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INTERNATIONAL FINANCE CORPORATION

COUNTRY PARTNERSHIP STRATEGY

FOR

THE REPUBLIC OF THE MARSHALL ISLANDS

FOR THE PERIOD FY13-FY16

February 19, 2013

Timor-Leste, Papua New Guinea and Pacific Islands Country Management Unit
East Asia and Pacific Region

The International Finance Corporation
East Asia and Pacific

CURRENCY EQUIVALENTS

Currency Unit: United States Dollar (USD)

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
COBP	Country Operations Business Plan
CPAP	Country Programme Action Plan
CPS	Country Partnership Strategy
CTF	Compact Trust Fund
GDP	Gross Domestic Product
Gbps	Gigabits per second
GEF	Global Environment Facility
GFDRR	Global Facility for Disaster Reduction and Recovery
GNI	Gross National Income
GPO	Global Partnership for Oceans
IBRD	International Bank for Reconstruction and Development
ICT	Information and Communication Technologies
IDA	International Development Association
IDF	Institutional Development Fund
IFC	International Finance Corporation
IMF	International Monetary Fund
MDG	Millennium Development Goals
MEC	Marshalls Energy Company
NGO	Nongovernmental Organization
NTA	National Telecommunications Authority
PNA	Parties to the Nauru Agreement
PROP	Pacific Islands Regional Oceanscape Program
RMI	Republic of the Marshall Islands
SDR	Special Drawing Rights
SOE	State-owned Enterprise
SPC	Secretariat of the Pacific Community
TRAM	Tax and Revenue Reform and Modernization Commission
UNDP	United Nations Development Programme
UNFPA	United Nations Population Fund
UNICEF	United Nations Children's Fund
UNV	United Nations Volunteers
US	United States
WDO	Women in Development Office

	IDA	**IFC**
Vice President	Axel van Trotsenburg	Karin Finkelston
Country Director	Franz Drees-Gross	Sergio Pimenta
Task Team Leader	Piers Merrick	Gavin Murray

THE REPUBLIC OF THE MARSHALL ISLANDS
THE WORLD BANK GROUP
COUNTRY PARTNERSHIP STRATEGY

TABLE OF CONTENTS

EXECUTIVE SUMMARY

i. ***This is the first World Bank Group Country Partnership Strategy (CPS) for the Republic of the Marshall Islands.*** The World Bank Group has been scaling up its engagement throughout the Pacific and this CPS reflects the commitment to transition from a regional engagement framework to individual country strategies that permit a more detailed analysis of a country's specific development challenges. This CPS outlines a program of assistance intended to strengthen economic governance to improve living standards and enhance service delivery. The CPS is presented together with the country's first International Development Association (IDA) operation.

ii. ***The Marshall Islands is one of the world's smallest, most isolated and vulnerable nations.*** The country consists of 29 atolls and 5 isolated islands (24 of which are inhabited) and has a total land mass of just 181 km^2 set in an ocean area of over 1.9 million km^2. The population of the Marshall Islands is estimated at 53,000 of which close to half are resident in Majuro, the capital city. The country is vulnerable to occasional typhoons and its 370km coastline renders it particularly susceptible to extreme waves and high tides.

iii. ***The Marshall Islands faces many of the development challenges common to small, remote economies.*** Small size and remoteness increase the costs of economic activity and make it difficult to achieve economies of scale. Remoteness also imposes transport costs that increase the costs of trade and fundamentally constrain competitiveness of exports of goods and services in world markets. These same factors also increase the cost and complexity of providing public services. There is also an opportunity and a need to bring greater attention to gender concerns in the Marshall Islands and all World Bank Group interventions will be informed by a consideration of these issues.

iv. ***The World Bank Group program will focus on strengthening economic governance and promoting the effective use of public resources to enhance living and service delivery standards for all Marshallese.*** To help mitigate the effects of economic isolation, the World Bank will seek to help the Marshall Islands take advantage of opportunities from closer regional and global integration. The World Bank Group will support the liberalization and regulation of the telecommunications sector with the aim of connecting more Marshallese to social and economic opportunities. The Marshall Islands has indicated it will participate in a proposed regional fisheries operation that would strengthen the governance and sustainable management of tuna fisheries and help increase the share of revenue captured by the Marshall Islands from this significant natural resource. The Government has also signaled a willingness to address important structural reforms in the energy sector, to improve management of Compact Trust Fund assets and to enhance the investment climate, all of which could also be supported by the World Bank Group.

v. ***World Bank Group support to the Marshall Islands will require an agile and flexible approach.*** As the World Bank Group deepens engagement in the Marshall Islands, there will be a need to balance selectivity with a willingness to support emerging development priorities and opportunities. Moreover, all World Bank Group interventions will need to be informed by an appreciation of the extraordinary capacity constraints facing the Marshall Islands.

I. INTRODUCTION

1. ***The World Bank Group has been scaling-up analytical and financial support throughout the Pacific and is now well-placed to provide International Development Association (IDA) support to the Republic of the Marshall Islands (RMI).*** The Marshall Islands became a member of the International Bank for Reconstruction and Development (IBRD) in May 1992, of the International Finance Corporation (IFC) in September 1992, and of IDA in January 1993. Upon membership, the Marshall Islands was classified as IBRD due to a high per capita income level. However, in part because of creditworthiness concerns, the Marshall Islands was unable to access IBRD resources, and the country's engagement with the World Bank was limited to support provided under the Institutional Development Fund (IDF), the Global Environment Facility (GEF), and analytical work. In July 2011, in the wake of successive food and fuel price increases and the lingering effects of the global financial crisis, the Marshall Islands was reclassified to IDA-only status under the exception for small island economies. This Country Partnership Strategy (CPS) signals the World Bank Group's long-term commitment to supporting the Marshall Islands' development and will be presented together with the *First Information and Communication Technologies (ICT) Sector Development Policy Operation.*

2. ***This CPS outlines a World Bank Group program that responds to the Marshall Islands' development priorities and that is informed by the broader themes guiding the World Bank Group's engagement in the Pacific.*** The practice of developing individual country strategies for all Pacific country members reflects that, while Pacific island countries face many common development challenges, Pacific members benefit from strategies that address their specific country conditions. Through this CPS, the World Bank Group aims to adapt its instruments to the Marshall Islands' country context, and to refine implementation approaches based on experience derived from engagement elsewhere in the Pacific. Country strategies in "micro-states" such as the Marshall Islands will of necessity be concise, selective, highly flexible, and seek to draw upon the full range of available instruments. As a result, the CPS should be viewed as providing a framework for engagement rather than a precisely detailed program as might be expected in a larger country or where Bank engagement is more established. The Government of the Marshall Islands is strongly supportive of the preparation of an individual CPS and of the program it outlines.

3. ***To deepen the World Bank Group's understanding of the Marshall Islands' context and priorities, the program will draw upon the analytical work and operational experience of more established development partners.*** The World Bank has participated in recent International Monetary Fund (IMF) Article IV missions, and the proposed interventions have been shaped through consultation with the Asian Development Bank (ADB) and the United States (US) Government.

II. COUNTRY CONTEXT AND DEVELOPMENT CHALLENGES

Sociopolitical Context

4. ***The Republic of the Marshall Islands is a Micronesian Island nation with a history of settlement stretching back 4,000 years to the arrival of the first navigators.*** The chance arrival of the Spanish voyager Alonso de Salazar in 1526 marked the first European contact with the country, and it was not until 1788 that British Naval Captain William Marshall named it when sailing through the area while transporting convicts to Australia. In the period 1885-1914, the Marshall Islands was annexed to Germany until its capture by Japan in the First World War. Japan governed the Marshall Islands until the allied occupation in the Second World War and the country's subsequent transfer to US control. From 1946-1958, the United States tested 67 nuclear weapons in the Marshall Islands including those in Bikini Atoll, and the 1952 test of the first US Hydrogen bomb that destroyed an island in Enetewok Atoll. The health effects from radioactive contamination persist, and in the period 1956-1998, the US provided US$759 million in compensation to affected Marshallese.

5. ***The Marshall Islands became self-governing in 1979. It achieved formal independence in 1990 and is governed as a mixed parliamentary-presidential system.*** General elections are held every four years (most recently in November 2011) with each of 24 constituencies electing one or more representatives (Senators) to the lower house of the bicameral legislature *Nitijela*. The President, and Head of State, is subsequently elected by the 33 Senators. The upper house *The Council of Iroij* is an advisory body comprising 12 tribal chiefs.

6. ***The Marshall Islands is one of the world's smallest, most isolated and vulnerable nations, and is already beginning to feel the effects of climate change.*** The country consists of 29 atolls and five isolated islands (24 of which are inhabited) and has a total land mass of just 181km^2 set in an ocean area of over 1.9 million km^2. The population of the Marshall Islands is estimated at about 53,000[1] of which over half are resident in the capital city of Majuro. The country is vulnerable to occasional typhoons and, like other low-lying Pacific nations, its 370km coastline, which is home to 99 percent of the population, renders it particularly susceptible to extreme waves and high tides. The Intergovernmental Panel on Climate Change concluded in their 4th Assessment Report (2007) that sea-level rise is likely *"to be of a magnitude that will disrupt virtually all economic and social sectors in small island nations…"*

Millennium Development Goals, Youth Development and Gender

7. ***Data suggest that the Marshall Islands' progress towards the Millennium Development Goals (MDG) has been uneven.*** A 2011 MDG Tracking Report[2] notes that the Marshall Islands is not on track to meet the MDG Goals on *Eradicating Extreme Poverty* (Goal 1) or *Combating HIV/AIDS and Other Diseases* (Goal 6). The country has made mixed progress towards *Achieving Universal Primary Education, Promoting Gender Equality and Empowering Women,*

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[1] The RMI 2011 Census of Population and Housing Summary Report.
[2] Pacific Islands Forum Secretariat. *2011 Pacific Regional MDGs Tracking Report* pp.74-75.Suva.

and *Ensuring Environmental Sustainability* (Goals 2, 3, and 7, respectively). It is on track to meet Goals 4 and 5 *(Reduce Child Mortality* and *Improve Maternal Health).*

8. ***A median age of 21*[3] *years makes the Marshall Islands one of the youngest Pacific nations in demographic terms.*** A high birth rate, the continuing effects of urbanization, and a largely stagnant economy are generating significant pressure on the country to provide increased educational and employment opportunities, and to provide social services. Urbanization has resulted in high population density in major capitals. Under these pressures traditional social structures (as reflected in the Marshallese saying *"jake jobol eo"* or "no person will go hungry through sharing") are beginning to break down. The Marshall Islands enjoys a relatively high and equal level of primary education for boys and girls. Among youth, unemployment levels are estimated to be more than twice the national unemployment rate and widely acknowledged as a major source of social tension. It is estimated that around 11,000 people emigrated between 1999 and 2011.

