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REPUBLIC OF THE MARSHALL ISLANDS

Selected Issues and Statistical Appendix

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Approved by Asia and Pacific Department

May 9, 2008

Contents Page

I. Compact Trust Fund and Long-Term Fiscal Sustainability....3
A. Compact Trust Fund: Background....3
B. 2023: Judgment Day....5
C. What Is To Be Done?....7
D. Conclusions....13
References....15

II. Strengthening the Tax Regime in the Marshall Islands....16
A. Tax Revenue in RMI....16
B. Weaknesses in the Current Tax Regime....17
C. Reform Efforts....21
D. The Way Forward....21
E. Conclusions....23
References....24

Boxes

I.1 Structure of the Compact Trust Fund....4
II.1 Tax Regime....18
II.2 Estimates of Tax Revenue Loss from Non-Compliance....20

Figure

I.1 Long-Term Fiscal Adjustment Scenarios: FY2007–30....12

Statistical Appendix Tables

1. Gross Domestic Product, FY2003–07 25
2. Copra Production, Producer Prices, and Export Unit Values, 2003–07 26
3. Majuro Consumer Price Index, 2005–08 27
4. Employment by Sector, FY2003–07 28
5. Balance of Payments, FY2003–08 29
6. Exports by Product Category, 2003–07 30
7. External Debt and Debt-Service Obligations, FY2003–08 31
8. Central Government Finances, FY2003–08 32
9. Central Government Current Expenditure, FY2003–08 33
10. Assets and Liabilities of Deposit Money Banks, FY2003–07 34
11. Interest Rates of Deposit Money Banks, 2003–07 35

I. Compact Trust Fund and Long-Term Fiscal Sustainability[1]

1. **The Compact Trust Fund (CTF) is the cornerstone of the Marshall Islands' future.** The Republic of Marshall Islands (RMI) is highly dependent on foreign grants, primarily those that are provided under the Compact of Free Association Agreement with the United States.[2] The Compact agreement stipulates that grants will steadily decline, and will be eliminated after 2023. After that, the CTF will be the main financial asset of the RMI, and the CTF income will be the key source of revenue for the RMI budget. It is therefore important to know whether the CTF proceeds after 2023 will be sufficient to replace the Compact grants.

2. **This chapter analyzes several different scenarios, to assess the likelihood of the RMI achieving budgetary self-sufficiency by 2023.** Section A provides the background information on the CTF, and describes its performance to date. Section B presents the baseline scenario, which shows that the CTF is not likely to be sufficient to replace Compact grants after 2023. Section C then analyzes various options that could help increase the CTF balance, and thereby to strengthen the RMI's fiscal position. The options include seeking additional financial support from the donors, securitizing future U.S. contributions to the CTF, pursuing a more aggressive investment strategy, and running budget surpluses to put additional reserves into the CTF. The analysis shows that options that do not involve decisive policy action can somewhat improve the situation, but will not resolve it. The chapter concludes that fiscal consolidation is a difficult, but necessary step to achieve budgetary self-sufficiency by 2023.

A. Compact Trust Fund: Background

3. **The CTF was established in 2004, as part of the amended Compact of Free Association Agreement with the United States (Box I.1).** The CTF is incorporated in the District of Columbia as a nonprofit corporation and is governed by the CTF committee, with the United States holding the majority of votes.[3] The committee's responsibilities include overseeing the fund's operation, supervision, management and investment. The trust fund committee also appoints a trustee, who has the entire care and custody of all of the assets, and an independent auditor, to audit the fund at appropriate intervals. In addition, the

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[1] Prepared by Dmitriy Rozhkov (ext. 39745).

[2] In FY2007, foreign grants accounted for about 62 percent of total revenue of the RMI budget. Compact grants accounted for about two thirds of total foreign grants.

[3] The CTF Committee consists of 7 members. Four members represent the United States, two represent the RMI government, and one represents Taiwan Province of China.

committee has the authority to appoint one or more investment advisers, who may engage in a separate agreement with one or more money managers.[4]

Box I.1. Marshall Islands: Structure of the Compact Trust Fund

The CTF consists of four interrelated accounts, labeled “A”, “B”, “C”, and “D”.

A Account forms the trust fund “corpus” and contains the RMI’s initial contribution as well as the U.S. contribution and any contribution from other donors. It also consists of income from the fund’s investment up to 6 percent per annum. Any annual investment income that exceeds 6 percent is deposited in the “C” account. At end–2007, the A account slightly exceeded $ 93 million.

B Account will be created in 2022 and used to disburse income after the compact grants come to an end.

C Account was created at the same time as the A account and was designed as a buffer against low or negative annual investment returns. Any annual income on the fund exceeding 6 percent will be deposited in this account.

D Account is an optional account created to hold contributions by the RMI from unanticipated sources, such as revenue surprises and additional grants from donors. The D account must be a separate account and not mixed with the rest of the trust fund; it is not part of the corpus of the trust fund. This account reached $ 3.6 million by end–2007.

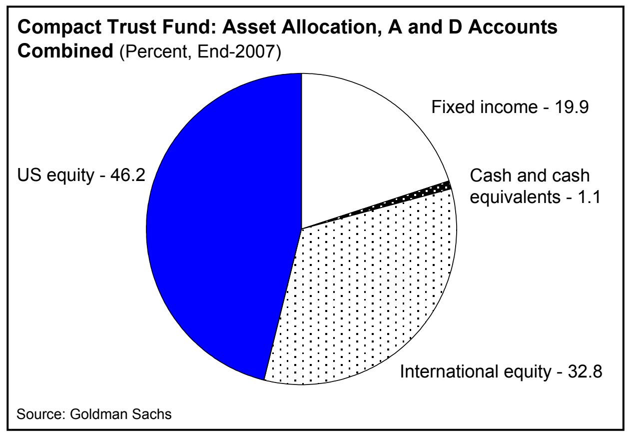
4. **The purpose of the CTF is to create an income stream to replace (partially or fully) the Compact grants after FY2023, permitting the RMI to achieve budgetary self-sufficiency.** According to the Compact agreement with the United States, the Compact grants will decline by $0.5 million per year. At the same time, the United States’ annual contribution to the CTF started with $7million in FY2004, and is scheduled to increase by $0.5 million per year until FY2023, with a partial adjustment for inflation. In FY2024, the Compact grants and the United States’ contributions to the CTF will terminate.

5. **The CTF has received contributions from the governments of the RMI, the United States, and Taiwan Province of China.** The RMI government has made a contribution of $30 million during FY2004–06. The United States made the scheduled contributions in FY2004–08, in line with the Compact agreement. In FY2005, Taiwan Province of China contributed $5 million to the CTF, and has pledged to further contribute $2.5 million per year until FY2023.

[4] Further details on the setup and governance arrangements of the CTF can be found in N’Diaye (2006).

6. **The full establishment of the CTF has been delayed.** Although a trustee and an investment advisor were appointed early on, an auditor had not been appointed until early 2008. This reflected a disagreement between the trustee and investment advisor over the assignment of custodial rights. As a result the investment advisor could not appoint a money manager, so funds invested in stocks had to be limited to index funds. Furthermore, the Trust Fund committee had not yet provided an annual report, although the RMI government has indicated its willingness to disclose information about the performance of the CTF, including reporting its performance in the annual Budget Statement.

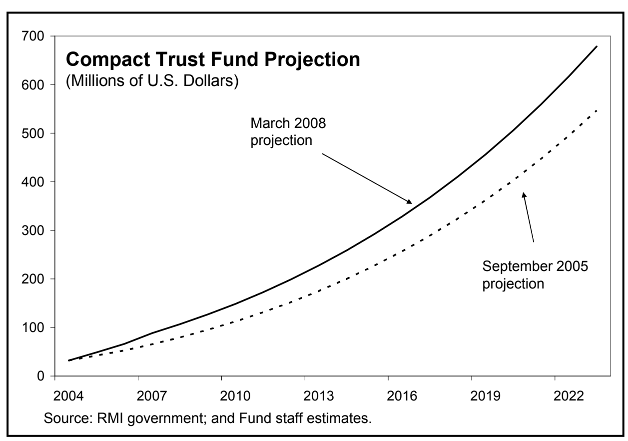
7. **At present, the CTF is fully invested in a relatively diversified portfolio.** Before 2006, the CTF was invested in a simple money market account. At end–2007, its portfolio consisted of cash equivalents, fixed income securities, and U.S. and international stocks. Almost 80 percent of CTF balance was invested in stocks. In early 2008, the dispute between the trustee and investment advisor over custodial rights was resolved, allowing the investment advisor to pursue a more active investment strategy.



