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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A PROPOSED GRANT

IN THE AMOUNT OF SDR 2 MILLION
(EQUIVALENT TO $3 MILLION)

TO

THE REPUBLIC OF THE MARSHALL ISLANDS

FOR A

FIRST ICT SECTOR DEVELOPMENT POLICY OPERATION

February 13, 2013

Transport, Water and ICT Department
Papua New Guinea, Pacific Islands, Timor-Leste Country Department
East Asia and Pacific Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective January 10, 2013)

Currency Unit	=	United States Dollar
SDR 1.00	=	USD 1.53

FISCAL YEAR
January 1 – December 31

ABBREVIATIONS AND ACRONYMS

$	All dollars are in United States dollars unless otherwise indicated
ADB	Asian Development Bank
AusAID	Australian Agency for International Development
CTF	Compact Trust Fund
Gpbs	Gigabits per second
GDP	Gross domestic product
GNI	Gross national income
ICT	Information communication technologies
IMF	International Monetary Fund
MEC	Marshalls Energy Corporation
MoF	Ministry of Finance
MTC	Ministry of Transport and Communications
NTA	National Telecommunications Authority
PRIF	Pacific Regional Infrastructure Facility
RUS	Rural Utilities Service
SOE	State-owned enterprise

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MARSHALL ISLANDS

FIRST ICT SECTOR DEVELOPMENT POLICY OPERATION

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GRANT AND PROGRAM SUMMARY

MARSHALL ISLANDS
FIRST ICT SECTOR DEVELOPMENT POLICY OPERATION

Recipient	Republic of the Marshall Islands
Implementing Agency	Ministry of Finance
Financing Data	IDA Grant Standard IDA terms SDR 2 million ($3 million equivalent)
Operation Type	Multiyear programmatic: first of three, single-tranche Operations. The indicative total of three Operations will be SDR 8.5 million ($13 million equivalent).
Main Policy Areas	The policy areas that the ICT Sector Development Program ("Program") will support are: (a) transition from a monopolistic to a liberalized telecommunications market; (b) reform and restructuring of the majority state-owned National Telecommunications Authority (NTA); and (c) development of a new legal and regulatory framework for telecommunications/ICT and an independent regulatory function.
Key beneficiaries	The main group of beneficiaries will be users of ICT services who will benefit from lower prices and increased access to modern communications, as a result of sector liberalization and the introduction of a modern legal and regulatory framework that supports a competitive environment and facilitates new investment. Other benefits will be fiscal: the Government, will experience significant fiscal relief through the restructuring of NTA (including the debt associated with NTA's cable investment) which continues to incur significant operating losses.
Program Development Objective and Contribution to the Country Partnership Strategy	The proposed series of three programmatic support Operations for ICT sector reform and development will provide rolling support to the Government's development strategy, with each Operation specifying a set of indicative triggers which will provide the basis for the preparation of the next Operation. The objective of the proposed Program is to increase the availability of ICT services and enable the more widespread application of ICT services supporting improvements in economic and social development in the Marshall Islands. The objective of this first Operation is to support policy development and prepare the foundation for the legal, regulatory and institutional reforms needed to support sector liberalization. A Country Partnership Strategy for the Marshall Islands has been prepared and will be presented to the Board with this Operation. 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. Support for the liberalization and regulation of the telecommunications sector, with the aim of connecting more Marshallese to social and economic opportunities, is a key component in helping the Marshall Islands to mitigate the effects of economic isolation and to take advantage of opportunities from closer regional and global integration.
Risks and Risk Mitigation	The main risks of the proposed Program and their associated mitigation strategies are as follows: • **The thin capacity of the public sector in the Marshall Islands** poses a risk that the policy actions cannot be implemented as quickly or successfully as expected. The new independent regulator will need to attract expert staff capable of regulating and administrating the sector and implementing the new regulatory framework. Technical assistance will be mobilized to support local institutional capacity, potentially in a "substitution" role. The design of the regulatory function will also encourage self-enforcement and incorporate structural features to focus

	scarce regulatory resources on core regulatory functions. • **Change in political commitment and cooperation of telecommunications industry (opposition to move from monopoly to competition).** This risk will be mitigated through continuous consultation with and awareness-raising of stakeholders around the benefits of liberalization and improved connectivity for the economy as a whole. • **Delays or partial implementation of some of the most critical reforms will jeopardize the entire reform process.** The existing law guarantees NTA a monopoly on supplying switched telecommunication services; the introduction of a new legal framework supporting liberalization is an essential step that must be completed before competition may be introduced. This risk can be mitigated through the provision of technical assistance. The Government has adopted a reform package for the sector including key policy principles for sector liberalization and the development of a new communications law to remove the exclusivity enjoyed by the incumbent operator and the establishment of an independent regulator. The first Operation is designed to assist Government to adopt a new ICT Sector Policy and draft Communications Law built on these key principles and committing to liberalization and the introduction of competition. • **Difficulties attracting private sector investment and sustaining effective competition**. This risk will need to be mitigated through broader measures to improve the investment climate in the country as a whole. For the ICT sector this risk can be reduced by designing a legal and regulatory framework that supports a competitive environment, and promotes transparent and predictable regulatory actions. In addition, flexibility will be needed depending on how the market responds to the proposed reforms; for example, a "regulated monopoly" which seeks to mimic the effects of competition is one possible approach in the event that a second mobile operator does not enter the market in the short to medium term post- liberalization. • **Fiscal risk for Government.** The Government currently holds an approximately 70 percent interest in NTA and may face fiscal risk in the event that NTA is unsuccessful in the market, including under the United States Department of Agriculture's Rural Utility Service loan to NTA for the submarine cable investment that is guaranteed by Government. The Program identifies a number of policy initiatives, including restructuring NTA and investigating the feasibility of transferring the cable and its associated assets, along with the liability under the RUS loan, to a new government-owned entity that will provide cost-based open access to the cable capacity to all operators. It is expected that this work will be supported through a complementary technical assistance Project. • **The dependence of the Marshall Islands' macroeconomic framework on the continued availability of grants from development partners** poses the risk that delays in the receipt of grants may lead to cash flow problems that undermine budget execution, impede the normal functioning of the government, and divert attention from the reform agenda. This risk is being mitigated by the World Bank's efforts, at the Government's request, to coordinate the support of development partners for a multiyear reform matrix.
Operation ID	P128013

IDA PROGRAM DOCUMENT FOR A PROPOSED FIRST ICT SECTOR DEVELOPMENT GRANT TO THE MARSHALL ISLANDS

I. INTRODUCTION

1.01 **This document describes a Program comprising a series of three Development Policy Operations to support ICT sector reform and development in the Marshall Islands.** The objective of this first Operation is to support policy development and prepare the foundation for the legal and regulatory reforms needed to support sector liberalization. The overall ICT Sector Development Program ("Program") is expected to increase the availability of telecommunications infrastructure and enable the more widespread application of ICT services supporting improvements in economic and social development. Consistent with this vision, the Program will support policy initiatives focused on the: (a) transition from a monopolistic to a liberalized telecommunications market; (b) reform and restructuring of the majority state-owned incumbent, the National Telecommunications Authority (NTA); and (c) development of a new legal and regulatory framework for telecommunications/ICT and an independent regulatory function.

II. COUNTRY CONTEXT

2.01 **Country development context.** The Marshall Islands is a group of 26 small atolls in the northern Pacific Ocean with a population of about 53,000. Over half the population resides in the capital city Majuro with a further 11,000 on Kwajalein island. Only three other islands, Ailinglaplap (1,706), Arno (1,753) and Jaluit (1,779) comprise more than 1,000 inhabitants. The remaining Outer Islands are dispersed and sparsely-populated. The economy is based on natural resources (fisheries), transfers and remittances from expatriate workers, and the United States Government through the Compact of Free Association ("Compact"). It is dominated by a large public sector. One of the main challenges facing the Marshall Islands is to overcome its remoteness and dispersed geography by developing the infrastructure it needs to connect its people domestically and internationally, and to encourage social and economic development.

Sectoral and Institutional Context

2.02 **The Marshall Islands is one of the least "connected" countries in the world.** There is a single service provider, the majority state-owned NTA–the Government holds 69.8 percent of the shares, private investors hold 16.4 percent and a further 13.7 percent are treasury stock (shares which are in effect held by NTA itself). 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[1] 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 (HANTRU) that links the Marshall Islands to Guam. Cable capacity is presently under-used, in part due to the monopolistic market environment.

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

2.03 **NTA presents a significant fiscal risk for the Government.** The Marshall Islands section of the HANTRU cable was installed in 2010, with a construction cost of $21.5 million, and financed by an $18.5 million loan to NTA from the United States Department of Agriculture's Rural Utilities Service (RUS), unconditionally guaranteed by the Government of the Marshall Islands, and around $3 million financed by NTA itself (of which $2 million comprised a grant from Government to NTA).[2] NTA's financial situation is deteriorating, in part, due to the burden of repayments under the RUS loan which amount to around $1.5 million per annum. The company faces a number of serious financial challenges in the short-term and is generating insufficient cash flow from its operations to meet its repayment obligations without additional financial support. It is apparent that, based on an analysis of its present financial position, NTA will not be able to undertake the continuing investments that are required to improve access and services in line with growing demand.

2.04 **Limited connectivity imposes high business and social costs, including the isolation of Outer Island communities and missed opportunities for economic and social development.** The main reasons for the limited and costly service include the high costs of connecting remote and sparsely populated islands and the monopolistic market structure. Reforms implemented in similar countries, including elsewhere in the Pacific such as Fiji, Samoa, Solomon Islands, and Vanuatu, demonstrate linkages between market-based reforms and improved economic and social indicators.

2.05 **Sharing regulatory tasks on a subregional basis**. Other countries in the region (Federated States of Micronesia and Palau) are considering the establishment of independent telecommunications regulators. There is, therefore, the potential to reduce the costs to each country of regulation and to enhance sharing of regulatory experiences through the establishment by the Marshall Islands and neighboring countries of a subregional body to which a national regulator could delegate specific activities. It is envisaged that the new Communications Law will allow the Government, after consultation with the Marshall Islands regulator, to authorize the regulator to delegate certain of its functions to such a subregional body. Notwithstanding any such delegation, however, overall responsibility for sector regulation at the national level would remain with the Marshall Islands' regulator.

