

Republic of The Marshall Islands

Meto2000

Economic Report and Statement
of Development Strategies

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in consultation with the
Government of the Marshall Islands

April 2001

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Cover photo: The cover shows a *meto*, a stick frame that was used for teaching traditional sea navigation. Photo courtesy of the Republic of the Marshall Islands.

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Abbreviations

ADB	–	Asian Development Bank
AIDS	–	acquired immune deficiency syndrome
AMI	–	Air Marshall Islands
AS	–	Associate of Science
BoP	–	balance of payments
CMI	–	College of the Marshall Islands
CMR	–	child mortality rate
DOE	–	US Department of Energy
DUD	–	Djarrit-Uliga-Delap
DWFN	–	Distance Water Fishing Nation
EEZ	–	exclusive economic zone
EPA	–	Environmental Protection Agency
EPPO	–	Economic Policy and Planning Office
ESCAP	–	UN Economic and Social Commission for Asia and the Pacific
FDIC	–	Federal Deposit Insurance Corporation
FFA	–	Forum Fisheries Agency
FSM	–	Federated States of Micronesia

GDP	–	gross domestic product
HIV	–	human immunodeficiency virus
IMF	–	International Monetary Fund
HSET	–	high school entrance test
IMR	–	infant mortality rate
KADA	–	Kwajalein Atoll Development Authority
MAEC	–	Marshall Islands Alternative Energy Company
MEC	–	Marshalls Energy Company
MHLC	–	multilateral high-level conference
MIAA	–	Marshall Islands Airports Authority
MIDA	–	Marshall Islands Development Authority
MIDB	–	Marshall Islands Development Bank
MIER	–	Marshall Islands Economic Report
MIITF	–	Marshall Islands Intergenerational Trust Fund
MIMRA	–	Marshall Islands Marine Resources Authority
MIPA	–	Marshall Islands Port Authority
MISSA	–	Marshall Islands Social Security Association
MIVA	–	Marshall Islands Visitors Authority
MOE	–	Ministry of Education
MOF	–	Ministry of Finance
MOHE	–	Ministry of Health and Environment
MR&D	–	Ministry of Resources and Development
NCSD	–	National Commission on Sustainable Development
NEMS	–	National Environmental Management Strategy
NESS	–	National Economic and Social Summit
NGO	–	nongovernment organization
NTA	–	National Telecommunications Authority
NTC	–	National Training Council
ODA	–	official development assistance
PFTAC	–	Pacific Financial Technical Assistance Center
PHRI	–	Pacific Health Research Institute
PILL	–	Pacific Islands Literacy Levels
PSC	–	Public Service Commission
PSRP	–	Public Sector Reform Program
PV	–	Photovoltaic
RIF	–	reduction in force
RMI	–	Republic of the Marshall Islands
STD	–	sexually transmitted disease
TA	–	technical assistance

TCMI	–	Trust Company of the Marshall Islands
Tobolar	–	Tobolar Copra Processing Plant, Inc.
TTPI	–	Trust Territory of the Pacific Islands
UNDP	–	United Nations Development Programme
US	–	United States of America
USAKA	–	United States Army of Kwajalein Atoll
USP	–	University of the South Pacific

Disclaimer: This report was prepared by consultants engaged by the Asian Development Bank at the request of the Government of the Marshall Islands. It is based on information and opinions gathered during an extensive consultative process described in Appendix 2. The ideas and recommendations expressed in the report do not necessarily represent the views of the ADB or the Government.

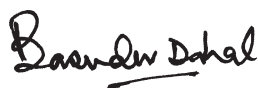
Foreword

This economic report reflects the lessons learned during the decade and a half of political independence of the Republic of Marshall Islands and the country's experience with the financial arrangements that came with the Compact of Free Association with the US. It is, in part, by design that the publication of this report coincides with preparations for the forthcoming renegotiations of the Compact agreement. This economic report, titled *Meto2000*, was developed in close consultation with the Government of Marshall Islands to provide inputs for this important exercise.

The report looks not only at the different elements of the economy, but also at cultural, historical and external influences on economic behavior. The Marshall Islands' extraordinary colonial history, traumatic post-WWII experiences and its continued importance to US defense strategy are examined, along with the effects of the substantial financial transfers on the ethics and aspirations of communities inhabiting remote atolls and governed by a hereditary power structure.

