstream/handle/10986/23743/9781464803192.pdf>

For the seven-year period between 2011 and 2017, RMI's remittance received increased following a decline between 2006 and 2011. Between 2005 and 2017, remittance received declined firstly from US\$26 million in 2006 to US\$22.1 million in 2011, then recovered to US\$29.4 million in 2017. As a percentage of GDP, remittance received has followed a similar trend, having declined from 18.1 percent of GDP in 2006 to 12.8 percent in 2011, and then recovering to nearly 15 percent of GDP in 2017.

Figure 33: Remittance received (US\$ million and as % of GDP), 2005–2017



Source: WDI.

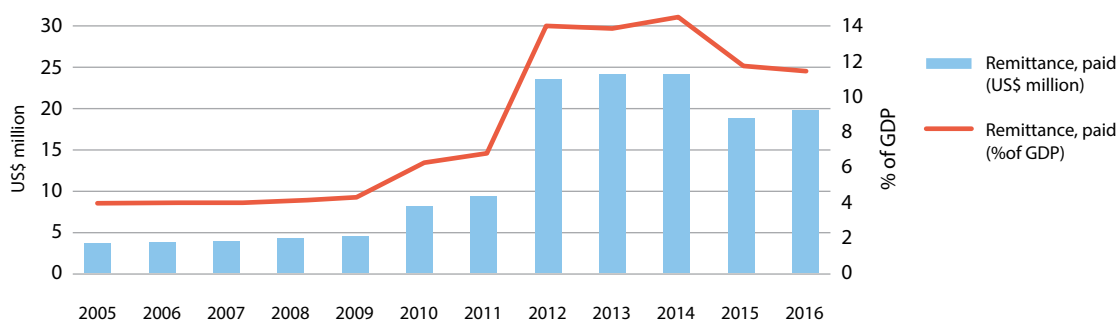
Around 90 percent of RMI's remittance received originated from the United States, which hosts around 26,000 Marshallese, accounting for more than 90 percent of the total diaspora population.

With the ongoing net migration of Marshallese to the United States to work and study without a separate permit under the Compact Agreement, remittance inflow to RMI is set to increase further. The prospect of the Compact Agreement terminating may accelerate the pace of migration of Marshallese to the United States in the next five years, and increase remittance in the future.

The extending of Australia and New Zealand's seasonal worker programmes to RMI could also increase the number of Marshallese working overseas and increase the inflow of remittances.

However, the significant remittance inflow is to some extent offset by the significant remittance outflow originating from RMI. The outflow of remittance from RMI is substantial, especially since 2010.⁵⁹ In fact, RMI is considered one of the top remittance-sending countries by the World Bank. Between 2010 and 2014, remittance originating from RMI increased from US\$7.9 million in 2010 to US\$23.8 million in 2014. As a percentage of GDP, remittance originating from RMI increased from 4.8 percent of GDP in 2010 to 13 percent in 2014. However, in 2015 and 2016, the amount of remittance originating from RMI dropped to US\$18.5 million and US\$19.5 million respectively. The major countries receiving remittance originating from RMI include China, Kiribati, the Philippines and the United States.

⁵⁹ These data should be used cautiously as there are two figures on remittance paid from the World Bank: one is US\$23 million in 2014 from the World Bank's WDI, the other one is around US\$5 million from the World Bank's Bilateral Remittance Matrix.

Figure 34: Remittance paid (US\$ million and as % of GDP), 2005–2016

Source: WDI.

The costs of transferring remittances to and from Pacific islands has increased as the major remittance-sending countries have strengthened anti-money-laundering and counter-terrorism financing legislation and global banks have closed the bank accounts of small money transfer operators, forcing transfer of remittances only through banks. This, combined with the loss of correspondent banking services for the Bank of Marshall Islands, could potentially cause concerns for RMI. So far, the cost of transferring remittances to the RMI has not been affected significantly, as almost all the remittances come through two large operators (MoneyGram and Western Union) that have existing partnerships with banks.

Currently, there is no remittance-specific regulation in RMI and no restrictions on foreign exchange, except that cash transactions and transfers exceeding US\$10,000 are reported by the banks to the Banking Commission. Banks do not currently provide services targeting at remittance-receiving households. However, the Bank of Marshall Islands, jointly with the company MoneyGram, has started to provide remittance services.

There are currently no specific policies in place to promote and utilize the remittance inflow to RMI and to regulate remittance outflows from RMI. Given the significance of remittances to RMI's economy, this is an area where policymakers could pay particular attention to encourage and to make the best use of remittance inflow.

3.4.3 Foreign Direct Investment

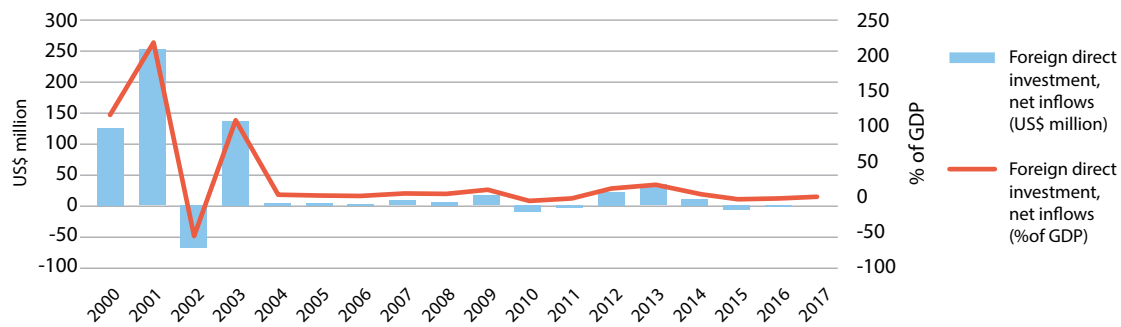
Foreign Direct Investment (FDI) is a major source of external private finance for long-term investment in physical capital, job creation, skills and technology transfer. Since 2000, the amount of net FDI flows to Pacific Small Island Developing States has been on the rise, with total FDI inflows to Pacific Small Island Developing States increasing from US\$258 million in 2000 to US\$687 million in 2015.⁶⁰

FDI inflow to RMI has, however, experienced a significant decline in the early 2000s. Since 2004, FDI inflow into the Marshall Islands has been low, with net FDI inflow to RMI lower than US\$20 million and FDI as a percentage of GDP lower than 10 percent of GDP in most of the 12-year period between 2004 and 2017. In a number of years, the net FDI inflow to RMI was negative, suggesting that divestment from RMI is greater than foreign investment. In 2017, the net FDI inflow was only US\$0.2

⁶⁰ FDI data for a number of Pacific countries in 2016 and 2017 are still in the process of being compiled.

million. FDI in RMI has also been volatile. In 2013, RMI's net FDI inflow was equal to 17 percent GDP, but dropped to -1.6 percent of GDP in 2015.

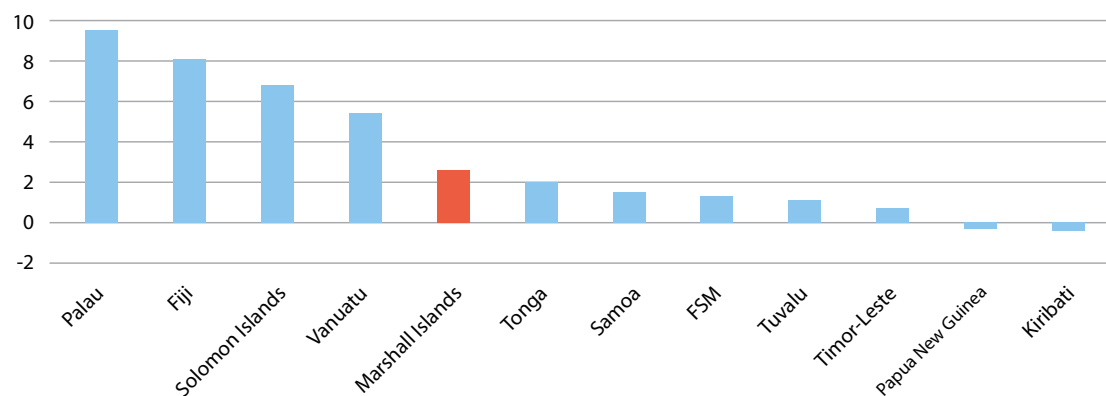
Figure 35: Net FDI inflow to RMI, 2000–2017



Source: WDI (2017).

However, for the eight-year period between 2010 and 2015, RMI had one of the highest FDI inflows among fellow Pacific Small Island Countries. Between 2010 and 2017, the average net FDI inflow to RMI was 2.7 percent of GDP, lower only than that to Fiji, Palau, Solomon Islands and Vanuatu.

Figure 36: Net FDI inflow as a share of GDP (average), 2010–2017



Source: WDI (2018).

FDI to RMI focuses mainly on agriculture (coconut oil in particular), fishing and tourism sectors. FDI in the Marshall Islands mainly comes from Australia, China, Japan and the United States.

The Government of the Marshall Islands recognizes the role of FDI in promoting private sector development and encourages foreign investment. In fact, the government has made “improving rules and regulations to encourage foreign investment” one of its national targets in the National Strategic Plan 2015–2017. The government has indeed provided a number of investment incentives to attract investment in agriculture, fisheries, tourism, light manufacturing and seabed mining, such as exemption of Gross Revenue Tax for five years for investors who invest a minimum of US\$1 million or provide employment and wages in excess of US\$150,000 annually to Marshallese citizens; this applies to both foreign and domestic investors. These policies are complemented by RMI’s low tax

rates, free repatriation of profits and dividends, and easy access to US markets. Furthermore, at the end of 2013, the Government created the Office of Commerce and Investment to be in charge of promoting investment in RMI, highlighting four strategic sectors: tourism, fishing, coconut transformation and the exploitation of marine waters.

Despite these efforts, **FDI inflows to RMI are still constrained by a number of factors, including rigid regulations on foreign investments, a weak investment climate, and issues of land accessibility, which are compounded by the limited connectivity, both physical and digital, to major markets.** According to IFC's Doing Business Report 2019, Marshall Islands ranked 150th out of 190 countries in IFC's Ease of Doing Business.

One of the most constraining factors to doing business in RMI is registering property. In RMI, land is all privately owned by Marshallese landowners, so foreign businesses must lease land from private landowners in order to operate. However, land property rights are not clearly defined and land registry records are not complete. As a result, disputes over land use and land rights are common, which are often resolved informally or after lengthy court processes.

Foreign investment in RMI remains very controlled. According to RMI's Foreign Investment Business License Amendment Act, a number of activities, such as small-scale agriculture, taxi and handicraft businesses, are reserved for RMI citizens only. At the same time, many sectors are SOE-dominated, which are heavily subsidized by the government. This leaves little space for private sector investment. This situation is compounded by RMI's weak infrastructure, in particular weak digital connectivity and the difficult to get to RMI by air. The government, however, is considering opening a number of sectors to private investment.

Furthermore, RMI has been listed on a number of lists of "non-cooperative states" (generally, because their tax regimes do not meet international standards), including EU's "List of Non-cooperative States and Jurisdictions";⁶¹ OECD's "List of Non-Cooperative Countries and Territories", and France's "List of Non-cooperative Jurisdictions." This subjects financial transactions with RMI to more restrictive provisions and scrutiny and constitute an extra hindrance to FDI.

Should an investor decide to invest in RMI, **the process of applying for a Foreign Business Licence is still cumbersome**, with multiple applications, including immigration forms, foreign investment business licences, the Majuro local business licence application, and Marshall Islands Social Security Agency forms, to be lodged with different agencies, such as the Registrar of Foreign Investment, Registrar of Companies, Tax and Customs, Immigration, the Majuro local government, and the Marshall Islands Social Security Administration. Under the current regime, even short-term consultants are required to obtain a Foreign Business Licence. Currently, the Office of Commerce and Investment is considering streamlining the process and implementing a "one-stop shop" system, with a universal application form covering all relevant applications.

The process of applying for work permits for non-resident workers is also cumbersome, with requirements to first notify your intention to employ a non-resident worker and to make an effort to employ a local worker for the same position. If unsuccessful in employing a local worker, companies must apply for the permission to hire a non-resident worker with evidence of effort to hire a local worker. While applying for work permits, the investor needs to demonstrate effort to hire local

61 The EU has again added the Marshall Islands to the list of non-cooperative jurisdictions since March 2019, <https://www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/>

workers, to demonstrate that the non-resident worker has the required skills and experience and a good police record, and has no communicable diseases. The work permits are granted on conditions to cover the repatriation cost of non-resident workers, to train local workers for the same position, and to pay levies on every hour non-resident workers have worked.

Nonetheless, FDI has already played an important role in RMI's economy, especially in the banking, retail and fishery sectors.

3.4.4 International Private Development Assistance

For the past 10 years, Private Development Assistance (PDA) or “philanthropic giving across borders”, including all international concessional resource flows transferred voluntarily from private sources to international development, has witnessed significant growth. By 2013, the estimated annual PDA from DAC countries reached US\$45 billion, 50 percent higher than that in 2006. PDA was already one-third of ODA (US\$134.8 billion) by 2013 (Development Initiatives, 2013). The top source countries of PDA are Australia, Canada, Germany, the United Kingdom and the United States; (Development Initiatives, 2013).

PDA from emerging countries is also significant. It is estimated that four countries – China, Saudi Arabia, Turkey and the United Arab Emirates – collectively contributed an estimated US\$1.1 billion in PDA in 2011 (Development Initiatives, 2013). Recent years have also witnessed the emergence of crowd-funding, which solicits large numbers of small, individual contributions for development assistance. All these international PDAs present opportunities of extra financial sources for RMI.

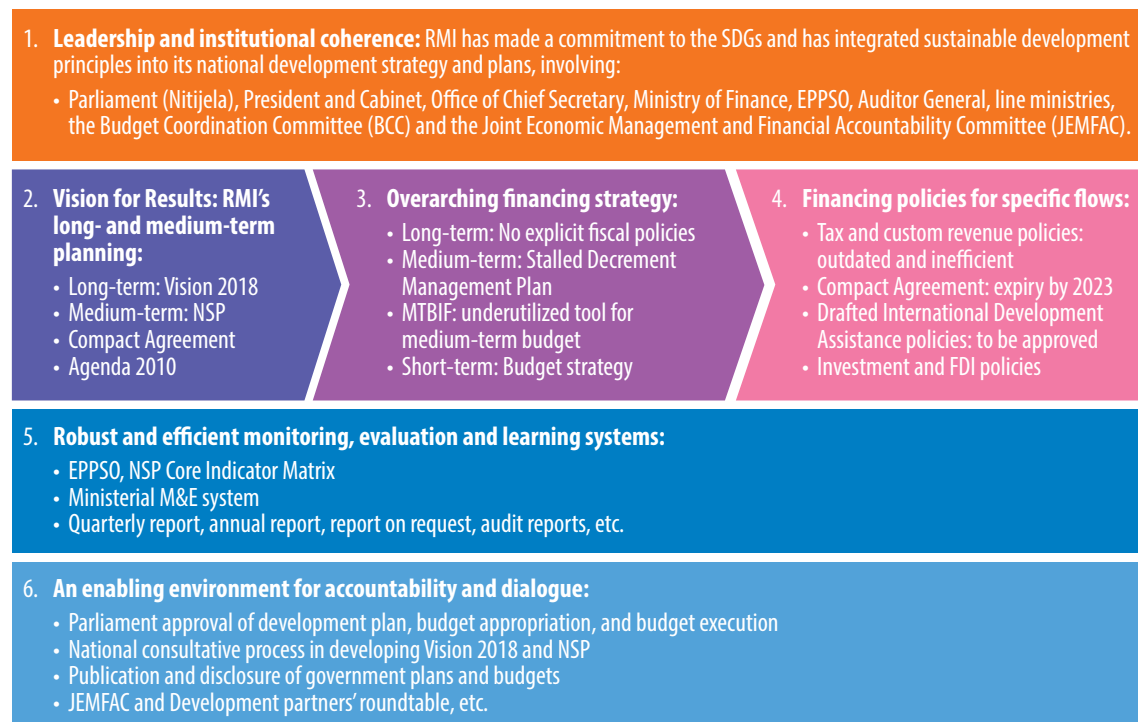
According to the limited recorded information, the scale of PDA to RMI is likely to be small. According to SDGfunders.org, since 2002, eight US foundations have provided a total of US\$350,000 of PDA to RMI. These foundations include the John D. and Catherine T. MacArthur Foundation, the Global Fund for Women, the Freeman Foundation and the Koch Foundation. About 60 percent of these PDAs are channelled to activities on environmental sustainability, followed by women's affairs. All these PDAs are distributed to either NGOs or universities, including the Friends of College of Marshall Islands Foundation, Women United Together in Marshall Islands, and the Prefecture Apostolic of the Marshall Islands. These figures, however, may underestimate the actual scale of PDA received in RMI due to the low traceability of PDA and the weak monitoring system of PDA activities around the world and in RMI.



4. The building blocks of RMI's INFF

This chapter explores to what extent elements of an integrated national financing framework have already been put in place in the Marshall Islands and highlights areas for improvement, in the context of identified financing challenges and opportunities, in order to accelerate progress toward achievement of national development ambitions. Figure 37 maps RMI's existing institutional structure to an INFF.

Figure 37: RMI's Integrated National Financing Framework



Source: DFA authors.

4.1 Block 1: Leadership and institutional coherence

RMI has made a commitment to sustainable development and has already integrated the principle of sustainable development into its long-term development strategy, Vision 2018, developed through a consultative process in 2001. In 2015, it endorsed the SDGs and the post-2015 agenda, the 2030 Agenda for Sustainable Development (the 2030 Agenda). Currently, it is aiming to integrate key SDG targets and indicators into its forthcoming National Strategic Plan. RMI has also been a signatory to a number of international and regional agreements and programmes of actions on sustainable development, including the Paris Climate Agreement, and has been a leading voice against climate change.