2.06 **Sector experience in comparable countries and analysis of the Marshall Islands economy supports an assessment that new licensees will be interested in entering the market upon liberalization of the ICT sector.** Nevertheless, the Government acknowledges that the size of the market means that, depending on prevailing economic conditions, it will be difficult to attract private sector investment. Accordingly, it is essential that the Government design the legal and regulatory framework to maximize the attractiveness of the ICT sector as an investment destination. The World Bank will provide guidance, and technical assistance will be mobilized to ensure that the Government maximizes the likelihood of creating a sustainable, workably competitive marketplace for ICT. In order to provide flexibility in the event that a second mobile operator does not enter the market in the short- to medium-term post-liberalization, the new legal and regulatory regime will also provide an effective and cost-

[2] NTA has received two loans from RUS, both guaranteed by the Government. In addition to the 2010 loan for the HANTRU cable, a loan of $18 million was made in 1989, at the time NTA was established, to finance investments in the domestic network. The 1989 loan has been serviced regularly by NTA and, with past principal repayments, the principal amount is reduced to approximately $10.5 million.

efficient mechanism for the Government to regulate a single monopoly operator, whether publicly or privately owned, in a manner that mimics the effects and benefits of competition.

2.07 **Responsibility for the ICT sector.** ICT Sector Policy falls under the Ministry of Transport and Communications (MTC), which is currently responsible for managing technical regulation, spectrum management, and numbering. MTC has very limited technical capacity to guide the development of the sector. It is anticipated that, as part of the reforms, a new independent regulator will be established to take on technical regulation responsibilities in relation to the telecommunications sector, as well as responsibility for economic regulation. The capacity of the MTC in the policy area—which cuts across other sectors—will need to be enhanced.

2.08 **Rationale for World Bank involvement.** Further to the Government's request for analytical/advisory assistance in 2010, the World Bank has so far provided technical assistance to the Government on: (a) ICT sector development options and strategy issues, including an assessment of existing network infrastructure, a supply and demand analysis, and an initial review of the current policy and legal environment (2010/2011); and (b) policy reform and development. The World Bank has extensive experience in the field of telecommunications policy, regulatory reform, and rural access issues. It has advised several Pacific and other governments globally on ICT issues. The proposed Program draws on lessons learned from implementing similar reforms in the Pacific region and other comparable countries.

Recent Economic Developments in the Marshall Islands

2.09 **The Marshall Islands faces many of the problems typical of 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.

2.10 **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 $176 million in 2011, compared to total goods and service exports of just $65 million. The current account deficit excluding grants has averaged 47 percent of GDP since 2007.

2.11 **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 United States, support reasonable standards of living for the majority of the population, with gross national income (GNI) per

capita of $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 $3,450 in 2010.[3]

2.12. **Public expenditure in the Marshall Islands has expanded rapidly since 2003 with the United States Compact of Free Association[4] 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 United States 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.[5] 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.

[3] OECD, World Bank.

[4] 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.

[5] The Marshall Islands' Fiscal year runs from October 1 – September 30.

Table 1. Recent Fiscal Trends FY2007-2012
(millions of 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: International Monetary Fund

2.13. **Under the Compact of Free Association, the Marshall Islands receives annual funding and access to domestic United States Federal Government programs**. These include disaster response and recovery, United States Postal Service, Federal Aviation Commission, and Federal Communications Commission. Total recurrent annual funding (including Compact sector grants – $35.2 million, Compact Trust Fund (CTF) contributions – $12.5 million, Kwajalein land owner compensation – $17.0 million, and Supplemental Education Grant – $5.9 million) currently stands at $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 United States-operated military facilities. Compact sector grants are scheduled to decline in real terms going forward, matched by increases to Compact Trust Fund contributions The United States has established the CTF that is designed to *"contribute to economic development and long-term budgetary self-reliance after FY2023"*[6](that is, after the Compact has expired).

2.14. **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

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

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.

2.15. **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.

2.16**.** **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 $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 $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.

2.17. **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 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.

2**.**18 **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 $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.

2.19. **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[7] 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.

2.20. **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

2.21 **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 United States Federal Aviation Administration-financed airport rehabilitation 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.

[7] 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.

2.22 **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 $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.

2.23. **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 Tax and Revenue Reform and Modernization Commission 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.

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: International Monetary Fund and World Bank

2.24. **With external debt of around 57 percent of GDP, the Marshall Islands is at high risk of debt distress.** Under the International Monetary Fund (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.

2.25. **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.

2.26. **The macroeconomic policy framework is adequate and suitable for the purposes of this Project, but is subject to uncertainty and will remain dependent on continued support from development partners**. 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 United States, 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 United States 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[8] 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.

III. THE GOVERNMENT'S PROGRAM AND PARTICIPATORY PROCESSES

3.01 **The Government has chosen to embark upon ICT sector reform as a component of broader economic and social development.** The country's long-term development objectives are set out in Vision 2018, the Marshall Islands Strategic Economic Development Plan for 2003-2018. This vision was developed through an extensive consultative process starting with the Second National Economic and Social Summit and then followed by extended deliberations by various Working Committees established by the Cabinet. The second and third segments of the Strategic Development Plan will consist of master plans focusing on major policy areas, and the action plans of Ministries and Statutory Agencies. These documents will show programs and projects together with the appropriate costing. It is also the Government's intention for all Atoll Local Governments to develop action plans tailored towards the achievement of the National Vision.

3.02 After the adoption of Vision 2018, master plans were developed in the following major policy sectors: Human Resources Development, Outer Islands Development, Culture and Traditions, Environment, Resources and Development, Information Technology, Private Sector Development, Infrastructure, and Tourism. In addition, action plans of ministries and statutory agencies are to be developed to state (in detail) the respective actions aimed at achieving the targets identified in the master plans. The new National ICT Policy, on access and affordability, developed and implemented under this first Operation, will advance the goal of Vision 2018 to

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

foster the development and use of affordable and reliable ICT services throughout the country, including on the Outer Islands.

3.03 The Government has prioritized, under existing policy initiatives, the need to improve communications facilities for schools (including Internet access to all schools nationwide), clinics, and government offices. The Program is anticipated to support the Government in this policy area: (a) to improve the Government's fiscal position so that it is able to provide funding for improved public services, such as improved ICT in schools and health clinics; (b) to establish a regulatory model that includes a mechanism, such as a universal access program, for prioritizing and subsidizing improved ICT services that would not be viable on purely commercial terms; and (c) to support the establishment of an open and competitive market which enhances access to services.

3.04 **The Government has indicated its commitment to liberalizing the ICT sector and supporting the introduction of competition.** The Government invited the World Bank to analyze the sector and evaluate reform options and their implications, as well as to advise on new directions in ICT policy, and, on that basis, provide support for implementation of reforms. Based on the World Bank's analytical work, the Government developed the above-mentioned National ICT Policy providing for market liberalization and prepared legislation to give effect to the policy reforms. The objective of the proposed sector reforms is focused on increasing private participation and investment in the provision of ICT services, strengthening the incumbent operator, and moving the sector towards competition. The Government recognizes that changes are needed to lead and implement its vision for the sector, in terms of market structure, regulation and the capacity of institutions. The pillars of the proposed reform program are:

(a) *New legal framework.* A modern enabling environment for telecommunications and ICT service provision is essential in order to permit and support private sector investment in the sector and to introduce competition, plus expanded access for populations in the Outer Islands. It is expected that the new legal framework will address a range of topics including (but not limited to): introducing a unified, technology neutral licensing regime; establishing an independent, industry funded regulator for the ICT sector; providing for wholesale access regulation, including access to infrastructure; provisions dealing with anticompetitive conduct and customer protection; technical regulation, including spectrum management and numbering; and monitoring, enforcement, and appeals.

(b) *Reform of the incumbent operator.* NTA has indicated that it lacks access to adequate financing for infrastructure upgrades and expansion, which has limited its ability to increase access to services. It has also indicated that it would benefit from private sector involvement to strengthen its operations and prepare it for competition. The Government will undertake an analysis of possible options for obtaining private sector investment in NTA, including the restructuring of its international cable asset and associated debt, and preparing NTA to operate in a competitive environment.

(c) *Introduction of competition.* The Government intends to open the market to competition through an open process pursuant to a new transparent licensing regime. Based on international and regional experience, it is anticipated that the introduction of competition will: (i) create pressures on NTA to improve its operational performance; (ii) increase access to services, including driving demand for international connectivity services; and

improving access in the Outer Islands; and (iii) create downward pressure on prices for ICT services.

IV. BANK SUPPORT TO THE GOVERNMENT'S PROGRAM

4.01 **Development objective.** The objective of the proposed Program is to increase the availability of ICT services and enable the more widespread application of ICT services supporting improvements in economic and social development in the Marshall Islands.

4.02 **Key beneficiaries.** The main group of beneficiaries will be the users of ICT services who will benefit from lower prices and increased access to modern communications, as a result of sector liberalization and the introduction of a modern legal and regulatory framework that supports a competitive environment, and facilitates new investment. Other benefits will be fiscal: the Government will experience significant fiscal relief from the restructuring of NTA (including the debt associated with NTA's cable investment) which continues to incur significant operating losses.

4.03 **The expected sector-specific outcomes are:**

- an open and competitive ICT market
- a universal access program for supporting the services that are not viable on purely commercial terms, including services on the Outer Islands
- increase in access to ICT services offered on Outer Islands currently without service; and
- reduced prices of core telecommunications services (local and international calls and Internet).

4.04 **The broader social and economic development impacts to which the Program will likely contribute include:**

- government subsidies towards NTA's operating costs reduced or eliminated
- increase in the availability of value-added services such as mobile phone-enabled banking (e.g., for remittance transfers), e-commerce, and, potentially, online government services; and
- improved communications facilities for schools (including Internet access to all schools nationwide), clinics and government offices.

Link to Country Partnership Strategy

4.05 The Program is consistent with the World Bank's regional engagement strategy in the Pacific. The Program supports improving incentives for private sector-led growth and employment. It also supports the regional strategy's objective of strengthening capabilities for service delivery, by both public and private sectors. The World Bank has extensive experience in supporting telecommunications market liberalization and development of new regulatory structures, including in small island economies in the Pacific (Fiji, Samoa, Solomon Islands, Vanuatu), and elsewhere in Africa and the Caribbean. The World Bank, together with other regional partners, has also supported the establishment and operation of a new Pacific ICT Regulatory Resource Centre for the Pacific, hosted in Fiji at the University of the South Pacific.

The World Bank has significant experience in extending communications to remote areas. The Program will draw on the lessons learned from implementing similar activities.