8. **The CTF reached $96.8 million by end–2007.** Driven by the surging equity and real estate markets, the returns on the CTF were very strong in FY2006 and FY2007, over 10 percent on average. In the first quarter of FY2008 the returns on the CTF were negative, following the declines in the U.S. and global equity markets. However, available information indicates that the CTF was able to avoid investments in subprime mortgages.

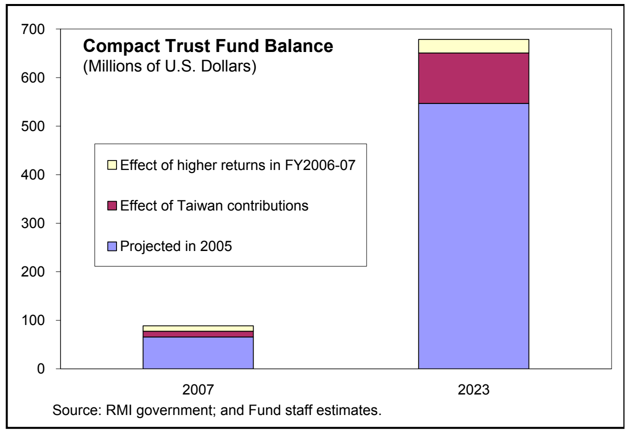
B. 2023: Judgment Day

9. **Staff projections show that the CTF can be expected to grow to $680 million by the end of FY2023.** These projections assume that the fund receives no new contributions from any donors, beyond what has already been pledged by the United States and Taiwan Province of China. It is also assumed that the annual returns on the CTF average 6 percent in nominal terms between now



and FY2023,[5] and that the U.S. inflation is equal to 2.4 percent per year on average over that period.[6]

10. **The projected balance for end–FY2023 is significantly higher than a similar projection made 3 years ago, when the CTF was being set up.** The difference is mainly due to the substantial contributions from Taiwan Province of China, and to a lesser extent to the high returns on the CTF that were achieved in FY2006 and FY2007. This underlines the importance for the RMI of receiving the future pledged contributions from Taiwan Province of China, and of seeking further contributions from other potential donors.



Compact Trust Fund: The Baseline Scenario

	(In millions of U.S. dollars)
CTF in 2023	678.6
Compact grants in 2023	47.0
CTF earnings available for withdrawal 1/	24.5
Annual surplus (+) or shortfall (-) 2/	-22.5

Source: Fund staff estimates.

1/ Maximum amount that can be withdrawn, so that the real value of the CTF does not decline.

2/ Calculated as earnings available for withdrawal minus the Compact grants in 2023.

11. **However, the CTF balance may not be enough to fully replace Compact grants in FY2024.** Given the terms of the Compact agreement (and assuming annual U.S. inflation of 2.4 percent), the annual Compact grants are projected to reach $47 million in FY2023. These grants will then terminate in FY2024, and will need to be replaced from other sources. Assuming the nominal returns on the CTF of 6 percent per annum, the fund's investment earnings are projected to reach $41 million in FY2024, $6 million short of the amount

[5] This assumption on nominal returns is similar to the assumption made in GAO (2007).

[6] This scenario also assumes that the RMI government is able to maintain a small fiscal surplus of about ½ percent of GDP, which would be necessary to make the scheduled debt payments over the medium term (see IMF Staff Report for the 2008 Article IV Consultation with Marshall Islands). This surplus, however, is not sufficient for the RMI government to make any additional contributions to the CTF.

needed to replace the grants. However, in order to preserve the real value of the fund, the RMI government would not be able to withdraw the full amount of the CTF's earnings to pay for annual budget expenditures. The maximum amount that can be withdrawn, so that the real value of the CTF is kept constant, can be calculated as

$$(CTF_{2023} - x)(1+i) = CTF_{2023}(1+\pi)$$

$$x = CTF_{2023}\frac{i-\pi}{1+i}$$

where x is the maximum amount that can be withdrawn, i is the annual nominal rate of return (assumed to be 6 percent), and π is the rate of inflation (assumed to be 2.4 percent). With these assumptions, x is equal to \$24.5 million. Therefore, in FY2024 the RMI government would need to either start eroding the real value of the CTF, with the prospect of eventually depleting the fund, or face the budgetary shortfall of \$22.5 million (equivalent to about 16 percent of projected budget expenditures in FY2023).

C. What Is To Be Done?

12. **This section considers various scenarios that could increase the CTF balance in FY2023, and therefore help the RMI to achieve fiscal sustainability at that time.** First, scenarios that do not require any significant policy action from the authorities are considered. Then, the last part of the section looks at the scenario that involves a substantial fiscal consolidation, in order to achieve sustained budget surpluses that can be used to add reserves to the CTF.

Alternatives that do not involve policy action

Additional contributions to the CTF

13. **The most straightforward way to boost the CTF would be through increased contributions from donors.** This could potentially include larger contributions from the United States or Taiwan Province of China, or persuading new donors to contribute to the fund.

14. **However, staff projections show that a very significant additional contribution would be needed to achieve fiscal sustainability after FY2023.** For example, if we continue to assume nominal returns of 6 percent on the CTF, an additional \$2.5 million contributed every year between FY2010 and FY2023 would increase the CTF balance in

FY 2023 by about $56 million.[7] The amount available for budget expenditures (keeping the CTF constant in real terms) will then increase by only $2 million, significantly less than the $22.5 million shortfall. In fact, projections show that even an extra $20 million a year would not be sufficient to cover fully the shortfall. To achieve fiscal sustainability through donor support, the CTF will need to receive either an additional $25 million per year for fourteen years from FY2010 to FY2023, or a lump-sum payment of $280 million in FY2010. Both alternatives appear equally unrealistic.

Compact Trust Fund: Alternatives Without Policy Action

	CTF in 2023	CTF earnings available for withdrawal 1/	Annual surplus (+) or shortfall (-) 2/
		(In millions of U.S. dollars)	
Baseline scenario	678.6	24.5	-22.5
I. Additional contributions to the CTF			
$2.5 mln per year from FY2009	734.7	26.4	-20.5
$5 mln per year from FY2010	790.4	28.5	-18.5
$20 mln per year from FY2010	1140.3	42.8	-4.2
$280 mln lump-sum in FY2010	1311.7	47.2	0.3
II. Securitization of future contributions 3/	707.8	25.5	-21.5
III. Higher returns on CTF investments			
7 percent per annum	754.7	34.7	-12.2
8 percent per annum	840.3	47.1	0.1

Source: Fund staff estimates.
1/ Maximum amount that can be withdrawn, so that the real value of the CTF does not decline.
2/ Calculated as earnings available for withdrawal minus the Compact grants in 2023 of $47 million.
3/ Securitization scenario is described in the text.

Securitization of future contributions to the CTF

15. **Another possible method to augment the CTF is to securitize the future contributions.** This method has been used by some international development institutions,

[7] The amount of $2.5 million per year is used in this example, because it implies the existence of a new donor with contributions equal to those of Taiwan Province of China, and an amount larger than that does not appear realistic. Similarly, the period starting from FY2010 is used, because currently there are no new donors that expressed willingness to contribute to the CTF, and FY2010 is probably the earliest period when any extra money can be expected.

and was also suggested in GAO (2007).[8] Ketkar and Ratha (2001) also argued that in some circumstances, securitization of future flow receivables can help public and private sector entities in developing countries obtain credit ratings higher than those of their governments and raise funds in international capital markets.

16. **However, in the case of Marshall Islands the arguments for securitization appear weak.** Staff analyzed a realistic scenario which involves borrowing $100 million in FY2010 at a 4 percent interest rate, collateralized by future U.S. contributions to the CTF. This scenario assumes relatively favorable terms of the loan, with only interest payments made during the first seven years, until FY2014. After that, if the U.S. contributions are fully used to repay interest and principal, the loan would be fully repaid by end–FY2023. However, with a nominal return on the CTF of 6 percent, the amount available for budget financing in FY2024 would increase only by $1 million. At the same time, securitization would introduce a number of additional risks, and would increase volatility of the CTF returns.[9] On balance, therefore, it appears that the benefits from securitization would be relatively small, and do not justify the incurring of additional risks.