All the elements of the report were examined using an extensive consultative process involving institutions and individuals in government, civil society and the private sector, both domestic and foreign. While some of the initial conclusions derived were controversial, this report has since been publicly reviewed in the Marshall Islands to ensure, as far as possible, that it reflects a consensus in the community about the country's economic performance and prospects; and what needs to be done to turn the Marshall Islands' potential for sound economic growth into reality, and how this may best be organized and implemented.

ADB is pleased to have been able to provide this assistance, and acknowledges with great appreciation the full, frank and positive participation of the Government and people of the Marshall Islands in the preparation of the report.

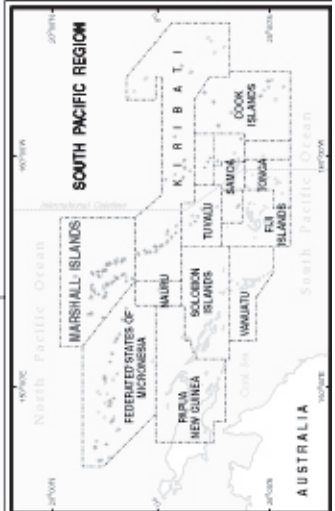
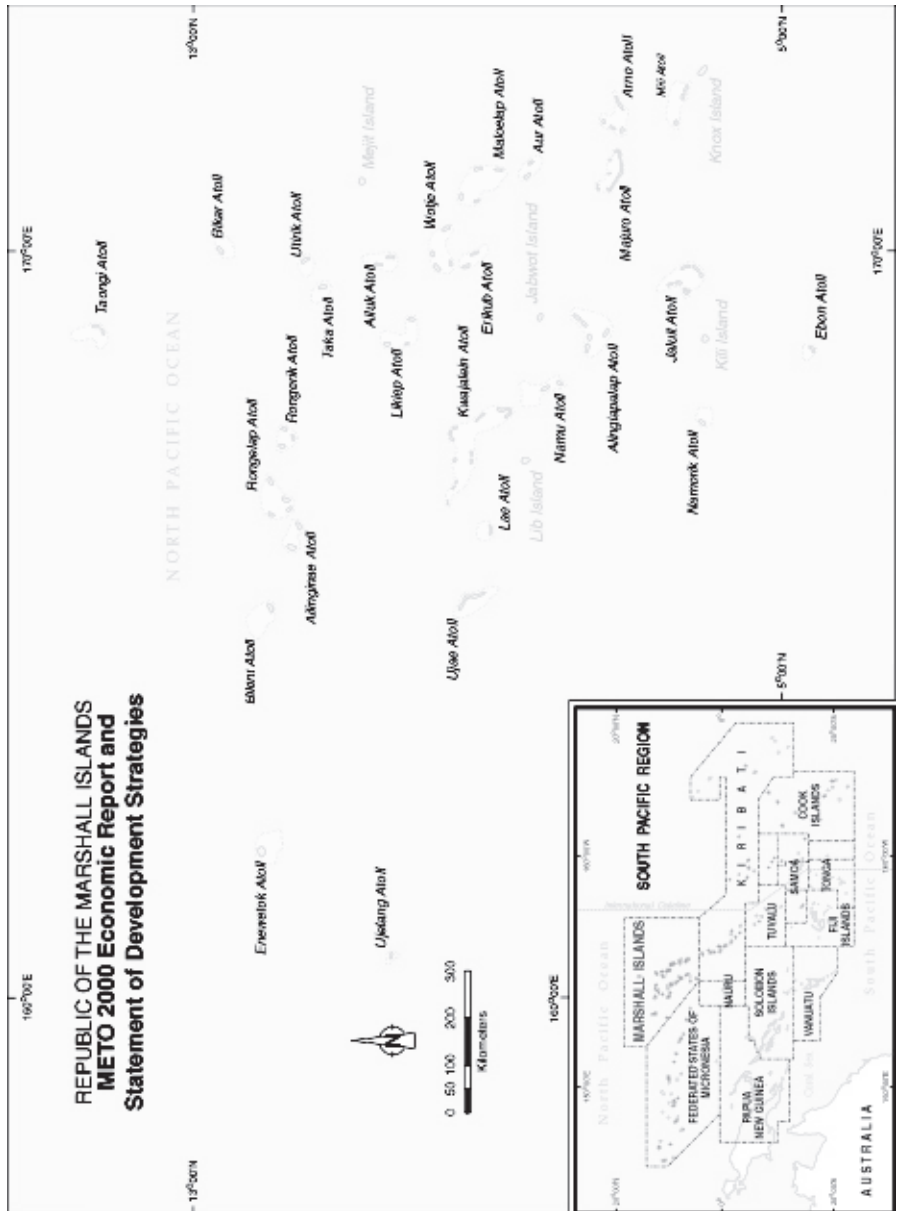


