FOR AGENDA

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September 4, 1992

To: Members of the Executive Board

From: The Secretary

Subject: Marshall Islands - Staff Report for the 1992 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1992 Article IV consultation with the Marshall Islands, which is tentatively scheduled for discussion on Wednesday, October 7, 1992.

Mr. Adarkar (ext. 37329) or Mr. Baban (ext. 37412) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

MARSHALL ISLANDS

Staff Report for the 1992 Article IV Consultation

Prepared by the Staff Representatives for the
1992 Article IV Consultation with the Marshall Islands

Approved by Linda M. Koenig and Michael E. Edo

September 3, 1992

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I. Introduction

The Marshall Islands became a member of the Fund on May 21, 1992. The first Article IV consultation discussions with the authorities were held in Majuro during June 20-July 1, 1992. 1/ The staff team 2/ met with President Amata Kabua, Minister of Finance Ruben Zackhras, other ministers, and senior government officials, and representatives of the private sector. The Marshall Islands has accepted the obligations of Article VIII, Sections 2, 3, and 4. It maintains an exchange system that is free of restrictions on payments and transfers for current international transactions.

II. Background and Recent Economic Developments

The Republic of the Marshall Islands, with a population of about 50,000, consists of 29 atolls and about 1,200 smaller islets with a total land area of about 181 square kilometers. The small amount of land, the poor quality of the coralline soil, and the scarcity of fresh water constrain agricultural development. The dispersal of the atolls over 1.9 million square kilometers in the central Pacific Ocean results in a vast exclusive economic zone. The country is remote from major markets.

Under a Compact of Free Association with the United States, which came into effect in October 1986, the United States will provide $640 million in grants over the period 1986-2001. 3/ Annual block grants, which comprise the largest component, are scheduled to decline in 1991/92 and again in 1996/97. 4/ U.S. aid is the main force propelling the economy. In 1990/91, aid inflows (including nonbudgetary grants) amounted to $51 million, equivalent to about two thirds of central government expenditure, over half of current foreign exchange inflows, and about two thirds of GDP (Table 1). A substantial proportion of government expenditures is devoted to public sector wages and salaries, which are almost wholly spent for consumption. In turn, consumption has a very high import component.

1/ These discussions represented the first opportunity for the staff to engage in a policy dialogue with the authorities. To them, such dialogue, especially during the preparation of the 1992/93 appropriations bill, was an important immediate benefit of Fund membership.

2/ The staff team comprised Mr. Adarkar (Head), Mr. Baban, Mr. Fairman, Ms. Lum, and Ms. Cullati (Administrative Assistant)(all SEA).

3/ This amount excludes $150 million provided under the Nuclear Claims Fund to compensate victims of nuclear tests conducted in the late 1940s and early 1950s. For the main terms of the Compact, see Annex I of "Republic of the Marshall Islands--Calculation of Quota" (EB/CM/Marshall Islands/92/1, 2/7/92).

4/ The fiscal year starts on October 1. In tables where columns refer to fiscal years, calendar year data refer to the latter year (i.e., 1986/87 means 1987).

Real GDP is estimated to decline in 1991/92, 1/ largely because of two typhoons and recurring drought. The adverse effect of weather on the rural sector was mitigated by increases in incomes from copra production following the more than doubling of producer prices in January 1992. Copra producers responded favorably to the higher producer prices, which have been maintained despite a subsequent easing of world coconut oil prices.

Inflation increased in early 1991/92, mainly because of the pass-through of an increase in effective business taxation (following a shift from a net profits basis to a gross receipts basis in October 1991) and temporary scarcities of food and construction materials in the wake of the two typhoons. However, with supplies returning to normal levels later in the fiscal year, inflationary pressures subsided and consumer prices are estimated to rise by 5 percent for the year as a whole.

The central government's finances are estimated to deteriorate in 1991/92, as expenditures increased despite lower grants and domestic revenues (Table 2). The overall deficit is expected to triple to $25 million (33 percent of GDP). A downward adjustment in total expenditures was avoided by the one-time effect on revenues of the shift in the basis of the business tax and by the floating in September 1991 of a third bond issue for $38 million secured by future Compact funds. 2/

The infusion of central government funds into nonfinancial public enterprises continues to be a significant drain on public finances (Table 3). Subsidies, transfers, and lending to the main enterprises amounted to about $11 million in 1990/91, equivalent to about a fifth of central government recurrent expenditure. Of this amount, about $8 million was accounted for by Air Marshall Islands, mainly reflecting the high costs of the Majuro-Honolulu route. Combined public enterprise requirements for 1991/92 are estimated to be in the same order of magnitude. The National Telecommunications Authority (NTA), which receives a small amount of earmarked Compact grants and is the sole profitable public enterprise, is in the process of being privatized. 3/

1/ Nominal GDP is estimated to increase by under 1 percent in 1991/92. Deflating by the increase in the Majuro CPI, the only price index available, this implies a decline in real GDP of about 4 percent, compared with a negligible decline in 1990/91.

2/ Two earlier bond issues were also collateralized by future Compact funds. In July 1987, the Government sold $65 million in bonds, mainly to refinance an outstanding debt of $53 million. In June 1989, the Government sold $20 million in bonds to fund a variety of development projects.

3/ Effective December 1991, the NTA offered to sell 270,000 shares out of a total of 360,000 shares, with the remainder to be retained by the Government. Sales were limited to citizens and to 1 percent of total shares per individual. As of May 1992, about 15,000 shares had been sold.