9. ***There is compelling evidence of the need for greater efforts to address gender disparities.*** The recent *"Stock-Take of the Gender Mainstreaming Capacity of the Republic of the Marshall Islands"* published by the Secretariat of the Pacific Community (SPC) in April 2012 provides a comprehensive analysis of the issues facing women and girls in the Marshall Islands. Teen pregnancy in the Marshall Islands is higher than for most other Pacific Islands and accounts for nearly 20 percent of all pregnancies. While two out of three men are economically active, only one in three women is, and unemployment rates are significantly higher among women than men (37 and 28 percent respectively). There is currently only one female member of the 33 seat *Nitijela*, and only three women out of twelve appointees in the largely consultative *Council of Iroij*. The report finds that 30 percent of women have experienced violence since the age of 15 (primarily at the hands of their husband or partner) and over 22 percent of all women have experienced violence in the last year. The Women in Development Office (WDO) was established by the Government in 1979 to serve as the designated policy coordination unit responsible for government-wide mainstreaming of gender issues. The WDO is significantly under-resourced (WDO currently receives an annual budget of about US$72,000) and has recently been absorbed into the Ministry of Internal Affairs. As a result, there is no ready mechanism by which gender considerations can be systematically integrated into national legislation or inform budgetary processes.

10. ***There is scope for the World Bank Group to provide a more systematic consideration of gender issues and to initiate assistance that could catalyze increased donor effort***. The World Bank will be assessing a number of the recommendations in the SPC report including the possibility of providing technical assistance for the development of a national gender policy, supporting the collection of gender-disaggregated statistics, and organizing a donors' meeting to enhance awareness and coordination on gender issues. All World Bank Group interventions will seek to include gender disaggregated indicators where possible, and all operations will be gender informed to the extent possible. A quantitative study to assess the impact of ICT reforms on women is proposed as part of the *First ICT Sector Development Policy Operation*, which may

[3] The RMI 2011 Census of Population and Housing Summary Report.

help to confirm the anecdotal reports of the positive impact of these reforms in the Pacific and elsewhere. The World Bank Group is exploring a range of possible interventions that may include collaboration with the Ministry of Internal Affairs to present the findings of the World Development Report on Gender to the Cabinet, an analysis of the existing legal framework applying to domestic violence (in the context of international conventions ratified by the Marshall Islands). A targeted trust-funded project might also be considered with the aim of strengthening the department within the Ministry of Internal Affairs responsible for women's issues.

Economic Context

11. ***The Marshall Islands faces many of the challenges common to small remote economies.*** Its size and remoteness increase the costs of economic activity and make it unable to achieve economies of scale. Remoteness also imposes transport expenses that increase the costs of trade, and fundamentally constrain the competitiveness of exports of goods and services internationally. These same factors also push up the cost and complexity of providing public services and fulfilling the basic functions of Government. Moreover, geographical characteristics, including populations centered on small, low-lying atolls, make the country vulnerable to natural disasters.

12***. These barriers have led to an undiversified economic base and persistent current account deficits.*** With limited export and domestic production opportunities, public administration and social services constitute the largest share of the economy – 40 percent of Gross Domestic Product (GDP). The fisheries sector comprises around 10 percent of GDP, while manufacturing makes up less than 2 percent. Copra and fisheries are the most significant exports, while the Marshall Islands is almost completely reliant on imports for food, fuel, and other basic needs. Imports of goods and services totaled US$176 million in 2011, compared to total goods and service exports of just US$65 million. The current account deficit excluding grants has averaged 47 percent of GDP since 2007.

13. ***With substantial constraints to export-led growth, the Marshall Islands is heavily dependent on aid and other fiscal transfers.*** The current account deficit is largely financed by grant inflows. Aid and fiscal transfers, primarily from the US, support reasonable standards of living for the majority of the population, with Gross National Income (GNI) per capita of US$3,910 in 2011. On-budget grant income from various sources is equivalent to 49 percent of GNI, and official development assistance per capita was over US$3,450 in 2010[4].

[4] OECD, World Bank.

14. ***Public expenditure in the Marshall Islands has expanded rapidly since 2003 with the US Compact of Free Association[5] and other grants, supporting reasonable levels of growth.*** The 2003 amended Compact includes various military and other access arrangements, and provides a 20-year stream of funding. Beginning 2005, the US also began to provide the Marshall Islands with a Supplemental Education Grant. Together, these grants were equivalent to, around 40 percent of GDP in 2011. This Compact agreement replaced the first agreement, which ran from 1986 to 2001, and included additional fiscal resources provided to the Government of the Marshall Islands. Increased fiscal resources allowed a period of rapid public sector expansion through FY2007.[6] Public expenditures grew by an annual average rate of 12 percent between FY2003 and FY2007, and employment in the public sector expanded by 507 jobs or at an annual average rate of 6 percent over the same period. Expansion in public spending fueled growth of 1.9 percent between FY2003 and FY2007, peaking at 3 percent in 2007.

Table 1: Recent Fiscal Trends FY2007-2012
(Millions of U.S. Dollars)

	FY2007	FY2008	FY2009	FY2010	FY2011 Est.	FY2012 Proj.
	(In millions of U.S. dollars)					
Revenue	108.2	107.1	104.9	109.2	110.4	116.0
Taxes	27.1	26.2	24.3	25.2	24.8	24.8
Taxes on income, profits, and capital gains	17.1	16.8	16.6	17.0	16.2	16.9
Taxes on international trade and transactions	9.4	8.7	7.1	7.7	6.8	7.0
Other taxes	0.6	0.7	0.6	0.5	1.8	0.9
Social contributions	6.3	6.9	6.7	7.2	7.2	7.2
Grants 2/	69.6	68.0	67.1	68.9	68.5	73.7
Other revenue	5.2	6.0	6.8	7.9	9.9	10.2
Property income	1.5	1.9	1.6	2.1	4.0	4.3
Sales of goods and services	1.2	1.5	1.4	1.5	0.4	0.5
Miscellaneous and unidentified revenue	2.4	2.7	3.8	4.3	5.5	5.5
Expenditure	107.8	101.3	102.8	101.7	107.9	114.1
Expense	82.1	82.9	85.9	84.3	89.7	90.3
Compensation of employees	33.5	34.2	34.3	35.0	35.0	35.4
Wages and salaries	33.5	34.2	34.3	35.0	35.0	35.4
Use of goods and services	31.7	34.9	37.5	33.3	36.6	37.7
Interest	0.9	1.3	0.9	0.9	0.9	1.0
Subsidies	7.9	6.9	7.5	6.7	5.2	5.4
Grants	8.2	5.6	5.7	8.4	12.0	10.8
Net acquisition of nonfinancial assets 3/	25.7	18.5	16.9	17.5	18.2	23.8
Net lending (+)/borrowing (–)	0.4	5.7	2.1	7.5	2.5	1.9
Net acquisition of financial assets	-1.4	4.6	0.0	5.0	9.5	-0.9
Net incurrence of liabilities	-1.7	-1.1	-2.2	-2.4	7.0	-2.8
Net financing 4/	0.4	5.7	2.1	7.5	2.5	1.9

Source: IMF

[5] The Compact of Free Association defines the relationship between the Marshall Islands and the US under which, while remaining a sovereign state, the Marshall Islands is considered an associate US state. The Marshall Islands receives guaranteed financial assistance from the US in exchange for relinquishing full defense authority and responsibilities.
[6] The Marshall Islands' Fiscal year runs from October 1 – September 30.

15. ***Under the Compact of Free Association, the Marshall Islands receives annual funding and access to domestic US Federal Government programs***. These include disaster response and recovery, US Postal Service, Federal Aviation Commission, and Federal Communications Commission. Total recurrent annual funding (including Compact sector grants - US$35.2 million, Compact Trust Fund contributions – US$12.5 million, Kwajalein land owner compensation - US$17.0 million, and Supplemental Education Grant – US$5.9 million) currently stands at US$70.6 million. Compact sector grants focus on the education and health sectors, public sector infrastructure projects, capacity building programs, as well as special allocations relating to the US-operated military facilities. Compact sector grants are scheduled to decline in real terms going forward, matched by increases to Compact Trust Fund contributions. The US has established the Compact Trust Fund (CTF) that is designed to *"contribute to economic development and long-term budgetary self-reliance after FY2023"*[7](that is, after the Compact has expired: *see Box 1*).

Box 1: Republic of the Marshall Islands' Compact Trust Fund

Established in 2004, the RMI Compact Trust Fund was established as part of the Compact of Free Association (the "Compact") agreement with the US. The CTF is designed to replace annual grant assistance from the US beyond 2023 and to contribute to economic advancement and long-term budgetary self-reliance. The CTF currently receives annual savings from fiscal surpluses along with donor contributions from the US (under the Compact) and Taiwan, China.