4.06 **A Country Partnership Strategy for the Marshall Islands has been prepared and will be presented to the Board with this Operation**. 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. Support for the liberalization and regulation of the telecommunications sector, with the aim of connecting more Marshallese to social and economic opportunities, is a key component in helping the Marshall Islands to mitigate the effects of economic isolation and to take advantage of opportunities from closer regional and global integration. In addition to this ICT Sector Reform Program, 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 CTF assets and to enhance the investment climate, all of which could also be supported by the World Bank Group.

4.07 **Role of the ICT sector in economic and social development.** The ICT sector is recognized worldwide as an enabler of economic growth and social stability and development. Reliable and affordable telecommunications support business development in all sectors, including small- and medium-enterprises. Existing business users of telecommunications can expand their reach and address new markets. A cross-country analysis on the growth effects of ICT undertaken by the World Bank—and others—demonstrates a linkage between the average growth rate of per capita GDP and access to ICT services, especially broadband Internet.[9] For example, the evidence suggests a noticeable growth dividend from broadband access for developing countries—an increase of about 1.38 percent for each 10 percent increase in penetration.[10]

4.08 Figure 2 shows the growth effect of ICT is stronger in developing countries than in developed ones. The impact is expected to be even more robust once penetration reaches critical mass. The impact of ICT sector liberalization on economic growth in the Pacific has not been measured systematically for several reasons, including difficulties in obtaining baseline data for various economic indicators, and because a range of other constraints also impede private sector development in the Pacific. However, liberalization has resulted in significant improvements in access to ICT services (increased mobile penetration, see Figure 3) and reduced costs of communications to households and business users. In the Pacific, ICT is seen to contribute to improved social outcomes, and facilitate improved service delivery.[11]

[9] See, World Bank, "Information and Communications for Development 2009: Extending Reach and Increasing Impact," Qiang et al, (2009).
[10] Ibid, Qiang, Chapter 3, at pg 45.
[11] See for example: *Net Effects, Social and Economic Impacts of Telecommunications & Internet in Vanuatu*, Pacific Institute of Public Policy, 2012.

Figure 1. Growth Effects of ICT[12]

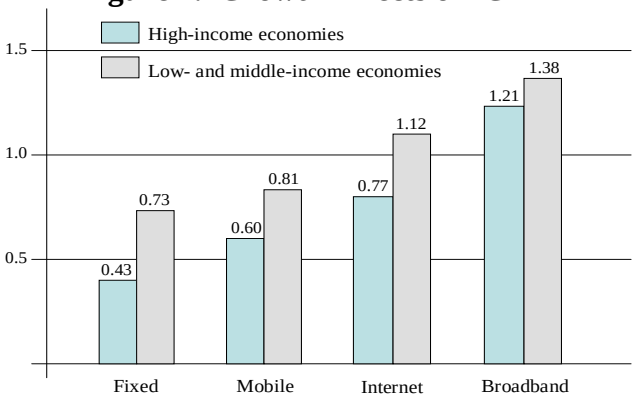
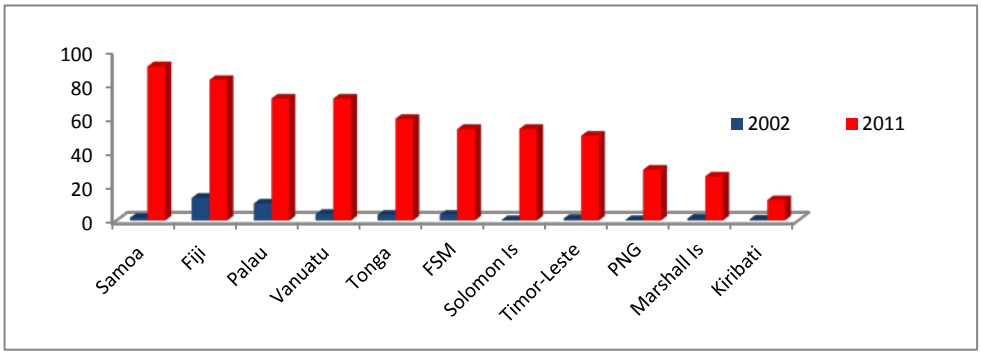


Figure 2. Pacific Islands Increased Mobile Penetration, 2002-2012
(% of population)



Source: International Telecommunication Union, Regulators and Operators in the Pacific

4.09 **Communications services constitute essential infrastructure for a modern economy.** ICT services are no longer a luxury for developing countries, but essential infrastructure to stimulate sustainable economic growth, improve service delivery, and promote good governance and social accountability. In addition to metrics measuring the potential economic impact, the social value of modern, reliable, affordable, and widely available communications services also needs to be emphasized—ICT services are essential for facilitating a more mobile work force, enabling family and community links to be preserved despite distance, and assisting interaction between islands and communities. Moreover, the reform program will also help to support government initiatives for the well-being and personal development of citizens, particularly for health and education. Increased availability of telecommunications will support the development and functioning of these services.

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[12] The y axis represents the percentage-point increase in economic growth per 10-percentage-point increase in telecommunications penetration. All results are statistically significant at the 1 percent level except for that of broadband in developing countries, which is at the 10 percent level.
Source: World Bank, *Extending Reach and Increasing Impact*. Information & Communications Technology for Development, 2009.

Collaboration with the IMF and Other Donors

4.10 **The World Bank and the IMF maintain a close working relationship with the Marshall Islands, and engage in an ongoing dialogue on a range of macroeconomic and structural issues.** The World Bank participated in the Article IV mission in the Marshall Islands from October 3 to 7, 2011, facilitating the discussions on fiscal policy and structural reform in particular. The World Bank and the IMF share a common view about the Marshall Island's priorities for macroeconomic and structural reform.

4.11 **The World Bank also consults with key development partners in the provision of analytical work and technical assistance to the Marshall Islands.** The Pacific Region Infrastructure Facility (PRIF) offers a framework for collaboration and continuous briefing/engagement among its partners, including ADB, the Australian Agency for International Development (AusAid), the European Investment Bank and the New Zealand Government, as well as the World Bank. The World Bank is also coordinating with the ADB on SOE reforms. ADB's experience in the Marshall Islands has been taken into account in designing the structure of this Program. The World Bank is also collaborating with the International Telecommunications Union in the area of ICT capacity-building in the Pacific.

Relationship to Other Bank Operations

4.12 **The proposed Operation will complement future World Bank activities in the Marshall Islands**. The proposed ICT Sector Development Policy Operation has been designed to help to build the capacity of Government to take on new sector reform projects, supported by the World Bank, particularly as the Government becomes more familiar with World Bank processes and procedures. The indicative World Bank support program is summarized in the new Country Partnership Strategy.

4.13 **A recipient executed technical assistance project will support and complement the proposed Program**. Funding has been provided by AusAID through the PRIF to support technical assistance for the development of policy and legal and regulatory reforms needed to complete the Program. The proposed financing instrument is a recipient-executed grant, with a small component of World Bank-executed funding. Implementation will be supervised by the World Bank. Technical assistance will be provided to: (a) build capacity in the MTC to undertake an expanded policy role; (b) assist with the establishment of the new Office of the Regulator, including the development of key capacities within that Office; and (c) advise the Government on restructuring of NTA, including options for infrastructure access and the financial and ownership structure.

Lessons Learned

4.14 **The proposed Program reflects lessons learned from the World Bank's two development policy operations in the Pacific Islands.** Budget support is a relatively new modality for World Bank operations in the Pacific, but it has proven successful. The proposed Program draws lessons from the Samoa Economic Crisis Recovery Support Credit in mid-2010 and the Tonga Energy Sector Development Policy Operation in late-2010.

4.15 **Development policy operations can be quickly mobilized and achieve good results in the context of strong reform momentum.** In both the Samoa and Tonga operations, budget support needed to be mobilized relatively quickly, with the World Bank's ability to respond facilitated by strong government ownership of the reform agenda. The World Bank's engagement provided momentum at a time when the reform agendas could have gone off-track due to the multiple challenges then facing the governments. In the case of Samoa, the reform agenda was broad, and substantive and realistic policy actions that could be supported within short timeframes were readily identifiable. In the case of Tonga, the government had a deep commitment to a sector-specific reform agenda, which formed a ready foundation for the operation. For the proposed ICT Sector Development Policy Operation, the Government of the Marshall Islands has indicated its strong commitment to the sector reform agenda. World Bank engagement has assisted the Government to clarify and sequence its reform program, and will provide momentum to implement the reforms in a challenging fiscal context.

4.16 **Project-level engagement can assist in identifying key priorities to be supported through policy operations.** Both the Samoa and Tonga operations demonstrated how prior project engagement helps to identify key policy reforms that can drive further progress in important sectors, assisting the implementation of the reforms, and tracking progress closely with relatively little additional monitoring effort. The leveraging of project and technical assistance engagements for policy programs is being repeated in the proposed Program.

4.17 **The proposed Program reflects lessons learned from a recent ADB budget support operation.** The ADB initiated a $14.5 million, two-tranche budget support operation in August 2010. The Public Sector Program supported broad-ranging expenditure and tax reforms, including SOE reform and the adjustments required to achieve fiscal sustainability. That program supported the implementation of the recommendations of the Tax and Revenue Reform and Modernization Commission and the Comprehensive Adjustment Program Advisory Group. While progress in implementing revenue and SOE reforms has been made under the program, some policy action related to fiscal adjustment have been missed and overall progress is uneven. Key lessons arising from the ADB experience include: (a) the need for technical assistance to support key reforms, with $700,000 of technical assistance being provided by the ADB providing vital support to government in implementing technical reforms under the program; (b) the need for policy triggers that are focused on and take adequate account of fundamental economic and political-economy constraints, with the broad spread of the Public Sector Program across different reform areas placing pressure on the government's implementation capacity, and fiscal adjustment requirements difficult to implement under prevailing macroeconomic and political conditions; and (c) the need for careful consideration regarding the appropriateness of loan-financed activities in small and volatile economies, with the Marshall Islands now considered at high risk of debt-distress.

4.18 **Commitment to private sector participation and competition.** The Program draws on lessons learned from previous and ongoing telecommunications projects in the Pacific region as well as international best practice and analytical work in the sector. Telecommunications sector reform in other countries demonstrates that a pro-competitive framework which supports private sector participation and competition tends to improve service coverage and quality more than a monopoly operator, especially in mobile services. This lesson is noted by the Government of Marshall Islands, and is reflected in the proposed prior actions and triggers for each subsequent Operation.