In the absence of restrictions on the transfer of capital, domestic interest rates have declined in line with the easing of interest rates in the United States. As of May 1992, domestic bank deposit rates fell to 4 percent for a three-month time deposit; lending rates for consumer loans fell to as low as 14 percent, while those for commercial loans eased to as low as 7.5 percent. 1/ While the demand for loans intensified, particularly in the wake of the two typhoons, the loan-to-deposit ratio of the two foreign commercial banks, which have about a 90 percent share of the $50 million deposit base, remained at about 50 percent as of May 1992. The ratio for the domestically chartered bank exceeded 100 percent.

A provisional balance of payments constructed by the staff indicates a weakened position (Table 4). 2/ The trade deficit for 1991/92 is estimated to widen only slightly, with the increase in imports nearly offset by the increase in coconut oil exports on account of a higher average price and larger volume. 3/ However, the services account, which shifted into deficit in 1990/91 (mainly because of higher airline service payments and lower interest earnings), is estimated to register a wider deficit in 1991/92 (principally because of higher interest payments associated with higher external debt and a marked increase in service fees associated with the upgrading of telecommunications equipment). Moreover, U.S. grants will decline in 1991/92, as the first programmed decline in Compact block grants takes effect. Mainly as a result of these developments, the current account is estimated to shift from surplus in the previous year to a deficit equivalent to about 11 percent of GDP.

The outstanding public and publicly guaranteed debt of the Marshall Islands is estimated to amount to $103 million, or about 135 percent of GDP, as of the end of 1991/92. This total includes the three bond issues floated by the central government, the service payments on which would amount to about $16.5 million in 1991/92 (Table 5), or about 25 percent of estimated recurrent expenditures.

The conduct of economic policy has been hampered by a weak statistical base. To alleviate this situation, the Asian Development Bank (AsDB) commenced a technical assistance project in mid-1992 to strengthen the Office of Planning and Statistics through training and scholarships. Also, a multitopic assessment mission from the Fund's Statistics Department visited Majuro in August 1992.

1/ The statutory maximum lending rate is 24 percent.

2/ A balance of payments is not compiled by the authorities. The financial holdings of the Government consist mainly of Compact funds disbursed but not yet spent, remaining proceeds of government bond issues, and balances in fiduciary funds. Amounts not earmarked for specific purposes, whether held domestically or abroad, are considered by the authorities as available for balance of payments purposes.

3/ Exports consist mainly of coconut oil and cake, chilled fish, and trochus shells.

III. Policy Issues and Medium-Term Outlook

1. Policy issues

The authorities regard the declining amount of foreign assistance as posing the central policy dilemma. Given the narrow productive base, it would not be possible to raise enough domestic revenues to offset such a decline. The staff proposed a rationalization of public finances involving an orderly scaling down of government operations, a reordering of expenditure priorities, stricter control over expenditures, and the reduction of subsidies, along with a comprehensive review of domestic revenue sources. In the present circumstances, the budget constraint would be effective because deficit financing for recurrent expenditure would not be an option. The Government has a severely limited capacity to borrow against future untied Compact funds and is unlikely to be able to borrow against purely sovereign guarantees. Also, the Government cannot print its domestic currency, the U.S. dollar, for deficit financing.

a. Real sector and development planning

The authorities place a high priority on the objective of expanding and diversifying the productive base, while recognizing the constraints imposed by the country's geography on the range of policy options. In particular, the authorities have decided to expand investment in the fishing sector by acquiring 10-13 long-line vessels that would unload their tuna catch at the Majuro fish base for air transshipment to Honolulu and Japan. 1/ In addition, the AsDB has approved a loan for the construction of a fish base in Ebeye (Kwajalein Atoll) and the acquisition of 14 long-line vessels to be based there. 2/ Despite the excess capacity existing at the Majuro fish base, the authorities justified the construction of the Ebeye fish base as a means to disperse the development effort to regions other than Majuro. They added that if the long-line vessels based in the two centers were successful, the excess freight capacity in Air Marshall Islands would be considerably reduced. A cannery is also under consideration, though the authorities are proceeding cautiously because of the scale of investment involved and the need to coordinate long-term fish supply agreements. 3/

A significant supply response could be expected in agricultural production when producers are provided with adequate incentives and reliable

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1/ The fish base provides docking, freezing, chilling, packing, and icemaking facilities.

2/ The AsDB has required that seven vessels would be built in Ebeye, so as to bolster local boatbuilding and dry-dock repair skills.

3/ The envisaged facility would be built with Government borrowing, the service payments on which would be covered by lease payments of an international operator. While the energy needs of the cannery can be met by the electricity company, its water requirements would necessitate the construction of dedicated desalinization plants.

marketing channels, as the case of copra shows. The authorities agreed with the need to intensify efforts to identify small-scale agricultural projects that would be viable in the country's environment. Several donor-supported projects in horticulture and poultry-raising have demonstrated potential competitiveness vis-à-vis imports. The staff stated that concerted efforts by institutional buyers, such as the national airline and the hospital, to purchase competitive local produce could enable producers to realize economies of scale. In addition, the institution of a weekly "Market Day" in the more populated atolls would provide a predictable marketing channel for small-scale agricultural producers.

At present, copra producer prices are administratively determined on an ad hoc basis. The staff team urged the authorities to adopt a transparent formula that would more predictably control government subsidies while smoothing the impact of fluctuations in world prices. The use of producer prices to calibrate rural cash incomes, as in the wake of recent natural disasters, inappropriately mixes policy objectives and does not necessarily ensure that the persons requiring relief are the ultimate beneficiaries. The authorities agreed to study the possible determinants of such a formula.