The RMI CTF has a sophisticated setup, and is not fully controlled by RMI. The RMI CTF consists of four inter-related accounts (a "capital" account, a "disbursement" account, a "buffer" account and a "windfall" account) with no withdrawals expected until 2024. Thereafter, CTF returns from the previous year can be transferred to government up to a limit equivalent to the annual grant assistance in 2023 (in real terms). The governance of these funds falls on the CTF committee (with the United States holding 4 out of 7 votes), which further appoints a trustee, investment manager, and independent auditor for the daily management of the assets.

The market value of the CTF fell significantly during the global financial crisis, given significant exposure to growth assets. The market value of the CTF stood at US$142 million (82 percent of GDP) as of end-June 2011. The assets of the CTF are invested in approximately 30 percent defensive assets and 70 percent growth assets. Returns of 11.8 percent and 15.6 percent were noted in FY2006 and FY2007 respectively. However during FY2008–09, when the global financial crisis occurred, the CTF faced a cumulative investment loss of over 20 percent, while the economy contracted by between 1½ - 2 percent in both 2008 and 2009.

Under current policies, the build-up in government assets in the CTF is projected to fall short of replacing Compact grants expiring in FY2023. Recently, the global financial crisis has resulted in capital losses and reduced investment returns, and has made it more difficult to achieve long-term budgetary self-reliance. Achieving longer term fiscal sustainability will require a combination of fiscal consolidation and a higher level of grants than currently projected.

[7] Public Law 108-188. 117 Stat, 2814. 2003. P. 77

16. ***The Marshall Islands was hit hard by the global food and fuel and economic crises.*** Growth in public expenditure was already slowing in 2008, and a range of major donor-financed projects had reached completion when fuel and food prices reached record levels. Heavily reliant on imports, inflation in the Marshall Islands reached 15 percent, eroding domestic real incomes and reducing demand from local businesses. Record fuel prices brought about a severe cash flow crisis at the state-owned electricity utility, the Marshall's Energy Company (MEC), requiring the Government to step in to meet the cost of fuel purchases. Domestic revenues declined slightly as the economy slowed. Facing a cash-flow crisis, the Government of the Marshall Islands imposed emergency measures.

17. ***Recovery resumed in 2010 and is being sustained through moderation of global commodity prices and progress with fiscal management, although risks remain.*** The economy grew by 5.6 percent in FY2010, driven by an expansion of fishery capacity and exports, a recovery of external demand and the moderation of fuel prices. Growth fell sharply to 0.8 percent in FY2011, as a result of high commodity prices, labor shortages, and a delay in the airport renovation project. Inflation stabilized in FY2010, falling to 1.8 percent but has remained elevated at above 5 percent since FY2011, driven by strengthening import prices. Government finances have also improved since FY2009 through the imposition of successive across-the-board spending cuts in FY2009 and FY2010 that have reduced total recurrent spending by more than 10 percent. The combination of economic recovery and expenditure control measures allowed the Government to avoid cash-flow problems in FY2011, and to generate a fiscal surplus, equivalent to about 3.7 percent of GDP. However, the FY2012 budget deficit is estimated at about 1.1 percent of GDP, with volatile domestic revenue, declining foreign grants, and occasional off-budget spending posing threats to fiscal management. Financial assistance to state-owned enterprises (SOEs) in the form of subsidies and capital transfers remains sizable.

18. ***While confronting fiscal challenges, the Marshall Islands is also struggling to address key vulnerabilities in the management of SOEs.*** SOEs are economically significant, holding assets of US$116 million as of end-FY2008 (about 76 percent of GDP) but the performance of many SOEs is poor, with Government subsidies to the SOE sector reaching an average of US$7.2 million per annum between FY2007 and FY2010 (around 4 percent of GDP). Poorly performing SOEs represent a fiscal risk for Government while also constraining growth providing poor service and charging high prices.

19. ***The Government is continuing to progress on key economic and public sector reforms, but challenges remain.*** Among the ongoing reforms are the Comprehensive Adjustment Program Advisory Group, created in 2010, and whose recommended priorities for fiscal and structural reform have been endorsed by the Cabinet. The Tax and Revenue Reform and Modernization Commission (TRAM) has also been created, and its recommendations are soon to be implemented through a program of reform supported by the Pacific Financial Technical Assistance Center. A report on SOEs was prepared with ADB assistance, which led to the MEC Board adopting a comprehensive recovery program. The ADB is supporting these reform efforts through a Public Sector Program including loan refinancing of the external debt of MEC. A recent review of the current status of the Public Sector Program has indicated that, while some reforms are on track (such as tax reform) others (such as generation of a sustained fiscal surplus and expenditure compression) are not.

Poverty

20. ***While the incidence of extreme poverty is low in the Marshall Islands, progress toward MDG 1 (Eradicate Extreme Poverty and Hunger) has been uneven.*** The 2011 GNI per capita figure of US$3,910 classifies the country as "lower middle-income" although there are substantial disparities in cash incomes, which are high in Majuro and Kwajalein (due to a greater concentration of highly paid public servants) relative to outer atolls. Although the incidence of absolute poverty is low, data indicate high levels of inequality, evidence of malnutrition in urban areas, and limited access to cash incomes in rural areas. Incomes in communities affected by nuclear testing and receiving compensation (such as Enewetak and Kili) are significantly higher than those in other islands. Elsewhere, lack of income-earning opportunities has led to concerns over rising unemployment, financial hardship (including declining real incomes and higher levels of consumer debt), and hunger. These factors provide powerful incentives for migration from outer atolls to the two major urban centers, as well as externally to the United States.

21. ***The benefits of economic growth have not been shared evenly and there is evidence of growing inequality.*** Economic growth has been driven by expansion in Government expenditure and payments to land-owners in certain islands, disproportionately benefiting urban populations and those with land title, with populations in outer islands left further behind. According to 1999 data, the Gini coefficient[8] in the Marshall Islands was 0.54, greater than Fiji at 0.46, Papua New Guinea 0.46, Samoa 0.43, Tuvalu 0.43, Tonga 0.42 and the Federated States of Micronesia 0.41. Rapid inflation over recent years is reported to have severely impacted the poor. Government revenue policy and expenditure do not counter existing inequalities, with an outdated tax system and various implicit and explicit exemptions and subsidies having a strongly regressive impact.

22. ***Improving the quality and availability of poverty data remains a priority for the Marshall Islands.*** The most recent census data documented in the 2011 Census of Population and Housing (previous census completed in 1999). A Household Income and Expenditure Survey was undertaken in 2002 but did not include a formal poverty analysis. A Community and Socioeconomic survey, and a Demographic and Health Survey were completed in 2006 and 2007 respectively. In similar situations throughout the Pacific, the World Bank has been able to work with respected regional partners – such as SPC – to prepare a comprehensive poverty assessment. An updated Household Income and Expenditure Survey would be a necessary prerequisite and might be conducted by SPC with the World Bank providing technical peer review and direct inputs during the analytical phase of work.

Macroeconomic Outlook and Debt Sustainability

23. ***The Marshall Islands faces important challenges over the medium-term.*** Economic growth is expected to remain moderate at around 2 percent in FY2012 and FY2013, supported by rising fisheries exports, a US Federal Aviation Administration-financed airport rehabilitation

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[8] A Gini coefficient is a statistical measure that can be used to measure income inequality. Gini coefficients are scored from zero to one, with a score closer to zero indicating a society with little income inequality, and a score closer to one indicating a society with significant income inequality.

project, and the planned Ebeye water and sanitation project. Beyond the short term, growth is expected to be subdued as a result of the gradual reduction in Compact inflows, planned downsizing of the Kwajalein military base, and the impact of poorly performing SOEs. Potential sources of growth over the medium-term include further donor-financed capital projects, an expansion of existing fishing operations, and an increase in fishing license revenues following recent international negotiations. Increased employment opportunities at the Kwajalein base may also materialize with the possible commencement of a new satellite project.

24. ***The prospective end of Compact funding presents a key challenge to fiscal sustainability.*** No Compact financing is assured beyond the life of the current arrangement. While the CTF was established to replace Compact grants from 2024 onward, based on current projections, contributions to the CTF are inadequate to assure a smooth transition, and annual CTF income can be expected to fall US$11 million (in 2011 prices) short of what is needed to replace Compact grants in 2024. Current public sector and structural reform measures if successfully implemented will help to significantly increase accumulation in the CTF. However, for the CTF to reach adequate capitalization by 2023 and for fiscal sustainability beyond 2023 additional grant support will likely be required under any realistic scenario.