Higher returns on CTF investments

17. **Sufficiently high returns on CTF investments can in principle help achieve fiscal sustainability.** In the above projections, a relatively conservative investment strategy for the CTF was assumed, with average annual nominal returns of 6 percent. A more aggressive investment strategy may yield higher returns on average, although it will also increase the risks. Projections show that, if the CTF investments yield average annual nominal returns of 7 percent instead of 6 percent, the budgetary shortfall in FY2024 would be reduced from $22.5 million to $12 million. A further increase of average annual nominal returns to 8 percent would eliminate the shortfall altogether. In this case, however, fiscal sustainability

---

[8] One example of securitization of future flows in the case somewhat similar to that of RMI is the International Finance Facility for Immunization Company (IFFIm). This organization used securitization of future legally binding grants from its sovereign sponsors to accelerate the availability of funds to be used for health and immunization programs. Details can be found at http://www.iff-mmunisation.org/02_financial_background.html.

[9] The general case of sovereign and public sector borrowing collateralized with future receipts instead of existing assets was analyzed in Geithner, Gianviti, Häusler, and Ter-Minassian (2003). Potential problems associated with such borrowing identified in that paper include: constraints on the flexibility of debt management; possible increases in future (and perhaps current) financing costs; excessive debt accumulation and the related erosion of the sustainability and future flexibility of fiscal policy; nontransparencies in the borrowing arrangements; and potential hindrances to privatization of public enterprises.

becomes contingent on being able to maintain the investment returns of at least 8 percent in every year after FY2024, which can be rather difficult.

18. **However, given the importance of the CTF for the RMI's future, the authorities need to be very cautious when choosing investment strategy.** Once the Compact grants and the United States' contributions to the CTF terminate in FY2024, the CTF would be the main financial resource that the RMI government can rely on to finance expenditures. Therefore, the authorities cannot afford to take any significant risks on the CTF, and need to adopt a conservative approach in the investment strategy. A nominal annual return of 8 percent or more will likely require an investment strategy that goes beyond the conservative approach.

19. **Additional contributions from donors could reduce the rate of return needed to build up sufficient CTF balance by FY2023.** The table below shows the annual surplus/shortfall of the CTF, given the various combinations of nominal investment returns and additional contributions from donors. Not surprisingly, both higher returns and contributions to the CTF reduce the shortfall. Nevertheless, eliminating the shortfall altogether inevitably requires either very high investment returns, or an implausibly generous support from donors. For example, even with annual nominal returns of 7 percent on CTF investments and an additional $10 million a year from donors, the annual shortfall would be substantially reduced, but not fully eliminated.

Compact Trust Fund: Annual Shortfall or Surplus in FY2024 Under Various Scenarios 1/
(In millions of U.S. dollars)

	Annual Return of:		
	6 percent	7 percent	8 percent
Additional annual contribution of:			
0	-22.5	-12.2	0.1
US$ 2.5 million	-20.5	-9.6	3.4
US$ 5 million	-18.5	-6.8	7.1
US$ 10 million	-14.5	-1.2	14.4

Source: Fund staff estimates.
1/ Calculated as earnings available for withdrawal minus the Compact grants in 2023 of $47 million.

Policy action: fiscal consolidation

20. **The strategy that has the best chance of allowing the RMI to achieve fiscal sustainability after FY2023 involves substantial fiscal consolidation.** The RMI needs to run sizable fiscal surpluses during the period until FY2023. These surpluses will help to achieve budgetary self-sufficiency in two ways. First, they will provide additional financial reserves that can be added to the CTF and will increase its balance in FY2023. Second, and

more importantly, the surpluses will create a wedge between budget revenues and expenditures, making the elimination of Compact grants in FY2024 less painful for the budget. In other words, running fiscal surpluses will mean that the adjustment to life without grants is made gradually and beforehand, instead of all at once in 2024.

21. **The alternative (policy action) scenario involves a substantial fiscal adjustment starting in FY2009.** Like the baseline scenario, it assumes that the CTF receives no new contributions from any donors beyond what has already been pledged. It also continues to assume nominal annual returns on CTF investments of 6 percent. Unlike in the baseline scenario, however, it is assumed that the authorities achieve a small fiscal surplus of around ½ percent of GDP in FY2009, and increase this surplus to around 3½ percent of GDP by FY2013 (Figure I.1).[1] The surplus then stays at that level until FY2024, when it decreases to the baseline scenario level of ½ percent of GDP (the level needed to make debt payments on schedule). This fiscal adjustment will require substantial cuts to current expenditure in the short term, and measures to raise additional revenue in the medium term.[2]

22. **Projections show that this strategy can succeed in achieving budgetary self-sufficiency.** Additional reserves added to the CTF are projected to increase its balance in FY2023 by $100 million, and provide additional earnings of $6 million that can be used to finance budgetary expenditures. More importantly, however, running sustained fiscal surpluses of 3.5 percent of GDP would result in a surplus of $17 million by FY2023, therefore reducing by the same amount the value of Compact grants that will need to be replaced. Together, these two factors would help to eliminate the shortfall of $22.5 million in the baseline scenario.

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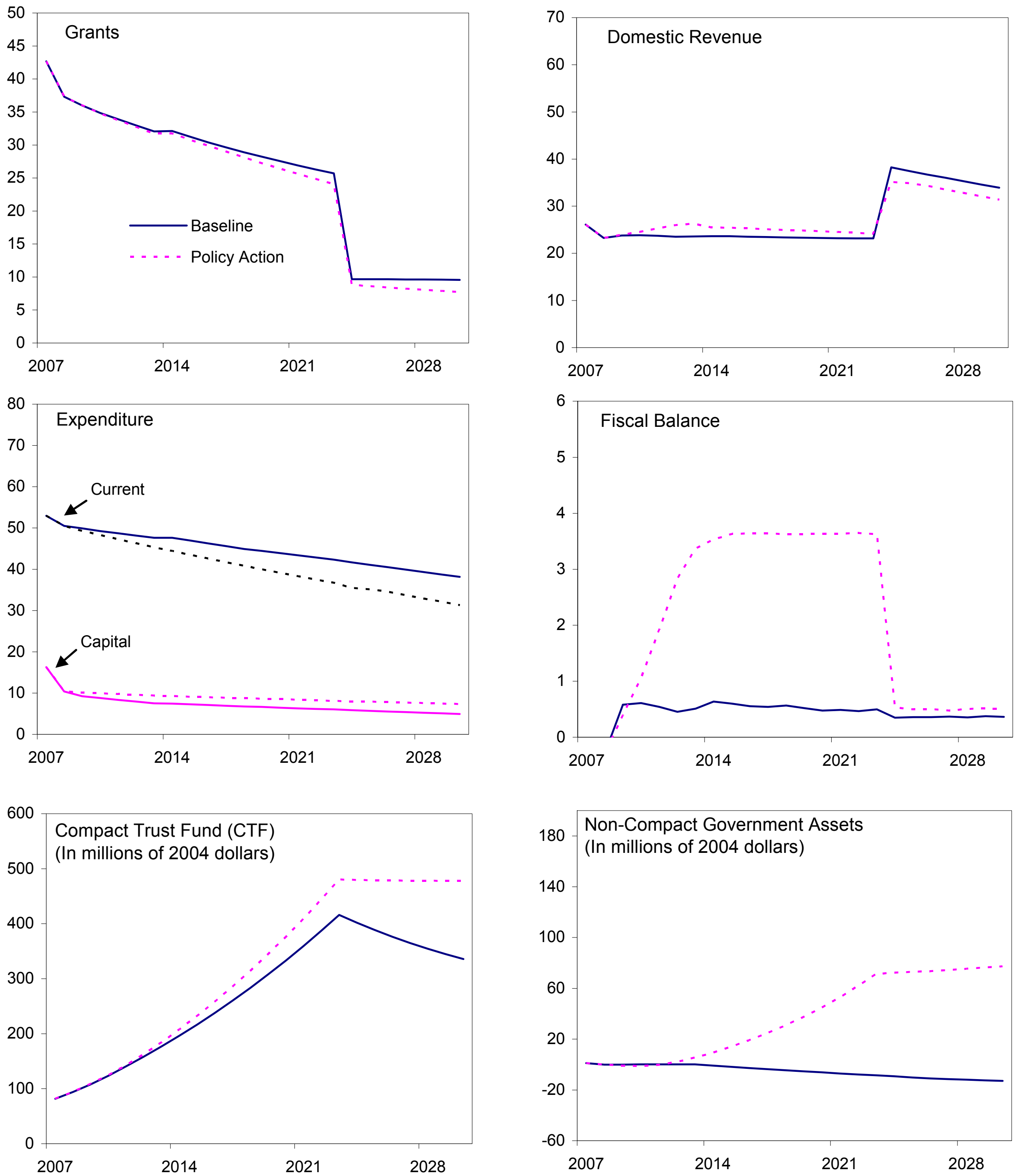
[1] The fiscal balance in FY2008 is projected to be -0.3 percent of GDP (based on the FY2008 Budget and the preliminary results for the first two quarters of the fiscal year).