The experience of similar economies in diversifying production provides a guide on other possible projects in the Marshall Islands. The authorities stated that a pilot project for the cultivation of seaweed, which had emerged as an important export crop in Kiribati, had been initiated; once viability was demonstrated, the next step would be to identify buyers and encourage private sector production. In the light of experience in the Federated States of Micronesia in the manufacture of soap and toiletries based on coconut oil, the Government authorized a pilot project at the Tobolar Copra Processing Plant (a public enterprise). Tobolar is now ready to begin commercial production of soap. The authorities added that light food processing (e.g., jams, breadfruit chips, and dried fish) was also a promising possibility.

At present, the Marshall Islands lacks international-grade tourist resorts. The authorities stated that they were examining a proposal by foreign investors to construct a self-contained resort, with its own airport, in Wotho atoll. While such a resort would not involve large public expenditures for upgrading infrastructure in the more populated areas, the authorities expressed concern about the resort's impact on traditional village life and on the environment. The staff team suggested that the authorities examine the experience of atoll-based resorts in such places as the Maldives and Tahiti.

Transportation between the dispersed atolls is a serious bottleneck that limits what can be traded domestically or abroad. High-bulk, low-value perishables cannot be economically transported by air. Moreover, inter-island vessels lack refrigerated holds and visit the outer atolls only once every quarter, essentially to bring supplies and purchase copra. The efficiency of domestic shipping could be enhanced by placing its management under a professional, corporate structure. The authorities stated that the establishment of a national shipping company was envisaged under the Second Development Plan. They emphasized that because domestic shipping must service all populated atolls by necessity, the company is not likely to be a candidate for privatization.

In the Second Five-Year Development Plan (1991/92-1995/96), development expenditures are targeted to amount to $307 million and would focus less on infrastructure and more on economic services. Identified funding for the Second Plan totals about $157 million. The authorities stated that, in response to this situation, they identified priority "A" projects involving expenditures of $159 million. Priority "B" projects would be implemented if funding becomes available. A Round Table Meeting was convened by the United Nations Development Programme (UNDP) in December 1991 to canvass more donor support. In view of the lack of close ties to donors other than the United States and the inability to finance projects domestically, actual Second Plan expenditure is not likely to exceed the amount of identified funding.

b. Public finance and nonfinancial public enterprises

With the decline in foreign assistance, the formulation of a fiscal adjustment policy has been an urgent concern. The authorities stated that, in preparing the 1992/93 appropriations, they decided to adopt a 10 percent across-the-board cut of departmental allocations. In absolute terms, the brunt of this reduction would be borne mainly by health and education, which normally received the largest allocations. A more comprehensive reappraisal of expenditure priorities is needed. In particular, a deterioration in health and education standards would be inconsistent with the future human capital demands of the economy. With the efficiency of public expenditure assuming even greater importance, the staff team also suggested that the Government consider establishing a unit, possibly under the Minister of Finance, that would subject all significant investments or expenditures to closer analytical scrutiny.

With the aim of intensifying domestic resource mobilization, a review of domestic sources of revenue is called for. With the highest marginal income tax rate at just 12 percent, there would be some scope for increasing taxation of income, possibly through the creation of a third bracket. 1/ With the average effective duty on commercial imports at just 12 percent, there would also be room for raising import duties. 2/ Government fees and charges, many of which had not been changed since the pre-independence

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1/ The personal income tax structure involves two rates: 8 percent on the first $10,400 and 12 percent for amounts above it.

2/ The staff recommended that all imports be subject to import duties to avoid the difficulties associated with administering the exemptions for government imports and imports by the private sector destined for the Government at the point of entry. In the circumstances, ex-post rebates of duties would be a more efficient method of authenticating and administering exemptions.

period, would need to be updated. The reinstatement of a tax on gasoline sales abolished in April 1992 would need to be reconsidered. The authorities agreed to consider these proposals.

Apart from helping conserve fish stocks, increased surveillance of the exclusive economic zone could raise revenue by encouraging legal fishing and fining illegal fishing. The authorities stated that recently such surveillance had been inadequate because of vessel maintenance difficulties and the need to use a patrol boat to ferry emergency supplies after the typhoons. The authorities agreed with the need to maintain surveillance activities at a level that would be credible yet cost effective. They stated that, with the help of a donor country, repairs were being made and a program had been established to train local sailors for patrol duty.

In the light of declining foreign grants, the difficulty of raising domestic revenues from a narrow tax base, and the lack of capacity for further borrowing, the subsidization of aviation, electricity, water and sewage, and copra purchases is not sustainable. Public utilities should move rapidly toward economic pricing, while searching for means to reduce costs. The authorities stated that they were considering proposals by the Marshalls Energy Company and the Majuro Water and Sewage Company to revise the respective tariff structures; under these proposals, rates would increase with usage for large consumers. Also, Air Marshall Islands will be progressively increasing the use of local staff and crew, with substantial resultant savings.

c. Money, credit, and financial institutions

The scope for monetary policy in the Marshall Islands is limited by the institutional framework, which involves the use of the U.S. dollar as the domestic currency and provides for generally unrestricted capital flows. 1/ However, the authorities agreed that there were other concerns that would require the revitalization of the Banking Commissioner's Office, namely, the inclusion of monetary analysis as an input to macroeconomic policy, prudential supervision of banks, and the expansion of banking services beyond Majuro and Kwajalein. As this Office had been inactive for some time, the appointment of a full-time Banking Commissioner should be considered. 2/

Another concern of the authorities was that, while the domestically chartered bank loaned out all of its deposits to local borrowers, the two larger foreign banks have low loan-to-deposit ratios, with the excess deposits invested with their headquarters abroad. The authorities stated that the foreign banks could make a greater contribution to the development

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1/ Foreign direct investment in the Marshall Islands requires prior Cabinet approval.