Analytical Underpinnings

4.19 **The proposed Program draws on analytical work undertaken in 2010-2011 on possible options for telecommunications development and reform, in consultation with the key stakeholders.** The 2010 analysis prepared for the Government provides an overview of the current and projected supply and demand for telecommunications services, including in the Outer Islands, the operational and financial position of NTA, the policy and legal framework, and the direct and indirect economic impacts of telecommunications market liberalization and privatization of NTA (under different scenarios). This analysis considered three possible scenarios for mobilizing additional investment in telecommunications/ICT in the Marshall Islands. It also outlined the associated policy, legal, and regulatory changes that would be required to give effect to the reforms.

- *Scenario 1.* Government maintains control of the NTA and permits competition.
- *Scenario 2.* Government transfers control of NTA to a strategic private investor, but does not permit competition (maintains NTA's monopoly).
- *Scenario 3.* Government transfers control of NTA to a strategic private investor, and permits competition.

4.20 Each reform scenario would likely produce net gains to consumers and result in direct and indirect benefits for the economy as a whole. The analysis suggested that Scenario 1 would have the least benefits and would likely result in the lowest gains to consumers and present the greatest fiscal risks for Government. Scenario 2 was considered the next best option. The predicted fiscal impact (net benefits to the treasury from sale of government assets) would be greatest under Scenario 2 in the short-term, but potentially outweighed by increased fiscal benefits in the medium-term (as the overall size of the market, and revenue sources, increases under Scenario 3). Direct and indirect economic benefits are also lower under scenario 2 than under Scenario 3. The greatest net benefits in terms of economic impact on consumers and fiscal impact, based on the analysis, would accrue under Scenario 3. The net benefits to consumers in the Marshall Islands (measured by the increase in consumer surplus) were estimated to amount to 0.51 percent of GDP per year or $0.78 million every year. Including indirect economic impact, the net impact under Scenario 3 increases to 2.23 percent of GDP, which is equal to $3.4 million per year.

4.21 ADB's recent reports on SOEs in the Marshall Islands highlights that weak oversight and accountability measures in the existing governance and policy regimes contributes to the poor performance of most state enterprises—see *Review of Public Enterprises and Options for Reform report (2010) and Finding Balance (2011).* ADB has emphasized the need for reform and warned against the existing practice of continuing to provide significant public resources to weakly performing public enterprises without any strong accountability requirements. The Fiscal Year 2010 Economic Review report (2011) prepared by the Graduate School USA (with funding provided by the United States Department of the Interior) similarly highlights the poor fiscal performance of SOEs in the Marshall Islands which, *"…continue[s] to underperform and to impose significant risk and burdens on the fiscal system and economy…"* (page 49).

4.22 The proposed Program takes into account the World Bank's 2010 analysis and the work prepared by other development partners on SOE reform (including the ADB and the Graduate

School USA) through provision for structural change to the sector to promote sustainable private sector development and mechanisms designed to address the potential fiscal risk to Government arising from its approximately 70 percent interest in NTA and its guarantee of the RUS loans. The first Operation identifies a number of policy initiatives, including restructuring NTA and investigating the feasibility of transferring the cable and its associated assets, along with the liability under the RUS loan, to a new government-owned entity that will provide cost-based open access to the cable capacity to all operators. This work will be supported through technical assistance.

V. FIRST MARSHALL ISLANDS ICT SECTOR DEVELOPMENT POLICY OPERATION

Operation Description

5.01 **The proposed Operation is the first of a series of three DPOs.** The Program consists of three ICT Sector Development Policy Operations covering the period 2013 to 2016. The first Operation ($3 million IDA Grant) will focus on the basic policy and regulatory foundations for ICT sector reform. The second Operation ($5 million indicative IDA Grant) will focus on key enabling legislation, the establishment of the new sector regulator, the adoption of a plan for restructuring of NTA, and the allocation of spectrum for new mobile operators. The third Operation ($5 million indicative IDA Grant) will focus on new licensing and market entry, the commencement of regulatory functions, and further strengthening of the ICT sector enabling environment, with a particular emphasis on facilitating access to ICT in Outer Islands.

5.02 This programmatic approach suits the gradual nature of the policy, legal, institutional and structural reforms that need to be implemented and sequenced appropriately to meet the development objective. Consistent with the policy context analyzed above, this section describes the overall approach of the proposed First ICT Sector Development Policy Operation. The policy actions envisaged as part of the overall Program are summarized in the matrix (Annex 2).

5.03 **The proposed multiyear programmatic series of Operations will assist the Government of the Marshall Islands to implement key aspects of its reform agenda for the ICT sector, while providing a predictable flow of resources in a challenging fiscal environment.** The Program will support the following initiatives: (a) policy development to guide sector reform and the transition from a monopolistic to a liberalized telecommunications market; (b) development of a new legal and regulatory framework for telecommunications/ICT and an independent regulatory function; (c) ICT sector liberalization, including restructuring the majority state-owned NTA; and (d) improving the legal framework and access to ICT services.

5.04 **The selected prior actions for the first Operation are summarized** in Table 3(a). The indicative triggers for the subsequent two Operations are set out in Tables 3(b) and 4(c). The evaluation of readiness for each successive Operation will be a bottom line assessment, meaning that, as long as most triggers are on track, the World Bank will proceed with the preparation of the subsequent Operation. The proposed target dates are indicative, and may be advanced.

Table 3(a). Prior Actions for DPO 1 (Target date: Board 2013)

Prior Action	Evidence for completion of Prior Action
1.Policy Development to Guide Reform and Development of the ICT Sector	
The Recipient has endorsed a new ICT sector policy and committed to liberalize the ICT sector introducing a modern legal and regulatory framework in the Recipient's territory and restructuring NTA.	▪ the ICT Sector Development Document, dated April 23, 2012; ▪ the Recipient's Cabinet Resolution endorsing said ICT Sector Development Document embodied in the Cabinet Minutes No.072 (2012) dated May 5, 2012) ▪ the Ministry of Finance press release dated July 13, 2012, as published in the Recipient's mass media (including the Marshall Islands Journal).
Strengthened Legal Framework 2. Legislative and Regulatory Reforms to Promote Private Sector Investment in the ICT Sector The Recipient has, through the Office of its Attorney General, prepared, satisfactory to the Association, a draft Communication Bill backstopping the new ICT policy framework adopted by the Recipient.	▪ copy of the Cabinet Meeting 184 [Reference - C.P.6696 (2012)] dated December 31, 2012, furnished to the Association by the Recipient's Ministry of Finance.

Table 3(b). Indicative Triggers for DPO 2 (Target date: December, 2013) (to be confirmed at appraisal for DPO 2)

New Communications Law enacted

1. Enactment of the new Communications Law that liberalizes market entry and provides for independent regulation of the sector in accordance with international best practices. The regulatory framework will provide for cost-based access to essential facilities, control of anticompetitive behavior, and improved consumer protection.

Improved governance arrangements

2. Establishment under the new Communications Law of an independent Regulator for the ICT sector. Preparation of an initial operating budget and provision of funding sufficient to cover the period until the regulator is self-funded by the ICT sector.

Opening of ICT market

3. A financial, ownership, and operational restructuring plan for NTA is developed and approved by Government.
4. Exclusive rights for the supply of ICT infrastructure or services in the Marshall Islands are terminated, subject only to the power of the regulator to issue licenses.
5. The submarine cable, the associated landing station and international gateway, and the debt owing to RUS in connection with the construction of the submarine cable are separated from the vehicle carrying out the retail operations previously conducted by NTA and vested in a Government-owned entity. Should this form of separation not be feasible, the Communications Law will empower the regulator to enforce open access to international connectivity at cost-based prices.
6. Government designates in the national table of frequency allocations specific blocks of spectrum in designated bands sufficient for new licensees to offer mobile wireless services.

Table 3(c). Indicative Triggers for DPO 3 (Target date: December, 2014)
(to be confirmed at appraisal for DPO 3)

Operationalization of the regulator
1. Key personnel of the Office of the Regulator are engaged, and the office has commenced its regulatory functions and responsibilities.
Opening of ICT market
2. Modern numbering plan adopted and lodged with the International Telecommunications Union that has adequate number-space for the introduction of new services, including mobile wireless services.
3. Access to all international cable capacity (and international communications services) in the Marshall Islands is offered to all access seekers on a (cost-based) nondiscriminatory, open access basis that does not favor one licensee over another.
4. Invitations issued internationally to apply for licenses permitting the supply of infrastructure based communications services (including the supply of mobile services) throughout the Marshall Islands in competition with NTA.

Policy Areas

5.05. The policy areas supported by the Program are as follows.

Policy Area 1: Introduction of a Pro-competitive ICT Sector Policy

5.06 The new National ICT Sector Policy establishes the Government's commitment to introducing a competitive market and sets out a roadmap for the transition to competition and implementation of the new market structure. The preparation of the ICT Sector Policy was the first step in the reform process; it affirms the Government's support of open and competitive markets and lays the foundation for future legislative and regulatory changes. A new Communications Law is needed to give effect to the initiatives described in the ICT Sector Policy.

5.07 The policy development phase carried out by Government incorporated: (a) a consultative process with key stakeholders; and (b) international best practice on telecommunications policy and regulation for a competitive market environment. A consultation process is especially important in order to build a broad consensus supporting the reforms. It is anticipated that, in the coming months, the Government will support the enactment by the *Nitijela* (legislature) of a new communications law which is needed in order to give effect to the policy initiatives set out in the ICT Sector Policy. The enactment of a new Communications Law is one of the indicative triggers identified for the second Operation under this Program.

5.08 The policy framework also sets out the Government's expectations and vision regarding its preferred structure for the ICT sector, including the restructuring of NTA which may include (but is not limited to) the introduction of a cornerstone private equity investor or other strategic partner. The objective is to strengthen NTA's financial position and to position NTA more effectively in a competitive market structure. The policy also identifies the future ownership structure for the submarine cable (and terrestrial network) as areas for review as part of the process of reforming the ICT sector and NTA. The guiding principle underpinning the ownership of essential facilities and the regulatory structure is to promote competition and

thereby to improve access and affordability of telecommunications services in the Marshall Islands.

5.09 As discussed above, the proposed Program draws on analytical work undertaken in 2010-2011 by the World Bank at the request of the Government on options for telecommunications development and reform. Beginning with the introduction of a new pro-competitive policy, reflected in the ICT Sector Development Document, whose official endorsement is a prior action for this operation the proposed multi-year Program will build upon the consensus and momentum that was established during the earlier engagement.