Table 2: Summary of Medium-Term Macroeconomic Indicators

	2010	2011	2012	2013	2014	2015	2016
Output and Prices							
Real GDP (percent change)	5.6%	0.8%	1.9%	2.3%	0.6%	1.4%	1.6%
Consumer Prices (percent change)	1.8%	5.4%	5.7%	3.9%	1.7%	1.9%	2.0%
Central Government Finance			*Percent of GDP*				
Total Revenues & Grants	67.0	63.7	60.8	61.1	57.9	56.6	55.4
Total Domestic Revenues	24.7	25.3	22.6	21.6	22.5	22.4	22.1
Grants	42.3	38.4	36.6	39.5	35.3	34.3	33.4
Total Expenditure & Net Lending	62.4	60.0	61.9	61.1	57.2	55.8	54.4
Current	51.7	49.3	50.5	49.0	44.6	46.6	45.5
Capital	10.7	10.7	11.4	12.1	9.6	9.3	8.9
Overall Balance	4.6	3.7	-1.1	0.0	0.7	0.8	1.0
Compact Trust Fund Balance			*US Dollar Millions (end of period)*				
Compact Trust Fund Balance	112.8	125.2	165.7	192.6	220.2	250.1	282.4
External Debt			*Percent of GDP*				
External Debt	64.2	64.1	57.2	53.8	49.3	44.8	40.4
Memorandum item:			*US Dollar Millions*				
Nominal GDP	163.2	170.7	182.4	192.7	197.1	203.6	211.0

Source: IMF and World Bank

25. ***Measures are in place to address fiscal sustainability challenges.*** The Public Sector Program supported by the ADB has led to the identification of several priorities for achieving savings and improving the effectiveness of public expenditure. An audit of public sector functions is expected to reveal duplication of certain roles and opportunities to reduce the wage bill, while the Ministry of Finance is working to eliminate unfilled positions. A review of Government allowances and benefits could deliver further savings. While these initiatives are

likely to produce some savings, further substantial reductions in payroll expenditure and overall public spending are unlikely to be achievable without broader counterproductive economic impacts, given the key role that Government plays as a source of employment, income, and demand. The priority for Government is therefore to improve efficiency and effectiveness of public spending, and to address structural barriers to private sector growth and revenue generation. Planned revenue reform under the TRAM process is expected to be largely revenue neutral, but the accompanying simplification of the tax regime may allow some gains through increased compliance, and make the economy more business friendly.

26. ***With external debt of around 57 percent of GDP, the Marshall Islands is at high risk of debt distress.*** Under the IMF-World Bank debt sustainability framework, the Marshall Islands exceeds several policy thresholds under baseline and stress-test scenarios of the draft 2011 Debt Sustainability Analysis prepared by the Bank. External debt is mostly in the form of concessional ADB loans but also includes new Government guaranteed debts in the SOE sector. Debt servicing obligations are equivalent to 16 percent of exports, although this is expected to decline to less than 5 percent of exports by 2016. Debt servicing is currently equal to around 20 percent of revenue, and is expected to decline gradually to below 10 percent of revenue in 2024. Debt dynamics vary substantially according to projected growth and export performance. Policy relevant thresholds are breached under any plausible scenario. The most extreme stress-test scenario (maintenance of historical averages minus one standard deviation in 2012-2013) would see the present value of public and publicly guaranteed debt exceed 350 percent of GDP over the next two years. Previous arrears to ADB have now been cleared, but the Government has yet to develop a clear debt management strategy that can address looming debt service payments. Debt management is an area in which the World Bank has a comparative advantage and is expected to be an area of focus as engagement evolves in the Marshall Islands.

27. ***The Marshall Islands remains heavily exposed to changes in global prices, but risks to external balances are limited.*** Inflation is expected to moderate to under 4 percent in FY2013 as fuel and other import prices ease. Current account deficits are expected to remain wide until FY2013, driven by imports for fisheries and airport expansion financed by foreign investment and capital grants. Compact-related funding is expected to continue to provide a reliable source of import financing over the next decade, and the current account deficit is expected to be close to around 5 percent of GDP over the medium-term. Exports have recently expanded in contrast to most Pacific Island countries, although this trend – driven by strong agricultural commodity prices and new fisheries investments – cannot be relied upon to continue. In the longer-term, the expiry of Compact funding could lead to an erosion of foreign assets, undermining external stability.

28. ***The macroeconomic policy framework is dependent on continued availability of grants from development partners and is subject to high levels of uncertainty.*** A sharper than expected rise in global commodity prices would exacerbate inflation and lead to further contraction of the Marshall Islands' economy. The macroeconomic policy framework also depends on the continued availability of grants from development partners over the medium-term, especially the US, and the inadvisability of borrowing to fund fiscal deficits. Any change in Compact arrangements or in the Marshall Islands' capacity to access federal grants, or from further effects of the global economic slowdown would have a significant and negative impact on macroeconomic stability. Uncertainty regarding the US plans for the Kwajalein military base

poses risk in terms of potential job losses but these may be offset by new projects. Finally, the country remains vulnerable to a variety of natural disasters that may also place considerable stress on the macroeconomic policy framework. In regard to the latter, the Marshall Islands has recently joined four other Pacific countries in a pilot catastrophic risk pool. This initiative is co-led by the World Bank, SPC/SOPAC[9] and ADB with financial support from the Government of Japan, and aims to increase the financial resilience of Pacific countries by providing them with access to a market-based catastrophe risk transfer mechanism as part of their comprehensive disaster risk financing strategy.

Government Priorities and Development Framework

29. ***The Marshall Islands' national strategic development plan is outlined in "Vision 2018" a framework for achieving a "…country within an interdependent world, with enhanced socio-economic self-reliance, [and] an educated, healthy, productive, law abiding and God-loving people…"*** The strategic development framework, drafted in 2001 is a wide-ranging document that sets out to address "Ten Challenges" essential to fulfilling the "Vision": i) good governance, political stability and a competent and honest public sector; ii) investment in education and research; iii) a culture of savings, investment and productivity; iv) a country able to take advantage of global trends; v) effective and responsible economic and financial institutions; vi) equitable development of the Outer Islands; vii) strengthening the spirituality of the Marshallese people; viii) promotion of healthy lifestyles, the prevailing culture and sustainable environment; ix) fostering fundamental change in the attitudes and behavior of citizens, Government, businesses, corporations and non-governmental organizations; and x) effective partnership between national and local Governments, NGOs, the private sector, civil society and citizens. In consultation with the World Bank Group and other stakeholders, the Government has identified areas in which the World Bank Group could provide support for more effective management of public and external resources and to improving living and service delivery standards.

Development Partner Engagement

30. ***Given the geographic and economic constraints facing the country, external assistance is unlikely to be a transitional phenomenon in the Marshall Islands.*** In common with many small island states, the Marshall Islands is heavily reliant on external assistance with on-budget grant income estimated to account for 40 percent of GDP. Development partner support being provided includes the following:

<u>Under the Compact of Free Association with the US,</u> the Marshall Islands will receive at least US$57 million in grants every year until 2023 including contributions to the jointly managed CTF (*see Box 1*). This figure is scheduled to increase to US$62.7 million per annum from FY2014 onward. At the end of this period, financial assistance from the US will end at which point the CTF is expected to serve as the country's principal source of budget revenue. The

[9] SOPAC is SPC's Applied Geoscience and Technology Division.

domestic economy is already highly dependent on the income generated by the disbursement of Compact funds to finance the public wage bill and major construction projects.

The ADB's Country Operations Business Plan (COBP) for 2012-14 identifies four areas of focus: i) macroeconomic and fiscal management; ii) private sector development; iii) human capacity development; and, iv) the environment and climate change. The overarching objective of ADB support is to help restore macroeconomic stability following the global financial crisis and to achieve long-term fiscal sustainability. The COBP identifies an indicative lending program of US$5m with the country eligible for funding from both the Asian Development Fund and Ordinary Capital Resources. This is expected to be supplemented with complementary technical assistance (largely focusing on economic planning and policy and enhancing public service delivery). The ADB is providing leadership in the critical area of SOE reform and recently signed a US$5m loan for public sector reform Other activities in the Marshall Islands include technical assistance provided under regional initiatives to strengthen capacity to respond to the effects of climate change and technical assistance to design technical and vocational training.

The Government of Australia has a small program of assistance in the Marshall Islands relative to the scope of Australia's engagement elsewhere in the Pacific. Support focuses on two areas: energy sector reform and improving access to clean water and sanitation. Australia's program in the Marshall Islands is outlined in the *Partnership for Development* signed by both countries in August 2010.

The European Commission's strategic framework for assistance is set out in the *Country Strategy Paper for the Marshall Islands 2008-13*. An indicative under the 10th European Development Fund focuses on support to the water and energy sectors, specifically sustainable energy supply to the country's outer islands. The program is also informed by cross-cutting issues that include climate change, environmental sustainability, gender equality, and the fight against HIV/AIDS.

The Government of Japan's *Rolling Plan for the Marshall Islands* identifies solid waste management, disaster risk management, the response to climate change, and strengthening of health services as priorities in a multi-year program of technical assistance.

Taiwan, China is a longstanding donor partner to the Marshall Islands and provides an annual grant and a range of technical assistance in areas including infrastructure rehabilitation, disaster risk management, support to public works projects, and health care. Funding provided by Taiwan, China in 2012 included budgetary support, a contribution to the CTF and assistance with debt service payments.

The United Nations System's Country Programme Action Plan (CPAP) for 2008-2012 outlines a program of assistance that leverages the technical expertise of UN organizations including UNDP, UNFPA, UNICEF and UNV. The CPAP focuses on: achieving MDG targets; livelihood development and employment generation activities with an emphasis on women and youth; strengthening of accountability and capacity of the national parliament; good governance; disaster risk management; environmental sustainability and civil society strengthening.

31. Throughout the implementation of the CPS program, the World Bank Group will seek to draw on the experience and expertise of the Marshall Islands' development partners to ensure that the assistance provided is closely aligned with existing programs and the country's development priorities.

III. WORLD BANK GROUP ENGAGEMENT IN THE PACIFIC

32. ***The World Bank Group's engagement with Pacific island countries reflects the fact their development trajectories will be shaped – more than perhaps any other nations – by their economic geography.*** The World Bank Group's Pacific island member countries (excluding Papua New Guinea)[10] have a combined population of about 2 million people spread across hundreds of islands in an ocean area equivalent to about 15 percent of the globe's surface. Given the permanent vulnerabilities that confront Pacific island countries stemming from intrinsic factors such as their small size, isolation, and enduring institutional and human capacity constraints, sustained development support is a long-term proposition requiring collaboration with international partners. Island states themselves also have a central role to play in establishing a policy environment that supports and promotes long-term development outcomes.