Achieving RMI's national vision and development objectives depends on efforts by all stakeholders in society. These stakeholders include the national government; local governments; the private sector including private households, private individuals, and private businesses; NGOs and civil society. Leadership and institutional coherence are essential for ensuring the alignment of national development objectives with the interests of stakeholders across and outside government to facilitate the participation of stakeholders from all parts of society, and ensuring the alignment of government financing policy with national development objectives.

RMI's Constitution (Articles VII and VIII) define the main leadership and institutions governing fiscal matters as the Parliament (Nitijela), President and Cabinet, Office of Chief Secretary, Ministry of Finance, Auditor General, and line ministries. The Constitution also sets out the fiscal roles of the executive, legislative and judicial branches, which provide the basis for revenue raising and expenditure.

Parliament (Nitijela) takes on the responsibility of legislative control of public revenue and expenditure, authorizing laws on raising revenues and spending public money and ensuring public money is spent properly. All seven permanent standing committees within the Parliament deal with issues related to financing for development.

The executive power lies with the President, who nominates Ministers to the Cabinet. Cabinet takes the responsibility for making proposals on budgetary matters to the Parliament, supervising public expenditure, and reporting to the Parliament on public revenue and expenditure.

The Economic Policy, Planning and Statistics Office (EPPSO) directly reports to the Office of the President and serves as an economic advisor to the President and Government, responsible for Policy & Strategy Development, Statistics & Analysis, and Performance Monitoring, Evaluation & Aid Co-ordination.⁶²

The Ministry of Finance (MOF), headed by the Secretary of Finance, is responsible for preparing accounts relating to all public revenues and expenditure for each financial year, and for advising the Minister of Finance on all matters pertaining to the budget. The Minister of Finance has the duty to lay before the Parliament budget estimates of the revenues and expenditure before the start of each financial year, and actual public revenues and expenditure after the end of each financial year.⁶³

⁶² See <http://www.eppso.org/>

⁶³ Constitution of the Republic of the Marshall Islands.

The Auditor-General is responsible for auditing the public funds and accounts of RMI, including those of all Departments or legislative offices, executive and judicial branches of government and of any other public corporations or other statutory authorities. They are also required to report at least once annually to the Parliament on the performance of their functions and any irregularities in the accounts audited by them.⁶⁴

The line ministries are responsible for formulating Sector Portfolios, including a Sector Policy Statement, Objective Areas, Outcome Groups per Objective Area, Expected Primary Results, and Financing per Outcome Groups. The Sector Portfolios are prepared based on ministry/agency strategies, plans and priorities. EPPSO facilitates ministries/agencies in sector portfolio preparation.

The Chief Secretary is the head of the Public Service and the chief administrative and advisory officer of the Government, responsible to the Cabinet for the general direction of the work of all Departments and offices of government, including both MOF and EPPSO. The heads of Department or office are required to report on the work of their Departments or offices to the Chief Secretary, as well as their responsible Ministers. As such, the Chief Secretary assumes the function of coordinating and monitoring the operation of government departments and offices.

Cabinet also appoints various **specialized committees, task forces, steering groups, specialized advisory groups, or similar entities, to coordinate economic and financial decision-making**, such as planning, budgeting, public sector reforms and tax reforms. For example, the annual budgeting is coordinated through a Budget Coordination Committee (BCC), which is established by the Cabinet and chaired by the Chief Secretary, and includes members from MOF (secretary and assistant secretary), the Attorney General, the Public Service Commission, EPPSO and the Cabinet. The drafting of the National Strategic Plan 2015–2017 was coordinated through a Steering Committee, which was also chaired by the Chief Secretary and included members from MOF, EPPSO and the Ministry of Foreign Affairs, as well as representatives from local governments, the private sector and NGOs. For tax reform, a Revenue and Tax Reform and Modernization Commission was created in 2009 by the Cabinet to develop a proposal to reform RMI's revenue system and strengthen compliance and collection.

Despite these coordination measures, there are areas where RMI's leadership and institutional coherence could be further strengthened. These can be divided into three areas: coherence between Cabinet and Parliament, coherence within government departments, and coherence between government and non-governmental stakeholders.

The weakness in leadership and institutional coherence between the government and Parliament can be demonstrated by the delayed implementation of tax reform proposals. In 2008, recognizing the economic and financial circumstances facing the nation, the Cabinet created the Tax and Revenue Reform and Modernization Commission (TRAM), tasked with developing a proposal to reform the existing revenue system and strengthen compliance and collections. With the support from PFTAC, a number of tax reform proposals were initiated and endorsed by the Cabinet, which were then drafted into laws intended to be submitted to the August 2011 session of the Parliament. However, this was extensively delayed until after the 2015 election. By 2017, these laws were still waiting in the Parliament for consideration.

⁶⁴ Ibid.

The weakness in leadership and institutional coherence at the government level can be demonstrated in the weaknesses in the coherence of government policies, government capacity for policy implementation, and policy implementation. There are also problems with policy coherence in regard to the different funds administered by the government. For example, in 2008, the Cabinet created a Comprehensive Adjustment Programs (CAP) Advisory Group, tasked with developing an internally conceived and designed actionable Comprehensive Adjustment Program to restore fiscal stability and to ensure medium- to long-term fiscal sustainability in RMI. The CAP advisory group has proposed a number of measures to reduce expenditure within the public sector, including a reduction in workforce in the public sector and reduction in subsidies and transfers to SOEs. While the Cabinet has endorsed CAP's recommendations, the implementation has been slow, and even stalled after the public fiscal situation improved due to the rapid rise in non-tax revenue.

Recent legislation, the 2015 State Owned Enterprise Act, requires SOEs to operate on a commercial basis with the identification of Community Service Obligations. However, the law still allows the direct involvement of the responsible ministers in all aspects of SOE's management, and allows increased representation by publicly elected officials on SOE Boards.

4.2 Block 2: Vision for Results: RMI's long- and medium-term planning

"Vision for Results" is the foundation of an INFF on which financing plans and targets are built. RMI's long-term (Vision 2018), medium-term development strategy and plan (the NSP), and action plans (Agenda 2020) collectively serve as the "Vision for Results" that shapes the implementation of the INFF in RMI. These documents have identified national development priorities, set up the development goals and targets for RMI to achieve in the medium and long-term periods, and have provided guiding principles for the annual budgeting and planning of public finance. However, none of these development strategies and plans have **explicitly considered or included affordability and costings of the resources needed to achieve the vision and development goals.**

4.2.1 Vision 2018: RMI's long-term development strategy

RMI's development efforts have been shaped by Vision 2018, which was developed in 2001 through a national consultation process. Vision 2018 defined where RMI wanted to be by 2018 and provided a long-term perspective for sustainable development in RMI.

Vision 2018 calls RMI's development vision "in our own hands is our future", which has been further articulated as "continuing to build a resilient, productive and self-supportive RMI. As such, it is founded on the attributes of self-reliance, mutual respect, tolerance and integrity in line with constitutional obligations and international promises." This has provided the basis for planning, target setting, and a financing framework for more detailed long-term strategies in 10 development thematic areas, and for operational policies in the short and medium term.

Vision 2018 has identified 10 development themes:⁶⁵

- **Good governance:** Ensuring and applying the practice of good governance principles to achieve effective governance through community planning and developing effective linkages between local and national governments.
- **Reduction in “access-related” poverty:** Empowering people and communities to reduce the incidence of “access-related” poverty through improvements in all areas including social, economic, environment, governance and infrastructure.
- **Strengthening ability to mobilize local and traditional knowledge** to address emerging challenges facing people, communities and governments.
- **Building up a caring society** embodied by traditional culture and values through continued focus on cultural awareness and cultural responsibility.
- **Innovative people:** Promoting an innovative people by improving health and education access and opportunities.
- **International cooperation:** Addressing globalization and regional cooperation challenges through focused legislation, international agreements and the implementation of regional and national policies.
- **Inclusive growth:** Ensuring broad-based growth and food security through a cross-cutting approach.
- **Sound infrastructure:** Building a sound infrastructure that provides energy, environmental, infrastructure and transportation security for all atolls.
- **Climate change:** Mitigating the impacts of climate change and creating awareness of the importance of environmental assets through community, national, regional and international approaches and specifically the implementation of the Majuro Declaration.
- **Outer island development:** Ensuring outer islands’ populations receive access to all necessary services allowing all RMI citizens to enjoy a high quality of life.

In response to these 10 development themes, Vision 2018 has also defined national development goals with detailed development targets.

The development themes and national goals defined in Vision 2018 form an integrated set of policies, which to a large extent aligns with the five pillars (human development, environment sustainability, inclusive growth, international partnership, and peace) embedded in the SDGs, aiming to:

- Foster environmental sustainability and human capital development
- Guide the development of productive sectors, outer islands, and science and technology for inclusive economic growth
- Protect culture and traditions
- Promote international cooperation and international participation.

⁶⁵ Republic of the Marshall Islands. NATIONAL STRATEGIC PLAN 2015–2017, available at: <https://www.adb.org/sites/default/files/linked-documents/cobp-rmi-2016-2018-ld-04.pdf>

Vision 2018 also includes master plans and action plans. While Master Plans focus on major policy areas, action plans of Ministries and Statutory Agencies detail the respective programmes of action aimed at achieving the targets identified in the Master Plans. These plans are also expected to contain programmes and projects together with the appropriate costings. However, they generally do not estimate the cost of interventions or the scale of private financing they aim to mobilize.

Vision 2018 was developed in 2001, before the Amended Compact Agreement was established, for the period between 2003 and 2018. While the majority of the issues addressed in Vision 2018, such as poverty reduction, inclusive growth and climate change, are still relevant today, RMI faces new challenges. The most prominent is the coming expiry of the Compact Agreement in 2023 and the associated changes in financial assistance from the United States, upon which RMI's public finance has been heavily reliant. This is coupled with the challenges to finance the achieving of the SDGs. The government has recognized the need to develop **a new national strategy, to address the new challenges RMI is and will be facing in the next 10 to 20 years.**

4.2.2 NSP: the Medium Term Development Plan

Framed by Vision 2018, the National Strategic Plan 2015–2017 (NSP) defined RMI's three-year medium-term strategic development plan. The NSP was developed through national consultation with both public sector stakeholders, including both local governments and SOEs, and private sector representatives, such as the Chamber of Commerce. The NSP was further operationalized by sector plans, such as plans for health, education, infrastructure, trade, energy and climate change. In essence, the NSP was a consolidation of policy statements and plans from government departments, agencies, and a variety of segments of the RMI community.

However, the NSP did not have fixed targets and a fixed time framework to achieve the targets, lacked the prioritization, commitment and discipline associated with achieving time-bound fixed targets, and created uncertainty associated with its flexibility.

Furthermore, except for a few sectors, such as education, the NSP did not incorporate an implementation roadmap, containing strategies, outcomes, and targets and monitoring indicators. The NSP did not contain costing of the programmes and interventions proposed within it, nor does it specify how to finance them. Consequently, the NSP can be seen as a list of aspirations RMI wanted to achieve rather than an operational document for use in planning and budgeting.

The NSP was developed in 2014 for the period between 2015 and 2017, and incorporates some of the MDG targets and indicators. The SDG period has now started from 2015. **RMI is in the process of developing a new NSP to incorporate SDG goals, targets and indicators to make the connection between national development objectives and the SDGs explicit and measurable.**

4.2.3 Compact Agreement: expiry by 2023

The Compact Agreement between the United States and RMI, and the associated targeted development assistance, also shapes RMI's national development framework. The Compact Agreement specifies that the objective of US economic assistance is to promote the economic advancement and budgetary self-reliance of RMI. It stipulates the amount of annual Compact Grants, targeted mainly at education, health care, the environment, public sector capacity-building, and private sector development, as well as the governance framework around Compact Grants. The

amount of the Compact Annual (Sector) Grants are reduced annually and will terminate by the end of 2023.

4.2.4 Agenda 2020: Action plan for the period up to 2020

After taking office in January 2016, the new RMI government put forward Agenda 2020 in 2017 as a whole-of-government action plan for the period up to 2020. It identified 10 challenges, and 10 priority reforms, as listed in Table 5.

Table 5: RMI Agenda 2020 Framework

10 major challenges	10 priority government reforms
Growing the economy, employment, and private sector	Improve fiscal and economic management
Preparing for the post-2023 Compact transition	Reform SOEs
Improving basic health services on Majuro	Salvage MISSA
Supporting education, youth, and vulnerable groups	Strengthen PSC, EPPSO and the Office of Chief Secretary
Adapting to climate change and reducing disaster risks	Improve infrastructure planning, development and management
Strengthening water, energy, and food security	Enhance accountability and good governance in the public sector
Improving the quality of life on Ebeye and other Kwajalein communities	Sharpen foreign policy and development assistance, and seek nuclear justice
Improving the welfare of outer island communities	Strengthen government's management of cultural and historical resources and assets
Tackling consumer debt and strengthening consumer protection	Improve and integrate information technology systems in government
Strengthening laws, justice and public safety	Amend and improve the Constitution

Source: Republic of Marshall Islands Agenda 2020.

Agenda 2020 also proposed priority actions for these challenges and reforms, and created an implementation roadmap for some of the programmes and interventions envisioned in the NSP, with clear priorities, clear targets, timelines and accountabilities.

However, RMI faces the challenges of a limited capacity to implement Agenda 2020, especially when there are so many actions to take.

4.3 Block 3: Overarching financing strategy

A financing strategy estimates the costs to achieve the long-term vision and develops proposals for the types of investments needed to meet the costs. It provides the framework within which specific financing policies can be developed and operationalized. It also takes into account the capacity of government institutions in delivering finance to achieve the Vision for Results.

RMI's overarching financing strategy lies with the vision of a "resilient, productive and self-supportive RMI" stated in Vision 2018 and the NSP. However, RMI does not have a set of concrete long-term social and economic targets that are conducive to a "resilient, productive, and

self-supportive RMI". Considering the challenges RMI is facing, these targets could include the pace of economic growth, the level and growth of investment, the level and growth of public revenue, a budget surplus to prepare for the post-2023 transition, and the level of debt and self-reliance.

Without such a set of targets, **RMI does not have explicit long-term fiscal policies** towards achieving a "resilient, productive and self-supportive RMI". These long-term fiscal policies could include promoting the productive capacity of the economy through sustainable infrastructure investment, improving the business-enabling environment, promoting private sector development, and promoting "blue growth" (i.e. based on sustainable use of marine resources).

At the medium-term level, **a Decrement Management Plan has been developed to serve as medium-term revenue and expenditure policies** in preparing for the post-2023 transition. The Decrement Management Plan includes a schedule for budget reduction and plans to implement a new tax system, to program fishing fees into the annual budget, and to reduce subsidies to state-owned enterprises. **However, concrete policies and action plans on how to reform SOEs and the tax system have not been fully developed, and the implementation of the Decrement Management Plan has been stalled** due to increased domestic revenue, in particular increased revenue from fishing fees.

The Medium Term Budget and Investment Framework (MTBIF), which RMI has adopted under the requirement of the amended Compact Agreement for the preparation of the annual budget and for requesting grants from the United States **has played a central role in providing overarching operational guidance for the government to mobilize all forms of public financial flows in the medium term**. MTBIF forecasts government medium-term revenue income and expenditure, covering government revenue, ministerial expenditure projection, and capital outlay in the coming three years based on the GDP and government debt stock projection and government policy priorities. MTBIF serves as policy guidance for government spending and public finance management in the medium term of three years. The results from MTBIF have been incorporated into RMI's annual appropriation bill.

Embedded in the MTBIF are long-term economic strategies, including aiming to raise domestic collected public revenue (tax and non-tax revenue) to 25 percent of the GDP, maintaining a balanced budget on the General Fund (including budget support grants) and achieving an overall balanced annual budget.

However, there are no alternative scenarios presented in the MTBIF, which suggests that many functions of the MTBIF, such as exploring the impacts of policy interventions, have not been fully utilized.

4.4 Block 4: Financing policies for specific flows

Building on and consistent with the overarching financing strategy, policies for each type of financing can guide the way resources are mobilized and harnessed to achieve development goals.

RMI has a number of policies, although in many cases informal and not reflected in official documents, governing the mobilization and use of different types of finance, including tax and customs revenue policies, expenditure policies, the Compact Agreement and policies governing Compact Grants, and investment policy for both domestic and foreign investment.

Tax and customs revenue policies. RMI's taxation mainly includes: import tax (customs), income tax (wages and salaries tax), business gross revenue tax (GRT), immovable property tax, hotel and resort tax, and non-resident gross income tax. Wages and salaries tax, import duties, and GRT account for the majority of domestic tax revenue income. In 2016, these three taxes accounted for more than 97 percent of domestic tax revenue. RMI does not have corporate tax.

As shown in section 3.1.1, RMI's current tax and customs system is characterized by a low tax to GDP ratio, a small tax base, manual tax and customs administration, a high level of non-compliance, and limited enforcement and dispute settlement capacity.

The current tax and customs system is considered to be outdated and inefficient. Tax reform has been proposed based on a set of principles, which are expected to be the principles for future tax policies. These include:

- Implementing a tax system that is simple, broadly based, fair, transparent and competitive
- Implementing a tax system that encourages private sector development and foreign investment
- Implementing a tax system that ensures fiscal sustainability
- Modernizing the tax and customs system to facilitate effective and efficient tax and customs administration.

Since 2008, a number of tax reform bills have been submitted to the Parliament for review. However, none of the bills have been enacted, and there is no progress yet in tax reform after many years of consideration.

Non-tax revenue policies. While non-tax revenue, in particular ship registry and fishing licences, account for a significant proportion of government revenue income, RMI does not have a policy on how best to utilize non-tax revenue, especially when non-tax revenue has been increasing rapidly in recent years and may not be sustainable in longer term.