Policy Area 2: Strengthened Legal and Regulatory Framework

5.10 The existing legal framework does not permit the introduction of competition and reserves a monopoly on all switched communications in favor of NTA. A new legal framework is an essential step required to support the implementation of a new sector policy. It is envisaged that the new legal enabling environment will include *inter alia* provisions for:

(a) Establishing an independent (industry funded) ICT sector specific regulator;

(b) Establishing an open and transparent, technology neutral licensing process which does not preserve any exclusivities currently reserved for NTA; and promoting nondiscrimination in regulation between like licensees;

(c) Ensuring transparent wholesale access arrangements (interconnection and access to essential facilities including international connectivity to lower barriers to entry and expansion) including open access and cost-oriented wholesale pricing regulation;

(d) Adding regulatory tools to address anticompetitive conduct and to protect the interests of users of ICT services (including on cyber-security and cyber-crimes);

(e) Resolving disputes between operators, and between operators and users of telecommunications services;

(f) Providing a mechanism for delivering subsidies to support increased connectivity for the Outer Islands;

(g) Technical regulation, including spectrum assignment and planning, numbering and other technical regulation matters;

(h) Land access arrangements;

(i) Appeals mechanism (with certain decisions subject to expert review) and enforcement; and

(j) Prescribing offences, including monitoring and enforcement powers, which are directed at ensuring compliance with the law.

5.11 The new legal framework will reflect international best practice on telecommunications regulation in a competitive market environment. As part of the reforms aimed at encouraging private investment in the ICT sector the legal framework is expected to provide for the creation of an independent ICT sector regulator to regulate a competitive market with multiple operators. International experience shows that independent and proportionate telecommunications

regulation promotes competition and transparent and predictable regulatory actions, which are critical to encourage private sector investment and reduce investment risk.

5.12 While it may be established under a communications law, the regulator will need financial support and operational support to recruit staff and prepare itself to perform its statutory responsibilities. The Government will prepare an initial operating budget and provide funding for the regulator, sufficient to cover the period until the regulator is self-funded by the ICT sector. The Government will also conduct an extensive recruitment process in order to attract suitably qualified individuals (according to the legislative requirements) to lead and staff the regulator. The areas of activity to be undertaken by the regulator include:

(a) Issuing licenses and other authorizations, monitoring compliance and enforcing sector legislation and regulatory instruments

(b) Establishing and regulating a wholesale access regime, including network interconnection

(c) Regulating competition; limiting anticompetitive behavior

(d) Resolving disputes between operators, and between operators and users of telecommunications services

(e) Monitoring and enforcement, to ensure compliance with the law

(f) Allocating, assigning, and supervising radio spectrum, numbering, and other technical regulation matters.

5.13 A prior action for this first Operation is the preparation of a draft communications law by the Office of the Attorney General. The Program includes, as an indicative trigger for the second Operation in the series, the enactment of the new draft Communications Law. Such an approach is considered appropriate in these circumstances due to the high level of consensus and support for the Program among political and industry stakeholders in the Marshall Islands. The introduction of a new law permitting competition (and providing the tools to regulate a multi-operator ICT sector) is essential if the development objective underpinning the Program is to be achieved. World Bank analysis of the ICT sector identified the need to increase the level of investment in the sector; currently, investment potential is restricted by the existing legislative settings which guarantee monopoly rights to NTA.

Policy Area 3: Restructuring and Liberalizing the ICT Sector

5.14 The sustainability of competition between a new entrant(s) and NTA will depend (in part) upon financial ownership and operational restructuring of NTA. The experience of other countries in the Pacific is that, without restructuring and preparation for competition, the government-owned incumbent operator may struggle to compete effectively in a liberalized market. Investments will need to be made by NTA to prepare its systems for network interconnection and the supply of wholesale access services to competing operators. NTA has also indicated that it lacks access to adequate financing for infrastructure expansion, which it claims has limited its ability to increase access to services. Accordingly, the Government has agreed to examine options for greater private sector involvement in NTA to strengthen its operations and prepare it for competition. By selling down its stake, either partially or fully, the Government would also reduce or eliminate its direct fiscal exposure to the performance of NTA

in a competitive marketplace; this would permit it to focus on the macroeconomic benefits of developing the ICT sector as a whole.

5.15 The legal structure for submarine cable and terrestrial network ownership will be considered as part of the reform and restructuring of NTA which will be undertaken in the course of the Program. During Program implementation, the Bank will be providing technical assistance to the Government, (see description in paragraph 4.13 above), to consider options for splitting the submarine cable assets and the associated RUS loan from the NTA. One of such options could be vesting the assets and debt in a new government-owned entity that could function as an open access provider of international capacity, thus facilitating the operations of new market participants that the Communications Law supported by this operation seeks to foster. Moreover, the new Communications Law will empower the regulator to enforce open access to international connectivity at cost-based prices..

5.16 The overriding imperative of the sector reforms is to increase access to infrastructure and ICT services in the Marshall Islands. International experience demonstrates that nondiscriminatory (open) access to essential facilities and especially international connectivity services is a critical element that affects retail competition and access to ICT services by consumers. Accordingly, the Government will implement measures that deliver nondiscriminatory access to international connectivity services on the submarine fiber optic cable. At a minimum these measures must ensure that access to services by all access seekers is available on a competitively neutral basis.

5.17 Splitting the international connectivity assets out of NTA into a Government-owned open access vehicle is one possible mechanism to reduce or eliminate incentives (on the part of the owner of those assets) to favor one access seeker over another. An alternative is to provide for an open access regime as part of the regulatory environment, although this will require significantly greater regulatory oversight and intervention. International experience supports the view that regulatory solutions that seek to overcome economic incentives (i.e., combining essential network and retail assets within a single entity) of market participants are difficult to implement effectively.

5.18 The final step in connection with restructuring and liberalizing the ICT sector is the introduction of competition, which is satisfied when the licensing authority offers new license(s) on competitively neutral, nondiscriminatory terms, to at least one additional telecommunications operator to supply services to the public using its own infrastructure. Licenses will be issued through an open and transparent process. As part of the process of making available new licenses, the regulator will designate in the national table of frequency allocations specific blocks of spectrum in designated bands sufficient for new licensees to offer mobile wireless services.

VI. OPERATION IMPLEMENTATION

Poverty and Social Impacts

6.01 The lack of significant data constrains understanding of the likely impacts of telecommunications liberalization on poverty and social conditions in the Marshall Islands. Limited data are available regarding the nature and incidence of poverty in the Marshall Islands.

The most recent census was completed in 2010, but the results are not yet available. The only Household Income and Expenditure Survey was carried out in Marshall Islands in 2002. A Community and Socioeconomic Survey was completed in 2006, and a Demographic and Health Survey was carried out in 2007. These provide cursory information regarding the level and geographical incidence of poverty. No further detailed poverty surveys are currently scheduled. Without detailed household expenditure and income information it is difficult to quantify the effects that telecommunications liberalization will have on poverty. Globally, numerous reports, including the World Bank's ICT for Development Report (2010), cite economic impacts of telecommunications liberalization including growth of mobile and broadband Internet. A recent report on telecommunications liberalization in Vanuatu (Pacific Institute of Public Policy, 2012 (see www.pacificpolicy.org) gives an overview of broad economic and social benefits of sector reform, particularly, the rapid growth of mobile telephony; and the International Finance Corporation's analysis is ongoing for Fiji, Papua New Guinea, and Solomon Islands.

6.02 The proposed Program will support the provision of public services within challenging fiscal constraints. To adequately capitalize the CTF to sustainable levels by the time Compact grants expire, the Government will need to achieve fiscal surpluses of around five percent of GDP through 2016. While some scope exists for fiscal consolidation through improvements in the efficiency of public service delivery, it unlikely that this target could be achieved in the short-term without some reductions to financing of core public services. The budget support (amounting to almost five percent of total Government expenditure in 2010 under DPO 1) will help the Government of the Marshall Islands achieve its objectives for fiscal sustainability over the short-term, while not compromising service delivery, as options are explored through planned reform programs to improve the allocation and technical efficiency of Government expenditure. In the absence of such assistance, the government faces a difficult trade-off between substantial cuts in public service expenditure in the short-term against inadequate capitalization of the trust fund, potentially undermining future service delivery.

6.03 International evidence demonstrates the potential for ICT liberalization to support private sector development and job creation. The current level of performance by the ICT sector imposes high business and social costs, including the isolation of entire island communities and missed opportunities for economic and social development. The introduction of competition and the reform of NTA are expected to lead to lower costs for ICT services and to increase access to ICT services in the Marshall Islands. While the overall macroeconomic and growth impacts of telecommunications liberalization have not been the subject of detailed analysis in Pacific contexts, market-based reforms implemented in similar countries (including elsewhere in the Pacific), demonstrate strong links between market-based reforms and improved economic indicators for rural and isolated households through job creation and access to economic opportunities. In Vanuatu, where competition was introduced in the mobile telephony sector in 2007, rural and Outer Island respondents to a recent survey considered access to affordable mobile phone services to be essential for business activity, and something without which it would be difficult to continue sustaining business activities.

6.04 Reducing prices and increasing access will provide nonmonetary but economically significant benefits to poor households. There is strong evidence across the region of high willingness to pay for telecommunications access for noneconomic use. This indicates high social benefits to a wide range of household types from reducing costs and improving access. Market-based reforms can be expected to benefit poor households through reducing the drain on

constrained discretionary incomes from existing high charges, and providing a large consumer surplus to new users.

6.05 Improved ICT access will facilitate access to public and privately provided services. Access to lower cost and more reliable telecommunications following market-based reforms is likely to facilitate the provision of public services and increase equity of access between urban and rural areas. Improved access to telecommunications can reduce perceptions of household vulnerability in rural areas through providing direct lines of communication to health and law and order services. Improved rural access through market-based reforms can also facilitate greater access to financial services over the medium-term, depending on the introduction of supporting technologies, further supporting job creation and expanding economic opportunities.

6.06 Experience elsewhere suggests that employment levels in the incumbent, NTA, which currently stands at around 100 relatively skilled staff, may fall in the event of restructuring and skills realignment. However, employment opportunities in new entrants, the regulatory institution, and ancillary services will likely increase. Overall, the number of structural redundancies (i.e., individuals who are unable to transition to an alternative role within the ICT sector) is expected to be limited.

Environmental Aspects

6.07 The policy actions supported under the proposed Program would not have a negative effect on the Marshall Island's environment or natural resources. As presented, the Program is not likely to cause significant effects on environment, forests, and other natural resources.