33. ***The World Bank Group continues to expand its programs and presence throughout the Pacific.*** Both IDA and IFC have been increasing their engagement in the Pacific significantly. As well as scaling-up in established clients, there is a renewed emphasis on forging relationships in countries – such as the Marshall Islands – in which the World Bank historically has been less active. The development of individual CPSs for each Pacific island member reflects a commitment to a sustained process of country engagement. The growth of World Bank IDA and trust fund commitments made to the Pacific in the last four years – amounting to about US$250m – is more than in prior history, as are IFC commitments of almost US$90m. Reflecting the common challenges facing Pacific countries, World Bank Group engagement in the Pacific has focused closely on four overarching themes: i) strengthening regional and global integration; ii) building resilience to economic shocks, natural disasters and climate change; iii) encouraging economic reform and private sector development; and, iv) improving health, education, and social services. This CPS is informed by these themes and aims to address the Marshall Islands' country-specific development challenges through an adaptive combination of analytical work, technical assistance, and lending operations based on the World Bank's comparative advantage and in partnership with other donors.

34. ***In countries where development is fundamentally constrained by economic geography, the objectives of development assistance and the delivery mechanisms used, need to be considered carefully***. Economic growth alone is unlikely to generate automatic development progress. Development outcomes should be measured in pragmatic terms such as improvements in social indicators, more effective delivery of public services and in increased opportunities for the Marshallese. Since a proliferation of projects would place an unsustainable burden on already overstretched public sector, the World Bank will seek to employ modalities that can help

[10] Fiji, Kiribati, Palau, Marshall Islands, Micronesia, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu.

strengthen the country's own systems (such as development policy lending and accessing regional programs), help leverage the country's IDA allocation and maximize benefits to countries facing common regional challenges.

35. ***A World Bank Group priority will be to translate the credibility and trust generated by deepening engagement in the Marshall Islands into a more substantive and coordinated dialogue to support its own reform efforts.*** The value of World Bank Group engagement is not principally defined in terms of the volume of lending, but in the extent to which the World Bank can "bundle" its expertise and financing, collaborate with other development partners, transfer global knowledge, develop institutional capacity, and support changes that result in significant and sustained development progress.

Translating Pacific Themes into the Marshall Islands Program

36. ***Like many small Pacific island states, the Marshall Islands faces significant obstacles to development.*** Isolation, small size, dispersed populations, and the high fixed cost of providing public services, present challenges to achieving sustained economic growth in the Marshall Islands. Moreover, "thin" institutional, human, and technical resources demand that limited reform capacity be tightly focused on mitigating these disadvantages to the extent possible. Increasing economic integration, promoting access to labor markets, employment and educational opportunities in metropolitan neighbors and the US, and retaining a more equitable share of revenues from natural resources (such as fisheries), will be central to the long-term future of the Marshall Islands.

37. ***Reflecting the Government's development priorities and the World Bank Group's engagement in the Pacific, the program in the Marshall Islands will focus on strengthening economic governance and promoting the effective use of public resources to enhance living and service delivery standards for all Marshallese.*** Each of the proposed interventions outlined in this joint CPS is designed to address this overarching objective.

38. ***The first IDA operation for the Marshall Islands, to be presented with this CPS, seeks to liberalize the ICT sector to foster market competition and to increase access to ICT services.*** The Marshall Islands is one of the least "connected" countries in the world. About 35 percent of the population subscribes to ICT services. Mobile phone penetration is around 26 percent of the population. Less than 2 percent of the population subscribe to an Internet connection. Mobile broadband is not yet available. Total broadband Internet [11] take-up is approximately 520 subscribers, or around 1 percent penetration (although only 120 subscribers have subscribed for speeds of 512kbs or greater). This is despite the fact that Majuro and Kwajalein are connected to a 10 Gbps capacity fiber-optic cable system that links the Marshall Islands to Guam. Cable capacity is presently under-used, in part due to the monopolistic market environment.

[11] NTA classifies broadband Internet as speeds 128kbs or greater; the International Telecommunications Union definition of broadband is a minimum download speed of 256kbps

39. ***The ICT Sector Development Policy Program is the first in a planned series of three development policy operations (DPOs) that aim to support ICT sector reform and reduce the economic costs of distance through greater regional and global integration.*** The first DPO prepares the foundation for the legal and regulatory reforms that are needed to support sector liberalization, with the ultimate objective of increasing access to telecommunications and promoting the widespread use of ICT services. Specifically, the operation will support the transition from a monopolistic to a liberalized telecommunications market, reform and restructure the National Telecommunications Authority (NTA), help develop a new legal and regulatory framework, and establish an independent regulatory function. The ICT DPO program has been informed by recent experience of budget support operations in the Marshall Islands (such as ADB's Public Sector Reform Program), and the World Bank Group's telecommunications assistance in the Pacific and elsewhere. It has also benefitted from the application of international best practice and the IFC's considerable experience in supporting private sector investment in liberalized telecom markets throughout the Pacific.

40. ***The Marshall Islands' reliance on expensive imported fuel and the current fuel pricing model continue to impose severe fiscal challenges, with effects felt throughout the economy.*** World Bank engagement in the energy sector was initiated shortly after the Marshall Islands became a member of the World Bank Group in 1992, when the Government requested analysis to be undertaken on the energy sector and, specifically, on the role of the state-owned MEC. That study, and the assessments undertaken by other partners since then, identified a range of important reforms intended to help address the structural challenges facing the sector. While some of the reforms were undertaken, the relative stability and low price of fuel imports in the period 1992-2008, reduced the urgency for fundamental reform. However, the fuel price spikes and increasing volatility in 2008 (reaching a high of US$160 per barrel), compounded by a fire that disabled the Majuro Number 1 power generation facility, precipitated an economic crisis in the country. The Government was forced to declare an "Economic State of Emergency", as the country experienced power rationing and blackouts. A Government Taskforce was convened to review the state of the energy sector and, in 2010, requested further World Bank technical assistance.

41. ***While the Government has expressed renewed interest in undertaking energy sector reform, successfully implementing these complex and wide-ranging measures will be difficult and require sustained commitment.*** Since 2010, the World Bank has undertaken dialogue on energy sector reform, and has outlined a set of carefully sequenced measures that could be implemented under a DPO program. The reforms proposed would seek to move away from the current policy that aims to provide cheap power to businesses and citizens and results in just 23 percent of diesel sold in 2010 being sold at a profit. The current policy exposes MEC to significant cash flow problems, insufficient funding of critical routine maintenance, inefficient use of power, and substantial technical inefficiencies. While key elements of a DPO program have been identified, detailed analysis on the potential poverty and social impacts of tax and price reforms will be needed. This analysis will also examine potential gender-specific effects of reform.

42. ***The Marshall Islands and the other seven member states of the Parties to the Nauru Agreement (PNA)[12] account collectively for approximately one-third of global pelagic tuna stocks.*** The abundant Pacific oceanscape is a shared natural capital asset for the entire region. It provides fish for food, key biodiversity and habitats that support tourism and carbon storage. Pacific tuna fisheries yield about 2.4 million tons per annum (58 percent of the global total) with a value on the order of US$4.5 billion. However, little of that annual revenue is captured by Pacific island countries as economic rent. Until 2007 license fees paid to Forum Fisheries Agency member countries in exchange for rights to fish tuna totaled only about US$8m each year (or about 7 percent of the first sale revenue received). The introduction of a rights-based regime for fishing effort (i.e. the total number of fishing days permitted, known as the Vessel Day Scheme) by PNA nations has already resulted in increases to licensing payments made by deep water fishing nations to PNA members of US$5,000 per day or about 10 percent of landed value with the expectation that the cost vessel days will continue to increase.

43. ***The Marshall Islands has expressed interest in participating in the Pacific Islands Regional Oceanscape Program (PROP)[13].*** This regional operation will be the first operation piloted under the *Global Partnership for Oceans* (GPO)[14] that was recently launched. The PROP aims to support Pacific Island Countries in the sustainable management of the region's oceanic fisheries, coastal fisheries and the critical habitats that support them. The PROP investment in the Marshall Islands is expected to concentrate on three areas: (i) strengthening regional governance through the implementation of a rights-based fishing management system; (ii) supporting systems to improve the management of coastal and reef fisheries, and (iii) developing regional frameworks and market systems to improve coastal and regional fisheries management. Assistance to undertake assessments of the relative costs (including gender based social costs) and benefits of investments in onshore processing and services associated with tuna product value chains would also be supported.

44. ***The World Bank Group aims to help support the Marshall Islands in making preparations to manage its "Post Compact" future.*** Although the Compact of Free Association does not expire until 2023 (and managing this transition will require concerted attention beyond the period of this CPS), the World Bank Group proposes to provide targeted technical assistance to strengthen the management of CTF assets. The World Bank Treasury department is currently exploring the development of a regional approach to asset management that will assess the strengths and weaknesses of current asset management approaches in the Marshall Islands and in countries with similar trust fund arrangements (such as the Federated States of Micronesia and Tuvalu). In addition to strengthening asset management, evidence from the *Cost of Doing*

[12] The PNA is a sub-regional agreement that controls fishing in the world's largest sustainable purse seine fishery. The PNA administers fishing activity in the exclusive economic zones of seven Pacific island countries including the Federated States of Micronesia, Kiribati, Marshall Islands, Nauru, Palau, Papua New Guinea, Solomon Islands, and Tuvalu.

[13] PROP is a regional project designed to strengthen the governance and sustainable management of the region's fisheries, and to ensure that Pacific countries receive a more equitable share of benefits from this resource.

[14] The GPO is a growing alliance of more than 100 governments, international organizations, civil society groups, and private sector interests committed to addressing the threats to the health, productivity and resilience of the world's oceans. It aims to tackle widely documented problems of overfishing, pollution, and habitat loss.