Compact Agreement. The Compact Agreement and the agreement concerning economic assistance provided under the Compact Agreement govern the amount, the target usage of Compact Grants, and the procedures required in implementing economic assistance provided under the Compact Agreement. The allocation of Compact Grants is organized through a Joint Economic Management and Financial Accountability Committee (JEMFAC). The implementation of Compact Grants is by the government of RMI, which is required to prepare and submit monitoring reports to the US government.

Other forms of development assistance are organized through bilateral agreements. RMI does not yet have an international development assistance policy covering all forms of development assistance. However, RMI is in the process of developing one. Two versions of International Development Assistance policies, with different coordination mechanisms (centralized vs multipolar), have been developed for debate. Agenda 2020 proposed enabling the Ministry of Finance to attain an accreditation status to access **global climate finance sources**.

Foreign Direct Investment. RMI's FDI is regulated by RMI's Foreign Investment Business License Amendment Act. The National Strategic Plan identified building an enabling business environment and promoting foreign investment as one of its development objectives. A number of tax incentives have been established to encourage foreign investment, especially in agriculture, fishery and tourism.

The Office of Commerce and Investment has been established with the task of promoting and facilitating both domestic and foreign trade and investment. Recently, a Foreign Investment Business License (FIBL) task force has been established, aiming to improve the business environment and attracting foreign investment. A universal online application form has been proposed to reduce the processing time for an FIBL application.

Remittance. While remittance inflow is significant, RMI does not have policies governing remittance and on utilizing remittance for development.

External debt. While the external debt level is high, RMI does not have an explicit debt policy either, although the CAP advisory group proposed in 2009 developing a national debt policy.

4.5 Block 5: Robust and efficient monitoring, evaluation and learning systems

Effective and efficient monitoring and evaluation (M&E) is an integrated part of INFF implementation. M&E is used to monitor the allocation, disbursement and movements of various financial flows, and the progress of programmes funded by these financial flows, and to evaluate their outcomes. It helps ensure that the allocation of financial flows aligns with national development priorities and the execution of these financial flows achieves their intended objectives.

RMI has a two-tiered M&E system, with the NSP Core Indicator Matrix representing the overarching M&E framework, and the M&E system at the level of Ministries and Statutory Agencies representing the second tier of the M&E system to monitor and evaluate programme or intervention progress, outcomes and impacts against intended development objectives.

NSP's Core Indicator Matrix includes indicators that can be categorized into 11 groups, which largely correspond to the 8 MDGs, and links to the 10 strategic areas identified in Vision 2018 and the National Strategic Plan. The NSP Core Indicator Matrix is organized as in Table 6. This matrix has the potential to provide an interlinked picture of progress towards outcome targets in different priority areas, to monitor government's efforts in mobilizing necessary resources and the outputs and impacts that those financial flows contribute to, and to inform government decision-making on future programme and policy interventions.

However, what is still missing from the framework is a set of targets and baseline values of all the indicators. Furthermore, while the Core Indicator Matrix is in place, the monitoring based on this matrix is still at its early stage. Regular updating of this matrix is needed to track progress towards national development targets.

EPPSO is the central M&E agency responsible for monitoring the implementation of the National Strategic Plan. However, the capacity of EPPSO is limited – in staff numbers, technical capability and technological capability – which may have constrained its functionality.

The M&E system at the Ministries and Statutory Agencies provides further details regarding implementation and progress of the Ministerial Development Objectives. For example, in the education sector, an education implementation matrix with medium-term targets and indicators as well as a medium-term strategy have been established. Similar implementation has also been established in the health sector, such as those presented in the RMI NCD/Nutrition Strategy

2008–2012. **However, these Ministries are also limited in M&E capacity.** PEFA found that there was no tracking system on resources received by schools and primary health facilities in the education and health sectors.

To strengthen the accountability of government and state entities, a number of reporting requirements have been established, under the requirements of FMA and the Compact Agreement, such as quarterly reports, an annual report, reports on requests, and audit reports, at both the whole-of-government level and sector level to monitor and evaluate the progress and performance of budget and programme execution.

However, **compliance with these reporting requirements still needs to be strengthened.** The PEFA 2012 found that “there were only limited in-year budget execution reports that have been issued, thereby providing insufficient information to management to monitor budget performance”. GAO (2016) also found non-compliance in both the content of the report and meeting the report deadlines.

Table 6: NSP Core Indicator Matrix

	Core indicator	Sector	Strategic Area	Source/Ministry	Availability	Indicator		Comments/Notes
						Status	Reporting year	
1	Poverty reduction							
1.1	Proportion of population living under the Basic Needs Poverty Line	Governance	Poverty reduction					
1.2	Poverty Gap ratio	Governance	Poverty reduction	MDG Report 2009	No			
...								
2	Achieve full and productive employment							
2.1	Employment to Population Ratio	Economic	Poverty Reduction	Census/EPPSO	Yes	40%		
...								

Source: Republic of Marshall Islands PUBLIC FINANCIAL MANAGEMENT REFORM ROADMAP, 2014–2016.

There are also concerns of data quality. Both Public Expenditure and Financial Accountability (PEFA) (2012) and the US Government Accountability Organization (GAO) found, in 2012 and 2016 respectively, problems with the quality of the data. PEFA found that there were no available data on resources received by schools and primary health facilities, while GAO found that there were no reliable grant performance data from the education and health sectors. The lack of reliable performance data could have prevented the United States and RMI from assessing the progress achieved toward the Compact Goals and from using data to set priorities and allocate resources to improve performance.

The financial performance data could be made more transparent and more accessible to all key stakeholders, through a web-based M&E system if possible. Currently, RMI does not issue official in-year budget execution reports, such as quarterly reports, and annual reports. It is also not easy to access the annual reports and/or annual corporate plans by government departments and state entities.

The financial performance data need to be audited by independent review. PEFA found that the annual financial statements are prepared and audited by the same externally contracted audit firm, which represents a key weakness in the chain of accountability. Another improvement that could be made in the chain of accountability is to establish the link between performance management and the M&E system.

4.6 Block 6: An enabling environment for accountability and dialogue

Strong mechanisms for dialogue and accountability, through transparent, fair, and integral public service delivery, will ensure that the private sector, development partners, NGOs and CSOs have trust in government's decisions and actions to mobilize their contributions toward national development goals. Dialogue with the private sector is particularly important for understanding the challenges faced by businesses and prioritizing reforms that can support greater and more impactful private sector development.

In RMI, dialogues and accountability have been facilitated mainly through dialogue between government and the general public, between government and private sector participants, and between government and development partners, as well as through the public's scrutiny of government's decisions and actions.

Dialogue and accountability between government and the general public has been facilitated through disclosing relevant planning and fiscal information to the general public directly. However, there is only limited fiscal information available to the general public.⁶⁶

Dialogue and accountability between government and the general public has also been facilitated through the Parliament's approval of government's development plans, annual budgets, reform initiatives, and scrutiny of the government's budget execution report and annual reports.

However, PEFA found that the budget documents presented to the Parliament are not comprehensive, with key information lacking; and that significant amounts of public resources are not included in the budget information provided to the Parliament for their scrutiny.

Another channel to ensure dialogue and accountability between the government and the general public is through the disclosure of independently audited financial statements of the whole government and statutory offices and authorities (Component Units). However, as described above, the government's financial statements are prepared and audited by the same externally contracted audit firm, which represents an important weakness in the chain of accountability. Furthermore, follow-up actions taken by the audited entities to address findings and recommendations are very limited.

⁶⁶ Since the assessment, RMI has published its Budget Book 2016–2021.

Dialogue between government and local governments and the non-governmental sector has been facilitated through the involvement of non-governmental stakeholders in the decision-making process, with the Chamber of Commerce working as a key channel for dialogue with the private sector in developing national development plans.

Dialogue between government and development partners is managed by four line ministries, with the Ministry of Finance responsible for funding from multilateral development banks; the Ministry of Foreign Affairs responsible for Compact Grants, grants from Taiwan Province of China, the Adaptation Fund and the GEF; OEPPC responsible for the GEF and Green Climate Fund; and EPPSO responsible for monitoring and evaluating of development assistance performance and planning. The dialogues between government and development partners are generally conducted through bilateral negotiations. For example, dialogue on Compact Grants was conducted through JEMFAC. A development partners roundtable was established with the intention to serve as a mechanism coordinating development assistance but meetings were held only twice, in 2010 and 2014.



5. Improving the public financial management system to mobilize domestic resources

Strengthening public finance management, the process through which the government of RMI raises funds from domestic sources and allocates them for economically and socially productive investments, will be critical for RMI to achieve its national development goals and the SDGs, especially after the expiry of the Compact Grants in 2023.

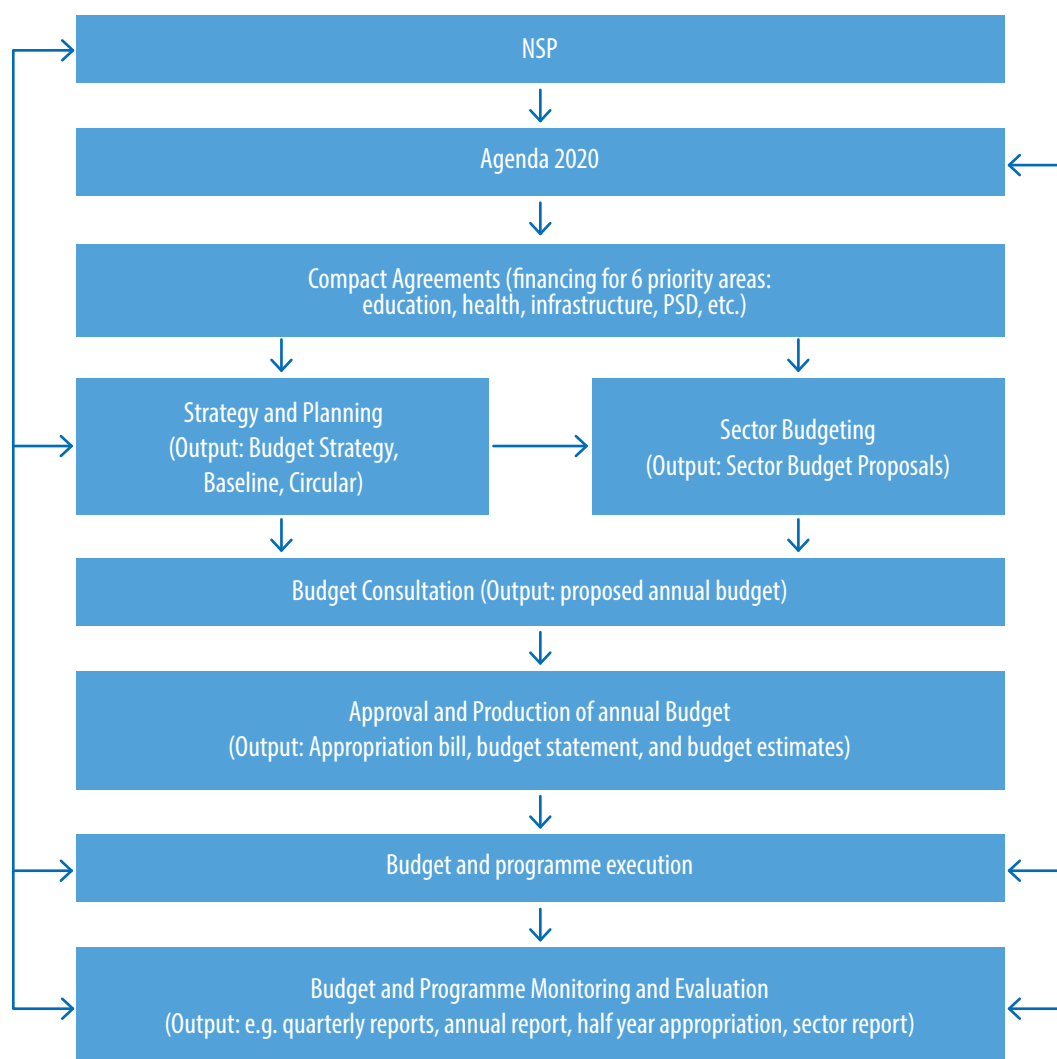
However, RMI has particular constraints in domestic resource mobilization due to its small, undiversified economy, a narrow resource base, relatively limited types of economic activities, heavy reliance on external aid, in particular Compact Grants, and high level of subsidies to loss-making SOEs. A key challenge for RMI is to achieve fiscal sustainability when Compact Grants expire from the end of 2023. The quality of public finance management is also weak, which makes achieving fiscal sustainability even more challenging.

Public financial management system reform, with the objectives to strengthen RMI's public financial management system and to improve SOE performance, will facilitate RMI's transition to the post-2023 period, channel public finance to where it is needed the most, and improve RMI's fiscal position.

5.1 Annual budget planning and appropriation

Mobilizing different forms of public financial flows for the achievement of national development goals is operationalized through the annual budgeting and appropriation process in RMI, which has incorporated Results-Based Management (RBM) systems and procedures. The Financial Management Act (FMA) and related regulations provide the legislative framework for the budget process.

The budget process consists of four major phases: strategy and planning, submissions of expenditure bids, budget consultations, and approval and production. Two other phases, budget and programme execution, and budget and programme monitoring, are also important in that the budget and programme execution phase implements what the national budget intends to achieve, and the M&E phase tracks the effectiveness and efficiency of the budget execution, and is used to provide feedback into the budgeting process for the next financial year or into the rolling National Strategic Plan.

Figure 38: Annual budgeting process in RMI

Source: Compiled by the DFA team, with consultation.

The budgeting process starts with the establishing of a Budget Co-ordinating Committee (BCC) to oversee the budget process and establishing a budget strategy. The BCC, established by the Cabinet and chaired by the Chief Secretary, includes members from the Ministry of Finance (secretary and assistant secretary), the Attorney General, the Public Service Commission, EPPSO and the Cabinet. The budget strategy is developed by BCC through a series of meetings, which discuss budget projections recommended by the Finance Secretary, following discussions with the Finance Minister and taking into account the Cabinets' desire for any tax or tariff increases and any specific items of expenditure. The budget strategy and the budget projections are then approved by Cabinet and sent out to the Ministries through a Budget Circular.

The second step in the budget process is for Ministries to develop sector-specific budgets and submit their portfolio budget proposals to the BCC. The portfolio budgets are generally performance-based, prepared by those ministries receiving Compact Grants according to the requirements of the Compact Agreement, as well as by Ministries not receiving Compact Grants. The portfolio budgets are generally developed based on previous year's actual spend and taking into account sectoral priorities for the next financial year, together with the overall baseline budget.

However, except for the ministries receiving Compact Grants, the timeframe for most portfolio budgets is one year only rather than multiple years. Furthermore, there are only weak links between sector plans and budgets, and there was no explicit linkage between recurrent expenditure and capital expenditure.⁶⁷

The third step is budget consultation with Ministries and Agencies, which result in a draft budget. Then, the draft budget is sent to the Parliament for approval and appropriation. However, the budget documents presented to the Parliament are not comprehensive with key information lacking.

To address the issue of balancing priorities within the budget, the Ministry of Finance uses the Medium Term Budget and Investment Framework (MTBIF) as a tool, although not using its full capacity, to assist in calculating annual budgets and projecting revenues and budgets over the medium term. The results from the MTBIF are entered into RMI's appropriation bill.

The effectiveness of the government's overall budget strategy depends on how it aligns with national development objectives and how well the public finance management system facilitates different forms of financing flows in achieving national development objectives.

RMI's budget strategy may not fully align with its national development strategy. While the National Strategic Plan has identified six priority sectors – social development; environment, climate change and resiliency; infrastructure development; sustainable economic development; good governance; and human resource capacity development – RMI's budget strategy, as demonstrated by its budget appropriation, focuses on:

- Financing recurrent operating expenditure rather than capital expenditure and investment;
- Financing social expenditure, including health and education, rather than economic and infrastructure expenditure;
- Balancing the budget, leaving no fiscal buffer for disasters and the post-2023 transition; and
- Subsidizing chronically loss-making SOEs.

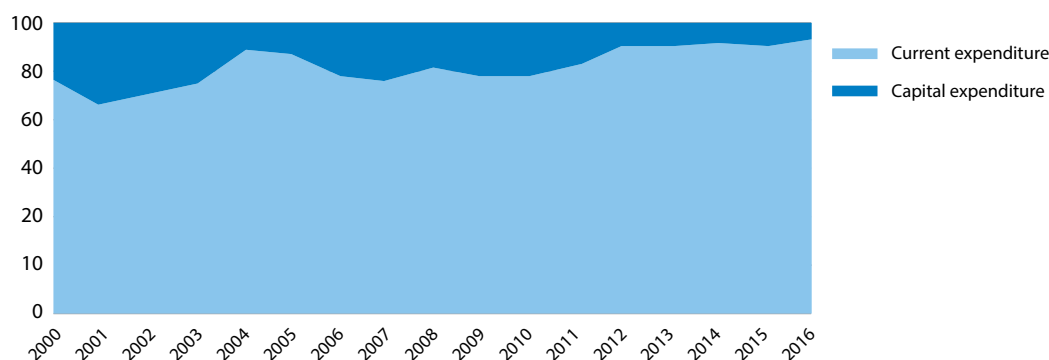
⁶⁷ PEFA.

5.2 Public expenditure: financing for social services and recurrent operating expenditures

The effectiveness of the government's overall public finance depends on how its allocation aligns with national development objectives and how well the public finance management system facilitates different forms of financing flows in achieving national development objectives.

RMI's allocation of public expenditure focuses mainly on current and recurrent expenditure and focuses less on capital expenditure. Meanwhile, the share of capital expenditure in public expenditure has been declining. In 2016, capital expenditure accounted for 5.4 percent of total public expenditure, having declined from a peak of 26.4 percent of public expenditure in 2001, while the share of operating expenditure increased from 73.1 percent of total public expenditure in 2001 to 94.6 percent in 2016. This trend suggests that the government's management of public expenditure in the last 15 years has shifted towards more recurrent operating costs.