Implementation, Monitoring and Evaluation

6.08 The existing institutional structure for aid management in the Marshall Islands will be used to implement and monitor the policy actions supported by the proposed Operation. The MoF will provide overall guidance for the budget support program, and will assume overall responsibility for coordinating the implementation, monitoring and evaluation of the proposed Operation. The MoF will also be responsible for reporting progress and coordinating actions among other concerned government agencies, including the MTC.

6.09 Specific indicators that the World Bank will monitor for the policy areas supported by the proposed Program are set out in Annex 2. The World Bank will work with the Government to assess progress in implementing the policy actions supported by the proposed Program, and to monitor the specific indicators associated with each of the policy areas. Through its ongoing dialogue with the Government, the World Bank will help to sustain the linkages between the policy actions under the proposed Program and the progress of the broader reform agenda. The World Bank will also play a role in supporting the Government as it seeks to coordinate the technical assistance that will be provided to further support the Government reform agenda for the ICT sector.

Fiduciary Aspects

6.10 Fiduciary risks remain high in the Marshall Islands. The country relies heavily on external funds and remains at risk from global factors, including rising prices of food and oil.

The Government is keen to improve public financial management and has undertaken taxation reform and modernization of the Public Financial Management Act.

6.11 The Republic of the Marshall Islands does not have a central bank, hence the IMF has not completed a fiduciary assessment. World Bank funds will thus be deposited into a designated account held in a commercial bank. On the other hand, the Marshall Islands uses the United States dollar as its currency so there is no foreign exchange risk (i.e., the United States dollar equivalent of funds disbursed are not converted into another currency).

6.12 Overall, the World Bank has judged the Government's commitment to public financial management improvements and its performance in implementing the public financial management reform program as showing adequate improvement. In this light, additional fiduciary arrangements are not considered necessary for this Operation.

Disbursement and Auditing

6.13 The proposed Operation would consist of a single tranche of SDR 2 million ($3 million equivalent) to be available upon effectiveness. The proposed Operation will follow IDA's disbursement procedures for development policy grants. Once the Operation becomes effective, and at the request of the Recipient, IDA will deposit the proceeds into a dedicated government account at the Government of Marshall Islands' bank which forms part of the country's foreign exchange reserves. As a due diligence measure, within 30 days of receipt, the Recipient will provide a written confirmation to IDA when the amount has been transferred to an account available to finance budgeted expenditures. Disbursement will not be linked to specific purchases. The proceeds of the Operation will not be used to finance expenditures excluded under the Agreement. If, after being deposited in a government account, the proceeds of the Operation are used for ineligible expenditures as defined in the Financing Agreement, IDA will require the Recipient to either: (a) apply the corresponding amount to eligible purposes, or (b) refund the amount directly to IDA. A designated account is required for this Operation.

6.14 The World Bank will request an audit of the designated account used to deposit the Operation funds which will give assurance of receipt of the disbursement through the designated account and into the budget management system of the Recipient at any time. In that event the Recipient would: (a) report the exact sum received into the deposit account and its supporting details; (b) indicate to the World Bank details of the designated bank account to which the equivalent of the disbursement proceeds would have been transferred; and (c) submit a report on receipts and disbursements for the designated account to enable the World Bank to review consistency of the withdrawal with the development financing agreement and achievement of the objectives of the Operation.

Risks and Risk Mitigation

6.15 The proposed Program carries six main risks, for which risk mitigation strategies have been adopted. These risks relate to: (a) the thin capacity of the public sector, (b) a change in political commitment to reforms, (c) implementation delays, (d) difficulties attracting private sector investment and sustaining effective competition, (e) fiscal risk, and (f) dependence on the continued availability of grants from development partners. These risks and the associated risk mitigation strategies are described below.

6.16 **The thin capacity of the public sector in the Marshall Islands poses a risk that the policy actions cannot be implemented as quickly or successfully as expected.** The new independent regulator will need to attract expert staff capable of regulating and administering the sector and implementing the new regulatory framework. Technical assistance, including knowledge transfer and capacity-building efforts, will be mobilized in order to increase local institutional capacity. This may need to be in a "substitution" role in the short-term.

6.17 **There is a risk of change in political commitment and opposition from the incumbent operator to the move from monopoly to competition.** This risk is being mitigated through: (a) continuous consultation and awareness-raising around benefits of competition, including improved access and increased affordability of services; (b) strong commitment from the Government to the reform program; and (c) Government support to the incumbent to assist it to restructure and prepare to compete effectively in an open market.

6.18 **Delays or partial implementation of the priority reforms will jeopardize the entire reform process.** The existing law guarantees NTA a monopoly on supplying switched telecommunication services. Termination of this monopoly through the new legal framework is an essential step that must be completed before competition may be introduced. This risk will be mitigated through the provision of technical assistance with the drafting of a new and modern communications law that supports market liberalization and sector regulation.

6.19 **Difficulties attracting private sector investment and sustaining effective competition.** The Marshall Islands is a very challenging environment for the private sector due to, *inter alia*, its remoteness and dispersed geography, small population, and public and private sector capacity constraints. This risk will need to be mitigated through broader measures to improve the investment climate in the country as a whole. For the ICT sector, this risk can be reduced through designing a legal and regulatory framework in such a manner that it: (a) maximizes the attractiveness of the ICT sector as an investment destination; and (b) provides a regulatory environment that supports effective competition and provides mechanisms for best practice for regulating a monopoly service provider. In addition, flexibility will be needed depending on how the market responds to the proposed reforms. For example, a "regulated monopoly" which seeks to mimic the effects of competition is one possible approach in the event that a second mobile operator does not enter the market in the short- to medium-term post-liberalization.

6.20 **Fiscal risk for Government.** The Government currently holds an approximately 70 percent interest in NTA. It currently faces fiscal risk in the event that NTA is unsuccessful in the market. Government also incurs contingent liabilities under guarantees it has provided to external lenders to NTA, particularly the approximately $29 million owned to RUS under the loans made to NTA in 1989 and 2010. The Program identifies a number of policy initiatives, including restructuring NTA to improve its viability, investigating options for reducing the risk of requirements for government financial support of NTA, and undertaking reforms to ensure that revenues from international connectivity increase to meet the capital and operating expenses associated with the submarine cable. This work will be supported through the provision of technical assistance.

6.21 **Dependence on continued availability of grants**. The dependence of the Marshall Islands' macroeconomic framework on the continued availability of grants from development partners poses the risk that delays in the receipt of grants may lead to cash flow problems that

undermine budget execution, impede the normal functioning of government, and divert attention from the reform agenda. At the Government's request, this risk has been mitigated by the World Bank's efforts to coordinate the support of development partners for a joint, multiyear reform matrix.

ANNEX 1: GOVERNMENT LETTER REGARDING ICT SECTOR DEVELOPMENT

REPUBLIC OF THE MARSHALL ISLANDS
OFFICE OF THE MINISTER OF FINANCE
MINISTRY OF FINANCE
P.O. Box D ~ Majuro ~ Marshall Islands ~ 96960
Phone No. (692) 625-7017~ Fax No. (692) 625-3607~ Email Address: dennismomotaro@yahoo.com

June 13, 2012

Mr. Robert Zoellick
President
The World Bank
Washington D.C., DC, 20433
United States of America

Dear President Zoellick,

Letter of Development Policy

The Government has chosen to embark upon ICT sector reform as an essential component of our vision for broader economic and social development in the Marshall Islands. Our long-term development objectives are set out in "*Vision 2018*", the Marshall Islands Strategic Economic Development Plan for 2003-2018, which was developed through an extensive consultative process starting with the Second National Economic and Social Summit and followed by extended deliberations by various Working Committees established by the Cabinet. The Government has also developed Master Plans, pursuant to Vision 2018, which focus on major policy sectors: Human Resources Development, Outer Islands Development, Culture and Traditions, Environment, Resources and Development, Information Technology, Private Sector Development, Infrastructure, and Tourism. Vision 2018 recognizes the critical role of ICT in the Marshall Islands' future economic development. ICT is a key ingredient in connecting people to each other and to vital services that underpin economic and social wellbeing. Consequently, the Government is committed to fostering the development and use of affordable, reliable ICT services in the interests of all of the people of the Marshall Islands.

The Marshall Islands faces a number of acute economic challenges and the introduction of policies designed to increase access to ICT services is a core element of the Government's response to these challenges. Affordable and reliable ICT services are a fundamental input for enhanced economic growth and development, particularly in the underserved and remote areas of the Marshall Islands. International experience, particularly in developing countries, shows that telecommunications are an essential input for other sectors, for the creation of wealth and jobs, and for improving access to essential public services, such as education and health, noting that penetration and usage must be significant or high for tangible results. Reliable and affordable ICT services support business development in all sectors, including small and medium enterprises. The social value of widely available communications is also very important and helps to facilitate a more mobile work force, enabling family and community links to be preserved despite distance, and assisting interaction between islands and communities. The Government is already

developing programs and services for the wellbeing and personal development of our citizens, particularly for health and education, and the increased availability of ICT services will help support the development and functioning of these services. Effective use of ICT by government will increase the ability of Marshall Islands people to access government services, participate in government initiatives and support the democratic process.

The Marshall Islands is one of the least "connected" countries in the world, with around 35 percent of the population subscribing to ICT services. Only a small proportion of households have landlines, mostly in Majuro. Internet access is only available over landlines, and mobile broadband has not yet been introduced. Mobile phone penetration is around 26 percent of the population. Less than 2 percent of the population subscribe to an Internet connection, with only 500 subscribers accessing a broadband connection. The main reasons for the limited and costly service include the high costs of connecting remote and sparsely populated islands and the monopolistic market structure. Geographical features and population dispersion present significant challenges for the provision of modern affordable telecommunications services, principally due to remoteness, small populations, low income and the lack of other supporting infrastructure, particularly electricity. Nevertheless, modern mobile solutions designed specifically for developing countries present economically viable ways to expand services in RMI. Reforms implemented in similar countries, including elsewhere in the Pacific such as Fiji, Samoa, Solomon Islands and Vanuatu, demonstrate linkages between market-based reforms and improved economic and social indicators. The Government believes that there are a number of commercially viable opportunities for the private sector in the Marshall Islands, including for a second mobile operator.