2/ The Secretary of Finance is at present the Acting Banking Commissioner.

of the economy. The staff team stated that banks should remain free to determine the level and allocation of credit according to market assessments of risk; efforts to aid the private sector identify and prepare bankable projects should increase domestic bank lending. The domestically chartered bank, which is not insured by the U.S. Federal Deposit Insurance Corporation, is hampered from competing effectively for deposits. To create a level playing field for commercial banks, the authorities could assist in establishing an arrangement to provide private deposit insurance for the domestically chartered bank, which would be responsible for the associated premiums.

Data on banking operations are not regularly collected. Though the Banking Act and the National Statistics Act empower the authorities to require commercial banks to report on their operations in the country, these laws have not been strictly enforced. 1/ The authorities agreed that a reporting system should be put in place to assist in policy-making.

d. External sector

The declining amount of U.S. grants underscores the importance of attracting private foreign investment, which could contribute towards overcoming the shortage of domestic investment capital and managerial skills. So far, such investment has been limited largely to fishing, trade, and construction. The staff team urged the establishment of a foreign investment board, which would formulate policy, process applications, record investment flows, and serve as a one-stop center to disseminate information and facilitate compliance with national and local regulations. The authorities agreed to review the present arrangement, under which applications are processed by the Cabinet and no record is made of actual investment or the amount of repatriated capital and profits.

e. Technical assistance

The authorities consider Fund policy advice, technical assistance, and training to be important benefits of Fund membership. They do not foresee the use of Fund resources. In August 1992, technical assistance assessment missions from the Fiscal Affairs, Monetary and Exchange Affairs, and Statistics Departments visited Majuro. The authorities agreed to compile an inventory of sources of technical assistance, so as to enable the various governmental departments to identify and mobilize such aid more effectively.

2. Medium-term outlook

The medium-term outlook for the economy is essentially conditioned on the scheduled decline of annual U.S. grants to a lower level for five years

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1/ Only the domestically chartered bank and the Marshall Islands Development Bank regularly issue annual reports on their operations in the Marshall Islands.

beginning in 1991/92 and to a still lower level for five years beginning in 1996/97. With public sector borrowing to be limited to capital projects, the likely consequence would be a marked reduction in public expenditures and in private activity dependent on such spending.

Real activity is expected to stagnate in 1992/93 (Table 6), as the decline in government operations and coconut oil export prices would be largely offset by a recovery in nonmarket production. However, real activity is expected to contract in 1993/94, as the budget constraint would require a sharp scaling down of imports. In the following two years, negligible growth is forecast, with the impetus to growth deriving mainly from the effect of population pressures on the subsistence economy. Unless significant progress is made in mobilizing domestic revenue and stimulating the private sector, real activity would decline again in 1996/97, in the wake of further cuts in budgetary expenditures and imports that would be necessitated by the decline in grants. Throughout this period, inflation is expected to remain moderate.

While the balance of payments data compiled by the staff are highly provisional, the broad outline of the country's likely external position over the medium term may nevertheless be drawn. Export receipts are expected to rise steadily from 1993/94 as indigenous fishing activities expand. However, even under more optimistic assumptions, the export sector would remain relatively small because of supply constraints.

To clearly illustrate the implications of the scheduled decline in grants and an effective budget constraint, the lines for imports and net services in Table 6 exclude from 1992/93 onward the expected lumpy payments for fishing vessels and telecommunications equipment and technical services, which are to be funded by loans from the AsDB and the U.S. Rural Electrification Agency. In the absence of external borrowing capacity on the part of both the public and private sectors, the current account deficit in 1992/93 would be financed by financial holdings of the Government. From 1993/94, with financial holdings expected to be at just working levels, the current account necessarily has to be in surplus to the extent of amortization on the external debt. Unless corrective policy actions are taken, this would imply a sharp compression of imports in the coming years and commensurately increased reliance by the people on the subsistence sector.

IV. Staff Appraisal

The economy of the Marshall Islands is faced with an unsustainable fiscal imbalance and deep structural problems. Given the severely limited external or domestic borrowing capacity, the formulation of a fiscal adjustment package is the Marshall Islands' most pressing concern in the near term. So far, the only concrete element of such a package is a 10 percent across-the-board cut in government appropriations for 1992/93. This would not be adequate to restore balance.

A more fundamental rationalization of public expenditures is required. The authorities would need to adopt a plan for an orderly downsizing of the public sector and to conduct a thorough reappraisal of priorities. In particular, the intended across-the-board cuts would impact heavily on investment in human capital, which deserves high priority inasmuch as the enhancement of the population's skills and health standards is crucial to further economic growth. To improve control over public expenditure and increase its efficiency, a unit could be established for the purpose of subjecting proposed public expenditures to closer analytical scrutiny.

A fiscal adjustment package would also require an intensification of domestic revenue mobilization to supplement expenditure cuts. The staff recommends a comprehensive effort that would cover all sources. In particular, economic pricing by nonfinancial public enterprises to sharply reduce and eventually eliminate government subsidies should be pursued vigorously. A thorough review of Air Marshall Islands' operations is needed, in the light of realistic forecasts of the excess freight capacity that would remain after the forthcoming expansion of the fishing fleet. The staff also urges that any further public or publicly guaranteed external borrowing for capital projects be limited to those with demonstrable economic viability.

The importance of a fiscal adjustment package goes beyond the requirements of 1992/93. In 1996/97, Compact funds are scheduled to decline again to a lower plateau for the next five years, requiring yet another round of adjustments. Moreover, while the Compact has an indefinite life, the United States is committed to providing grants only up to 2001. Preparations for fiscal developments known in advance would help assure that adjustments would be orderly and consistent with well-considered priorities.