BASUDEV DAHAL

Director

Office of Pacific Operations

REPUBLIC OF THE MARSHALL ISLANDS
**METO 2000 Economic Report and
 Statement of Development Strategies**



Introduction

M*eto2000* is a strategic planning document. It does not allocate resources to activities. It aims to set the economic and social scene, and define the medium-term goals and strategies for developing operating plans and budgets that can move the economy of the Republic of the Marshall Islands (RMI) in the direction its people want it to go. *Meto2000* combines a highly participatory review of the economic history and situation of the RMI (based on over 150 wide-ranging interviews conducted over a six-month period and supported by extensive documentary research) with a statement of proposed development goals and key strategies derived from that consultative process and the experiences of comparable island economies.

Meto2000 comes at a time of great importance for the RMI. Negotiations are about to begin for an extension of the financial aspects of the Compact of Free Association with the United States of America (US), and the RMI's economic performance and standards of financial governance are coming under unprecedented scrutiny. It is widely understood in the RMI that the Government has to make substantial and permanent improvements to its management of public finances and economic assets. This is critically important to securing domestic revenues and long-term external funding, and to making effective developmental use of all public resources. Far-reaching improvements in public financial management and a pervasive change in attitudes toward the maintenance of natural and purchased assets are at the heart of *Meto2000's* situation analysis and proposed directions.

The first two chapters describe the economic history and current situation of the RMI. Special attention is given to the reasons for the unusual structure of the economy, and the high level of financial and psychological dependence that was clearly identified during the consultative process. Chapters 3 through 8 describe specific social and economic sectors, identifying in each case the main factors and problems that need to be addressed in defining medium-term goals and strategies and preparing operational plans.

Chapter 9 draws together several cross-cutting themes—participation, equity, process, coordination, sustainability—to identify six principal goals for the RMI's medium-term development, each supported by a cluster of key strategies to shape public sector operating plans and budgets. Particular attention is given to ensuring policy coordination, describing the number and type of plans and budgets that will be needed, and the importance of a close-knit relationship between them. The social and political context of economic activity is emphasized throughout this report. Chapter 9 ends by stressing the importance of attitudinal change at all levels of the community, if political sovereignty is to bring sustained benefits to the Marshallese people at large, and divisive inequity is to be avoided.

Meto2000 is intended to be read and discussed by many people in the Marshall Islands and elsewhere. It will be a major input to the RMI's Second National Economic and Social Summit being planned for early 2001.

Summary of Contents by Chapter

Chapter 1: Understanding the RMI Economy

The remoteness, strategic location and extraordinary colonial history of the RMI—four different colonial regimes and the Pacific War in five generations—have powerfully shaped its social and economic condition. In the last 40 years, financial inflows arising from civilian injuries from US nuclear testing and the continued military importance of the Kwajalein base have given the RMI a uniquely dependent psychological and economic relationship with the US. This is characterized by relatively high personal incomes, diminished community self-reliance and accountability of traditional leaders, an inefficient public sector, weak fiscal management, and low domestic and external regard for the RMI's financial and economic governance.

Chapter 2: Economic Performance

Official statistics indicate no real growth in national income per capita since independence and little change in structure of the economy. Expenditure on imports from the US exceeds the annual value of Compact receipts. The labor force is growing much faster than jobs and open unemployment is increasing. There is scope for greater private investment provided costs and productivity are made competitive, and positive policy statements are fully implemented. Use of the US dollar limits economic policy options but underpins public confidence. The FY2001 budget is under severe pressure despite (non-Compact) external funding, but this will ease when bond repayments cease in FY2002. It is critically important that most of the funds available thereafter from Compact transfers are saved and invested in the Intergenerational Trust Fund to create post-Compact income. Enforcement of tax collection and review of the tax structure for greater efficiency and equity are overdue. Import smuggling, under-invoicing and other revenue failures are widely reported. Stronger, more accountable management of public finance and development of a firm revenue base are essential for sustained economic growth.

Chapter 3: The Public Service

The public service has been reduced in size by one-third, but much remains to be done to improve its efficiency. New hirings are again increasing payroll costs. The role of the Public Service Commission (PSC) and its relationship with departmental management needs further definition. Responsibility for professional standards is not clear. Contracting-out of services requires stronger supervisory skills in the public service. The public service wage structure needs review to motivate performance, but its general level is still uncompetitively high.