The Program consists of three ICT Sector Development Operations covering the period 2012-2016. The first operation (US$3 million IDA Grant) will focus on the basic policy and regulatory foundations for ICT sector reform and on an investigation of the feasibility of splitting the submarine cable assets and a related United States Department of Agriculture's Rural Utilities Service loan out of the incumbent monopoly operator, the National Telecommunications Authority (NTA). The second operation (US$5 million IDA Grant) will focus on key enabling legislation, the establishment of the new sector regulator, the adoption of a plan for restructuring of NTA, and the allocation of spectrum for new mobile operators. The third operation (US$5 million IDA Grant) will focus on new licensing and market entry, the commencement of regulatory functions, and further strengthening of the ICT sector enabling environment, with a particular emphasis on facilitating access to ICT in outer islands. The Government has elected to follow this programmatic approach due to the gradual nature of the policy, legal, institutional and structural reforms that will need to be implemented and appropriately sequenced to meet the Development Objective of increasing the availability of ICT services. Moreover, the proposed multi-year programmatic series of operations will assist the Government to implement key aspects of our reform agenda, while providing a predictable flow of financial resources.

The proposed sector reforms are focused on increasing private participation and investment in the provision of ICT services, strengthening NTA, and moving the sector towards competition. The Government recognizes that changes are needed in terms of market structure, regulation and the capacity of institutions to lead and implement the Government's vision for the sector. Accordingly, the Program has been designed around supporting five guiding principles that underpin the objectives of the Government's approach to ICT sector reform. These principles are: (1) open and competitive markets; (2) modern, independent and proportionate regulation; (3) non-discrimination and technology neutrality; (4) optimal use of scarce resources; and (5) universal service for remote areas of RMI. The Government is looking to these principles to encourage and facilitate entry of a variety of competing infrastructure and service providers and deliver the best outcomes for the Marshall Islands. The promotion of universal service, in particular, is a critical component of these reforms. The Government is focused on ensuring

that access to a minimum standard of voice calling and Internet is available, to the greatest extent feasible, to all of the people of the Marshall Islands. Our people living outside the main centers must share in the transformational opportunities which ICT can deliver.

The Program draws upon the analytical and advisory assistance that the World Bank has already provided to the Government, with funding from the Australian Agency for International Development (AusAID) through the Pacific Region Infrastructure Facility (PRIF), on (a) ICT sector development options and strategy issues; and (b) policy reform and development. We are pleased to benefit from the lessons learned by countries from implementing similar reforms in the Pacific region and other comparable countries. I would also like to acknowledge the funding support from PRIF, which will be implemented by the World Bank over the next 12 – 24 months, for the development of policy, legal and regulatory reforms needed to complete this Project. The Government is firmly committed to implementing this reform program and looks forward to the continued engagement of the World Bank in the Marshall Islands in order to support this reform process.

The Government has elected to pursue a Development Program Operation as the most appropriate mechanism to support the provision of public services within challenging fiscal constraints. No Compact financing is assured beyond the life of the current arrangement and the prospective end of Compact funding presents a key challenge to fiscal sustainability. To prepare for this eventuality, a Trust Fund has been established to replace Compact grants from 2024. But based on current projections, contributions to the Trust Fund are inadequate to assure a smooth transition and annual Compact Trust Fund income will fall US$15.4 million short of what is needed to replace expiring Compact grants in 2024. To adequately capitalize the Compact Trust Fund to sustainable levels by the time Compact grants expire, the Government will need to achieve fiscal surpluses of around 5 percent of GDP to 2016. While some scope exists for fiscal consolidation through improvements in the efficiency of public service delivery, it unlikely that this target could be achieved in the short-term without some reductions to financing of core public services. The budget support will help the Government of the Marshall Islands achieve fiscal sustainability objectives over the short-term, while not compromising service delivery as options for improving the allocative and technical efficiency of government expenditure are explored through planned reform programs. In the absence of such assistance, the government would face a difficult trade-off between substantial cuts in public service expenditure in the short-term against inadequate capitalization of the Trust Fund, potentially undermining future service delivery.

On behalf of the Government of the Marshall Islands, I would like to thank you for your assistance and emphasize that we are looking forward to the opportunities presented by the proposed operation.

Yours sincerely,

Hon. Dennis Momotaro
Minister of Finance

ANNEX 2: ICT SECTOR DEVELOPMENT PROGRAM: POLICY MATRIX

Policy Area	Baseline	Prior Actions for DPO 1	Triggers for DPO 2	Triggers for DPO 3	Target End DPO 3	Medium-term Outcomes
1. Pro-competitive ICT Sector Policy	Inadequate ICT sector planning. No policy outlining the Government's vision for sector development.	The Recipient has endorsed a new ICT sector policy and committed to liberalize the ICT sector introducing a modern legal and regulatory framework in the Recipient's territory and restructuring NTA	Sector policy adopted setting out the Government's vision for the ICT sector and providing a roadmap for (a) implementing a new legal framework, and (b) introducing competition.			**Sector specific outcomes** An open and competitive ICT market Universal access program for supporting the services that are not viable on purely commercial terms, including on the Outer Islands. Increase in access to ICT services offered on Outer Islands (without coverage under the Baseline scenario) Reduction in prices of core ICT services (local, international calls and Internet services)
2.Strengthened Legal and Regulatory Framework	Inadequate ICT sector legal and regulatory framework. Existing laws prohibit competition and provide inadequate mechanisms for oversight of service outcomes.	The Recipient has, through the Office of its Attorney General, prepared, satisfactory to the Association, a draft Communication Bill backstopping the new ICT policy framework adopted by the Recipient.	New legal and regulatory framework enacted (a) encouraging private-sector led investment, including mandatory (cost-based) passive infrastructure sharing; and (b) prescribing a modern licensing framework permitting the introduction of competition. Independent ICT sector regulator established with authority to regulate multiple operators. Spectrum management plan, numbering plan,	Modern numbering plan adopted and lodged with the ITU that has adequate number-space for the introduction of new services, including mobile wireless services. Access to all international cable capacity (and international communications services) in the Marshall Islands offered to all access seekers on a (cost-based) nondiscriminatory,		**Broader outcomes** Government subsidies towards NTA's operating costs reduced or eliminated Increased availability of value-added services such as mobile phone-enabled banking (e.g., for remittance transfers), e-commerce, and, potentially, online government services Improved communications facilities for schools (including Internet access to all schools nationwide), clinics and government offices

Policy Area	Baseline	Prior Actions for DPO 1	Triggers for DPO 2	Triggers for DPO 3	Target End DPO 3	Medium-term Outcomes
			interconnection regime, and dispute and mediation procedures adopted. Specific blocks of spectrum in designated bands sufficient for new licensees to offer mobile wireless services designated in the national frequency allocations table.	open access basis that does not favor one licensee over another.		
3.ICT sector restructured and liberalized	No competition for the supply of ICT services. Approximately 35 percent of the population subscribes to ICT services. Mobile phone penetration is approximately 26 percent of the population. Approximately 2 percent of the population subscribe to an Internet connection. Total broadband Internet take-up is approximately 1		Government approves a financial, ownership, and operational restructuring plan for NTA. Any remaining exclusive rights in connection with the supply of ICT infrastructure or services in the Marshall Islands are terminated subject only to the power of the regulator to issue licenses. The submarine cable, the associated landing station and international gateway, and the debt owing to RUS in connection with the construction of the submarine cable are	New licenses offered permitting at least a second national mobile operator to supply services to the public using its own infrastructure.	Increase in the level of competition in the ICT sector to 2 licensees (assumes increase in the number of Internet service providers) Percentage of population with access to ICT services on Outer Islands (without coverage under the Baseline scenario) increases. Reduction in prices of core ICT services (mobile and fixed local and international calls; Internet services).	

Policy Area	Baseline	Prior Actions for DPO 1	Triggers for DPO 2	Triggers for DPO 3	Target End DPO 3	Medium-term Outcomes
	percent of the population. Access to ICT services offered on Outer Islands Baseline prices for ICT services: Local calls (mobile) International calls Monthly Internet subscription (128kbps)		separated from the vehicle carrying out the retail operations previously conducted by NTA and vested in a Government-owned entity. Should this form of separation not be feasible, the new Communications Law will empower the regulator to enforce open access to international connectivity at cost-based prices.			

ANNEX 3: FUND RELATIONS NOTE

Preliminary Conclusions of the 2012 Staff Visit

November 7, 2012

This statement summarizes the mission's preliminary views and policy recommendations based on meetings in Majuro from November 5–7, 2012. This year's staff visit takes stock of the economic developments since the 2011 Article IV consultation amid increasing uncertainties surrounding the global economy.

The economy of the Republic of the Marshall Islands (RMI) experienced an impressive recovery in FY2010 from the recession in preceding years, but the rebound proved short lived. After a 5½ percent expansion in FY2010, helped by an expanding fishery sector, growth fell sharply to 0.8 percent in FY2011, as a result of high commodity prices, labor shortages, and delay in the airport renovation project due to disagreement on the environment protection standard to be applied. Inflation remained elevated at 5½ percent in FY2011, reflecting high commodity prices. The economy is heavily dependent on foreign grants which fund a large public sector.

Selected Economic Indicators

	FY2009	FY2010	Est. FY2011	Est. FY2012	Proj. FY2013
		(year-on-year changes)			
Real GDP	-1.5	5.6	0.8	1.9	2.3
CPI	0.5	1.8	5.4	5.7	3.9
		(in percent of GDP)			
Overall Fiscal Balance	1.4	4.6	3.7	-1.1	-0.1

Source: RMI Authorities and Fund staff estimates.

In the near term, staff estimates that growth will remain weak. GDP growth is projected at 1.9 percent in FY2012 and expected to stay around 1½ percent over the medium term. Resumption of the airport renovation project after the agreement between the U.S. and RMI government on the environment standard, and the planned Ebeye water and sanitation project to be funded by the Australian Agency for International Development and administered by Asian Development Bank (ADB), along with rising fish exports, will render support to the growth in the near term, but will be largely offset by shrinking public sector demand from declining Compact grants. Inflation will gradually decline from 5.7 percent in FY2012 as the effect of commodity prices increase tapers off, and is expected to approach 2 percent in the medium term.

Risks to the outlook are on the downside, with a further global slowdown affecting exports, foreign direct investments and non-U.S. grants. The economy's high import dependence poses a substantial risk to real incomes from fluctuations in commodity prices and private foreign direct investment. On the upside, possible satellite upgrading project in the Kwajalein military base and airport renovation projects in outer islands could provide some additional support to growth over the next several years.