The authorities recognize the need to develop an institutional capacity to conduct monetary analysis. One indispensable step in this direction is the establishment of a reporting system for the banking system. The appropriate vehicle for these tasks would be a revitalized Office of the Banking Commissioner.

The expansion and diversification of the productive base is also a pressing concern, though results are likely to be realized only over the long run. Success in this area would mitigate the decline in the economy in the face of burgeoning population growth. The staff recommends an intensification of efforts to identify projects suitable to the country's geographic circumstances and to assist in the establishment of marketing channels, using experience in similar economies as a guide. While the constraints on agriculture are daunting, experience with copra production suggests that agricultural producers would be responsive to financial incentives and predictable marketing arrangements.

The producer price for copra has been revised periodically in an ad hoc manner. The adoption of a transparent formula would better serve the objectives of cushioning fluctuations in international prices and minimizing government subsidies. The importance of this task is underscored by the narrowing of the gap between international prices and domestic producer prices since 1985.

The staff broadly supports the authorities' efforts to stimulate the expansion of the fishing sector. While recent fishing ventures in purse seiners have yet to yield profits, the efficient exploitation of marine resources remains the activity with the greatest export potential. The acquisition of locally based long-line fishing vessels, through domestic and AsDB funds, should enable more intensive use of existing cold storage and airfreight capacities. However, because commercial fishing and support operations are capital intensive and inherently risky, the staff urges the authorities to gain experience with the vessels coming on stream prior to investing in further expansion of the local fleet.

In view of the shortage of investment capital and managerial skills, private foreign direct investment could contribute significantly to providing further impetus to development. The establishment of a one-stop foreign investment board would facilitate the dissemination of information and expedite the fulfillment by investors of various national and local regulations.

It is proposed that the Marshall Islands be placed on the bicyclic consultation procedure. Accordingly, the next interim Article IV consultation will be completed within 12 months of the present consultation.

Table 1. Marshall Islands: Selected Economic and Financial Indicators, 1986/87-1991/92 1/

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92 Est.
Real sector						
GDP (in millions of US$)	64.8	69.8	70.1	73.2	75.7	76.1
(Percent change)	(14.8)	(7.7)	(0.5)	(4.4)	(3.4)	(0.6)
CPI inflation (percent change) 2/	-0.6	2.6	2.1	0.7	4.0	5.0
Copra production (short tons) 3/	5,401	5,477	5,712	5,140	4,214	6,000
Public finance (in millions of U.S. dollars)						
Central government						
Revenues	69.7	72.3	67.5	76.3	66.9	63.3
Local	15.9	18.9	21.6	24.1	23.6	22.6
Grants	53.8	53.4	45.9	52.2	43.3	40.7
Expenditures	57.5	60.2	63.2	75.0	75.2	88.7
Recurrent	45.7	44.0	46.8	51.3	58.8	65.0
Development	11.8	16.3	16.4	23.7	16.4	23.8
Overall balance	12.2	12.1	4.3	1.3	-8.2	-25.4
(In percent of GDP)	(18.8)	(17.3)	(6.1)	(1.8)	(-10.8)	(-33.4)
Trust funds						
Revenues	170.9 4/	12.1	23.0	26.0	22.5	...
Expenditures	18.1	24.6	23.7	27.8	30.9	...
Net transactions	152.8 4/	-12.5	-0.7	-1.8	-8.4	...
Balance of payments (in millions of U.S. dollars)						
Exports (f.o.b.)	1.7	2.1	2.2	1.7	2.1	3.6
Imports (f.o.b.) 5/	-39.9	-41.0	-42.4	-44.2	-46.8	-48.9
Trade balance	-38.1	-38.9	-40.2	-42.5	-44.6	-45.2
(In percent of GDP)	(-58.8)	(-55.7)	(-57.3)	(-58.1)	(-58.9)	(-59.4)
Services	13.1	2.2	10.7	4.6	-1.2	-9.3
Receipts	33.2	26.4	37.1	38.1	42.7	42.4
Payments	-20.2	-24.2	-26.4	-33.5	-43.9	-51.7
Unrequited transfers	208.4 4/	59.9	55.5	62.8	50.1	45.9
Private	-0.9	-1.0	-1.0	-1.0	-1.3	-1.4
Official	209.3 4/	61.0	56.5	63.8	51.4	47.3
Current account balance 5/	33.3 6/	23.2	26.1	24.9	4.3	-8.6
(In percent of GDP)	(51.4)	(33.2)	(37.2)	(34.2)	(5.7)	(-11.3)
External debt	65.0	58.5	72.0	73.3	104.9	102.6
External debt service	5.3	12.1	11.5	14.0	14.0	18.0

Sources: Data provided by the Marshall Islands authorities; and staff estimates.

1/ The fiscal year begins on October 1.
2/ Refers to price movements in Majuro only, on a calendar year basis.
3/ On a calendar year basis.
4/ Includes $150 million provided under the Compact to set up the Nuclear Claims Fund.
5/ Import figures for 1986/87-1989/90 may be underestimated. Data on government imports and private imports on behalf of the Government during this period of rapid expansion of governmental infrastructure are not available.
6/ Excludes inflows to the Nuclear Claims Fund.