[2] Chapter 2 and the Staff Report for the 2008 Article IV consultation with the Marshall Islands provide details on specific measures that can be taken to achieve these goals.

Figure I.1. Marshall Islands: Long-Term Fiscal Adjustment Scenarios: FY2007–30 [1]

(In percent of GDP)



Source: IMF staff estimates.

1 From FY2024 onward, interest income from the trust fund is considered as part of domestic revenue.

23. **The fiscal consolidation will be difficult, and will have to be accompanied by structural reforms to improve real growth.** The current size of the government sector is not sustainable, and delaying the adjustment will only make it harder for the country to adjust and achieve sustainable growth in the longer term. Nevertheless, given the current size of the government sector and its dominant role in economic activity, fiscal adjustment will inevitably be painful, and is likely to negatively affect growth. Fiscal consolidation will therefore need to be complemented by structural reforms to boost private sector growth, which will be vital to absorb redundant labor from the public sector and ameliorate the impact of declining external support.[12]

Marshall Islands: CTF: The Baseline Versus the Policy Action Scenario

	Baseline: no policy action	Policy action: structural reforms and fiscal consolidation
	Millions of US Dollars	
CTF in 2023	678.6	778.9
Compact grants in 2023	47.0	47.0
Compact grants net of fiscal surplus	47.0	30.6
Earnings available for withdrawal 1/	24.5	30.7
Annual surplus (+) or shortfall (-) 2/	-22.5	0.1

1/ Maximum amount that can be withdrawn, so that the real value of the CTF does not decline.

2/ Calculated as earnings available for withdrawal minus the Compact grants in 2023 net of fiscal surplus

Source: IMF staff calculations

24. **Depending on the success of structural reforms, the required fiscal consolidation may be slightly smaller than in the scenario above.** The scenario presented above assumes that the authorities implement modest reforms, resulting in an increase of real GDP growth to 2.3 percent per year (compared to 1.8 percent under the baseline scenario). More ambitious and successful reforms (for example, increasing real GDP growth to 2.7 percent) would produce additional $4 million in budget revenues by FY2023, thereby reducing the necessary fiscal surplus by about ½ percent of GDP.

D. Conclusions

25. **Without decisive policy action, the CTF will not be sufficient to replace grants that will terminate after 2023.** Projections show that obtaining additional funds from donors, securitizing future CTF contributions, and achieving higher returns on CTF investments can improve the situation, but is not likely to resolve it. Furthermore, risks and

[12] Staff Report for the 2008 Article IV consultation with Marshall Islands provides details on some specific structural reforms that could be undertaken.

benefits need to be carefully assessed, when making decisions on securitization of CTF contributions and when choosing investment strategy, so that the most important financial asset of the country (the Compact Trust Fund) is not jeopardized.

26. **Substantial fiscal consolidation in the short-term is necessary to achieve budgetary self-sufficiency after 2023.** Achieving a fiscal surplus of between 3 and 3½ percent of GDP (depending on the success of structural reforms) within the next 5 years, and then maintaining it until 2023, should be enough to achieve budgetary self-sufficiency. This is undoubtedly a challenging task. However, alternatives are lacking, and delaying reforms will only result in a more painful adjustment in the future.

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II. STRENGTHENING THE TAX REGIME IN THE MARSHALL ISLANDS[1]

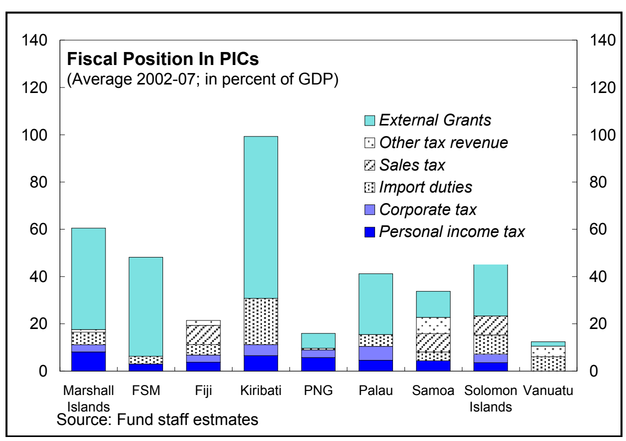
1. **The Republic of the Marshall Islands (RMI) needs to tackle fiscal consolidation given the steady decline in Compact grants and increasing external debt service payments.** Compact grants will decline by $0.5 million per year (expiring in 2023) and debt services on external debts will increase steadily, peaking in 2019. RMI's heavy reliance on the public sector makes cutting expenditure difficult, leaving the improvement of revenue collections a critical step toward the required fiscal consolidation. A comprehensive tax reform is vital to raise additional revenue, which will help achieve the necessary fiscal adjustment.

2. **The authorities have recently shown renewed interest in tax reform.** Prior to this impetus, tax reform lingered despite a detailed action plan developed by the Pacific Financial Technical Assistance Center (PFTAC). Lately the authorities have strengthened the tax audit unit and are aggressively pursuing non-compliant entities. In addition, the authorities are working together with key stakeholders in the process. Nevertheless, the tax reform is in the initial stage that requires ongoing efforts to obtain its intended results.

3. **This chapter reviews the current tax regime, and outlines steps toward a comprehensive tax reform.** Section A describes RMI's current tax structure, and compares it to other Pacific island countries (PICs). Section B examines some weaknesses in the current tax regime, section C highlights actions that the government has recently undertaken. Section D proposes changes to address the shortcomings in tax regime. It argues that comprehensive tax reform should address the weaknesses in both tax administration and tax policy. Section E concludes that RMI should implement tax reform as soon as possible, focusing initially on tax administration matters.

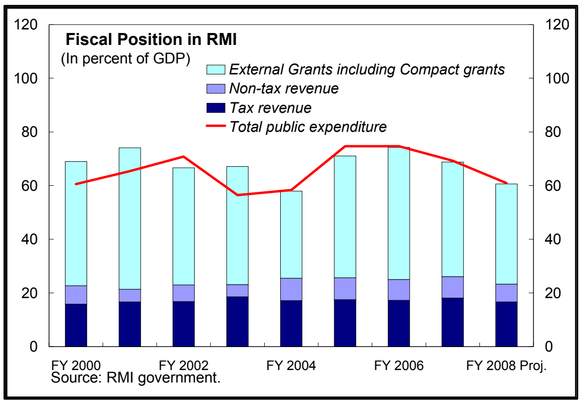
A. Tax Revenue in RMI

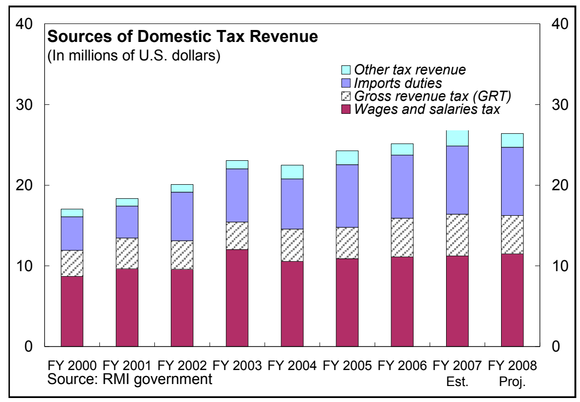
4. **RMI's revenue composition is similar to other PICs that receive large external grants.** In most PICs domestic revenues usually come mainly from import duties and sales taxes, while corporate taxes contribute a much smaller share of tax revenue. RMI receives external grants amounting to 40 percent of GDP, the second highest among the PICs (after Kiribati).