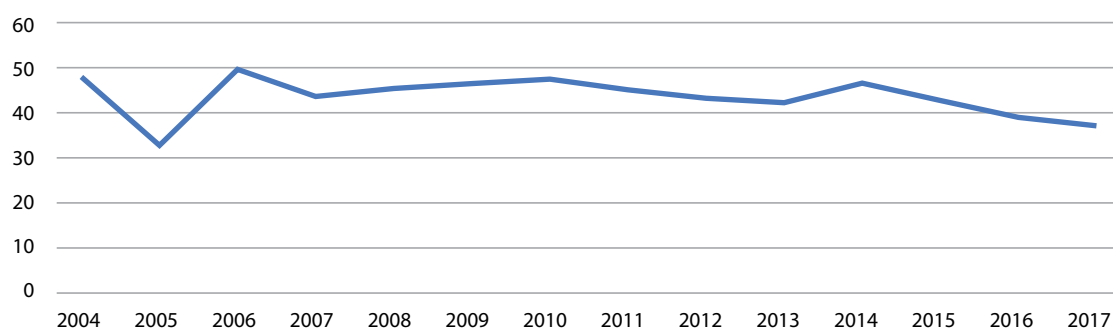
Figure 39: Actual capital vs current expenditure (% of total public expenditure), 2000–2016



Source: ADB Key Indicators.

Compensation to employees, one component of recurrent operating expenditure, accounts for a significant proportion of public expenditure. Since 2007, compensation to employees fluctuated at around 45 percent of total public expenditure, despite the Comprehensive Adjustment Program (CAP) group's call for reduction of the annual wage bill.

Figure 40: Compensation to employees (% of Total Public Expenditure), 2004–2017

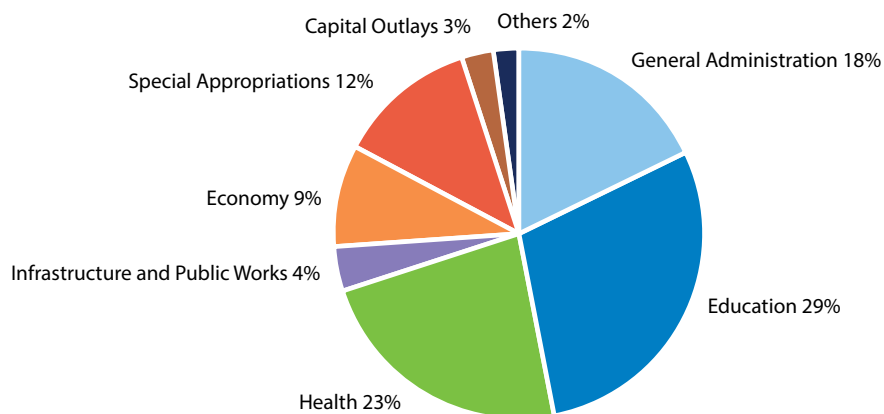


Source: EPPSO.

Two reasons may explain the low level of capital expenditure and high level of operating expenditure. First, there is hardly any capital income from government-owned assets in SOEs; instead, a significant proportion of government budget has been allocated to subsidizing loss-making SOEs. For example, in 2015, subsidies to SOEs accounted for 10.9 percent of total public expenditure. Second, the level of grants, which have provided the most funding for capital expenditure, has been reduced. In fact, between 2012 and 2015, a moratorium was put on Compact Grant-funded infrastructure projects, with most of the grants allocated for infrastructure projects also put on hold. Furthermore, of the limited capital expenditure, the majority was allocated for the education and health sectors.

By sector, the majority of allocation of public expenditure is to social services, including education and health, followed by general administration, subsidies to SOEs, and economic agencies. Social services, including health and education, accounted for more than 50 percent of the total government expenditure budget in 2017, with education accounting for 29 percent of the total public expenditure, and health accounting for 23 percent. General administration, including budgets for the President, Cabinet, Parliament, and law and justice accounted for 18 percent of the total public expenditure. Social service and general administration, together, accounted for 70 percent of the total public expenditure. Budgeting to the economic sector, including both government subsidies to SOEs and budgets to economic agencies, accounted for 21 percent of the total public expenditure. In fact, SOEs are a drain on the public finance. In 2017, the budget for government subsidies to SOEs alone accounted for 12 percent of the total public expenditure. Budgets for infrastructures and capital investments are low, accounting for 4 percent and 3 percent of the total public expenditure in 2017 respectively.

Figure 41: Distribution (%) of public expenditure by sectors in 2017



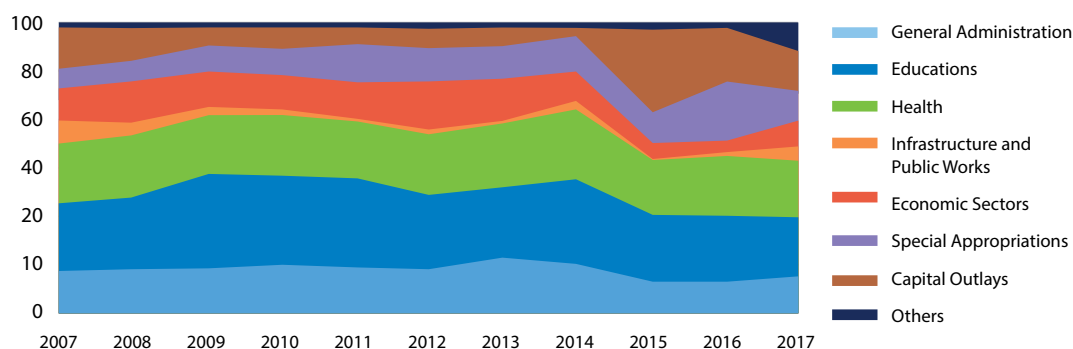
Sources: MOF and MTBIF.

The recent evolution of public expenditure between 2007 and 2014 has involved a gradual shift towards more general administration and social services, and away from capital expenditure and infrastructure and economic services. The combined share of expenditure on general administration and social services has increased from 58.5 percent of total public expenditure in 2007 to 70.1 percent in 2014. Within the budget for economic activities, the share of subsidies to SOEs has also been increasing. Between 2007 and 2014, subsidies to SOEs increased from 6.6 percent of total public expenditure in 2007 to 12.1 percent in 2014.

On the other hand, capital expenditure declined from 14.9 percent in 2007 to 2.9 percent in 2014, and expenditure allocated for infrastructure and public work agencies declined from 8 percent in 2007 to 3.6 percent in 2014. The budget for economic agencies is relatively stable.

Since 2015, more budget has been allocated for capital expenditure. However, the actual capital expenditure figure seems to be smaller.

Figure 42: Distribution (%) of public expenditure (budget) by sectors from 2007–2017



Sources: MOF, MTBIF and Budget Appropriation Bill (2017).

5.3 Sources of public finance: Reliance on foreign aid

RMI's public revenue comes from tax revenue, non-tax revenue, Compact Grants, and other development assistance grants. Table 7 shows the amounts of public revenue from tax revenue, non-tax revenue and grants.

Table 7: Sources of central government public revenues (current US\$ million), selected years

	2000	2005	2010	2015	2016	2017	2017/2000
Central Government Public revenue	74.1	87.0	101.0	105.1	122.4	145.5	1.96
Tax revenue	17.0	24.2	25.1	24.4	28.4	29.8	1.75
<i>Income tax</i>	8.7	10.9	10.8	11.9	13.8	14.8	1.70
<i>Turnover and tax on goods and services</i>	3.2	3.8	6.2	5.0	5.7	5.7	1.78
<i>Imports duty</i>	4.5	8.8	7.7	7.4	8.2	8.5	1.89
Non-tax revenue	7.3	6.3	7.7	24.2	34.9	50.4	6.90
<i>Fishing fee</i>	3.7	1.4	2.0	15.8	26.3	40.0	10.81
<i>Licences (Vehicle & ship registry)</i>	1.0	1.1	3.1	6.1	6.2	7.4	7.40
Grants	49.7	56.6	68.2	56.5	59.1	65.3	1.31
<i>Compact Grants</i>	31.1	27.6	45.6	35.8	36.0	42.4	1.36

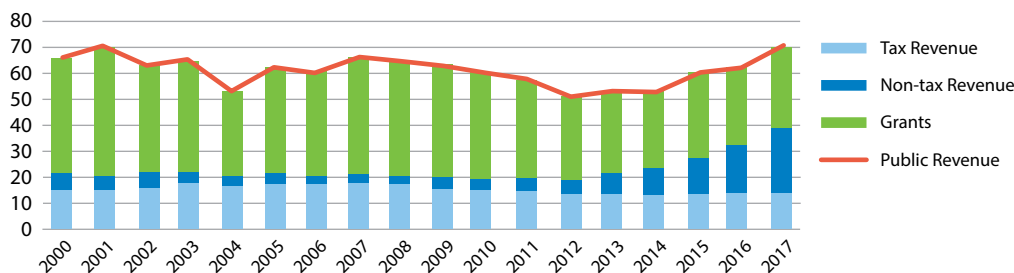
Sources: ADB Key Indicators (2017) and EPPSO.

In 2017, the total public revenue reached US\$145.5 million, 96 percent higher than that in 2000. Tax revenue reached US\$29.8 million, 75 percent higher than that in 2000; non-tax revenue reached US\$50.4 million, 6.9 times of that in 2000. In particular, fishing fees and ship registry fees, two forms of non-tax revenue, increased by more than 9 and 6 times respectively between 2000 and 2017. The amount of grants in the budget was US\$65.3 million in 2017, only 31 percent higher than that in 2000, and 6 percent lower than the peak of US\$69.6 million in 2007.

Domestic revenue sources, both tax and non-tax revenue, contributed the most to the increase in public revenue. The increase in non-tax revenue contributed 60 percent of the increase in public revenue, and the increase in tax revenue contributed nearly 18 percent of the public revenue increase.

As a percentage of GDP, the levels of both tax revenue and grants have been declining, while the level of non-tax revenue has been rising. Figure 43 shows that between 2007 and 2017, tax revenue as a share of GDP declined from 17.6 percent of GDP in 2007 to 14.3 percent in 2017, and grants declined from 45.1 percent of GDP in 2007 to 31.4 percent of GDP in 2017. For the same period, non-tax revenue increased from 3.1 percent of GDP in 2007 to 24.3 percent of GDP in 2017, a 21 percentage point increase. Domestically collected public revenue, including both tax revenue and non-tax revenue, has increased from 20.7 percent of GDP in 2007 to 38.6 percent of GDP in 2017.

Figure 43: Sources of public revenue (% of GDP), 2000–2017



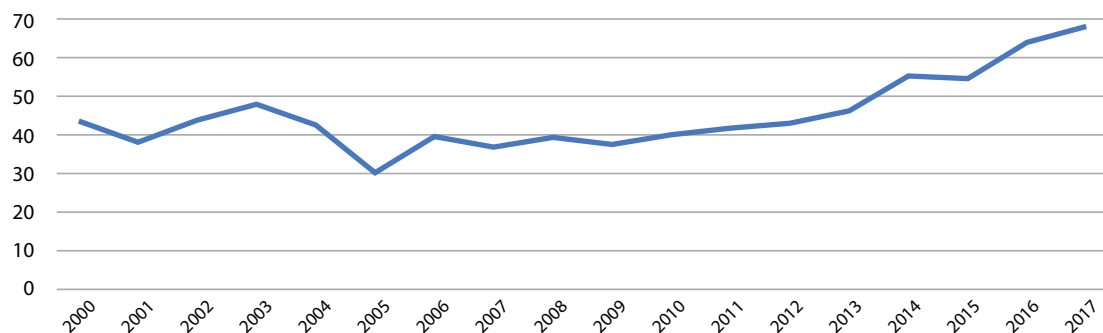
Sources: ADB Key Indicators and EPPSO.

RMI's public finance still relies heavily on foreign aid. In 2017, grants accounted for 31.4 percent of RMI's total public revenue. In fact, all RMI's public capital expenditure since 2000 has been financed by grants, and around 50 percent of government operating expenditure is covered by grants. The amount of budget support grants has been declining since 2007, from a peak of US\$69.6 million in 2007 to US\$65.3 million in 2017.

Non-tax revenue has witnessed the fastest increase in recent years. The amount of non-tax revenue increased from US\$7.3 million in 2000 to US\$50.4 million in 2017. In 2017, non-tax revenue accounted for 35 percent of the total public revenue, representing a nearly 28 percentage point increase from 7.2 percent of total public revenue in 2004. **Non-tax revenue has overtaken tax revenue to be the second most important source for public revenue.**

As a result, RMI has improved its ability to finance its own expenditure using public revenues collected domestically. Its self-reliance ratio, a measure of this ability, increased from 34 percent in 2006 to 58.9 percent in 2017, meaning that 58.9 percent of public expenditure is funded by domestically collected public revenue.

Figure 44: Self-reliance ratio (domestically collected revenue as % of public expenditure), 2000–2017

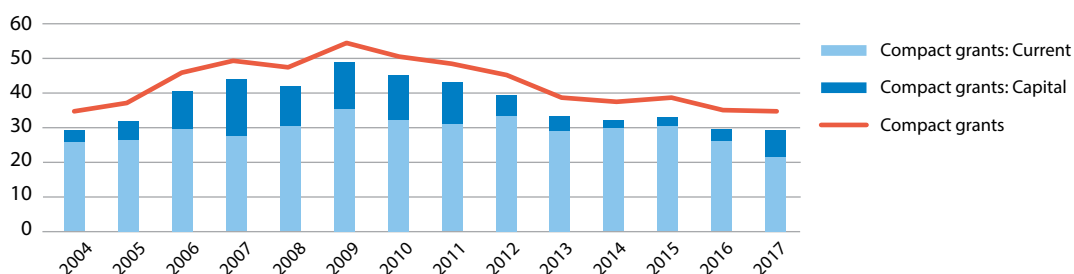


Source: ADB Key Indicators, compiled by DFA.

Compact Base Grants accounted for a significant proportion of the government's public revenue. However, their importance in RMI's public revenue has been declining since 2009.

Between 2004 and 2009, the share of Compact Sector Grants in RMI's public revenue increased from 29.2 percent in 2004 to 48.7 percent in 2009, close to a 20 percentage point increase. Since 2009, this share has been declining, decreasing to 29.2 percent of public revenue in 2017. The majority of the Compact Sector Grants support recurrent operating expenditure, accounting for roughly 30 percent of the total public revenue. The proportion of Compact Sector Grants allocated for capital expenditure is relatively small and has been declining since 2009.

Figure 45: Compact Base Grant (% of public revenue), 2004–2017



Source: EPPSO.

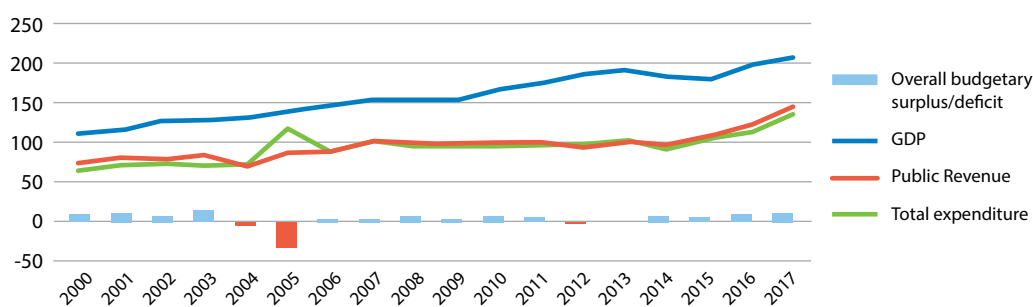
Compact Grants will expire by 2023, which will leave a significant financial gap in RMI's public finance. It is expected that this gap will be filled by investment income from the Compact Trust Fund, which the US government has been contributing to since 2004, complemented by contributions from RMI and Taiwan, Province of China. A number of studies have suggested that the size of the Compact Trust Fund may be insufficient to provide a reliable source of income to replace the expiring Compact Grants.

5.4 Public revenue vs expenditure: slow-rising revenue and a balanced budget

Since 2000, RMI's public revenue has been rising gradually. This trend was only temporarily interrupted by the uncertainty associated with the negotiation of the amended Compact Agreement, which may have led to the decline in public revenue to US\$70.4 million in 2004. Since the signing of the amended Compact Agreement in 2003, public revenue increased relatively rapidly between 2004 and 2007, rising from US\$70.4 million in 2004 to US\$101.6 million in 2007. Between 2007 and 2014, public revenue stabilized at around US\$100 million. Since then, it started to increase again. By 2017, public revenue reached US\$145.5 million.

The trend of public expenditure follows closely that of public revenue, except in 2005 when there was a sharp increase in public expenditure, due to RMI's US\$33.8 million contribution to the Compact Trust Fund.

Figure 46: Public revenue, expenditure and deficit (US\$ million), 2000–2017



Source: ADB Key Indicators (2017) and EPPSO (2017).