The fiscal balance is estimated to turn into a deficit in FY2012, according to the latest available data to the authorities. Although the FY2012 budget outturn data are still being finalized, the deficit is likely to be about $2.0 million (1.1 percent of GDP), compared to the surplus of 3.7 percent of GDP in FY2011. While budgeted current expenditure has been contained relative to GDP in recent years, volatile domestic revenue, declining foreign grants, and occasional off-budget spending by ad-hoc directives pose constant threats to maintaining fiscal surpluses. Financial assistance to SOEs in the form of subsidy and capital transfer remains sizable.

With the expiry of Compact grants looming in FY2023, achieving long-term budgetary self-reliance and sustained growth is becoming an even more urgent task for the RMI. The Compact Trust Fund (CTF), established in FY2004 to accumulate financial assets to generate sufficient investment income to offset the impact of Compact grants expiry in FY2023, had a lackluster investment performance in FY2011 and its trajectory of asset accumulation is well below the level needed to achieve self-sufficiency. Under the baseline projections, staff estimates a large revenue gap—the difference between expiring grants and CTF income in 2024—of about $10.9 million in 2011 prices, raising a significant challenge for the economic and fiscal viability of the RMI.

A steady and decisive fiscal adjustment is required to avoid a disruptive fiscal shock in FY2024. To generate cumulative savings in the Trust account large enough to avoid the projected large revenue gap in FY2024, the government would need to build up a fiscal surplus of 6.0 percent of GDP (about $10.2 million in 2011 prices) by FY2017, which would then need to be maintained until FY2023.

Submission of the tax reform bill to the Nitijela (Parliament) in September 2011 is a very positive step towards self-sufficiency. The mission believes that early implementation of the tax reform bill—with a modernized net profit tax and consumption tax—will make the RMI economy more business friendly, and looks forward to the passage of the tax reform bill envisaged in January 2012. While no strong oppositions from the public to the proposed tax reform are perceived so far by the authorities, it is important to step up public outreach to gain public buy-in. The mission also encourages the authorities to undertake the required revenue administration changes in parallel so as to implement the reform as planned once the bill is approved by the Nitijela.

On the expenditure side, it is critical to maintain the announced policy of containing public wage growth and reducing allowances. The targeted expenditure cuts could include rationalization of public payroll through workforce planning, limiting financial

support to SOEs, and reducing excessive allowances to civil servants and public officials. In this context, the recommendations of the Comprehensive Adjustment Program (CAP) group, which were approved by the cabinet, could provide a valuable guidance on feasible options of expenditure cuts.

It is important to protect the benefits of reform through a strong institutional framework. While the improved tax collection and enforcement is a welcome development, further efforts to identify unreported tax liabilities as well as progress on the public finance management would be needed to complement the reform process. In this context, the mission strongly encourages the authorities to devise a framework that ensures that unexpected revenue increases are transferred into the CTF.

There is an eminent need to reform SOEs. The level of subsidy and capital transfer to SOEs amounted to over $8 million per year on average during the FY2009-FY2011 period. Recognizing the need to reform SOEs and reduce their fiscal strain on the budget, the Cabinet endorsed a set of good practice principles and a new SOE act was introduced into the Nitijela in September this year. The mission encourages the authorities to advance the SOE reform to address key issues of governance, disclosure, corporate planning, and pricing in selected SOEs, with the assistance of the ADB as needed.

Social security liabilities continue to constitute a sizeable contingent fiscal risk. The 2011 financial statements of the Marshall Islands Social Security Administration (MISSA) identify $222 million of unfunded liabilities (130 percent of GDP). In light of the unsustainable financial situation, the mission encourages swift preparation of a bill to reform the social security system. Reform options could include an increase in contribution rates, a revision of benefit structure, an increase in the standard retirement age, and a lengthening of the minimum contributions period.

To ensure the stability of banking sector, the mission encourages the authorities to place the Marshall Island Development Bank (MIDB) under appropriate supervision in line with international best practices. The MIDB continues to extend its consumer lending without being monitored or regulated by the appropriate authorities. This poses a significant risk to its capital base and to the government as its sole owner. The mission also supports an early modification of the Banking Act to strengthen bank supervision.

The RMI is facing a wide range of challenging reforms and those reforms cannot be carried out and sustained without broad-based support of the public. The mission encourages the authorities to step up its efforts to better communicate the benefit of reforms to the people of the RMI.

The mission would like to thank the authorities for their hospitality and thank members of the government, private sector, and civil society for the fruitful discussions.

Table 1. Marshall Islands: Basic Data, FY2008–13 1/

Nominal GDP for FY2011 (in millions of U.S. dollar): 170.7

Population (2011): 52,158

GDP per capita for FY2011 (in U.S. dollar): 3,212

Quota: SDR 3.5 million

	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$; end of period)	75.7	90.9	112.8	125.2	165.7	192.6
Commercial banks (in millions of US$)						
Foreign assets	57.1	63.6	71.8	71.9	73.2	…
Private sector claims	58.2	62.0	63.3	60.2	61.1	…
Total deposits	89.0	93.3	102.1	98.2	100.0	…
One-year time deposit rate (in percent)	3.6	6.0	3.5	3.5	3.5	…
Average consumer loan rate (in percent)	18.5	13.9	14.0	14.0	14.0	…
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

Note: the Article IV Missions to Marshall Islands are on a 24-month cycle

Sources: RMI authorities and Fund staff estimates.

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 AsDB.

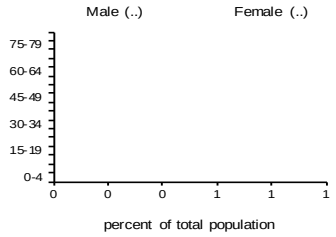
ANNEX 4: COUNTRY AT A GLANCE

Marshall Islands at a glance

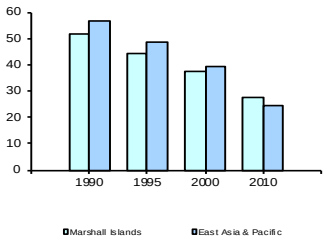
2/12/13

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

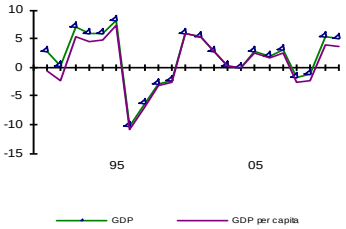


Under-5 mortality rate (per 1,000)



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					1980–90	1990–2000	2000–11
					(average annual growth %)		
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$)	1.0	1.0	1.0	1.0			
Terms of trade index (2000 = 100)	..	..	..	..			
Population, mid-year (millions)	0.0	0.0	0.1	0.1	4.4	1.0	0.5
GDP (US$ 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).

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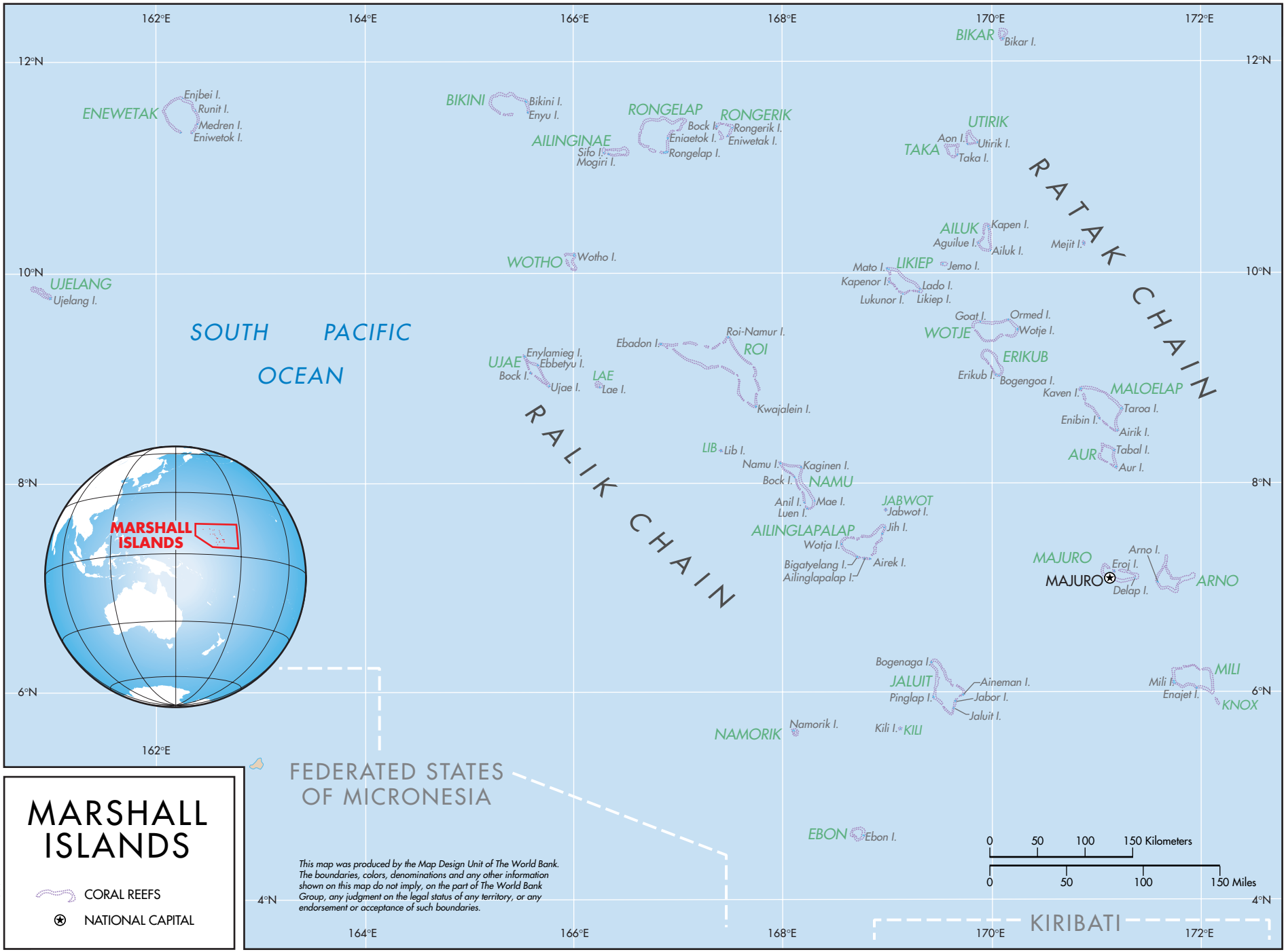

MARSHALL ISLANDS

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MARCH 2005

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