[1] Prepared by Raphael W. Lam (ext 39327)

5. **The tax revenue in RMI comes from three major sources (Box II.1).**[2] The largest tax component is from wages and salaries, which is over $11 million and contributes about 40 percent of tax revenue. The second largest component is import duties at about $8 million, contributing about one-third of total tax revenue. Gross revenue tax (GRT), at $5 million in FY2007, accounts for about 17 percent of total tax revenue. Domestic revenue in RMI has been stable at an average of 17 percent of GDP since FY2000, but has increased in nominal terms to $27 million in FY 2007.





B. Weaknesses in the Current Tax Regime

6. **The tax policy on the three main taxes contains weaknesses, which hamper revenue collections.** These include:

- *Tax on wages and salaries.* The tax on wages and salaries raises the concerns of equity and efficiency. Deductibles on income tax are applicable to the low-income class and is eliminated once income exceeds a certain threshold (at $5,260 per year), leading to a sharp increase in the marginal tax rate on additional wages and salaries.
- *Import duties.* Tax rates on imported goods are not uniform, and sometimes levied on a per-unit instead of a value basis. As a result, similar type of imported goods may carry different duties without an objective customs valuation.
- *Gross revenue tax (GRT).* GRT is levied on a revenue basis, instead of a net profit basis that is widely used in other countries. Although the current GRT schedule is uniform across businesses, the effective tax rates on net profit vary significantly depending on their operating scales. It does not take into account the production and operation costs in the businesses, and tends to favor those that operate at a low turnover, but high profit margin. The GRT also discourages the replacement or reinvestment in capital equipment and human capital for the long-term benefits.

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[2] In addition to the three major taxes, RMI also has immovable property tax, hotel and resort tax, non-resident gross income tax, and local governments' sales tax (Box II.1). These accounted for less than $1.5 million on average in past years. Non-tax revenue includes fishing rights fees and ship registry fees.

Box II.1. Marshall Islands: Tax Regime

The three main sources of tax revenue are wages and salaries tax, import duties, and GRT. Together they account for more than 90 percent of annual tax revenue. Other types of taxes include property tax, hotel and resort tax, and non-resident gross income tax. Some local governments also impose a general sales tax in addition to the taxes of the national government. The tax rates on different categories are listed below.[1]

Tax category	Tax rate[2]
Wages and salaries tax	8 percent upon first \$10,400 and 12 percent for any amount over. Full exemptions given for income not exceeding \$5,200.
Gross revenue tax (GRT)	\$80 tax on amount not exceeding \$10,000 per year; and 3 percent on gross revenue exceeding that.
Import duties	8 percent on most imported goods, with a lower rate of 5 percent on foodstuff. A selected number of goods (cars, tobacco products, and alcoholic and carbonated beverages etc) are subject to an excise tax levied at ad-valorem or specific rates that range from 2 percent to 150 percent.
Fuel tax	Tax on gasoline is at 25 cents per gallon; diesel at 8 cents per gallon.
Immovable property tax	3 percent on gross income or rent from property leased.
Hotel and resort tax	8 percent on daily room rate on hotel and resort facilities.
Non-resident gross income tax	10 percent on the gross income earned by non-resident.
Local government sales tax	General sales tax on goods at 4 percent in Majuro local government; sales tax of 10 percent at the wholesale level in Kwajalein Atoll local government.[3]

[1] Ministry of Finance (2008) and Andic (2005).
[2] On a per annum basis.
[3] Both local governments also impose a tax on gasoline, alcoholic beverages, and hotel rooms that vary with the sales tax listed above.

7. **There are further weaknesses in the tax regime, which include:**

- *Cascading tax effect.* The tax rates are cascading towards the final consumers, as the duties on imported goods cannot be deducted from the GRT or the sales tax imposed by the local governments. A large portion of tax burden is likely to transfer to the final consumers under the small market structure in RMI.

- *Membership in regional trade arrangements*.[3] RMI's commitment to regional trade arrangements poses an additional challenge by introducing more complex tariff structures as different rates could apply to the same goods depending on the origin of the goods (within or outside the region). When all agreements come into effect, the associated customs revenue could eventually decline.[4]

8. **The present tax administration also has limited enforcement capacity.** This leads to a low compliance across all type of taxes, hampering the authorities' ability to generate sufficient revenue at the present tax rates. Some weaknesses in tax administration are as follows:

- *Low tax compliance.* The non-compliance rate is estimated to be 25–50 percent. Based on this rate, it is calculated that improving compliance could generate about $7-8 million in additional tax revenue (Box II.2).
- *Weak administration in customs.* There is no objective valuation of imports and the procedure in levying duties is inefficient. Mis-reporting and undervaluation tend to be common (McNeill (2007) and PITAA (2006)).

- *Lack of coordination between revenue collection agencies.* RMI currently has three revenue collection agencies: national government, local governments, and social security administration. They run parallel collection and auditing units with duplicating efforts. Reported inconsistencies are not uncommon across agencies.
- *Arrears from the local governments.* Some local governments have built up tax arrears to the national government.

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[3] RMI participates or is negotiating a number of free trade agreements with other PICs, Australia, New Zealand, and the European Union. RMI is involved in the Pacific Agreement on Closer Economic Relations and the Pacific Islands Countries Trade Agreement. It is discussing with the European Union on a new trade arrangement under the Economic Partnership Agreement.

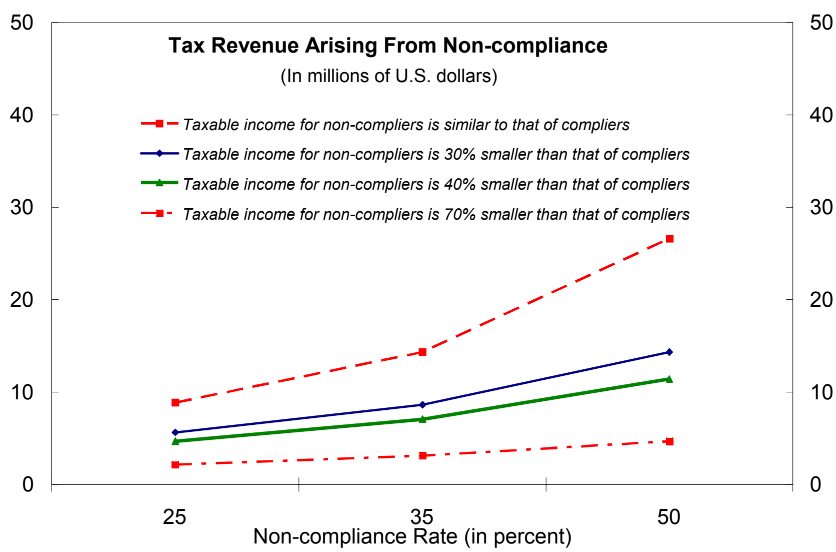
[4] The experience of low- and middle-income countries shows that trade liberalization often leads to decline in collections from customs duties (IMF 2007).

Box II.2. Marshall Islands: Estimates of Tax Revenue Loss from Non-Compliance

Non-compliance is estimated to be about 25–50 percent, and remains one of the key issues in RMI's tax reform.[1] Previous studies suggest that the informal sector (mostly consisting of low-income individuals and mom-and-pop businesses) is more likely not to comply.[2] The example below illustrates the additional tax revenue that could have been collected under different scenarios. Several assumptions for the calculations are taken:

- Calculations are shown for non-compliance rates at 25, 35 and 50 percent respectively. The range of 25–50 percent is estimated by PFTAC experts.
- The taxable income of the non-compliers as compared to tax compliers is assumed to be 30–70 percent smaller. This assumption takes into consideration that the operating scale or personal income for non-compliers is generally smaller than those that file tax.
- The issue of under-reporting for the compliers is abstracted in the calculations.

Given data limitations, a benchmark estimate was calculated to quantify the problem of non-compliance. The figure below shows the additional tax revenue that could have been collected under full compliance based on the estimated tax revenue in 2007. The range varies significantly given the non-compliance rate and the difference in taxable income between compliers and non-compliers. However, a reasonable estimate would be about $7 to 8 million per year, assuming a 35 percent non-compliance rate, with the non-compliers' income 30–40 percent smaller than that of compliers. The results suggest that the tax revenue loss arising from compliance is large, and measures to enhance compliance are critical in the tax reform.



Source: Fund Staff estimates

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[1] Estimates are from PFTAC and are consistent with Ministry of Finance (MoF) estimates. The non-compliance rates are similar across different type of taxes. Other issues related to under-reporting, and tax accruals and arrears further complicate the progress in the tax reform.

[2] Robles (2007) suggested the informal sector is about 30–40 percent smaller than the formal sector.