The RMI government has kept a relatively balanced budget and has recorded a budgetary surplus in most of its financial years except in 2004, 2005, 2012 and 2013. The jump of public expenditure in 2005 was due to the initial contribution of US\$30 million to the Compact Trust Fund. This, on one hand, suggests that the government has maintained a relatively tight control over its spending. On the other hand, this reflects its limited ability to borrow from both domestic and international sources due to its high level of debt stress. In fact, due to its high debt stress, ADB has put RMI in the category of “grant only”, meaning that the Marshall Islands can no longer borrow from ADB and will only receive grants. **With a limited ability to borrow, the balanced budget leaves limited financial space for RMI to prepare for the post-2023 transition and to prepare for disasters.**

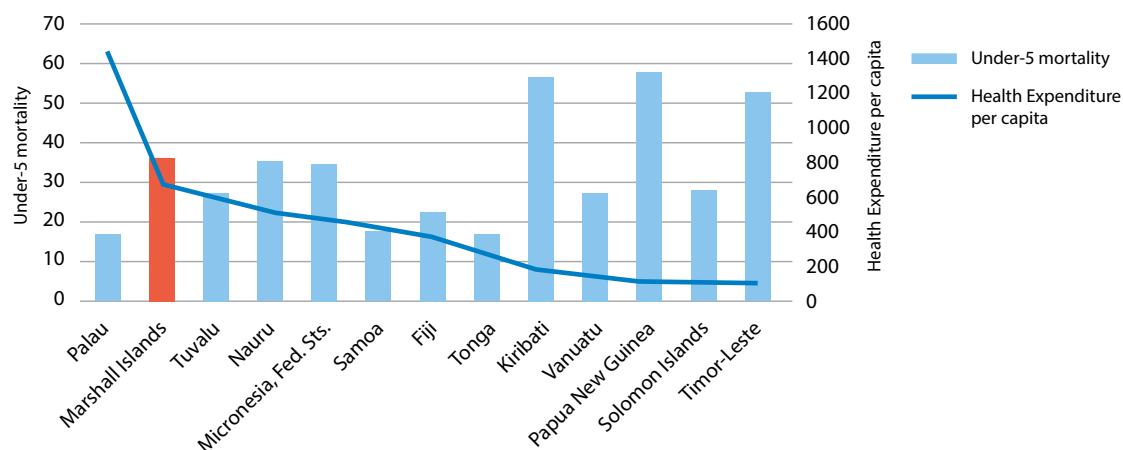
The public deficit, if there is any, is mainly financed through cash transfer, drawing on the government's cash reserves, complemented by small domestic and foreign borrowings. For example, in 2005, the public deficit of US\$30.7 million was funded by a cash transfer of US\$26.6 million, domestic borrowing of US\$2.5 million, and foreign borrowing of US\$1.5 million. Even when there is a budget surplus, the government does take on small short-term loans from both domestic and international markets to cover short-term financial needs or to lend to both domestic and foreign lenders.

5.5 Inefficient public expenditure

Sustainable development will depend not just on the expansion of national public finance but also on improving the efficiency and effectiveness of public expenditure. A number of sources of government spending inefficiency include expenditure on an inefficient public sector and ever-increasing subsidies to loss-making SOEs.

As discussed previously, the government's expenditure on the social service sector has been increasing, but the public sector can be inefficient. For example, RMI has the second highest health expenditure per capita among the Pacific Island countries, second only to Palau; however, the infant mortality rate and under-5 mortality rate are among the highest in the Pacific.

Figure 47: Health expenditure per capita versus the under-5 mortality rate in Pacific Island Small States



Source: WDI.

In a contrary example, there has been some success in the education sector where RMI has one of the lowest pupil-to-teacher ratios at both the primary and secondary education levels among Pacific Small Islands States. In the school year 2012/13, RMI's average student-to-teacher ratio in primary education was 11 students per teacher. In Majuro and Kwajalein, where 75 percent of the population reside, the average student-to-teacher ratio was around 18 students per teacher.⁶⁸ These figures are much lower than that in Fiji for the same year, with an average 28 students per teacher.

RMI's public sector is characterized by a high level of excess employment and high wages and salaries that diverge from underlying productivity. Despite having similar productivity, the average wage and salary rates in the national and local governments are nearly three times of those in private enterprises. In 2015, private enterprise labour productivity, measured by the ratio between private sector GDP and private sector employment, is around US\$12,700 per employee, while government sector labour productivity is US\$14,800 per employee. At the same time, the private enterprise wage rate is around US\$5,500 per employee, and the average central and local

⁶⁸ Education For All Assessment, see <http://unesdoc.unesco.org/images/0022/002297/229722E.pdf>

governments wage rate is US\$12,500. The wage rate in central government is even higher, standing at US\$14,000 per employee.⁶⁹

Having the most productive labour attracted to the public sector by the high pay rate, which is nearly three times as high as that in private enterprises, and having productivity similar to the private enterprises suggest significant inefficiency in the delivery of public service. This also indicates a waste of human capital, which may be better utilized in the non-governmental sector. Inefficiency in the delivery of public services is also the result of shortages of technically qualified labour, and weaknesses in institutional capacity.

High public sector pay rates may also create a benchmark wage that the private sector endeavours to match, which leads to high business costs for private businesses, reduces international competitiveness, and may mean that only the most profitable businesses can survive.

Another source of inefficiency in RMI's public sector comes from inefficient SOEs, which will be discussed in more details in Chapter 7.

5.6 Weak Public Financial Management System

RMI's Public Financial Management (PFM) System is weak. According to the 2012 PEFA assessment report, RMI's PFM system is *"centered on a basic legislative framework for financial management, summarized in the RMI Code. There is not yet in place an up-to-date set of financial management regulations to accompany the Financial Management Act. In general, there is a lack of accompanying regulations to support PFM legislation (e.g. in taxation, procurement and expenditure management), and this serves to undermine the overall clarity and comprehensiveness of the underlying processes."*

The PEFA assessment report concluded that the RMI's PFM system scored B and above in only 5 out of the 31 areas measured, and RMI was underperforming in the remaining 26 areas, scoring either a C or D. RMI scored high in the following five areas: "A" for "Predictability of Direct Budget Support"; "B+" for "Orderliness and participation in the annual budget process"; and "B" for "Aggregate expenditure out-turn compared to original approved budget", "Aggregate revenue out-turn compared to original approved budget", and "Transparency of inter-governmental fiscal relations".

In response to the concerns raised and recommendations proposed in the 2012 PEFA report, RMI has developed a detailed and ambitious PFM reform roadmap with the objective to improve RMI's PFM system in the medium term, with technical assistance from the Pacific Financial Technical Assistance Centre (PFTAC) of the International Monetary Fund (IMF). The PFM reform roadmap has specifically set targets to improve RMI's performance ratings in the next PEFA, which was due in 2015 but has not been conducted yet.

The PFM reform roadmap proposed to implement reforms by 2015 and beyond in 30 areas of the PFM system, together with the timelines (sequence) for actions. The proposed reforms and their timelines are shown in Table 8.

69 EPPSO.

Table 8: Sequencing of PFM Roadmap by PFM reform area

	PFM Reform Component	2013	2014	2015	Beyond
1.	Strengthened PFM Legal and Policy Framework	X	X		
2.	Improved Budgeting Framework	X	X	X	
3.	Strengthened Accounting Systems	X	X		
4.	Strengthened Fiscal Reporting	X			
5.	Annual Reporting by LMs		X		
6.	Creation of GRMI Web Portal and MoF/LM webpages	X			
7.	Improved Cash Management	X	X		
8.	Strengthened Procurement Management	X	X	X	X
9.	Improved Payroll Management	X	X		
10.	Strengthened Asset Management	X	X		
11.	Strengthened Inventory Management			X	
12.	Automated Costing of Government Outputs, Outcomes and Programmes			X	
13.	Introduction of a performance-based management framework				X
14.	Improved SOE Oversight	X			
15.	Improved Local Government Financial Management	X	X		
16.	Improved Tax Administration	X	X	X	X
17.	Improving management of GRMI Embassy imprest accounts	X			
18.	Implement a Government-wide intranet system for email and automated FMIS/HRMIS workflow	X	X		
19.	Strengthened Management of Non-Tax Revenue	X			
20.	Improved Debt Management	X			
21.	Strengthened management of trust funds and other managed financial investments				X
22.	Improved management of contingent liabilities	X			
23.	Establish Internal Audit function		X	X	
24.	Strengthened External Audit function	X	X		
25.	Review of Social Security framework	X			
26.	Strengthen oversight by Public Accounts Committee	X	X		
27.	Quarterly follow-up of Internal Audit, External Audit and Public Account Committee recommendations	X	X		
28.	Strengthened Aid Coordination	X			
29.	PFM Reform Project Governance	X	X	X	X
30.	PFM Reform Communications and Training	X	X	X	X

Source: Republic of Marshall Islands PUBLIC FINANCIAL MANAGEMENT REFORM ROADMAP, 2014–2016.

Public Financial Management and Reform has been identified as one of the priority areas under the Good Governance pillar of RMI's National Strategic Plan. The newly proposed Agenda 2020 has also made it a priority action to expedite the implementation of the PFM Reform Roadmap to improve fiscal and economic management.

However, international experience shows that PFM reforms are not linear and may take considerable time to produce the desired results. Strong leadership, a long-term and systematic approach, and sufficient international funding and technical support are also pre-conditions for the PFM reforms to achieve their desired results.

5.7 Improving public finance management

To improve the performance of RMI's public finance management system, RMI could consider implementing the following activities:

5.7.1 Reforming the tax system and enhancing tax administration

The tax system in RMI is considered outdated and inefficient and has little potential for extra tax revenue generation (IMF, 2009). The system also has a low compliance rate and issues with fairness. Since 2008, the RMI government, with assistance from PFTAC, has proposed a number of tax reforms to broaden the tax base, improve tax compliance, and minimize tax distortions. However, most of the tax reform bills are still pending for approval in the Parliament, and none of the proposed tax reforms have been implemented.

Together with the tax reforms proposed by PFTAC, RMI could consider the following taxation initiatives:

- **Broadening the existing tax base through the adoption of a more modern tax system**

While RMI's Compact Sector Grants have been declining and are set to expire by 2023, RMI's tax revenue, as a share of GDP, has been also declining since 2007. Consequently, RMI is facing the challenges of mobilizing extra financial resources, in particular domestic financial resources, for financing national development goals and the SDGs. Tax reform is a critical step for RMI to raise additional revenue.

To ensure the efficient operation of RMI's tax system and its harmonization with its major trading partners and its Pacific Small Island Developing States counterparts, RMI could consider adopting international best practices and harmonization with international standards.

As such, it is recommended that tax reforms be reviewed, updated and approved, and implemented as soon as possible. At the same time, supplementary guidelines and standard of procedures, consistent with international best practices and standards, need to be developed for each tax stream.

- **Enhancing tax and customs administration**

RMI could consider taking steps to enhance tax and customs administration. Together with the automation of the tax and customs administration systems (as discussed below), RMI could consider establishing a registered taxpayer database and to effectively use this database for tax administration. At the same time, RMI could put in place a mechanism to detect potential

taxpayers who are required to pay tax but have not done so, and to make it easy for potential taxpayers to register and pay tax.

Considering the fact that RMI has a relatively large informal sector,⁷⁰ **RMI could consider encouraging the formalization of the informal sector and to integrate the informal sector into the formal sector**, for example by reducing the costs for doing business in the formal sector, **to increase the tax take.**

In response to RMI's low tax compliance rate, **RMI could consider improving tax compliance, through reducing tax compliance procedures and costs, conducting tax risk profiling and monitoring, mitigating non-compliance risks, and enhancing tax audit and tax dispute resolution.** One way to improve tax compliance could be the issuing of tax compliance certificates to a person or a business as a proof that the individual or the business is compliant with the relevant tax laws, which could be later used for economic activities, such as seeking government contracts and bank loans.

The system could also be strengthened by improving the tax administration's transparency and accountability to the taxpayers, local community and government, through establishing effective internal assurance and external oversight mechanisms, and through regularly publishing tax administration activities and results, and conducting taxpayer perception surveys.

- **Improving tax and customs administration capacity through automating the tax and customs administration system**

Currently, tax and customs administrations are handled manually. **RMI could consider improving tax and customs administrative infrastructure by automating the business processes and procedures for tax and customs administration.** This would facilitate online registration, electronic transactions and online payments, and likely improve rates of filing compliance and taxpayer registries.

Automation would also eliminate the element of discretion on the part of tax officials, and reduce the number of tax officials required and the time and costs associated with tax collection and tax compliance. It would also make possible the sharing of information between tax payments, social security contributions, and bank transaction records to tackle tax avoidance and tax evasion.

One way to automate the customs administration system is through the installing of the "Customs Single Window System". For example, Fiji has rolled out the Automated System for Customs Data (ASYCUDA) World Declaration Process, which was recently integrated with the Fiji Integrated Tax System (FITS).

RMI also needs to improve human capital for tax and customs administration. Tax officials should be trained in adopting international best practices and standards, and in dealing with more complicated industries and tax evasion activities.

Tax administration capacity could also be improved through the elimination of duplicated tax collection efforts. Currently, RMI has three sets of tax collection systems, with the Ministry of Finance responsible for the collection of nationally imposed tax and customs duties, local governments responsible for the collection of locally imposed local government sales taxes, and MISSA responsible for the collection of social responsibility contributions. This, however, represents duplicated tax collection efforts from central and local governments, as well as from the social security system. Eliminating duplication in tax collection efforts could consolidate the tax

70 Schneider (2007), *Shadow Economies and Corruption All Over the World: New Estimates for 145 Countries.*

administration capacity and fully utilize the improved tax administration infrastructure. It could also reduce the discretion of tax officials and improve tax compliance through better information sharing.

5.7.2 Developing a policy on how to best utilize non-tax revenue

Non-tax revenue, in particular ship registry fees and fishing licences, accounts for a significant proportion of RMI's public revenue, in particular domestically collected public revenue. Fishing licence fees, in particular, have been increasing rapidly. However, the increases in non-tax revenue have been mainly used for financing government expenditure.

As an important source of public revenue, which has a limit in growth, **RMI could consider developing a policy on how to best utilize non-tax revenue and balance the needs for current public expenditure, public expenditure post-2023, and the needs for investment in making fishing and the marine ecosystem sustainable.**

The government's Agenda 2020 proposed negotiating increased contributions from both the ship registry and MIMRA (Marshall Islands Marine Resources Authority) to the Compact Trust Fund to finance future government public finance. Another option might be to allocate a proportion of the non-tax revenue to an investment fund for ensuring the sustainability of the marine ecosystem.

5.7.3 Prioritizing public expenditure for financing infrastructure investment and economic activities towards growing a self-reliant economy

RMI's allocation of public expenditure is mainly towards recurrent government operating expenditure, and less on capital expenditure; and is more on providing for social services, including education and health, and less on infrastructure investment and economic activities.

RMI's allocation of public expenditure needs to be guided by a comprehensive and coherent financing policy, and to be aligned with the national development priorities. In particular, RMI could consider prioritizing financing for infrastructure investment and economic activities towards growing a self-reliant economy, which is inclusive and sustainable, and limit expenditures on recurrent operating expenditures.

To better mobilize public finance for development, **the government could consider leveraging public finance for the involvement of private sector in funding key infrastructure projects,** particularly in the power, water, roads, ports, airports and telecommunication sectors. If managed correctly, public-private partnerships (PPPs) are a potentially useful option for RMI to involve the private sector in financing infrastructure projects. RMI could consider identifying opportunities for PPPs and establish a pool of potential PPP projects.

The DFA report also found that RMI's public sector service delivery is inefficient (see section 5.5). In response to this issue, **RMI could consider reforming the public sector,** reducing public sector expenditure by involving the private sector in service delivery, improving public sector efficiency by enhancing public sector capacity and accountability, and promoting good public sector governance. This reform will also promote a performance-oriented framework, and ensure that government ministries and agencies are provided adequate autonomy and are held accountable for their actions.



6. Safeguarding the Compact Trust Fund

The Compact Trust Fund (CTF) was created under the Amended Compact Agreement, with the objectives to provide an ongoing source of revenue for RMI after 2023 and contribute to the long-term budgetary self-reliance of RMI. With contributions from RMI, Taiwan Province of China and the United States, and CTF investment income, the CTF is a vital resource to protect development progress after 2023.

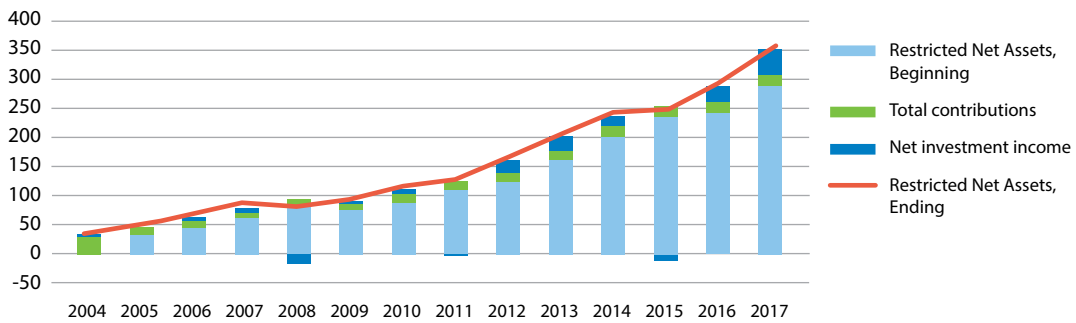
By the end of 2023, both the Compact Sector Grants and the Compact contribution to the CTF will discontinue. It is envisioned that after 2023, investment income from the CTF will fill the gap in the public revenue left by the discontinuation of Compact Sector Grants. The targeted sectors for CTF assistance are education, health care, the environment, public sector capacity-building, private sector development, and public infrastructure.

6.1 Performance of the Compact Trust Fund

RMI made an initial contribution of US\$25 million to the CTF in 2004, and committed to contribute US\$2.5 million each in 2005 and 2006. In 2004, the United States contributed US\$7 million to the CTF, and committed to increasing the annual contribution by US\$0.5 million annually between 2004 and 2023. In May 2005, Taiwan Province of China also committed to contribute a total of US\$50 million to the CTF between 2004 and 2023. The contributions to the CTF are locked away from use in the corpus of the CTF.

Between 2004 and 2017, the United States contributed a total of US\$160.9 million to the CTF, while Taiwan Province of China contributed US\$25.6 million. Contributions from the RMI government have fallen short of its targeted contribution of US\$2.5 million each year in 2005 and 2006. In 2011, 2015 and 2016, RMI contributed US\$0.12 million, US\$0.65 million, and US\$2.2 million respectively to the CTF. By the end of 2017, the assets of the CTF had reached nearly US\$357 million.