Business Indicators and enterprise survey data suggest that there may be a range of reforms that might enhance the climate for private sector investment. The joint IFC/WB Indicator-based Advisory Group stands ready to help develop a Reform Memorandum that would diagnose the principal challenges in the Marshall Islands and could serve as a roadmap for subsequent reforms. Beyond this, as the World Bank Group engagement deepens in the Marshall Islands, additional opportunities may be identified in which IFC can support greater private sector involvement and investment. IFC's Pacific Investment Climate Rapid Response project could also provide IFC expertise to assist the Government in identifying potential for private sector involvement in service delivery.

Selectivity, Flexibility and New Ways of Doing Business

45. ***In providing support to the Marshall Islands, the World Bank Group will exercise a high degree of selectivity.*** At this initial stage of reengagement in the Marshall Islands, the World Bank Group has yet to develop the depth of knowledge and country experience that would permit a more expansive program. The program outlined in this CPS is informed by the themes that guide the World Bank Group's engagement throughout the Pacific, and aims to replicate successful approaches in the World Bank's other Pacific country programs. Acknowledging the challenge of calibrating World Bank Group interventions to the limited capacity of this small state, all activities will be carefully designed in collaboration with the Government, and instruments more suitable to low capacity contexts, such as development policy lending and regional approaches, will be utilized wherever appropriate. The World Bank Group will retain flexibility and, as the partnership with Government deepens, the World Bank expects to play a greater role in addressing the substantial threats that the Marshall Islands faces from natural hazards, the effects of climate change and sea-level rise.

46. ***Developing leadership and institutions in the Marshall Islands capable of successfully implementing reforms demands World Bank Group commitment to a sustained capacity enhancement effort.*** The Marshall Islands, and islands throughout the Pacific, face significant challenges in recruiting and retaining domestic expertise. In "micro-states" such as the Marshall Islands, the size of the population and the pull of opportunities overseas only increase this challenge. By being selective, flexible, and by adopting a pragmatic approach to these constraints, the World Bank Group will place a premium on coordination, intensive implementation support and on projects whose design is carefully calibrated to the country's capacity.

47. ***A targeted program of analytical work that focuses on sectors in which the World Bank Group is initiating engagement and complements analysis being undertaken by other partners is proposed***. Indicative analytical and technical assistance activities anticipated during the CPS period are set out below:

Box 2: Proposed Analytical, Advisory and Technical Assistance Activities

- Poverty Assessment
- World Bank Treasury Asset Management CTF Diagnostic
- Investment Climate Diagnostic
- Beneficiary Impact Assessment on ICT Reform with Gender Focus

Financing Terms and Sources

48. ***The indicative IDA16 resource envelope is on grant terms and amounts to SDR7.6m (US$ equivalent 11.4m).*** The CPS spans two years in the IDA16 period (FY13 and FY14) and two years in the IDA17 period (FY15 and FY16). It is assumed that the IDA17 envelope will be equivalent to the IDA16 level, but only the FY13 amount is firm, while the amounts for FY14-16 are indicative only. Actual allocations will depend on: i) the country's own performance; ii) its performance relative to other IDA recipients; iii) the amount of overall resources available to IDA; iv) changes to the list of IDA-eligible countries; and v) terms of financial assistance provided (grants or credits). Also, the Marshall Islands could potentially benefit from additional resources from the IDA Regional Program, which provides financing on top of national IDA envelope to promote regional integration by supporting qualified multi-country regional operations. Furthermore, in case of severe economic shocks and natural disasters, the Marshall Islands could potentially access the IDA Crisis Response Window.[15]

Table 3: The Marshall Islands: Indicative IDA and Trust Fund Operations – FY13-16

	Fiscal Year	IDA	Co-Financed/Trust Funded
ICT Development Policy Operations	FY13-16	Y	PRIF
Pacific Island Regional Ocean Operation	FY14	Y	tba
Energy Sector Development Project	FY14	Y	tba
Addressing Gender-based Violence	FY14	N	JSDF/IDF

49. ***The World Bank's expanded program of Pacific engagement has been made possible through access to trust funds, and IDA is expected to leverage trust fund resources in the Marshall Islands.*** While the principal trust fund resources available to the Pacific countries have been from donors (e.g. Australia and New Zealand) with longstanding relationships in the South Pacific, it is expected that as the World Bank Group's program in North Pacific countries such as the Marshall Islands are developed there will be opportunities to provide increased trust fund resources. Looking to global programs, both the GEF and the Global Facility for Disaster Reduction and Recovery (GFDRR) are also expected to provide support.

IV. MANAGING RISK

50. ***Absolute capacity limitations could constrain program implementation.*** The enduring nature of capacity constraints in micro-states such as the Marshall Islands pose extraordinary challenges to effective implementation, and is only exacerbated by the lack of in-country presence. Experience from the World Bank Group's engagement in other small states such as Kiribati and Tuvalu underscores the importance of calibrating and sequencing interventions

[15] For details of the eligibility criteria, see Annex 3 of IDA (2011) "Additions to IDA Resources: Sixteenth Replenishment," available at http://siteresources.worldbank.org/IDA/Resources/IDA16_Report-English-Final.pdf.

carefully, and in designing operations that account specifically for the current level of capacity. An explicit recognition of the need for intensive and sustained implementation support will be paramount.

51. ***The Marshall Islands remains highly vulnerable to external shocks, and subject to many factors beyond its control.*** Reliance on imports whose prices are subject to considerable volatility (particularly petroleum products) poses significant macroeconomic threats to the Marshall Islands. The World Bank Group stands ready to offer continued support under this CPS to reform efforts in the energy sector to mitigate these risks. The Marshall Islands is also highly vulnerable to natural disasters and sea-level rise. The World Bank will look for opportunities to strengthen the disaster risk management capacity of the Marshall Islands, and to help the Marshall Islands build resilience to external shocks, including natural and man-made disasters. Additionally, the World Bank Group will promote stronger regional and global integration through enhanced ICT connections, as well as making appropriate use of regional interventions that encourage exchange and closer integration with neighboring countries. The World Bank will also work with the authorities to fully explore the flexible use of IDA assistance, including of the Immediate Response Mechanism that allows the inclusion of emergency related contingent components in selected projects to further support rapid response in eligible crisis and emergency situations.

52. ***The macroeconomic policy framework is dependent on continued availability of grants from development partners, and subject to high levels of uncertainty.*** A sharper than expected rise in global commodity prices would exacerbate inflation, and lead to further contractions of the Marshall Islands economy. The macroeconomic policy framework also depends on the continued availability of grants from development partners over the medium-term, especially the US, and the inadvisability of borrowing to fund fiscal deficits. The World Bank Group will continue to work in close collaboration with the IMF as well as with other donors including the ADB, Australia, and the US to monitor changes in the macroeconomic situation and ensure that the World Bank Group's assistance is effectively coordinated and aligned with Government priorities.

53. ***The prospective end of Compact funding presents a fundamental challenge to fiscal sustainability in the Marshall Islands***. No further Compact financing is assured beyond the life of the current arrangements. The CTF that has been established to replace Compact grants from 2024 is not currently at a level which would ensure a smooth transition to budgetary self-reliance. The World Bank Group's program is intended to support the important structural reforms that are needed to return the Marshall Islands to a more sustainable fiscal path.

54. ***To mitigate the above risks, the World Bank Group will continue to draw on the experience and expertise of longstanding partners, and will find ways to adapt its approaches and operational models to achieve results on the ground.*** The World Bank Group is proposing a program that is intended to be both pragmatic and flexible, and one that draws on relevant regional and global experience, as well as that of partners with a longer track record in the Marshall Islands. The absence of the World Bank Group in-country presence underscores the need for donor coordination issues to be carefully and creatively managed.

Annex 1: Development Partner Engagement by Sector

	ADB	Australia	EU	IMF	Japan	Taiwan, China	UN	US	WB
Human Development			X		X	X	X	X	
Macroeconomic & Fiscal	X			X				X	X
Energy		X	X		X		X		X
Climate Change/DRM	X				X	X	X	X	X
Infrastructure/ Rural/Community Development			X		X			X	
Finance/Private Sector	X						X	X	X
Public Admin.	X							X	
Water & Sanitation		X			X				
ICT									X
Fisheries/Oceans						X			X

Annex 2: The Marshall Islands CPS Results Matrix[16]

Medium-term Goals	Key Issues	Expected CPS Outcomes	Milestones	WBG Instruments and International Partners
Strengthening economic governance to improve living standards and enhance service delivery				
Increased economic competitiveness and enhanced regional and global integration through ICT reform and market liberalization.	One of the least connected countries in the world where only 35 percent of the population has internet access.	Improved access of population to ICT services: • Increase in number of mobile phone subscribers from 26 percent of the population to 40 percent of the population. • Increase in internet subscriptions from 2 percent of the population to 30 percent of the population. • Quantitative analysis on the impact of ICT reform on vulnerable and underserved groups including women.	• Government adoption of a sector policy implementing a new legal framework and introducing competition • Establishment of an independent ICT regulator • Government approval of a financial, ownership and operational restructuring plan for the NTA • New licenses offered permitting a second national operator to supply services to the public using its own infrastructure.	• Series of IDA-financed Development Policy Operations • IDA-financed Technical Assistance to support market liberalization • IFC advisory/investment assistance to private sector market entrants

[16] This CPS results matrix reflects the initial scope of the World Bank's program in the Marshall Islands and will be adjusted as the engagement evolves and activities are confirmed over the CPS period. Items in parentheses are indicative only and not currently part of the CPS framework. It is anticipated that additional activities will be formally integrated into the CPS results framework at the time of the CPS Progress Report.