C. Reform Efforts

9. **Tax reform efforts lingered for many years.** In 2003, PFTAC designed a modernization strategy and action plan for customs, including improvements to the Customs Act, automation, and compliance units. The FY2006 Budget Statement also outlined many changes to tax regime, including unifying import duties and changing the income tax structure. There was, however, limited follow-up action on these initiatives.

10. **Since the publication of the FY2006 Budget Statement, tax reform action has taken the form of:**

- *Changes in tax policy.* Fuel tax on gasoline and diesel was adjusted to 25 cents and 8 cents per gallon respectively.

- *Improvements in tax administration.* A number of measures to strengthen the tax collection were initiated and a dialogue with key stakeholders has been established (Ministry of Finance (2006 and 2007)).

11. **Recently, however, the authorities have shown renewed interest in tax regime reforms.** They have sought guidance from PFTAC on the tax policy front, and have taken several steps on the tax administration front. In particular, the authorities have enhanced coordination among the revenue collection agencies in tax filing matters. They also attempted to strengthen the tax audit unit, and pursued more aggressively the non-compliant businesses.[5] They have begun the issuing of public notices in attempt to strengthen tax enforcement, and plan to conduct an island-wide survey in increasing the public awareness of the tax reform.[6] Nevertheless, the tax reform is in the beginning stage that requires ongoing efforts to achieve its intended results.

D. The Way Forward

12. **A comprehensive tax reform should address the weaknesses in both tax policy and tax administration.** At least initially, the authorities should consider implementing many of the proposed changes spelled out in the 2006 Budget Speech. Further measures that are consistent with those outlined by PFTAC should be adopted, as they are necessary to achieve fiscal consolidation.[7]

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[5] The Customs, Treasury, Tax and Revenue Division of the Ministry of Finance has issued a public notice in January 2008 on the tax procedures and filings due dates. The tax office plans to compile and publicize a list of non-compliant entities.

[6] The authorities have reported that in most cases of non-compliance, a response was received after a Notice of Lien was issued.

[7] Ministry of Finance FY2006 and FY2007 Budget Statements and McNeill (2007).

13. **In designing and introducing the new tax regime, the authorities should adhere to several key principles.** These principles are generally applicable regardless of specific tax policy or administration structure.

- *Simplicity and Fairness.* The new tax regime should contain simple features that provide a level playing field among individuals and businesses. Tax exemptions or non-compliance should be kept to a minimum.

- *Low compliance cost.* The tax reform should attempt to reduce the compliance cost for individuals and business. The cost of complying with the new tax rules need to be low enough to avoid non-filings from the taxpayers.

- *Broad tax base.* Given the non-compliance issue, the current tax regime has a concentrated tax base with relatively high tax rates to generate sufficient tax revenue. The tax reform may broaden the tax base with improved compliance rate.

- *Minimal distortions.* The new tax regime should only contain minimal distortions on trade and investment opportunities.

14. **The authorities should revise the tax policy in accordance to the key design principles:**

- *Gross revenue tax.* The authorities should adopt a corporate tax on the basis of net profit, as the existing GRT tends to violate the above principles of fairness and minimal distortions. The corporate net profit tax would take into account the production cost and other relevant expenses.

- *Import duties.* A uniform structure based on the value would be preferable once the customs develop an objective valuation procedure and method.

- *Tax on wages and salaries.* Deductibles on personal income should be applicable to every employee to achieve fairness and avoid a sharp rise in marginal tax rate.

15. **The authorities should take additional steps in enhancing tax administration, including:**

- *Improving tax compliance from individuals and businesses.* Given a low tax compliance rate, the authorities should further strengthen the audit units and increase the penalty for repeated non-compliant cases.[8] Aligning foreign business to RMI's tax laws would be important to avoid unfair treatments among domestic and foreign businesses. The customs collection of import duties should be improved by shortening the clearance

[8] The authorities' recent efforts in pursuing non-compliant cases by issuing public notices and conducting island-wide surveys have been important steps toward strengthening the tax regime.

procedures, using a consistent valuation method, and introducing reliable technology. The authorities may learn from the successful experience of the Social Security Administration in addressing non-compliance issues.

- *Harmonizing tax collection of national and local governments.* It is necessary to eliminate the dual and duplicate efforts running parallel across various revenue collection agencies. Harmonization in tax collection also improves the credibility to address the non-compliance. Information sharing and coordination beyond the measures undertaken would be necessary.

16. **In the long run, a consumption-based tax regime could benefit the economy and might secure revenue sources, but there are downside risks.** Several PICs have introduced the value-added tax (VAT) regime as part of a comprehensive tax reform.[9] The efficiency of the VAT is generally high across the PICs (Grandcolas (2004, 2005)). However, there would be downside risks if the tax reform was not accompanied with a strong political commitment, a simple regime with minimum exemptions, and a detailed preparation on the implementation plan.

E. Conclusions

17. **RMI should implement tax reforms as soon as possible to help it face the challenges ahead.** In light of declining external grants and current weaknesses in the tax regime, the authorities need to continue their determined efforts in tax reform. Tax reform is a crucial element in the required fiscal consolidation to achieve budgetary self-sufficiency. It is important that the new tax regime is designed to be simple and fair, easy to implement, with relatively low compliance costs, and with minimal distortions on investments.

18. **Several issues should be noted in designing and introducing a new regime.** The authorities need to address the high non-compliance and harmonize tax collection across government agencies. They have taken initial measures to involve the key stakeholders during the process of the tax reform. It is important to extend their determined efforts on the remaining weaknesses of the current tax regime. Effective tax policy, coupled with strong enforcement, would improve the revenue collections towards the required fiscal consolidation.

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[9] For example, Fiji, Samoa, Cook Islands, and Papua New Guinea introduced the VAT in the 1990s, and Tonga introduced it as recent as in 2005. The VAT across the PICs tends to be single-rate and within a 10-15 percent range, with the VAT generating about 20-50 percent of the total tax revenue.

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Table 1. Marshall Islands: Gross Domestic Product, FY2003–07[1/]

	FY2003	FY2004	FY2005	FY2006	FY2007 Est.
			(In thousands of U.S. dollars)		
Private Enterprise	36,711	40,717	41,686	44,588	47,217
Compensation of employees	18,640	18,534	17,834	19,419	20,590
Operating surplus (gross)	15,049	17,499	16,818	19,649	20,949
Offshore fishing surplus	3,022	4,683	7,034	5,520	5,678
Public Enterprise	11,773	10,252	8,980	8,640	10,021
Compensation of employees	9,180	9,184	9,236	9,243	9,755
Operating surplus (gross)	5,783	3,557	2,003	1,965	2,834
Less Subsidies	-3,190	-2,488	-2,259	-2,568	-2,568
Finance (Banks)	6,254	6,609	7,366	8,322	8,823
Compensation of employees	2,285	2,518	2,943	3,252	3,448
Operating surplus (gross)	3,969	4,092	4,424	5,070	5,375
Government (compensation of employees)	44,309	47,945	51,751	54,777	53,420
RMI Government	26,842	30,385	33,396	37,109	34,992
Government Agencies	9,539	9,206	9,257	7,473	7,856
Local Government	7,928	8,355	9,099	10,195	10,572
NGOs (compensation of employees)	2,052	2,117	2,138	2,182	2,208
Households	16,350	16,998	17,722	18,727	19,482
Mixed Income	2,824	3,041	3,118	3,181	3,298
Copra production	1,027	1,186	1,178	1,115	1,147
Fishing	581	599	627	667	695
Handicrafts	997	1,029	1,076	1,146	1,193
Other	220	227	237	253	263
Subsistence	6,802	7,019	7,344	7,818	8,139
Home ownership	6,724	6,939	7,260	7,729	8,046
Indirect taxes less Subsidies	14,093	14,166	16,709	17,195	17,895
Import and fuel taxes	7,040	6,681	8,830	8,601	8,455
Other Indirect taxes	3,407	4,015	3,882	4,778	5,688
Indirect taxes (Local Government)	3,646	3,470	3,997	3,816	3,751
Nominal GDP (Gross)	124,159	131,328	138,336	145,559	149,659
			(In percent of GDP)		
Private Enterprise	29.6	31.0	30.1	30.6	31.5
Public Enterprise	9.5	7.8	6.5	5.9	6.7
Finance (Banks)	5.0	5.0	5.3	5.7	5.9
Government (compensation of employees)	35.7	36.5	37.4	37.6	35.7
NGOs (compensation of employees)	1.7	1.6	1.5	1.5	1.5
Households	13.2	12.9	12.8	12.9	13.0
Indirect taxes less Subsidies	11.4	10.8	12.1	11.8	12.0

Source: Data provided by the RMI authorities.