Figure 48: Compact Trust Fund Assets (current US\$ million), 2004–2017



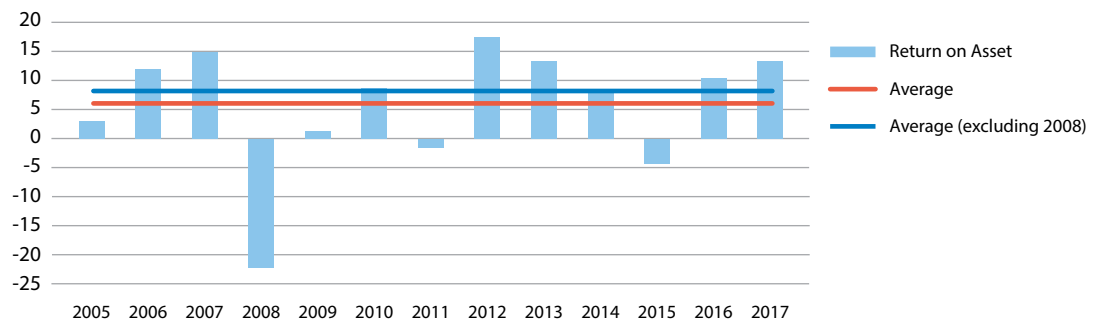
Source: EPPSO.

The CTF’s investment is focused on US markets, with a diversified portfolio of US domestic equity, non-US equity, fixed income products, real estate, hedge funds, and private equity. As of 30 September 2017, 29.4 percent of its investments are in US Public Equity, 29.2 percent are in International Public Equity, 21.1 percent in fixed income products, 12.8 percent in hedge funds, and 7.5 percent in private equity.⁷¹

The CTF has performed reasonably well for the 14 years of its existence. In fact, according to the CTF’s annual financial statements, the CTF’s annual investment returns beat the total US Trust Benchmark.⁷² Between 2005 and 2017, the CTF achieved an average investment return on assets of 5.8 percent. Excluding the very low investment return in 2008 due to the extreme event of the Global Financial Crisis, the average annual investment return on assets was a decent 8.1 percent.

However, the CTF’s investment return is highly volatile. For example, in 2012, the CTF’s investment return on assets reached 17.9 percent, yet in 2015, the rate was -4.1 percent, even excluding the very low return in 2008. Of its 14 years of existence, the Fund has had 11 years of positive returns and 3 years of negative returns, and has had 6 years of growth exceeding 10 percent.

Figure 49: Compact Trust Fund investment return on assets (%), 2005–2017



Sources: EPPSO and CTF Annual Reports.

71 Fiscal Year 2016 Annual Report, Trust Fund for the People of the Republic of the Marshall Islands.

72 Ibid.

6.2 Prospects of the Compact Trust Fund

It is estimated that by 2023, the size of the CTF may need to reach a minimum of US\$543 million to ensure a smooth and sustainable transition from Compact Annual Sector Grants to annual CTF distributions to the RMI.⁷³ The newly elected government has set up a target for the CTF to reach US\$588 million by 2023.

It is likely that this target will be exceeded unless the performance of CTF is hit hard by crises such as the 2008 financial crisis. Considering its historical performance since inception, the investment return from the CTF is likely to be sufficient to replace the discontinued Compact Sector Grants post-2023, especially in the longer term. However, under certain situations, CTF may not generate a sufficient return to preserve the real value of the CTF. Figure 50 shows three major scenarios of CTF performance up to 2050.

Scenario one shows the scenario of CTF reaching the targeted US\$588 million by 2023. It shows that at the current size of US\$356.9 million, the CTF only needs to achieve an average 3.65 percent return in the next 6 years to achieve the US\$588 million target by 2023.

After 2023, CTF needs to achieve an average 5.45 percent of annual return in the next 26 years to generate sufficient investment income, together with draw-down from the CTF for the majority of the years between 2024 and 2050, to replace the discontinued Compact Sector Grants and still maintain the size of the CTF at around US\$588 million by 2050. However, the real value of the CTF will not be preserved. If the CTF achieves an annual average of 5.8 percent rate of return, its long-term average since inception, the CTF is likely to generate sufficient investment return, together with the initial draw-down from the CTF, to replace the Compact Sector Grants and increase the size of the CTF, but is unlikely to preserve the real value of the CTF. If the CTF achieves an average of 8.1 percent rate of return, the CTF's long-term average rate of return excluding 2008, CTF is likely to generate sufficient investment income to replace the Compact Sector Grant, to increase the real value of the CTF.

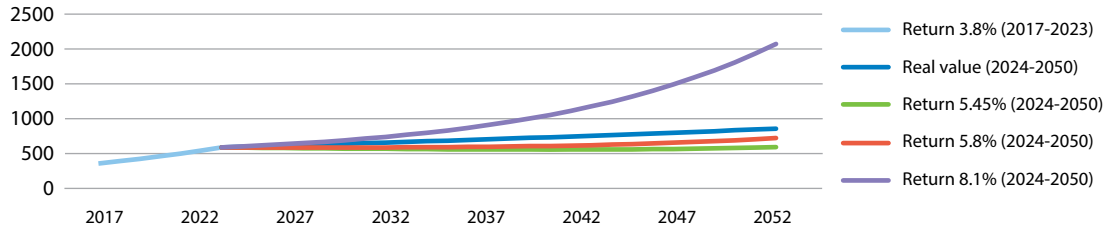
Scenario two shows the scenario of CTF achieving an average rate of return of 5.8 percent between 2018 and 2023 and reaching US\$659 million by the end of 2023. After 2023, CTF needs to achieve an average rate of return of 4.85 percent between 2024 and 2050 to generate sufficient investment income, together with draw-down from the CTF for the majority of the years between 2024 and 2050, to replace the Compact Sector Grants and maintain the size of the CTF at around US\$660 million by 2050. If the CTF achieves an average 5.8 percent or 8.1 percent rate of return after 2023, the CTF is likely to generate sufficient investment income to replace the Compact Grants and increase the real value of CTF.

Scenario three shows the scenario of the CTF achieving an 8.1 percent annual rate of return between 2018 and 2023 and reaching US\$746 million by the end of 2023. After 2023, with an initial size of US\$746 million, the CTF needs to achieve an average rate of return of 4.25 percent to generate investment income to replace the Compact Sector Grants and maintain the size of the CTF at its initial size of US\$746 million by the end of 2050. If the CTF achieves an average rate of return of 5.8 percent or 8.1 percent between 2024 and 2050, the CTF is likely to generate sufficient investment income to replace Compact Sector Grants and to increase the real value of CTF.

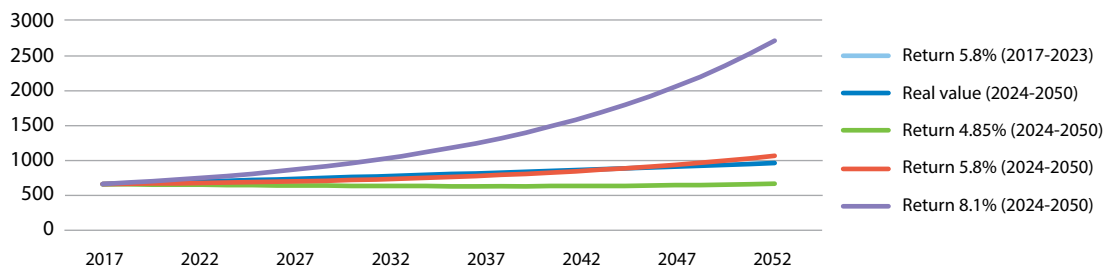
⁷³ EPPSO (2016), RMI Economic Review, FY2015, http://www.pitiviti.org/news/wp-content/uploads/downloads/2016/11/RMI_EconReview_FY15.pdf

Figure 50: Scenarios for the CTF up to 2050

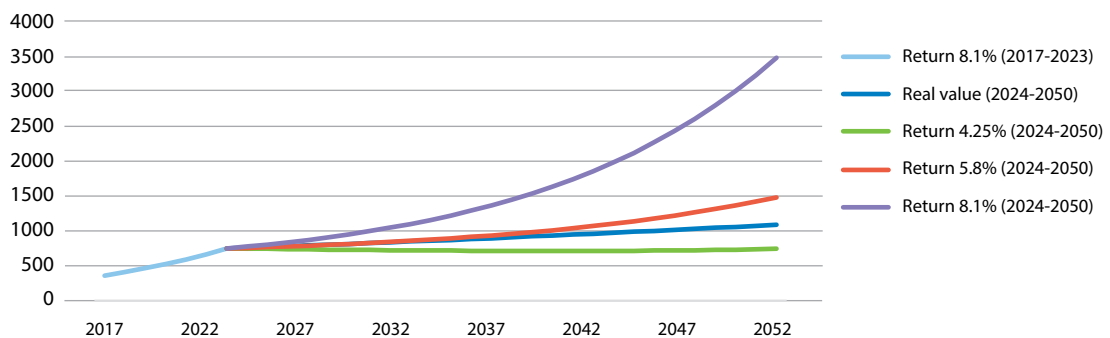
Scenario 1: Size of CTF Reaches US\$588 million by 2023



Scenario 2: Size of CTF Reaches US\$659 million by 2023



Scenario 3: Size of CTF Reaches US\$746 million by 2023



Sources: EPPSO and CTF Annual Reports.

While the above scenarios look at the long-term prospects of the CTF with the average rate of return, in reality investment income is highly volatile. In fact, the CTF may not generate positive or sufficient investment income for some years. Consequently, RMI needs to cope with market volatility in investment returns to ensure the stability required for public finance after 2023. It will be important for the parties to the CTF to come up with mechanisms to deal with this issue.

The above scenarios have suggested that RMI will have more financial space to deal with market volatility and maintain financial stability, as the initial size of the CTF increases. For example, with an initial size of US\$588 million, the CTF needs to achieve an average 5.45 percent of annual return to replace Compact Grants and maintain its initial size; while at an initial size of US\$746 million, the CTF needs only to achieve an average return of 4.25 percent annually to replace Compact Grants and maintains its initial size. This suggests that additional contributions to the CTF beyond those currently

scheduled from RMI, Taiwan Province of China and the United States, as well as CTF investment income, would improve RMI's capacity to deal with market volatility and maintain financial stability.

Currently, the main function of the CTF post-2023 is to generate sufficient investment income to replace the Compact Sector Grants that will be discontinued. As the size of the CTF increases, the parties to the CTF could consider expanding the functions of the CTF as a financial buffer for macroeconomic management and as a source for financing large domestic investment. Of course, appropriate governance structures and investment strategies need to be established around these additional functions.

Another important issue is the need to safeguard the real value of CTF, an important financial resource for the people in RMI. This issue has been made more prominent by the illegal withdrawal of nearly US\$1 million from Marshall Islands' Trust Fund in June and July 2017.⁷⁴ This situation may have to be dealt with through improving the governance of the CTF.

74 During June and July 2017, a series of 12 unauthorized withdrawals, totalling US\$982,265, from the Marshall Islands Trust Fund "A Account" at State Street Bank and Trust Company were sent to accounts at banks in Ireland and Malaysia. By the end of October 2017, all funds were recovered.



7. Improving SOE performance

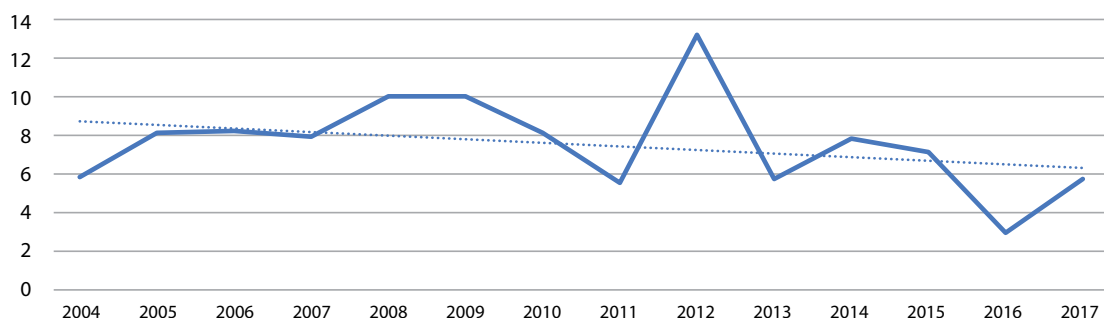
The presence of state-owned enterprises (SOEs) is prominent in RMI. There are nine active SOEs, covering a range of economic activities: air transport, telecommunication, power, hotel, shipping, copra processing, ports, water and sewage. As of 2015, the total assets in the SOE sector totalled US\$138 million, amounting to 77 percent of the RMI's GDP or around 20 percent of the total capital stock in the RMI economy. However, they contributed only about 8.3 percent of its GDP.⁷⁵

Most SOEs in RMI chronically make a financial loss, and subsidies to SOEs drain RMI's public finance. Reducing the fiscal burden from subsidizing loss-making SOEs is critical to overall PFM reforms and overall fiscal sustainability, especially post-2023.

7.1 SOE's drain on public finance

Most of RMI's SOEs are chronic loss-makers. For example, between 2004 and 2017, three SOEs – Air Marshall Islands, Kwajalein Atoll Joint Utilities Resources, and Majuro Water and Sewer Company – have made losses in each of these 14 years; Marshall Islands Port Authority, Marshall Islands Resort, and Marshall Islands Shipping Corporation have not been profitable since 2007; and Tobolar has been profitable in only 2 of these 14 years. In fact, some SOEs are already technically insolvent, suggesting that their assets are smaller than their liabilities. Between 2004 and 2017, aggregate SOE losses averaged around US\$7.6 million annually. SOE losses peaked at US\$13.2 million in 2014 and declined to US\$2.9 million in 2016 but have bounced back to US\$5.7 million in 2017. The return on SOE assets is in fact negative. Between 2013 and 2017, the average rate of return on SOE assets was -7 percent.

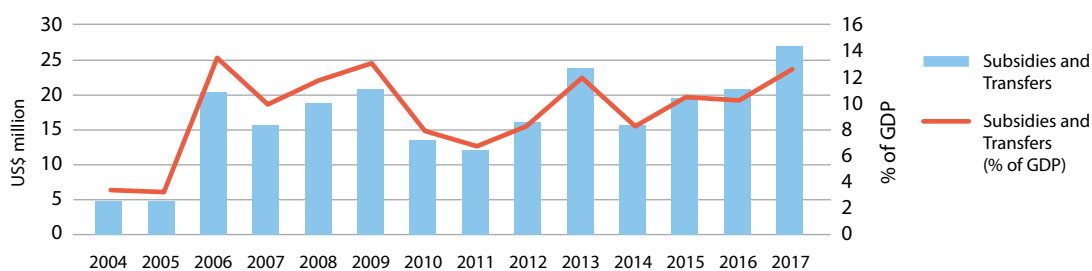
⁷⁵ Calculated based on the EPPSO Annual Economic Review.

Figure 51: SOE losses (US\$ million), 2004–2017

Source: EPPSO.

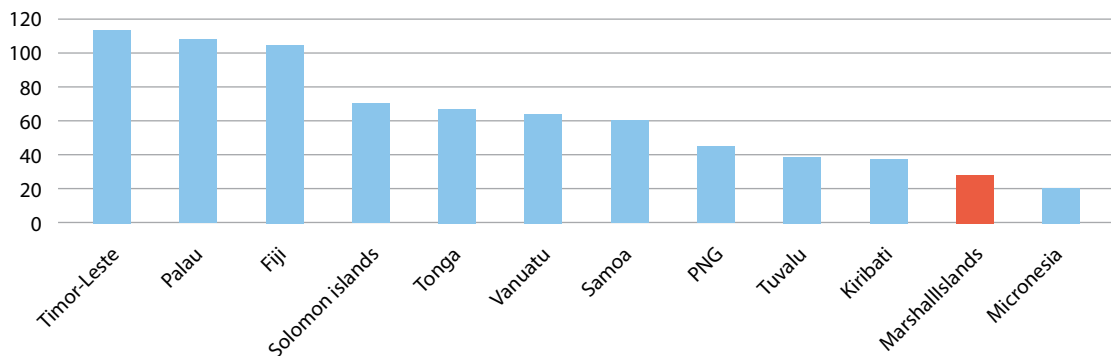
RMI's SOEs are sustained by a high level of government transfers. In 2017, subsidies to SOEs, including both subsidies and capital transfers, were nearly US\$26.2 million, having increased from US\$4.6 million in 2004. As a percentage of GDP, subsidies to SOEs were equal to 12.6 percent of GDP in 2017 or nearly a third of RMI's domestically collected public revenue, increasing from 3.4 percent of GDP in 2004. However, there has been hardly any dividend income from government-owned assets.

SOEs pose a significant burden to public finance and drain resources away from financing for other potential social and economic priorities, such as infrastructure building. The high level of subsidies to SOEs also results in an uneven competitive environment for private sector businesses, discouraging private sector development. SOEs' monopolies or quasi-monopolies often result in poor service delivery and high costs, and constitute a source of inefficiency that affects the overall competitiveness of the private sector.

Figure 52: Subsidies and transfers to SOEs, 2004–2017

Source: EPPSO.

In principle, public subsidies to SOEs can be justified on the basis of providing social services to communities that would not otherwise be reached by entirely commercially oriented businesses, such as providing connectivity to the remote island communities. However, in practice the service provisions are typically not explicitly mandated and properly costed, which does not provide incentives for SOEs to reduce costs and improve service and performance. Consequently, this rationale may have been compromised by SOEs' poor performance. One example is mobile connectivity. Despite providing subsidies to the National Telecommunication Authority (NTA) and letting NTA access discounted external debt, RMI is the least connected country in the region (see figure 53).