Table 2. Marshall Islands: Central Government Finances, 1985/86-1991/92

(In millions of U.S. dollars)

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92 Est.
Total revenue and grants	38.1	69.7	72.3	67.5	76.3	66.9	63.3
Domestic revenue	14.3	15.9	18.9	21.6	24.1	23.6	22.6
Tax revenue	10.8	1.0	11.3	13.7	13.8	14.7	16.6
Income tax	4.9	5.4	5.7	7.7	6.1	7.4	7.7
Import duties	3.8	4.5	4.4	4.5	5.5	5.9	5.8
Gross business tax	1.6	1.0	0.9	0.9	0.5	--	2.2
Fuel tax	0.3	--	0.2	0.5	0.7	0.5	0.6
Other	0.2	0.1	0.1	0.1	1.0	0.8	0.3
Nontax revenue	3.6	4.9	7.5	7.9	10.3	9.0	6.0
Fishing rights income	0.8	0.8	1.2	1.3	1.2	1.9	1.6
Philatelic sales	0.3	0.5	--	0.2	0.4	0.3	0.2
Interest income	0.2	1.0	2.5	2.9	3.9	2.6	2.1
Fees and charges	1.2	1.0	2.5	1.1	1.5	1.9	1.3
Other	1.0	1.5	1.3	2.4	3.3	2.3	0.8
Grants	23.8	53.8	53.4	45.9	52.2	43.3	40.7
Compact	--	37.9	40.6	36.0	40.0	37.0	31.7
Other	23.8	15.9	12.8	9.9	12.2	6.2	9.0
Total expenditure	40.9	57.5	60.2	63.2	75.0	75.2	88.7
Current expenditure	39.2	45.7	44.0	46.8	51.3	58.8	65.0
Wages and salaries	11.7	12.8	14.3	15.5	16.5	17.6	...
Purchases of other goods and services	16.5	19.1	16.6	19.7	20.8	21.4	...
Interest payments	5.4	5.3	5.6	5.0	6.7	5.9	8.9
Subsidies and other current transfers	5.7	8.5	7.5	6.6	7.3	13.9	13.9
Trust Funds	2.4	3.0	1.4	0.8	1.0	1.2	0.8
Public enterprises	2.8	4.3	3.1	2.6	3.4	8.0	10.5
Other	0.5	1.3	3.1	3.2	2.9	4.7	2.6
Capital expenditure	1.7	11.8	14.0	18.7	19.8	12.5	21.2
Net lending	--	--	2.3	-2.3	3.9	3.9	2.5
Overall balance	-2.9	12.2	12.1	4.3	1.3	-8.2	-25.4
Change in deferred payments (net)	...	-3.8	-0.7	0.8	0.6	-1.2	...
Cash balance	...	8.4	11.4	5.1	2.0	-9.4	...
Financing	4.7	-8.4	-11.4	-5.1	-2.0	9.4	25.4
Net long-term borrowing	...	12.0	-6.5	13.5	-7.2	35.0	14.9
Gross borrowing	...	65.0	--	20.0	--	42.5	22.5
Repayments	...	-53.0	-6.5	-6.5	-7.2	-7.5	-7.6
Other	...	-20.4	-4.9	-18.6	5.2	-25.6	10.5

Sources: Comprehensive Annual Audits; 1991/92 Appropriations Act; and Second Five-Year Development Plan (1991/92-1995/96).

Table 3. Marshall Islands: Summary Accounts of Public Enterprises, 1990/91

(In millions of U.S. dollars) 1/

	Total	Tobolar Copra Processing Plant	Marshalls Energy Company	National Telecommunications Authority	Air Marshall Islands	M & D Fishing	Kwajalein Atoll Development Authority
Operating revenues	29.8	2.2	5.3	2.9	11.4	3.9	4.2
Sales of goods and services	25.5	1.4	4.8	2.6	10.7	3.9	2.1
Subsidies	4.1	0.8	0.4	--	0.7	--	2.1
Other	0.4	--	0.1	0.3	--	--	--
Operating expenses	38.2	1.8	6.3	2.0	19.7	4.7	3.7
Employee compensation	5.2	0.1	0.9	...	4.1	...	0.1
Other goods and services	30.0	1.6	5.3	1.7	15.1	3.4	2.9
Depreciation	3.0	0.1	0.2	0.3	0.5	1.3	0.7
Operating surplus	-8.3	0.5	-1.0	0.9	-8.4	-0.8	0.5
Nonoperating surplus	4.6	0.2	--	0.1	4.7	--	-0.4
Capital transfers	4.7	0.1	--	--	4.7	--	--
Other	-0.1	0.1	--	0.1	--	--	-0.4
Income before direct taxes	-3.8	0.6	-1.1	1.0	-3.7	-0.8	0.1
Retained income	-3.8	0.6	-1.1	1.0	-3.7	-0.8	0.1
Net acquisition of capital assets	1.4	0.3	1.4	1.6	-0.1	-1.3	-0.6
Financing requirement	5.2	-0.3	2.5	0.6	3.7	-0.5	-0.7
Financing	5.2	-0.3	2.5	0.6	3.7	-0.5	-0.7
Change in cash balances	0.3	0.2	--	0.3	0.1	--	--
Long-term borrowing	3.2	-0.4	--	0.9 2/	2.8	-0.2	0.2
Change in deferred payments (net)	1.6	-0.1	2.5	-0.6	0.8	-0.2	-0.9

Source: Data provided by the Marshall Islands Ministry of Finance.

1/ Components may not add exactly due to rounding.
2/ Provided by the U.S. Rural Electrification Agency.