1/ The fiscal year ends on September 30.

Table 2. Marshall Islands: Copra Production, Producer Prices, and Export Unit Values, 2003–07

	2003	2004	2005	2006	2007 Est.
Production (in short tons)	4,283	4,868	4,908	4,646	6,053
Average producer prices (in U.S. dollars per short ton)	240	240	240	240	299
Total income (in thousands of U.S. dollars)	1,027	1,186	1,178	1,115	1,810
Export unit value (in U.S. dollars per short ton) 1/	304	201	536	452	678

Sources: Data provided by the RMI authorities and Fund staff estimates.

1/ Export unit values are estimated by dividing the value of exports of coconut oil and copra cake by total copra production.

Table 3. Marshall Islands: Majuro Consumer Price Index, 2005–08 1/

Groups	All Groups	Food	Alcoholic Beverages	Housing, Utilities and Major Appliances	Apparel	Transport.	Medical Care	Recreation	Education and Comm.	Other Goods and Services
Weights	100.00	35.91	1.68	17.07	4.33	13.73	2.23	2.32	6.56	16.17
					(2003Q1 = 100)					
2005	107.7	106.6	124.7	109.3	103.1	114.5	100.0	93.1	113.0	103.2
2006	112.4	109.6	132.8	124.1	106.1	126.8	100.0	87.5	115.9	97.2
2007	115.8	111.0	135.0	135.9	104.3	136.2	100.0	85.1	115.9	96.3
2005										
March	105.1	105.3	120.3	104.8	102.8	107.1	100.0	92.6	111.1	102.4
June	106.7	106.7	123.5	105.9	102.4	110.7	100.0	95.2	111.1	104.2
September	108.3	107.3	126.4	107.1	103.8	118.4	100.0	94.5	113.8	103.1
December	110.8	107.1	128.6	119.5	103.5	121.7	100.0	90.3	115.9	103.3
2006										
March	111.3	110.0	131.7	119.5	104.0	121.3	100.0	91.3	115.9	99.3
June	111.6	110.2	133.4	120.9	110.0	123.1	100.0	90.0	115.9	96.3
September	113.0	108.0	135.6	128.4	106.1	131.3	100.0	83.7	115.9	96.4
December	113.7	110.3	130.6	127.7	104.3	131.7	100.0	84.9	115.9	96.9
2007										
March	113.2	110.6	133.1	127.9	105.8	126.3	100.0	85.6	115.9	96.9
June	115.1	112.0	134.3	129.9	102.9	138.5	100.0	85.5	115.9	96.8
September	116.3	108.8	136.2	142.3	103.1	138.6	100.0	85.6	115.9	94.7
December	118.6	112.5	136.2	143.5	105.3	141.5	100.0	83.7	115.9	96.7
2008										
March	121.9	112.7	137.0	149.5	113.1	153.0	100.0	83.7	115.9	98.7
					(Annual average change in percent)					
2005	4.4	0.3	16.8	9.9	-0.7	12.7	0.0	-4.8	7.0	2.1
2006	4.3	2.8	6.5	13.6	2.9	10.8	0.0	-6.1	2.6	-5.8
2007	3.0	1.2	1.6	9.5	-1.7	7.4	0.0	-2.7	0.0	-1.0
					(Four-quarter percent change)					
2005										
March	2.8	-0.9	17.6	5.8	-2.8	9.3	0.0	-7.1	11.1	1.6
June	4.1	0.0	20.7	6.5	-1.3	11.6	0.0	-5.7	11.1	3.8
September	4.7	1.4	23.6	6.7	0.2	15.9	0.0	-2.3	2.5	2.1
December	6.2	0.8	6.9	20.8	1.0	13.9	0.0	-4.2	4.3	1.1
2006										
March	5.9	4.5	9.5	14.0	1.2	13.3	0.0	-1.3	4.3	-3.1
June	4.6	3.3	8.1	14.2	7.4	11.2	0.0	-5.5	4.3	-7.6
September	4.3	0.6	7.3	19.9	2.2	10.8	0.0	-11.4	1.8	-6.4
December	2.6	3.0	1.5	6.9	0.7	8.2	0.0	-5.9	0.0	-6.1
2007										
March	1.7	0.5	1.1	7.1	1.7	4.1	0.0	-6.3	0.0	-2.4
June	3.2	1.7	0.7	7.4	-6.5	12.5	0.0	-5.0	0.0	0.5
September	2.9	0.8	0.5	10.8	-2.8	5.6	0.0	2.3	0.0	-1.8
December	4.3	1.9	4.4	12.3	1.0	7.4	0.0	-1.4	0.0	-0.3
2008										
March	7.7	1.9	2.9	16.8	6.9	21.1	0.0	-2.1	0.0	1.8

Source: Data provided by the RMI authorities.

1/ The CPI index developed in 1977 was revised. The revised CPI index, starting in 2003Q1, consists of prices of 61 goods and services collected in Majuro organized into nine groups. The CPI index is rebased to 2003Q1=100 from 1982=100.

Table 4. Marshall Islands: Employment by Sector, FY2003–07[1/]

	FY2003	FY2004	FY2005	FY2006	FY2007
Total	9,947	10,071	9,579	9,920	10,129
Public sector employees	4,167	4,317	4,452	4,539	4,638
Private sector employees	5,780	5,754	5,127	5,381	5,491
Of which:					
Fishing	903	1,003	281	345	281
Manufacturing	48	41	48	48	60
Construction	559	499	519	677	782
Wholesale and retail trade	1,635	1,719	1,765	1,782	1,791
Average wages (in U.S. dollars)					
Public Sector	10,676	11,473	11,543	11,639	11,592
Private Sector	6,653	6,777	7,676	7,975	7,812
Memorandum item:					
Estimated population2/	50,968	51,541	52,111	52,709	53,338

Source: Marshall Islands Social Security Administration (MISSA).
1/ Based on MISSA payroll data. Figures partially reflect improvements in data coverage.
2/ Public sector employees include those employed in the public enterprise, RMI government, government agencies, and local governments.

Table 5. Marshall Islands: Balance of Payments, FY2003–08 [1/]

	FY2003	FY2004	FY2005	FY2006	FY2007 Est.	FY2008 Proj.
Trade balance	-60.1	-52.9	-56.2	-56.1	-58.2	-60.1
Exports, f.o.b.	14.5	18.6	24.0	21.6	22.1	24.3
Imports, f.o.b.	-74.6	-71.5	-80.1	-77.7	-80.3	-84.4
Net services	-5.7	-8.0	-11.1	-8.7	-7.4	-6.8
Receipts	14.6	12.8	11.3	11.8	12.8	13.9
Payments	-21.2	-20.3	-20.8	-22.4	-20.5	-20.2
Net income	37.8	29.9	32.3	32.9	35.0	36.8
Receipts	43.6	36.4	39.0	41.4	43.7	45.1
Payments	-5.8	-6.4	-6.7	-8.5	-8.7	-8.3
Unrequited transfers	14.3	22.7	27.0	29.7	26.0	27.0
Private	-12.5	-12.0	-12.2	-12.4	-12.6	-12.9
Official	26.8	34.7	39.2	42.0	38.6	40.0
Compact grants 2/	23.8	28.4	34.4	38.0	33.6	35.3
Other	3.0	6.3	4.8	4.0	5.0	4.6
Current account including current official transfers 3/	-13.7	-8.2	-7.9	-2.3	-4.7	-3.1
(In percent of GDP)	-11.1	-6.3	-5.7	-1.6	-3.1	-2.0
Current account excluding official transfers	-40.5	-43.0	-47.1	-44.3	-43.3	-43.1
(In percent of GDP)	-32.6	-32.7	-34.1	-30.4	-28.9	-27.2
Capital and financial account	20.1	-25.8	0.4	10.5	10.3	4.6
Official Capital Grants	27.8	14.9	23.5	40.4	37.8	29.6
Capital transfers to central government	27.8	7.9	10.9	29.7	26.3	17.4
Trust Fund contributions	0.0	7.0	12.6	10.7	11.4	12.2
Direct investment, net	1.7	4.1	6.5	6.2	12.2	5.5
Short-term liabilities, net 4/	-10.9	-13.6	-12.1	-19.9	-13.0	-13.4
Medium-term liabilities, net	1.7	2.3	-3.5	2.4	-6.0	-0.2
Inflows	5.0	6.1	1.0	9.8	12.0	7.6
Outflows	-3.2	-3.8	-4.5	-7.4	-18.0	-7.8
Other net government flows 5/	-0.3	-33.5	-14.0	-18.6	-20.7	-16.8
Errors and omissions	-6.4	34.1	7.6	-8.2	-5.6	-1.5
Overall balance	16.4	-23.5	-5.3	-0.7	-1.6	-1.4
Gross official reserves 6/	34.1	10.6	5.3	4.6	3.0	1.6
Of which: Usable government financial assets	2.9	4.5	1.6	3.0	1.3	-0.1
(In months of imports of goods and services)	0.4	0.6	0.2	0.4	0.2	0.0

Sources: Data provided by the RMI authorities; and IMF staff estimates.