Medium-term Goals	Key Issues	Expected CPS Outcomes	Milestones	WBG Instruments and International Partners
Enhanced energy security through effective regulation, management and governance of the energy sector	Outdated MEC business model and fuel price volatility has resulted in economy-wide impacts, poor service, high cost, and inadequate maintenance of MEC assets.	Cost reflective fuel tariffs introduced: • Reform MEC's fuel prices such that: a) the full cost of supply e.g. capital costs, depreciation and O&M are recovered; b) capital expenses to upgrade MEC's fuel tank farm to safe standards can be financed • Technical and non-technical losses reduced from 18 percent (2010) to 14 percent over a 4 year period	• Government adoption of electricity tariff review proposals • Undertake essential maintenance of auxiliary generators • Increase frequency of meter-reading, improve billing and collection rates	Technical Assistance; AAA; IDA Development Policy Operation
Increased net economic benefits to the country from its fisheries, through transparent and sustainable management of ocean resources	Pacific tuna fisheries yield about 58 percent of the global total with an estimated value of US$4.5 billion but countries such as the Marshall Islands retain only 7 percent of the first sale revenue	• Increase in the percentage of the landed value of the tuna caught in RMI's waters that is retained by the country via sale of access rights, from 10 percent to 12 percent	• Introduction of market mechanism permitting the trade of fishing licenses at international market rates.	• PIRO IDA regional investment • GPO support
Enhanced capacity to manage the Post-Compact transition to increased budgetary self-reliance	Expiry of Compact funding requires effective management of public and external resources and increased support for private sector development	• CTF objectives, strategic asset allocation and investment management strategies reviewed and options identified to improve long-term sustainability in response to economic and financial market volatility • Legislative and regulatory improvements to investment climate	• Government and CTF stakeholders undertake review of fund objectives and asset management framework	World Bank Treasury Technical Assistance; Australia, New Zealand and US support Analysis and Technical Assistance from IFC/WB unit

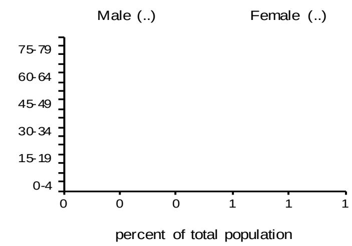
Annex 3

Marshall Islands at a glance

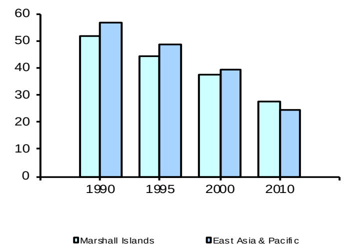
2/12/13

Key Development Indicators	Marshall Islands	East Asia & Pacific	Lower middle income
(2011)			
Population, mid-year (millions)	0.05	1,962	2,519
Surface area (thousand sq. km)	*0.2*	16,302	23,579
Population growth (%)	1.4	0.7	1.5
Urban population (% of total population)	72	46	39
GNI (Atlas method, US$ billions)	0.2	7,249	4,078
GNI per capita (Atlas method, US$)	3,910	3,696	1,619
GNI per capita (PPP, international $)	..	6,657	3,632
GDP growth (%)	5.0	9.7	6.9
GDP per capita growth (%)	3.5	8.9	5.3
(most recent estimate, 2005–2011)			
Poverty headcount ratio at $1.25 a day (PPP, %)	..	14	..
Poverty headcount ratio at $2.00 a day (PPP, %)	..	33	..
Life expectancy at birth (years)	..	72	65
Infant mortality (per 1,000 live births)	22	20	50
Child malnutrition (% of children under 5)	..	6	25
Adult literacy, male (% of ages 15 and older)	..	96	80
Adult literacy, female (% of ages 15 and older)	..	91	62
Gross primary enrollment, male (% of age group)	102	111	110
Gross primary enrollment, female (% of age group)	101	112	104
Access to an improved water source (% of population)	94	90	87
Access to improved sanitation facilities (% of population)	75	66	47

Age distribution, 2010

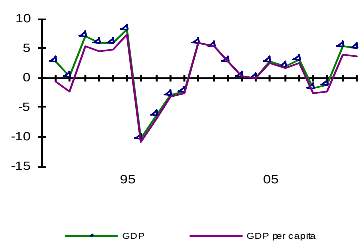


Under-5 mortality rate (per 1,000)



Net Aid Flows	1980	1990	2000	2011 [a]
(US$ millions)				
Net ODA and official aid	..	*0*	57	91
Top 3 donors (in 2010):				
United States	..	*0*	43	68
Japan	..	*0*	3	13
Australia	..	*0*	1	2
Aid (% of GNI)	..	..	38.9	45.9
Aid per capita (US$)	..	*6*	1,098	1,677

Growth of GDP and GDP per capita (%)



Long-Term Economic Trends	1980	1990	2000	2011	1980–90	1990–2000	2000–11
Consumer prices (annual % change)	..	0.7	1.4	9.5			
GDP implicit deflator (annual % change)	*7.4*	5.0	-3.0	1.5			
Exchange rate (annual average, local per US$)	1.0	1.0	1.0	1.0			
Terms of trade index (2000 = 100)	..	..	..	..			
					(average annual growth %)		
Population, mid-year (millions)	0.0	0.0	0.1	0.1	4.4	1.0	0.5
GDP (US$ millions)	*31*	78	111	174	*7.0*	0.4	1.5
		(% of GDP)					
Agriculture	..	..	..	..	..	..	..
Industry	..	..	..	..	..	..	..
Manufacturing	..	..	..	..	..	..	..
Services	..	..	..	..	..	..	..
Household final consumption expenditure	..	..	..	..	..	..	..
General gov't final consumption expenditure	..	..	..	..	..	..	..
Gross capital formation	..	..	..	..	..	..	..
Exports of goods and services	..	..	..	..	..	..	..
Imports of goods and services	..	..	..	..	..	..	..
Gross savings	..	..	..	..			

Note: Figures in italics are for years other than those specified. 2011 data are preliminary. .. indicates data are not available.
a. Aid data are for 2010.

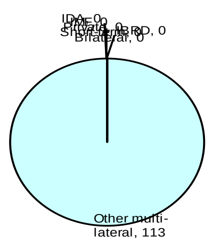
Development Economics, Development Data Group (DECDG).

Balance of Payments and Trade	2000	2011
(US$ millions)		
Total merchandise exports (fob)	15	41
Total merchandise imports (cif)	55	106
Net trade in goods and services	-93	-119
Current account balance	-23	-22
as a % of GDP	-20.6	-12.6
Workers' remittances and compensation of employees (receipts)	..	..
Reserves, including gold	..	*2*

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	66.8	63.6
Tax revenue	15.4	14.3
Current expenditure	47.7	51.6
Overall surplus/deficit	8.1	1.4
Highest marginal tax rate (%)		
Individual	..	..
Corporate	..	..

External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	92	117
Total debt service	22	*9*
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	82.8	67.4
Total debt service (% of exports)	31.5	*9.7*
Foreign direct investment (net inflows)	..	..
Portfolio equity (net inflows)	..	..

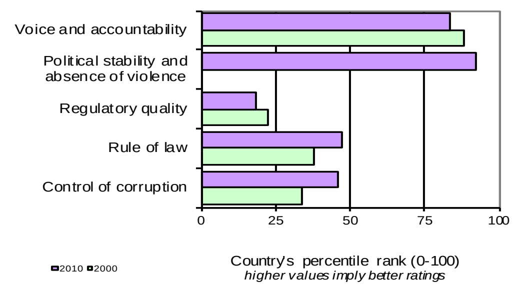
Composition of total external debt, 2010



US$ millions

Private Sector Development	2000	2011
Time required to start a business (days)	–	17
Cost to start a business (% of GNI per capita)	–	17.3
Time required to register property (days)	–	..
Ranked as a major constraint to business	**2000**	**2010**
(% of managers surveyed who agreed)		
n.a.	..	..
n.a.	..	..
Stock market capitalization (% of GDP)	..	..
Bank capital to asset ratio (%)	..	..

Governance indicators, 2000 and 2010



Source: Worldwide Governance Indicators (www.govindicators.org)

Technology and Infrastructure	2000	2010
Paved roads (% of total)	..	..
Fixed line and mobile phone subscribers (per 100 people)	9	15
High technology exports (% of manufactured exports)	..	..

Environment		
Agricultural land (% of land area)	72	*72*
Forest area (% of land area)	72.2	72.2
Terrestrial protected areas (% of land area)	3.1	3.1
Freshwater resources per capita (cu. meters)	..	..
Freshwater withdrawal (billion cubic meters)	..	..
CO2 emissions per capita (mt)	1.5	*1.9*
GDP per unit of energy use (2005 PPP $ per kg of oil equivalent)	..	..
Energy use per capita (kg of oil equivalent)	..	*610*

World Bank Group portfolio	2000	2010
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	–	–
Disbursements	–	–
Principal repayments	–	–
Interest payments	–	–
IDA		
Total debt outstanding and disbursed	–	–
Disbursements	–	–
Total debt service	–	–
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	–	–
of which IFC own account	–	–
Disbursements for IFC own account	–	–
Portfolio sales, prepayments and repayments for IFC own account	–	–
MIGA		
Gross exposure	–	–
New guarantees	–	–

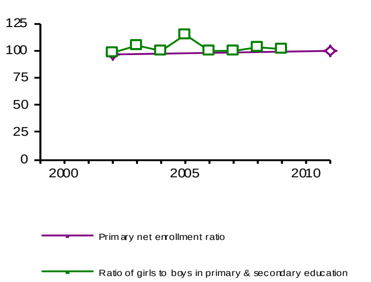
Note: Figures in italics are for years other than those specified. 2011 data are preliminary. 2/12/13
.. indicates data are not available. – indicates observation is not applicable.

Development Economics, Development Data Group (DECDG).