Figure 53: Mobile subscription rate (% of population) in 2015

Source: WDI.

7.2 Promoting market-oriented SOE reforms

SOE reforms, with the objectives to make SOEs independent economic entities, to make their own business decisions and to be responsible for their own finance, and to improve their performance, will relieve the SOEs' burden on the public finance on one hand and potentially make SOEs contribute positively to the public finance.

A new SOE Act was enacted in 2015, which clearly defines that "The primary objectives of each State-owned enterprise are: (a) to be a successful business and, to this end, to be at least as profitable and efficient as comparable businesses; and (b) to maximize the net worth of the public investment in the State-owned enterprise" and that "Each State-owned enterprise must conduct its business and operations with a view to achieving its primary objectives". This will provide a foundation for SOE reform.

However, the law still allows the direct involvement of the responsible ministers in all aspects of SOE's management, and allows increased representation by publicly elected officials on SOE Boards. This undermines the international best practice of avoiding political interference in SOE management and ensuring that the government functions at an arm's length from SOE management.

A number of SOE reform initiatives have been implemented, including the Comprehensive Recovery Plan (CRP) for the Marshalls Energy Company (MEC) featuring a set of financial, operational and governance reforms aimed at improving the solvency and sustainability of the utility, and the ICT reform programme for the National Telecommunication Authority aimed at liberalizing RMI's telecommunication market. However, the impact of SOE reform on SOE performance improvement until now is weak. The ICT reform for the National Telecommunication Authority has been reported as broadly unsuccessful,⁷⁶ and the impact of MEC reform on its financial performance has been only minimal.

⁷⁶ World Bank (2017), First ICT Sector Development Operation ICR Review, available at: <http://documents.worldbank.org/curated/en/316191498832815061/pdf/ICRR-Disclosable-P128013-06-30-2017-1498832808311.pdf>

RMI could consider exploring why the reforms of MEC and the National Telecommunication Authority have not achieved what they intended and learn lessons from these experience. RMI can also learn lessons from SOE reforms in other Pacific countries.

While the current SOE reforms focus on management and operational changes, RMI could consider pursuing **SOE reform through a number of other mechanisms, including corporatization, separating social and economic responsibilities, partial or full privatization, and public-private partnerships.**

More importantly, in order to drive up productivity, measures should be implemented to improve competition. In particular, ownership and corporatization-based reforms, such as asset sales, as well as management and operation-oriented **SOE reforms, should be accompanied by opening the markets formerly dominated by SOEs, encouraging the entry of more private sector players.** However, this is a difficult challenge to achieve in RMI, due to the size of its domestic market. To ensure fair competition in the market, RMI could consider establishing an appropriate competition and regulatory framework to ensure fair competition.

Of similar importance is that the granting of more autonomy to SOEs should be accompanied with more oversight of SOEs' performance and more accountabilities from SOEs, especially when the market is still underdeveloped and does not function fully. RMI's SOE Act 2015 has defined the governance structure for SOEs, specified the reporting requirements and information disclosure obligations, and empowered the Audit-General to audit SOEs.

Nonetheless, SOE reform in RMI is hampered by the absence of a comprehensive, economy-wide reform framework. Such a framework could be built on a set of widely accepted good practice principles, such as:

- Setting out the strategic direction, building up the mandates, and establishing a strong champion for SOE reform;
- Clearly delineating the roles, responsibilities and accountability between SOEs and the State as owners; separating SOEs' economic and social responsibilities;
- Aligning prices and charges with the total cost of service delivery, and eliminating subsidies except where community service obligations are required;
- Ensuring SOEs operate as commercial businesses and are responsible for their own profits and losses;
- Establishing appropriate governance mechanisms and performance requirements for SOEs; and
- Building a level playing field and ensuring fair competition.

Developing an SOE reform policy will guide the implementation of good practice principles across the SOE sector. Key steps for SOE reform include:

- Building up the mandates for SOE reform; establishing taskforces to champion SOE reforms;
- Prioritizing reforms for those SOEs that pose the highest fiscal risk over the short to medium term;
- Selecting the most feasible and appropriate forms of reform (including corporatization, separating social and economic responsibilities, partial or full privatization, and public-private partnerships);
- Implementing SOE reform; and

- Establishing appropriate state asset management mechanisms and appropriate corporate governance mechanism for SOEs.

As part of the ADB PFM project to support the Ministry of Finance with implementing the PEFA road map, the ADB is supporting the establishment of an SOE monitoring unit to enhance RMI's SOE monitoring capacity. The EU has also agreed to provide budgetary support of US\$9.6 million through the European Development Fund for the reform of the energy sector.



8. Promoting “blue growth” and private sector development

Growing a self-reliant economy has been an important objective for Vision 2018, the National Strategic Plan, and the Agenda 2020, and will be part of any other key strategies in the near future. To achieve self-reliance, RMI could consider shifting from the current service-based economy, driven by a large government sector, to a private-sector-led “blue economy”, taking advantages of emerging “blue economy” activities and positioning RMI’s economy on a market segment with global comparative advantages.

8.1 Promoting blue growth

While RMI has only limited land-based natural resources, RMI is abundant with marine resources, with an exclusive economic zone of around 2 million km². RMI could therefore explore opportunities to better leverage these endowments to build an economy based on its abundant marine resources and related activities. This is what is meant by the emergence of a “blue economy”.

Marine-oriented fishery activities have already contributed significantly to RMI’s economy and public finance. In 2016, the fishery sector accounted for around 10 percent of RMI’s GDP, and fishing fees accounted for more than 21 percent of public revenue. The fishery sector also contributed to 7.5 percent of the total employment in 2016.

RMI’s fishery sector focuses mainly on fishing, the sale of fishing rights, and transshipment activities, which are all at the lower end of the value chain, and are dominated by foreign fishing activities, which contributes to RMI’s public revenue through paying fishing licence fees. According to MIMRA, 257 foreign-flagged vessels were licensed to fish in the Marshall Islands in 2017. There were only 10 Marshall-Islands-flagged vessels; the government owns 4 of them; the rest are owned by domestic businesses with foreign owners. Marshall-Islands-flagged vessels only accounted for around one third of the total catch in the RMI zone.

Several fishery-sector-specific policies have been developed – including the Ministry of Resource and Development Strategy and Action Plan (2005–2010), the Fishery Sector Master Plan 2002–2018, the Marshall Islands Marine Resources Authority (MIMRA) Mission Statement, the RMI Fisheries Policy (MIMIRA), the RMI Fisheries National Development Plan (1997), and the Tuna Development Strategy

– with the objectives to improve economic benefits from within sustainable limits; to promote responsible, private-sector-led developments, in particular domestic private-sector-led development and export; and to strengthen fishery infrastructure, including both physical and institutional infrastructure for responsible fisheries development and management.

However, a number of factors constrain the further development of RMI's fishery industry, including its long distance from the global market and demand; difficulties for small-scale fishers in accessing offshore fishery resources; lack of skilled labour; lack of local processing infrastructure; and difficulties to access and compete in the global market. As a result, there is a limit to the growth of traditional fishing activities. According to an estimate by the World Bank,⁷⁷ by 2040, the fishery sector's annual contribution to public revenue is likely to increase in the range of US\$1 million to US\$5 million, and the sector's contribution to RMI's GDP is likely to increase by US\$15 million.

To further develop RMI's fishery industry and to mitigate the impacts of constraining factors, RMI could consider developing backward and forward linkages to the value chains of current fishery activities to capture more added value of the global value chains, through encouraging the participation of local or locally based vessels for offshore fishing; developing local process capacity for the domestic market and sales to the military in particular, as well as for export; maintaining current market access and developing the capacity to secure future market access. Developing a clearer national brand identity is one potential route to developing a clear value proposition to improve international competitiveness.

In addition to traditional fishing-related activities, RMI can also diversify its economy to avoid overconcentration on fishing activities and to take advantage of other emerging blue economy activities, including marine tourism, marine aquaculture, marine aquarium fishery, offshore renewable energy, marine research and ocean monitoring and surveillance, which all provide opportunities for economic growth, job creation and poverty reduction while conserving the natural environment.

Promoting and engaging blue economy activities may provide opportunities for RMI to attract and utilize new sources of finance for investments in coastal and ocean health, and ecosystems and to diversify its economy. The challenge for RMI in exploiting the opportunities offered by the blue economy is to identify catalytic investment opportunities and new and innovative investments in the blue economy as well as opportunities for established industries to transition to more environmentally sustainable practices.

8.2 Promoting private sector development

Private sector development is also critical for RMI to grow a self-reliant economy. This powers economic growth and creates jobs. The business environment, defined as the interplay of policy, legal, institutional, regulatory and physical conditions that facilitate business activities, has impacts on private sector development through affecting the cost of doing business (transaction costs) and consequently influencing the incentives of private enterprise to invest. This affects their survival and expansion thereafter, and consequently affects the level of employment, trade, investment and growth.

⁷⁷ World Bank (2017). Pacific Possible: long-term economic opportunities and challenges for Pacific Island Countries.

Currently, the private sector accounts for less than 50 percent of RMI's GDP, of which private enterprises contribute around 30 percent of GDP. RMI's private enterprises focus mainly on the wholesale and retail trade, fisheries, construction and transport sectors. Together, these sectors accounted for 87 percent of private sector employment in 2016.

The development of the private sector has been constrained by unfavourable business-enabling environments, in particular that protect the interests of minority investors, create problems in registering property, and that cannot resolve bankruptcy issues. Additionally, private sector development is also constrained by weak physical infrastructure, including land accessibility and limited connectivity, both physical and digital, to major markets.

Attractiveness to FDI has been constrained by rigid regulations on foreign investments, a challenging business environment, vulnerability to environmental, economic and political shocks, and low land accessibility, combined with RMI's smallness and remoteness from the international market, which put constraints on setting up new businesses, increases costs and inhibits both domestic and foreign investment. Meanwhile, weak infrastructure facilities, including both physical facilities and service facilities, also restrict FDI that aims at the export markets.

To promote the development of the private sector, RMI could consider creating a level playing ground for private businesses through SOE reform and establishing appropriate policy and regulatory frameworks to ensure fair competition. Currently, SOEs, heavily subsidized by public finance, dominate RMI, in particular in sectors such as infrastructure. Private businesses, in particular private small and medium-sized enterprises, are disadvantaged in accessing finance and the market. The monopolistic or quasi-monopolistic positions held by inefficient SOEs affect the cost of doing business and reduce the competitiveness of the private sector. In addition to SOE reforms, RMI could consider liberalizing sectors formally dominated by SOEs, make them accessible to private businesses, and make SOEs and private businesses subject to the same market regulations.

Agenda 2020 has set as a priority action addressing critical constraints to private sector development and improving the enabling environment for doing business. Agenda 2020 has proposed reviewing all laws, policies and regulations related to doing business in RMI, including review and revision of the Reserve List defined in the Foreign Investment Business License Act, and to implement the necessary reforms to improve the overall environment for doing business. The Office of Commerce and Investment is considering streamlining the process of foreign investment licensing and implementing a "one-stop shop" system to combine all required application forms into one "universal application form".



9. Prospective analysis of development finance flows

9.1 Prospective analysis of development flows

Based on this DFA analysis, a number of facts about the likely path of development finance flows over the medium term can be inferred:

- **Tax revenue.** If RMI implements the proposed reforms and takes measures to enhance tax and customs administration, tax revenue may increase in size significantly from the current 15 percent of GDP or so to 23 percent or even 25 percent of GDP, a target informally set in the MTBIF in a planning tool.
- **Non-tax revenue.** Non-tax revenue has been increasing rapidly during recent years, driven by the increase in fishing licence fees resulting from the implementation of PNA since 2010. However, there is a limit in the possible increase in fishing licence fees. For the past years, fees from fishing licences have already shown signs of plateauing. Currently, the increase in non-tax revenue has been used mainly for public expenditure. In the future, part of the non-tax revenue may be used for contribution to the Compact Trust Fund.
- **Compact Grants.** Compact Sector Grants have been declining in size, and will terminate after 2023. The gap left by Compact Sector Grants is to be filled by investment income from the Compact Trust Fund. By the end of 2023, the size of the Compact Trust Fund is on track to exceed the targeted US\$588 million. However, the investment income may be insufficient to fill the gap, at least for some years, due to the volatility of investment income.
- **Other ODA.** The overall size of Non-Compact ODA has been increasing; however, the size of on-budget ODA has been relatively stable. There is room for improving the alignment of ODA with national development priorities and for enhancing cooperation between development partners.
- **Foreign Direct Investment.** There are good prospects for improving FDI, but these will depend on progress in building a business-enabling environment and developing segments of the economy with global competitive advantages.
- **Remittance and Compact Kwajalein Impacts Payment.** The volume of these flows are likely to increase due to increased emigration. These flows can be mobilized to align with national priorities.

- **Public borrowing.** Public borrowing could increase in size if the government develops new mechanisms or instruments to mobilize remittance and Compact Kwajalein Impacts Payment, as well as to mobilize the underutilized domestic credit. As RMI gradually eases its debt stress, RMI could also be more able to borrow from external sources.
- **Public expenditure.** While the size of public expenditure will increase, the ratio of public expenditure to GDP is likely to decline due to the reform of SOEs and the reform of the public sector. Allocation of public expenditure will shift more towards infrastructure investment and economic activities.
- **Vertical funds and climate finance.** RMI has opportunities to access more sources of climate finance. To do so, RMI needs to improve its capacity in mapping international resources, and understanding the requirements for and the limitations to accessing available international resources. Government oversight of climate finance, or ODA in general, should also be improved.

9.2 Scenario analysis of development finance

This section explores the prospects of development finance flows in RMI up to 2030, and gauges the potential impacts of taxation reform and SOE reform, the two reforms with relatively clear impacts.

For this prospective analysis, we compare two scenarios, a business-as-usual (BAU) scenario vs a scenario with reforms in taxation and SOEs. We hope to use this simple analysis to demonstrate the impacts of tax reform and SOE reforms on RMI's public finance. One factor common to both scenarios is the expiration of the Compact Trust Agreement by 2023, in particular the replacing of Compact Sector Grants by investment income from the Compact Trust Fund.

A number of assumptions underlie this prospective analysis, including:

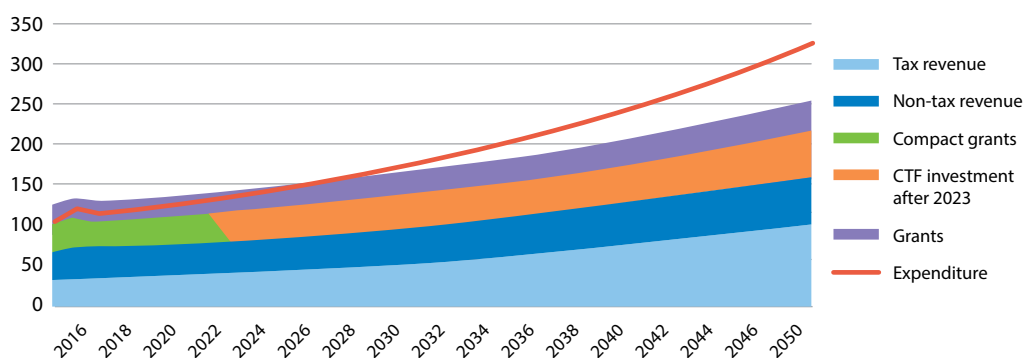
- Mid-term GDP growth until 2021 follows the real GDP growth forecasted by IMF; the termination of Compact Grants is likely to cause some shocks to the economy, even though the Compact Grants are to be replaced by investment income from the Compact Trust Fund; however, GDP growth will recover to a long-term trend of 2 percent annually in the absence of structural reform.
- The GDP deflator follows the long-term trend of 1.4 percent annually.
- The baseline tax revenue to GDP ratio is assumed at 17.6 percent, which is the average level for the period between 2015 and 2017, in the absence of tax reform.
- Non-tax revenue, which reached US\$35 million in 2016, is assumed to remain at this level in the long term.
- On budget Non-Compact ODA was US\$23 million in 2016, which is assumed to be at this level in the long term.
- The long-term investment return of the Compact Trust Fund since inception is 5.8 percent; post-2023, the investment income is available for use to fill the gap left by the Compact Grants.
- The baseline ratio of public expenditure to GDP is assumed to be at 55 percent, which is the average for the period between 2015 and 2017, in the absence of reform in public expenditure.
- The baseline ratio of transfer to SOEs to GDP is assumed to be 5 percent.

These scenario analyses only look at RMI's public financial situation on average. Fluctuations in the economy and shocks to the economy due to natural disasters would affect RMI's fiscal stability, which would make public finance management all the more challenging.

9.2.1 Baseline scenario of public finance

Figure 54 demonstrates the public finance scenario for RMI until 2050, without any reforms. It suggests that under the baseline scenario, without any major reforms, RMI is likely to maintain a finance surplus until 2029, due to the high level of non-tax revenue income in recent years. However, as the income from non-tax revenues, mainly fishing licence fees and ship registry fees, reach their limits, RMI's budget balance will eventually become negative from 2030, if there are no major reforms in economic structure, public finance and SOEs. This is the case even if the Compact Trust Fund has a higher investment return, which would only delay a budget deficit.

Figure 54: Baseline analysis of public finance in RMI (US\$ Million), 2017–2050



Source: Author, own calculation.