Chapter 4: Population and Health

The natural rate of population growth is around 3.5%, but in recent years emigration has absorbed the annual increment. In 1999, 55% of the population were under 20 years old. Child mortality and life expectancy have significantly improved in recent years. Apart from nuclear injuries, much ill health in the RMI is self-inflicted and life-style related. Health services are concentrated in urban areas. Outer island services suffer from poor transport and communications. The Ministry of Health and Environment (MOHE)'s current 15-year Strategic Plan targets primary health services and greater self-care, but present costs are skewed towards curative services by heavy dependence on costly overseas referrals. Domestic curative facilities need to be improved to reduce referral costs and release recurrent funds to strengthen preventive health care. MISSA's recent financial mismanagement has undermined health funding, but in any case the funding structure for health services needs adjustment to reflect the strategic goals more closely, including greater contributions from users of costly services.

Chapter 5: Education and Training

There has been a slight improvement in literacy, but there is much concern over low standards of output at all levels of education. Young people need to be equipped to make their way in the RMI and overseas. Literacy in English and applied mathematics have to be greatly improved. School attendance and student motivation, teacher qualifications and materials supply are all unsatisfactory. Facilities are concentrated on Majuro and Ebeye. The ministry's current strategic plan targets greater community responsibility for schools, more diversified funding, teacher training/career development and enforcement of educational standards. Better coordination of resources and institutions engaged in tertiary education and skills training is essential.

Chapter 6: Financial System

Commercial banks have large unlent reserves and could attract more deposits if lending opportunities justified it. The Marshall Islands Development Bank (MIDB) has a record of political interference and poor debt collection, and its role in credit operations/small business development needs review. Legislation is in hand to enable land leases to be used as loan security. Government will need to take a role in facilitating micro-finance services for new and small enterprises, and extension of financial services to rural areas. Offshore banking is increasingly problematic due to increasing international scrutiny, but the shipping registry is operating satisfactorily.

Chapter 7: Transport, Communications and Utilities

International air links to the north and west have recently improved. Talks continue about long-discussed subregional links to the south. Air Marshall Islands (AMI) is rebuilding its domestic services after years of under-investment in essential infrastructure, but is still greatly overstuffed. Domestic shipping, now operated by commercial firms under contract to the Government, needs better coordination, performance monitoring and competitive pricing. Maintenance of roads and other public infrastructure is unfunded and commonly neglected. Improvements to outer island port facilities are planned under an Asian Development Bank (ADB) loan, and Kwajalein/Ebeye utilities are being rehabilitated with contracted management and ADB funding. The National Telecommunications Authority (NTA) needs a competitive attitude, investment funds and technical back-up, so it is a natural candidate for privatization, but foreign ownership is presently prohibited. The Marshalls Energy Company (MEC) is providing reliable power to Majuro and Jaluit, but its financial performance is being boosted by profits from the sale of fuel to fishing vessels. The financing of Majuro water supply remains problematic despite substantial investment in storage and reticulation. Similarly, air and sea port operations by statutory corporations place key decisions on infrastructure investment, pricing and use of income out-

side direct government control. Critical issues of corporate governance arise with all of the RMI's state-owned enterprises, requiring coordinated review, performance monitoring and stronger public accountability.

Chapter 8: Agriculture, Fisheries and Tourism

The Ministry of Resources and Development is pursuing collaborative planning in the three sectors with the Marshall Islands Marine Resources Authority (MIMRA), Tobolar Copra Processing Authority, and Marshall Islands Visitors Authority (MIVA). Copra production and incomes have declined since the mid-1990s, despite substantial price subsidies by the Government, because of poor shipping services and low world prices. The commercial future of copra is unclear, but the copra subsidy is a major transfer of income to rural areas from government funds. Shipping problems also hold back coastal and lagoon fisheries development, which is mainly Japanese-funded, and rural production of food for urban markets. Public preference for imported convenience foods further depresses local farm sales. More effective sales promotion, credit and extension services are needed for small farmers. Commercial pearl farming is making headway after successful MIMRA pilot projects. Distant water fisheries are contributing \$4-5 million to overall revenues from license fees, of which MIMRA retains about one quarter for its budgeted operating and development costs. Vessel servicing and tuna processing are providing employment on Majuro. The poor state of the Fishing Base hinders efforts to lease it out. Tourism at present is very small but has specialized potential. Development aims at niche markets in Japan and the US for outer island/atoll cultural experience, diving and fishing.