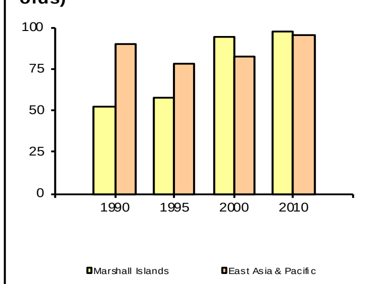
With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Marshall Islands			
Goal 1: halve the rates for extreme poverty and malnutrition	**1990**	**1995**	**2000**	**2010**
Poverty headcount ratio at $1.25 a day (PPP, % of population)	..	..	..	..
Poverty headcount ratio at national poverty line (% of population)	..	..	..	..
Share of income or consumption to the poorest qunitile (%)	..	..	..	..
Prevalence of malnutrition (% of children under 5)	..	..	..	..
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	..	..	*96*	*99*
Primary completion rate (% of relevant age group)	..	..	*93*	*97*
Secondary school enrollment (gross, %)	..	..	*68*	*99*
Youth literacy rate (% of people ages 15-24)	..	..	..	..
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	..	..	*102*	*101*
Women employed in the nonagricultural sector (% of nonagricultural employment)	..	..	*29*	..
Proportion of seats held by women in national parliament (%)	..	..	3	3
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	52	44	38	*26*
Infant mortality rate (per 1,000 live births)	41	35	31	*22*
Measles immunization (proportion of one-year olds immunized, %)	52	57	94	97
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	..
Births attended by skilled health staff (% of total)	..	..	*95*	*86*
Contraceptive prevalence (% of women ages 15-49)	..	*37*	*34*	*45*
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	137	190	263	*536*
Tuberculosis case detection rate (%, all forms)	*37*	*57*	25	70
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	95	95	95	94
Access to improved sanitation facilities (% of population)	64	67	70	75
Forest area (% of land area)	..	..	72.2	72.2
Terrestrial protected areas (% of land area)	..	..	3.1	3.1
CO2 emissions (metric tons per capita)	1.0	1.3	1.5	*1.9*
GDP per unit of energy use (constant 2005 PPP $ per kg of oil equivalent)	..	..	..	..
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	1.1	6.2	7.7	8.1
Mobile phone subscribers (per 100 people)	0.0	0.5	0.9	7.0
Internet users (per 100 people)	0.0	0.0	1.5	*3.5*
Computer users (per 100 people)	..	..	..	..

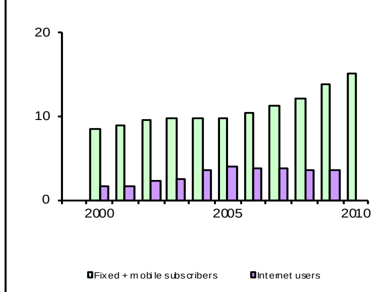
Education indicators (%)



Measles immunization (% of 1-year olds)



ICT indicators (per 100 people)



Note: Figures in italics are for years other than those specified. .. indicates data are not available. 2/12/13

Development Economics, Development Data Group (DECDG).

Annex 4: The Marshall Islands: Key Indicators Table, FY2008–13 [1/]

	2008	2009	2010	2011 Est.	2012 Est.	2013 Proj.
Real sector						
Real GDP (percent change)	-1.9	-1.5	5.6	0.8	1.9	2.3
Consumer prices (percent change)	14.7	0.5	1.8	5.4	5.7	3.9
Central government finances (in percent of GDP 2/						
Revenue and grants	70.2	69.2	67.0	63.7	60.8	61.1
Total domestic revenue	25.6	25.0	24.7	25.3	22.6	21.6
Grants	44.5	44.3	42.3	38.4	36.6	39.5
Expenditure	66.4	67.8	62.4	60.0	61.9	61.1
Current	54.3	56.7	51.7	49.3	50.5	49.0
Capital	12.1	11.2	10.7	10.7	11.4	12.1
Overall balance	3.7	1.4	4.6	3.7	-1.1	-0.1
Compact Trust Fund (in million of US$; end of period)	75.7	90.9	112.8	125.2	165.7	192.6
Balance of payments (in millions of US$)						
Trade balance	-69.8	-73.5	-100.8	-68.6	-68.8	-68.4
Net services	-39.2	-53.6	-41.5	-41.9	-40.3	-43.6
Net income	44.0	41.4	35.6	39.1	36.8	37.7
Unrequited transfers (private and official)	62.2	60.2	60.8	60.8	60.7	69.4
Current account including official current transfers	-2.7	-25.6	-45.9	-10.6	-11.5	-4.9
(In percent of GDP)	-1.8	-16.9	-28.1	-6.2	-6.3	-2.5
Current account excluding budget grants 2/	-60.0	-80.0	-102.1	-66.7	-67.7	-69.7
(In percent of GDP)	-39.3	-52.8	-62.5	-39.1	-37.1	-36.2
External debt (in millions of US$; end of period) 3/	94.6	106.8	104.7	109.5	104.3	103.7
(In percent of GDP)	62.0	70.4	64.2	64.1	57.2	53.8
External debt service (in millions of US$)	7.5	7.1	7.8	7.4	7.7	7.6
(In percent of exports of goods and services)	24.7	22.7	17.6	11.3	11.3	10.5
Exchange rate						
Real Effective Exchange Rate (2000 =100)	102.7	104.5	101.9	101.9	105.3	...
Memorandum Item:						
Nominal GDP (in millions of US$)	157.7	151.7	163.2	170.7	182.4	192.7

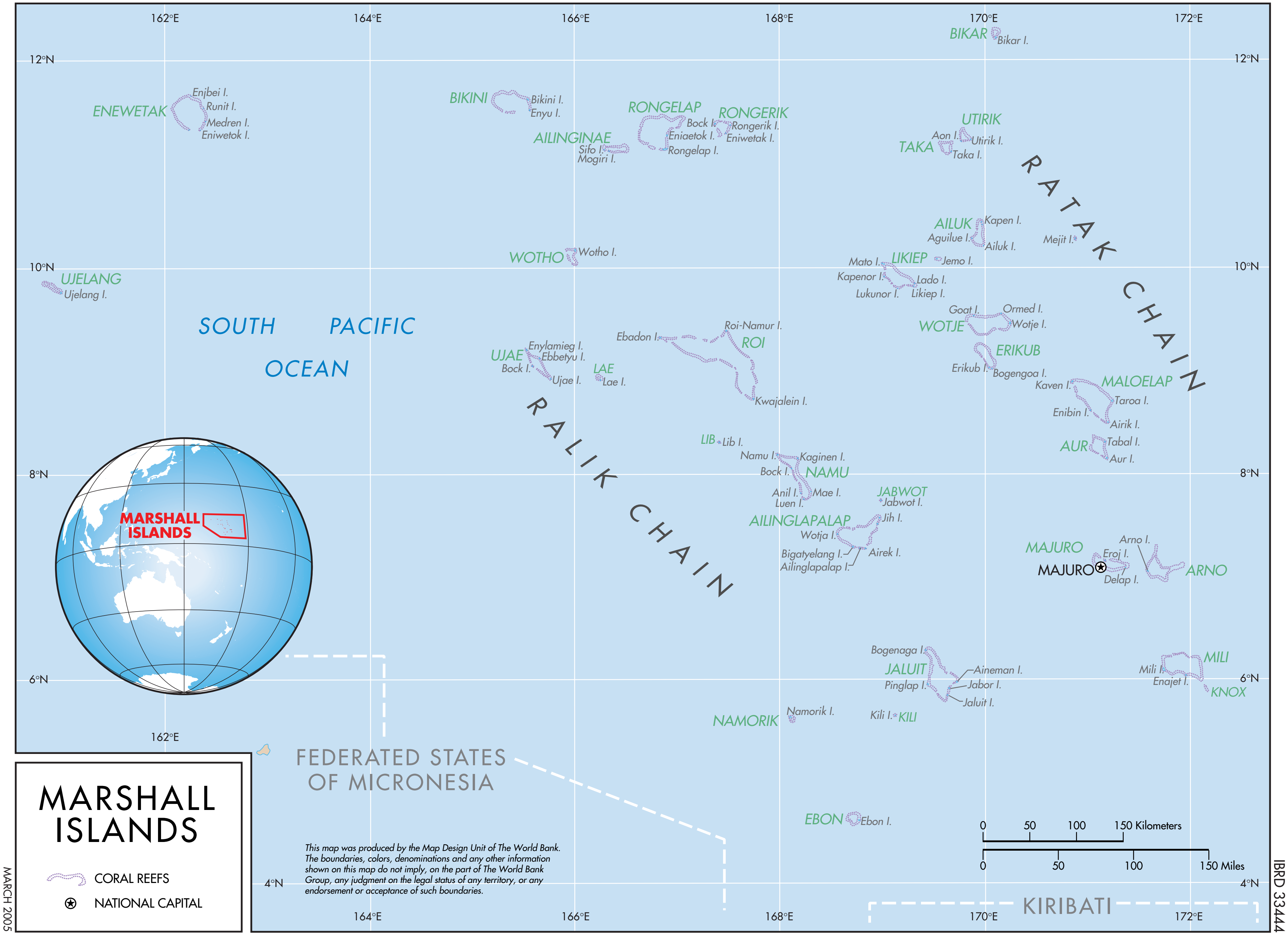
Sources: RMI authorities and IMF staff estimates.

Note: Small discrepancies exist between table presented in the text and the one above, partly explained by differences in the level of grants.

1/ Fiscal year ending September 30 unless otherwise stated.

2/ Official transfers include current transfers, but exclude capital transfers and Trust Fund contributions.

3/ Government and government-guaranteed debts, which include the first tranche disbursement of $9.5 million in FY2011 and a projected second tranche disbursement of $5 million in FY2013 from ADB



MARSHALL ISLANDS
CORAL REEFS
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SOUTH PACIFIC OCEAN
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RATAK CHAIN
FEDERATED STATES OF MICRONESIA
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