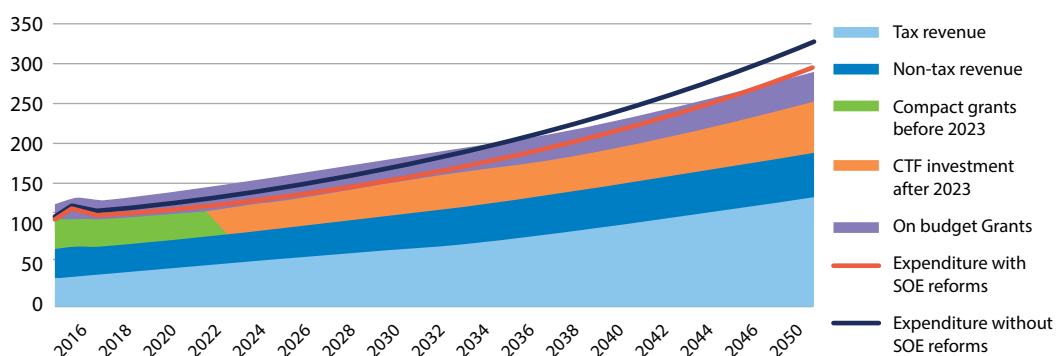
9.2.2 Scenario with reforms

Under this scenario, the report considers two policy interventions: taxation reform and SOE reforms, assuming:

- **RMI reforms its taxation system to broaden RMI's tax base and improve compliance.** As a result, the tax revenue to GDP ratio gradually increases from around 17.3 percent of GDP in 2016 to 23 percent of GDP, which is implied in the PFTAC 2008 study as RMI's potential level of taxation is similar to the level in Fiji and Samoa. However, this is still lower than RMI's target tax revenue level of 25 percent of GDP, as implied in RMI's MTBIF.
- **RMI implements its SOE reform to improve SOE performance and to reduce government transfer to SOEs.** As a result of the reform, it is assumed that RMI is to reduce the level of public transfer to SOEs from 5 percent of RMI's GDP in 2018 to 0 percent of GDP in five years.

Figure 55 demonstrates the scenario of public finance with reforms in taxation and SOEs for the period between 2017 and 2050. It shows that even with reforms in taxation and SOEs, RMI is likely to maintain a budget surplus until 2046. Beyond 2046, RMI is still likely to have a fiscal deficit.

Figure 55: Public finance in RMI (US\$ Million) with SOE Reforms, 2017–2050



Source: Author, own calculation.

Additionally, RMI could also implement other initiatives to promote economic growth and increase public revenue on one side, and improve public sector efficiency on the other, which can in turn improve RMI's financial stability and self-reliance.



10. Recommendations: Developing the current system to address sustainable development challenges

RMI will have to address significant challenges to finance and achieve the goals defined in its Vision 2018, National Strategic Plan, and the SDGs, especially after 2023 when the certainty of Compact Sector Grants ends. Addressing these challenges will require the strategic mobilization of resources and coordination of efforts across a range of public and private actors. Strengthening an integrated approach to raising and using resources can help the RMI government in developing and delivering a strategic, holistic approach towards managing financing for addressing these challenges.

While elements of the INFF already exist explicitly or implicitly in RMI, there is scope for RMI to strengthen all six building blocks of the system. Establishing an INFF, to mobilize all sources of financial resources (public and private, domestic and external) and to support the implementation of complex, cross-sector strategies, remains a challenge.

In addition to the recommendations put forward separately in chapters 5, 6, 7 and 8, this section will lay out other key recommendations for improving RMI's national development financing framework.

10.1 Ensuring leadership and institutional coherence

RMI has made a commitment to the SDGs and has integrated the principles of sustainable development into its national development strategies and plans. Achieving RMI's national development goals and the SDGs will require high-level political commitment; coherent strategic policy frameworks; and effective and well-functioning institutional coordination mechanisms. It will require the active involvement and the alignment of interests of a wide range of stakeholders that allow for a holistic, whole-of-government, and whole-of-society perspective of the issues at stake.

RMI has put in place a set of legislation and institutional frameworks to facilitate the achievement of the SDGs and its own national development goals. However, there are some areas for improvement in policy coordination, demonstrated by the long delays in implementing some of the proposed reforms.

In driving forward policy initiatives for national development and the SDGs, **RMI could consider appointing a strong champion both in terms of individual and institutional leadership.** A champion agency, such as the Chief Secretary, the Ministry of Finance, or a designated committee, should be empowered to coordinate and lead the effort. This agency should receive support from the president's office.

RMI could consider strengthening its policy coordination mechanisms in both policymaking and policy implementation. This will require the engagement of key actors and stakeholders in the priority-setting process from the outset, and stimulating multi-stakeholder participation for policy implementation, multi-stakeholder policy dialogue to identify barriers to, and the catalysts for, achieving development objectives, and multi-stakeholder involvement in resolving policy conflicts.

Strengthening the M&E system and establishing an effective public sector performance management system would improve coherence between policy setting and policy implementation.

10.2 Developing a new long-term development strategy and updating the medium-term NSP to establish a new vision for the result

RMI has established a long-term national development vision, Vision 2018, a medium-term nation development plan, the National Strategic Plan, and Agenda 2020, which have identified national development priorities, and set up development goals and targets for RMI to achieve in the medium and long-term periods, and have provided guiding principles for the annual budgeting and planning of public finance.

However, none of these development strategies and plans have explicitly considered the affordability, costing and financial resources needed to achieve the vision and development goals.

Vision 2018 was developed in 2001 and the National Strategic Plan 2015–2017 was developed in 2014. While many of the development objectives and goals listed in Vision 2018 and the National Strategic Plan are still relevant, RMI faces new challenges, including committing to achieve the SDGs by 2030 and preparing for the termination of Compact Grants by 2023.

It is therefore recommended that RMI:

- **Establish a new long-term development strategy and update the medium-term NSP, taking into account the current social, economic and environmental challenges facing RMI and integrating SDG targets and indicators.** Integrating the SDG targets and indicators into the national development plans will also have implications for establishing an overarching financing strategy and policies. For example, the SDGs explicitly include a number of targets and indicators that could constitute long-term development targets, such as GDP per capita growth, level of government revenue and debt service level.

- **Include the cost estimations for achieving these development goals, consider the affordability and financial resources needed to achieve the development goals, and prioritize the implementation of these development goals in newly updated development visions and strategic plans.**
- **Develop sector strategies that integrate and operationalize the targets and goals proposed in national development visions and strategic plans.** RMI, with support from UNDP, has initiated the process of integrating and mainstreaming all the SDG goals and targets in its NSP.

10.3 Establishing an overarching financing policy

RMI does not yet have explicit long-term fiscal policies towards achieving its long-term development vision of a “resilient, productive and self-supportive RMI”. In the medium term, while a Decrement Management Plan has been developed to serve as medium-term revenue and expenditure policies in preparing for the post-2023 transition, its implementation has been stalled.

RMI could consider establishing a long-term holistic financing strategy, taking into account the evolving development finance landscape, in particular the termination of Compact Sector Grants after 2023, to facilitate RMI’s effort to grow a self-reliant economy. The strategy will provide guidance and direction for the government’s effort in mobilizing and combining all forms of financial resources – national and international, public and private – and maximizing their impacts in achieving national development goals as well as the SDGs. The strategy could also include how to establish an enabling environment to be more conducive to mobilizing these financial resources.

RMI could consider developing an overall financing strategy with clearly articulated goals, targets and priority development programmes, as well as considering the potential role of different actors in contributing to specific development priorities. Based on RMI’s vision for development, the long-term financing strategy could focus on financing activities towards achieving a “resilient, productive and self-supportive RMI”, such as promoting the productive capacity of the economy through sustainable infrastructure investment, improving the business-enabling environment, and promoting private sector development. Similarly, SOE reform, tax system reform, preparing for post-2023 transition, and mobilizing domestic finance resources for national development goals should also find their places in the strategy. This strategy should be explicit and be a guiding document for government public financing decision-making, and consider not just government finance but also the role of private capital in financing for development.

The strategy should also include some rough cost estimates for implementing RMI’s long-term vision and develop estimates and targets for the types of investments needed. This can provide the overarching framework within which specific financing policies to mobilize resources can be developed and operationalized.

RMI could consider strengthening its macroeconomic modelling capacity to improve its public revenue forecast and to fully utilize the functions of MTBIF, including exploring the impacts of potential economic policies. RMI could consider strengthening the capacity of line ministries to cost policies and to develop integrated sector strategies that are clearly linked to the national MTBIF.

10.4 Strengthening the M&E system to monitor and provide evidence-based support for financing for development

RMI has a two-tier M&E framework in place; however, the effectiveness of this framework is still weak. The framework has a matrix of core indicators, incorporating MDG indicators and representing the overall M&E framework, and was developed to monitor progress towards achieving national development objectives. However, the use of this matrix in monitoring development progress is still limited. There is also a significant data gap in establishing baselines; the baseline values of many of the indicators do not exist or are in the process of being compiled.

As RMI is in the process of integrating the SDGs into its national development plans, **a monitoring system, incorporating SDG targets and indicators, needs to be developed.** This monitoring system will set up the targets, establish baselines, and monitor progress on national development. It will be essential for RMI to ensure evidence-based policymaking and to ensure effective and efficient mobilization and utilization of various financial resources, and to ensure development progress towards national development goals and the SDGs. Considering the number of SDG indicators, the data requirements for this new monitoring system will be even more challenging for RMI.

RMI could consider conducting a data mapping exercise, after the establishment of the Core Indicator Matrix for the updated National Strategic Plan, to identify the current available data sources and institutional settings and identify any data and institutional gaps for establishing baselines and monitoring national development.

Then, RMI could consider developing a strategy to address the gaps and to ensure the implementation of monitoring and evaluation based on the Core Indicator Matrix at both the national level and the linked sector level. Such a strategy should clearly define the roles and responsibilities of various agencies, ensure the harmonization of information systems and information-sharing across agencies, and avoid duplication and overlaps. It should also establish a proper feedback and lesson-learning mechanism to ensure M&E results are fed back into the decision-making process, and an information-disseminating mechanism to generate public awareness, public support and political will for national development, and to build momentum for future development. The strategy should also address capacity-building gaps and issues.

10.5 Building an enabling environment for accountability and dialogue

An enabling environment for accountability and dialogue is essential to build the trust necessary to mobilize non-governmental stakeholders for achieving national development goals and the SDGs. Private sector institutions and NGOs can play a crucial role and become important partners for the government, both in terms of mobilizing additional finance and improving efficiency in the delivery of government policies and services. Encouraging further engagement of the private sector and NGOs may be helped by inviting their involvement more systematically in the project cycle, and ensuring a legal framework is in place to do so.

RMI needs to strengthen accountability mechanisms that support transparent and open dialogue between government, the private sector and NGOs. The following measures could be considered:

- **To improve accountability and dialogue, it will be essential that government institutions in RMI provide credible, comprehensive and transparent information to civil society and the private sector.** Transparent and credible information dissemination can demonstrate the government's accountability in pursuing policy objectives, signal the government's intended policy action, and generate public awareness and understanding to encourage wider participation, enhancing government policy credibility, garnishing support for policy initiatives, and eventually enhancing the effectiveness of policy initiatives.
- **To make the government's decision-making – including the development of the National Strategic Plan, annual budget and any policy initiatives – participatory and inclusive, and to engage key actors and stakeholders in the priority-setting process from the outset.** The National Strategic Plan, annual budget and policy initiatives need to have clearly defined targets and priorities, with clear expectations of the contributions from stakeholders.
- In the implementation process, the **RMI government could consider establishing a formal mechanism to stimulate multi-stakeholder participation for policy implementation and multi-stakeholder policy dialogue to identify barriers to, and the catalysts for, achieving development goals, and multi-stakeholder involvement in resolving policy conflicts.** In conducting dialogue with various stakeholders, champions from both the public, private and non-governmental sectors, such as the Chamber of the Commerce from the private sector, are needed to driving forward the dialogue process.
- **RMI needs to establish a robust and efficient monitoring, evaluation and learning system** to monitor the allocation, disbursement and movement of various financial flows, and the progress of the programmes funded by these financial flows, to evaluate the outcome and impacts of programmes funded by these financial flows, and to provide evidence-based policy advice for government policymaking.
- **RMI may need to establish an effective review and independent audit mechanism.** The capacity of the Office of the Auditor-General should to be strengthened and its independent review function enhanced to ensure that audited reports are independent and are accessible to interested stakeholders and the general public.



11. Roadmap for key actions

This assessment has identified several opportunities for the further development of main financial flows and for managing them to support RMI in achieving its national development goals and the SDGs.

Most of these opportunities are related to improvements to the INFF that govern each flow as well as the overarching financing policy. RMI's National Strategic Plan and Agenda 2020 have already identified many of them. The main message from this assessment is to recommend their prioritization. The summary of the main actions recommended in the assessment is presented in Table 9 below.

Table 9: Key action areas identified

Recommendations		Key activities
To ensure leadership and institutional coherence	1.1	To establish a strong champion both in terms of individual and institutional leadership in driving forward policy initiatives for national development and the SDGs.
	1.2	To strengthen RMI's policy coordination mechanisms in both policy setting and policy implementation.
	1.3	To establish an effective M&E system and an effective results-based public sector performance management system.
To develop a new long-term development strategy and update the medium-term NSP to establish a new vision for the result	2.1	To establish a new long-term development strategy and update the medium-term NSP, taking into account the current social, economic and environmental challenges facing RMI and integrating SDG targets and indicators.
	2.2	To include the cost estimations for achieving development goals, consider the affordability and financial resources needed to achieve the development goals, and prioritize the implementation of these development goals in the newly updated development visions and strategic plans.
	2.3	To develop sector strategies that integrate and operationalize the targets and goals proposed in national development visions and strategic plans.
	2.4	To develop an industrial transformation strategy with the objective: <ul style="list-style-type: none"> • To transform RMI from a service-based and public-sector-driven economy into an economy lead by the "blue" and private sector • To reposition RMI's economy on a market segment with global comparative advantage, taking advantage of emerging "blue economy" activities

Recommendations		Key activities
To establish an overarching financing strategy	3.1	To develop an overall financing strategy with clearly articulated goals, targets and priority development programmes, as well as the potential role of different actors in contributing to specific development priorities
	3.2	To strengthen macroeconomic modelling capacity to improve public revenue forecast capacity and to fully utilize the functions of MTBIF.
	3.3	To strengthen the capacity of line ministries to cost policies and to develop integrated sector strategies that are clearly linked to the national MTBIF.
To implement public finance management reform and to improve the quality of public finance management	4.1	<p>To reform the tax system and enhance tax administration, including:</p> <ul style="list-style-type: none"> • To review, update if necessary, approve, and implement the proposed tax reforms as soon as possible • To develop for each tax stream the supplementary guidelines, standard of procedures and other key documents, consistent with international best practices and standards. • To enhance tax and customs administration • To improve tax and customs administration capacity through automating the tax and customs administration system
	4.2	To develop a policy on how to best utilize non-tax revenue and balance the needs for current public expenditure, public expenditure post-2023.
	4.3	<p>To prioritize financing for infrastructure investment and economic activities towards growing a self-reliant economy:</p> <ul style="list-style-type: none"> • Ensuring the allocation of public expenditure to be guided by a comprehensive and coherent financing policy, and to be aligned with the national development priorities • Considering leveraging public finance for the involvement of private sector for infrastructure investment • Promoting the delivery of public services by the private sector and improving public sector efficiency
To safeguard the value of CTF and to manage the fiscal instability associated with the volatility	5.1	<p>This will involve:</p> <ul style="list-style-type: none"> • Setting up an appropriate investment strategy for CTF investment • Setting up rules and regulations, and procedures for drawing-out investment returns • Setting up a mechanism to deal with the volatility of investment returns arising from market volatility • Exploring the feasibility and mechanisms for attracting contributions from beyond the United States, Taiwan Province of China, RMI and CTF investment • Exploring the feasibility of utilizing CTF as a buffer for macroeconomic stability and for large domestic infrastructure projects

Recommendations		Key activities
To promote market-oriented SOE reforms	6.1	<p>This will involve:</p> <ul style="list-style-type: none"> • Developing a comprehensive economy-wide SOE reform strategy • Building up the mandates for SOE reforms, establish taskforces to champion the SOEs reforms • Prioritize reforms to those SOEs that pose the highest fiscal risk over the short to medium term • Selecting the most feasible and appropriate forms of reform (including corporatization, separating social and economic responsibilities, partial or full privatization, and public-private partnerships (PPPs)) • Implementing SOE reform • Establishing appropriate state asset management mechanisms and appropriate corporate governance mechanism for SOEs • Accompanying SOE reforms with market liberalization, such as price reform, opening the markets formerly dominated by SOEs, encouraging the entry of private sector players, and generating competition • Developing an appropriate policy and regulatory framework to ensure fair competition
To develop robust and efficient monitoring, evaluation and learning systems	7.1	<p>To develop an M&E system, incorporating SDG targets and indicators with:</p> <ul style="list-style-type: none"> • Clearly defined roles and responsibilities of various agencies • A proper feedback and lesson learning mechanism • An information disseminating mechanism
	7.2	<p>To conduct a data mapping exercise to:</p> <ul style="list-style-type: none"> • Identify the current available data sources and institutional setting and identify any data and institutional gaps for establishing baselines and monitoring national development
	7.3	<p>To develop a strategy to address the gaps and to ensure the implementation of monitoring and evaluation based on the Core Indicator Matrix at both the national level and the linked sector level</p>
To develop an enabling environment for accountability and dialogue	8.1	<p>To strengthen accountability mechanisms that support transparent and open dialogue between government, private sector and the voluntary sector, through:</p> <ul style="list-style-type: none"> • Transparent and credible information dissemination • Participatory and inclusive decision-making, policy dialogue, effective M&E and lesson learning, effective reviews and independent audits.

Source: DFA team

The actions listed above may require systemic reforms and involve a wide variety of areas, from public administration to good governance and the strengthening of the management capacity of the central government and line ministries.

Implementing them all at once will be big challenge for RMI. Therefore, the government should consider the prioritization of these policy areas and develop a realistic roadmap of interventions based on the outcomes of this assessment and other government priorities. The implementation of the prioritized agenda will require leadership and coordination from the highest levels of the government.

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