Table 4. Marshall Islands: Balance of Payments, 1986/87-1991/92 1/

(In millions of U.S. dollars)

	1986/87	1987/88	1988/89	1989/90	1990/91	1991/92
Trade balance	-38.1	-38.9	-40.2	-42.5	-44.6	-45.2
Exports, f.o.b.	1.7	2.1	2.2	1.7	2.1	3.6
Imports, f.o.b.	39.9	41.0	42.4	44.2	46.8	48.9
Commercial	32.8	33.7	34.8	36.2	38.4	40.2
Other 2/	7.1	7.3	7.5	7.8	8.3	8.6
Kiribati copra 3/	--	--	0.1	0.2	0.1	--
Services account	3.1	2.2	10.7	4.6	-1.2	-9.3
Receipts	33.2	26.4	37.1	38.1	42.7	42.4
Transportation 4/	0.8	2.3	2.5	2.9	6.2	6.4
Travel	1.6	2.4	2.6	3.2	4.1	4.8
Interest earnings 5/	13.7	6.0	17.5	19.0	11.5	10.1
Fishing rights income	0.8	1.2	1.3	1.2	1.9	1.6
Kwajalein Atoll land royalties	6.2	6.2	6.2	6.2	6.2	6.2
KMR labor earnings 6/	9.6	7.9	6.3	4.5	11.2	11.6
Other	0.5	0.5	0.7	1.1	1.7	1.7
Payments	20.2	24.2	26.4	33.5	43.9	51.7
Transportation 4/	1.0	3.7	5.4	8.7	17.8	16.6
Freight and insurance	11.2	11.6	11.9	12.5	13.2	13.8
Travel	1.7	2.0	2.3	2.7	2.9	2.7
Interest payments	5.3	5.6	5.0	6.9	6.7	9.8
Telecommunications	--	--	0.2	0.5	1.0	6.6
Other	0.8	1.4	1.5	2.2	2.3	2.2
Unrequited transfers	208.4	59.9	55.5	62.8	50.1	45.9
Private	-0.9	-1.0	-1.0	-1.0	-1.3	-1.4
Workers' remittances	-0.9	-1.0	-1.0	-1.0	-1.3	-1.4
Inflow	0.5	0.5	0.5	0.5	0.5	0.5
Outflow	1.4	1.5	1.5	1.5	1.8	1.9
Official	209.3	61.0	56.5	63.8	51.4	47.3
U.S. grants	58.6	60.4	56.0	63.4	50.9	46.6
Nuclear Claims Fund	150.0	--	--	--	--	--
Other	0.7	0.6	0.6	0.4	0.5	0.7
Current account (includes official transfers except nuclear funds) 7/	33.3	23.3	26.1	24.9	4.3	-8.6
Current account (excludes official transfers)	-26.0	-37.7	-30.4	-39.0	-47.1	-55.9
Capital account 8/	-138.3	-6.5	13.5	1.2	31.7	-1.4
Public sector	-138.3	-6.5	13.5	1.2	31.7	-1.4
Gross borrowing	65.0	--	20.0	8.4	39.6	7.4
Nuclear funds	-150.0	--	--	--	--	--
Amortization	-53.3	-6.5	-6.5	-7.3	-7.9	-8.8

Sources: Data provided by the Marshall Islands authorities; and staff estimates.

1/ Provisional. Components may not add exactly to totals due to rounding. The balance of payments is presented on a fiscal-year basis, as nontrade data are collected mainly on a fiscal-year basis. Merchandise trade data are compiled and published on a calendar-year basis, and these data were converted to a fiscal-year basis by the staff.

2/ Refers to duty-free government imports and private imports made on behalf of the Government. Estimates for 1986/87-1989/90 may underestimate noncommercial imports during a period of rapid expansion of governmental infrastructure.

3/ This copra is processed in Majuro on a consignment basis; the resulting oil and cake are included in exports.

4/ Service receipts include receipts from Air Marshall Islands, airport landing fees, and fees from the use of the seaport. Service payments pertain to the expenses of Air Marshall Islands.

5/ Excludes interest earned by financial institutions on balances held abroad, for which estimates cannot be made in the absence of banking data.

6/ Refers to earnings of Marshallese workers employed at the Kwajalein Missile Range, a U.S. base on Kwajalein atoll.

7/ The relatively high current account surpluses during 1986/87-1989/90 probably reflect an underestimation of noncommercial imports.

8/ Excludes private sector capital transactions.

Table 5. Marshall Islands: Projected External Debt Service Payments, 1991/92-1996/97 1/

(In millions of U.S. dollars)

	1991/92 Est.	1992/93	1993/94	1994/95	1995/96	1996/97
Amortization	8.1	8.4	9.0	10.0	11.2	13.8
Bond issues						
Central government	7.6	7.9	8.3	9.3	10.4	13.0
Loans	0.4	0.5	0.7	0.7	0.8	0.8
National Telecommunications Authority	--	--	0.1	0.1	0.1	0.1
M & D Fishing, Inc. 2/	0.2	0.3	0.3	0.3	0.4	0.4
M & F Fishing, Inc.	0.2	0.2	0.3	0.3	0.3	0.3
Interest	9.9	9.2	8.5	7.6	6.6	5.4
Bond issues						
Central government	8.9	8.1	7.3	6.5	5.6	4.5
Loans	1.0	1.1	1.1	1.1	1.0	0.9
National Telecommunications Authority	0.2	0.5	0.5	0.5	0.4	0.4
M & D Fishing, Inc. 2/	0.4	0.3	0.3	0.3	0.3	0.2
M & F Fishing, Inc.	0.4	0.3	0.3	0.3	0.3	0.3
Debt service	18.0	17.6	17.5	17.6	17.8	19.2

Sources: Data provided by the Marshall Islands Ministry of Finance; and staff estimates and projections.

1/ Based on estimates of public and publicly guaranteed external debt as of the close of 1991/92.

2/ Debt service shown is for the full amount of the loan, although only 75 percent of it is guaranteed by the central government. The other 25 percent is guaranteed by the U.S. Government.