Chapter 9: Development Strategies

Participation and Process

To obtain the support and participation of its people in the development process, the Government will have to consult them, and listen to what they say. Moreover, to achieve those com-

mon goods that they cannot produce by themselves, people have to make concessions to the views and needs of others. Such a process of consultation and cooperation, based on mutual respect, is critical to nation-building. The planned second National Economic and Social Summit (NESS 2) in early 2001 will be an important part of the process.

Goals and Strategies

Starting with a statement of overall vision prepared separately by the National Commission on Sustainable Development (NCSD), six national development goals are identified in this report. Each is supported by a set of development strategies designed to achieve the goal over a 5 to 10-year period. Once adopted, these goals and strategies should govern the whole range of public sector policies and activities—everything for which the Government is responsible—until they are reviewed and revised in due course. They are set out in the first table at the end of this chapter.

Planning, Budgeting, Implementing

To manage the tension between policy coherence and managerial autonomy, and to be able to respond to changing circumstances without losing sight of the agreed goals, reasonable flexibility and delegation is required. In the RMI's situation, where reform of public financial management is essential to economic progress, this can be achieved through the set of planning and budgetary instruments described in the second table at the end of this chapter.

Policy Coordination

Separate parts of government have to work together to achieve developmental objectives. A competent and well-connected Economic Policy and Planning Office (EPPO), working with an economic policy committee of the Cabinet, is a well-trying coordination method. Policies need to be based on prior consultation with all concerned, including private sector and civil society

Proposed National Goals and Development Strategies

Goals	Strategies
1. Increased self-reliance	<ol style="list-style-type: none"> 1. change perceptions 2. restructure Compact payments 3. diversify sources of external aid 4. reform public financial management 5. build fiscal income reserves (MIITF)
2. Renewed economic growth	<ol style="list-style-type: none"> 1. promote private enterprise 2. improve infrastructure 3. redefine and strengthen privatization 4. emigration equal to population growth
3. Equitable distribution	<ol style="list-style-type: none"> 1. mobilize anti-poverty forces 2. community action on deprivation 3. outer island development program 4. redistribute burden of taxation
4. Improved public health	<ol style="list-style-type: none"> 1. promote self-awareness and self-care 2. improve onshore treatment facilities 3. align health funding with strategic priorities
5. International competitiveness	<ol style="list-style-type: none"> 1. raise awareness of need and scope 2. drive down input costs 3. raise education standards 4. optimize use of training resources
6. Environmental sustainability	<ol style="list-style-type: none"> 1. revive the Environmental Protection Agency 2. implementation the National Environmental Management Strategy 3. policy integration 4. remedial measures

Schedule of Proposed Plans and Budgets

Title	Period	Prepared by
Statement of National Goals and Development Strategies	About 4-year intervals, or more often if events require	Government, on the basis of wide consultation and national summit
Economic Policy Statement	Annually, covering a rolling 3-year period, with review of progress	Economic Planning and Policy Office (EPPO) in consultation with finance and others
Annual Budget	Annually, in full detail for accountability and control by the <i>Nitijela</i>	Ministry of Finance, in a methodical, participatory budgetary process
Medium-Term Budget Framework	Annually with the budget, year 3 of a 5-year budget framework	Ministry of Finance in consultation with EPPO and Foreign Affairs
Departmental/Corporate Operating Plans	As required by the nature of activities. Conforms to overall plans, and contains more detail	Department/corporation, consulting with government finance, planning, personnel staff, etc.
Project Plans	As required by the nature of the project, procedures of funding agencies, etc.	Project manager; department responsible, technical assistance, etc.
Long-Range Prospective Plans	As required by the subject, e.g., climate change, land reform, education, health	Sector ministry, with NGO and technical assistance inputs as required

(i.e., nongovernment organizations [NGOs], community groups, traditional leaders). Liaison should be strengthened with the Chamber of Commerce and formally established with NGOs.

Strengthening Independence

A dependent mindset is handicapping the RMI's development. The way people think of themselves, the community and the nation-state needs to change in three respects: working together more effectively in all walks of life; sharing the costs and benefits of the development process more fairly; and learning to compete commercially at home and internationally.

Sustainability in economic management involves reconciling the needs of competing natural and economic systems. For the RMI, it is critically important to restore integrity to the damaged natural environment, and to develop effective responses to new threats and changing circumstances, particularly climate change. Sustainability of the nation-state requires security of income, skills and outside support; efficient conversion of inputs to outputs; and equitable social and inter-island distribution of the costs and benefits of that process.