Table 6. Marshall Islands: Medium-Term Scenario, 1990/91-1996/97

	1990/91	1991/92 Est.	1992/93	1993/94	1994/95 Projected	1995/96	1996/97
				(Percentage change)			
Real GDP	-0.6	-4.4	--	-2.0	1.0	1.0	-3.0
Consumer prices	4.0	5.0	3.0	3.0	3.0	3.0	3.0
				(In millions of U.S. dollars)			
Exports	2.1	3.6	3.0	3.5	4.0	4.0	4.5
Imports 1/	-46.8	-48.9	-45.0	-33.0	-32.5	-31.3	-26.2
Services, net 1/	-1.2	-9.3	-5.0	-5.0	-5.0	-5.0	-5.0
Transfers	50.1	45.9	43.5	43.5	43.5	43.5	40.5
Official 2/	51.4	44.5	45.0	45.0	45.0	45.0	41.0
Private, net	-1.3	-1.4	-1.5	-1.5	-1.5	-1.5	-1.5
Current account		-8.6	-3.5	9.0	10.0	11.2	13.8
External debt 3/	104.9	102.6	94.3	85.3	75.3	64.1	50.2
Debt service 3/	14.0	18.0	17.6	17.5	17.6	17.8	19.2

Sources: Data provided by the Marshall Islands authorities; and staff estimates and projections.

1/ For illustrative purposes, from 1992/93 lumpy payments for fishing vessels and telecommunications equipment and technical services, which will be funded by the AsDB and the U.S., are not included in the current account.
2/ Mainly Compact and other U.S. grants.
3/ Assumes no further borrowing after 1991/92.

Marshall Islands: Fund Relations

(As of August 31, 1992)

I. Membership Status: Joined May 21, 1992/Article VIII 1/

II. General Resources Account:

	SDR Million	% Quota
Quota	1.5	100.0
Fund holdings of currency	--	--
Reserve position in Fund	--	--
Operational budget transfers (net)	--	--

III. SDR Department:

None

IV. Outstanding Purchases and Loans

None

V. Financial Arrangements

None

VI. Projected Obligations to Fund:

None

VII. Exchange Rate Arrangement:

The U.S. dollar is the official currency of the Marshall Islands.

VIII. Article IV Consultations:

(a) Consultation cycle: Marshall Islands is expected to be placed on the bicyclic consultation cycle.

(b) The first Article IV consultation discussions were held during June 20-July 1, 1992.

1/ The Marshall Islands has consented to an increase in its quota to SDR 2.5 million in accordance with the Ninth Review and has accepted the Third Amendment.

IX. Technical Assistance:

Department	Purpose	Timing
FAD	To assess technical assistance needs for strengthening the tax system, tax administration, and expenditure control	August 1992
MAE	To assess technical assistance needs in regard to improvement of the banking system and the conduct of bank supervision	August 1992
STA	To assess the existing system for compilation of statistical data and technical assistance needs for improving institutional capabilities	August 1992

X. Resident Representative:

None

Marshall Islands: Relations with the World Bank Group

The Marshall Islands joined the World Bank on May 21, 1992. The Bank fielded a mission in late August 1992 to prepare an economic report and formulate a possible operational strategy.

Marshall Islands: Relations with the Asian Development Bank

The Marshall Islands joined the Asian Development Bank in April 1990. The main objective of the AsDB's operational strategy is to assist the Government in achieving greater self-reliance in order to be prepared for the decline and eventual phasing-out of U.S. assistance. The loan and technical assistance program encompasses human resource development, strengthening the production base for both export promotion and import substitution, employment creation, promotion of the private sector, and institutional strengthening. A technical assistance study for human resource development has been concluded and is expected to lead to a project loan in 1993 for education and training. The 1994 technical assistance for water supply has been brought forward to be processed in 1992, leading to a water supply loan project in 1993 to assist in the alleviation of droughts. The 1992 technical assistance for health and population is being moved to 1993. Other technical assistance in 1992 will be for improving domestic resource mobilization, institutional strengthening of the Ministry of Finance, small and cottage industry development, and environmental protection. A technical assistance project for the Office of Planning and Statistics (approved in February 1992) will provide training to officials and six scholarships for the pursuit of four Bachelor's and two Master's degrees. The Bank's first loan ($6.95 million from the Asian Development Fund) has been approved for a fisheries project in Ebeye to set up a fishing base with 14 fishing boats, 7 of which are to be built locally.

Marshall Islands: Statistical Issues

The statistical base of the Marshall Islands needs substantial improvement. The national accounts, originally estimated with the aid of the Economic and Social Commission for Asia and the Pacific (ESCAP), are available only on a factor-cost basis. Output data on a national accounts basis are not collected. However, data on copra production and some estimates on production of livestock, fruits, and vegetables are available. Data on the labor market are compiled as part of censuses conducted in 1980 and 1988. The consumer price index for Majuro is the only price index compiled. Besides its narrow geographic coverage, it is subject to unrepresentative fluctuations because of the small number of items in the basket.

The format of the available fiscal data is not entirely consistent with the Manual on Government Finance Statistics. The fiscal data cover the operations of the central government and the main nonfinancial public enterprises. One of the two major commercial banks operating in the Marshall Islands (both are branches of foreign banks) has not submitted reports on its financial operations in the Marshall Islands. The domestically chartered commercial bank and the Marshall Islands Development Bank, which are relatively small, provide annual reports.

Apart from trade statistics, balance of payments data are not compiled. Historical import statistics are incomplete, as records of duty-free public imports and private imports made on behalf of the Government were not compiled prior to 1991. Export and import unit value and volume indices have not been compiled. The volume of oil imports is available from 1986. It is not likely that the Marshall Islands would be able to provide data for a page in International Financial Statistics in the near term. A technical assistance assessment mission from the Statistics Department visited Majuro in August 1992.