1/ Fiscal year ending September 30.

2/ Compact funding pertaining to the Kwajalein Atoll Trust Fund and Kwajalein resident and landowner compensation Trust Fund contributions by the U.S. and Taiwan Province of China, are regarded as capital transfers.

3/ Official transfers include current transfers but excludes capital transfers and Trust Fund contributions.

4/ Includes changes in social security fund investments, banking system assets held overseas, and government assets held in the capital and special fund accounts.

5/ Changes in government assets, excluding the general fund.

6/ Including MIITF which is deposited in domestic financial institutions.

Table 6. Marshall Islands: Exports by Product Category, 2003–07

(In thousands of U.S. dollars)

Product	2003	2004	2005	2006	2007
Copra cake	230	209	107	100	113
Coconut oil, crude	1,070	770	2,526	2,000	3,990
Frozen fish	5,197	8,358	9,870	9,035	...
Reexport of diesel fuel	8,108	9,745	12,056	8,347	...
Other exports	600	700	800	800	...
Total	15,205	19,781	25,359	20,283	...

Source: Data provided by the RMI authorities.

Table 7. Marshall Islands: External Debt and Debt-Service Obligations, FY2003–08[1/]

(In millions of U.S. dollars)

	FY2003	FY2004	FY2005	FY2006	FY2007	FY08
					Est.	Proj.
Total debt outstanding	90.0	94.7	92.1	99.3	98.7	94.6
(in percent of GDP)	72.5	72.1	66.6	68.2	65.9	59.7
Debt service	3.9	4.2	6.2	4.7	5.0	5.9
(in months of exports of goods and services)	1.9	1.8	2.9	2.1	1.7	1.9
Amortization	3.2	3.8	4.5	6.9	16.2	7.8
Interest Payment	2.1	2.3	2.5	3.3	3.6	3.3
Of Which:						
Medium-term bond issues						
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0
Outstanding principal	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	0.0	0.0	0.0	0.0	0.0	0.0
Interest	0.0	0.0	0.0	0.0	0.0	0.0
Asian Development Bank						
Disbursements	5.0	2.0	1.0	0.1	0.0	0.0
Outstanding principal	56.0	60.9	62.6	63.2	62.5	61.8
Amortization	0.6	1.2	1.4	1.6	1.6	2.2
Interest	0.5	0.9	0.9	0.8	0.8	0.8
Other central government[2/]						
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0
Outstanding principal	1.9	1.9	1.7	1.5	1.3	1.1
Amortization	0.0	0.0	0.2	0.2	0.2	0.2
Interest	0.0	0.0	0.0	0.0	0.0	0.0
National Telecommunications Authority						
Disbursements	0.0	0.0	0.0	0.0	0.0	0.0
Outstanding principal	17.6	17.0	16.3	15.7	14.9	14.1
Amortization	1.5	1.5	1.4	1.5	1.5	1.5
Interest	0.9	0.8	0.8	0.8	0.7	0.7
Marshalls Energy Company, Inc.						
Disbursements	0.0	0.0	0.0	11.4	12.0	0.0
Outstanding principal	10.7	10.2	9.8	20.8	32.3	20.0
Amortization	1.1	1.1	1.1	3.8	14.3	3.5
Interest	0.7	0.6	0.6	1.7	2.0	1.6

Sources: Data provided by the RMI authorities; and Fund staff estimates.

1/ Fiscal year ending September 30.

2/ Includes financial assistance from the Federal Emergency Management Agency, the National Marine Fisheries Service, and Taiwan Province of China.

Table 8. Marshall Islands: Central Government Finances, FY2003–08 1/

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007 Est.	FY 2008 Proj.
			(In millions of U.S. dollars)			
Total revenue and grants	83.3	76.1	98.3	108.1	103.0	96.0
Total domestic revenue	28.7	33.4	35.5	36.4	39.1	36.9
Taxes	23.1	22.5	24.3	25.1	27.1	26.4
Income	12.0	10.6	10.9	11.1	11.2	11.5
Gross revenue	3.4	4.0	3.9	4.8	5.2	4.7
Imports	6.6	6.2	7.8	7.8	8.5	8.5
Other	1.0	1.7	1.7	1.4	2.2	1.7
Nontax	5.6	11.0	11.2	11.2	12.0	10.5
Fishing rights	1.7	0.9	1.4	1.5	1.4	1.5
Social contributions	0.0	6.3	6.2	6.4	6.7	5.8
Fees and charges	0.8	1.4	1.4	1.3	2.1	2.0
Investment income	0.2	0.1	0.1	0.1	0.2	0.1
Other	2.8	2.1	2.2	1.8	1.7	1.2
Grants	54.6	42.6	62.8	71.7	63.9	59.1
Of which: current grants	26.8	34.7	51.9	55.3	37.6	41.8
Compact 2/	32.7	20.5	27.6	35.5	40.9	42.3
Other	21.9	22.1	35.2	36.2	23.0	16.8
Total expenditure	70.1	76.6	103.2	108.7	103.6	96.5
Current expenditure	56.3	65.5	77.8	80.8	79.2	80.0
Wages and salaries	25.6	30.1	32.8	34.1	32.1	33.7
Goods and services	21.9	26.8	31.2	32.9	33.5	32.5
Interest payments	0.9	0.8	0.9	0.9	1.0	0.8
Subsidies to public enterprises	3.1	4.8	6.2	5.1	4.8	4.8
Other subsidies and transfers 3/	5.0	2.9	6.7	7.8	7.1	8.1
Capital expenditure	13.8	11.1	25.5	27.8	24.4	16.5
Current balance	-0.9	2.7	9.6	10.8	-2.6	-1.3
Overall balance	13.2	-0.5	-5.0	-0.6	-0.6	-0.4
Financing	13.2	6.9	11.9	16.7	21.7	17.8
Net government debt repayment	-4.1	-2.1	-0.5	0.6	1.0	1.0
Principal repayment	0.2	0.2	0.5	0.7	1.0	1.0
Gross borrowing	4.3	2.3	1.0	0.1	0.0	0.0
Change in government financial assets	17.3	9.0	12.4	16.1	20.7	16.8
Of which: Trust Fund	17.1	7.5	16.9	17.3	22.3	18.3
			(In percent of GDP)			
Revenue and grants	67.1	57.9	71.0	74.3	68.8	60.6
Revenue	23.1	25.5	25.7	25.0	26.1	23.3
Grants	44.0	32.5	45.4	49.3	42.7	37.3
Expenditure	56.4	58.3	74.6	74.7	69.2	60.9
Current	45.4	49.9	56.2	55.5	52.9	50.5
Wages and salaries	20.6	23.0	23.7	23.4	21.5	21.3
Goods and services	17.6	20.4	22.6	22.6	22.4	20.5
Capital	11.1	8.5	18.4	19.1	16.3	10.4
Current balance	-0.7	2.0	6.9	7.4	-1.7	-0.8
Overall balance	10.6	-0.4	-3.6	-0.4	-0.4	-0.3
			(In millions of U.S. dollars)			
Memorandum items:						
Total expenditure excl. non-compact grants	48.2	54.5	68.0	72.4	80.7	79.7
Total government financial assets	50.0	59.0	71.4	87.5	108.2	125.0
Of which: Trust Fund	31.2	38.2	52.6	67.9	90.6	109.3
Usable government financial assets 4/	2.9	4.5	1.6	3.0	1.3	-0.1
Outstanding government debt	62.4	64.5	65.7	65.8	64.8	63.8
Nominal GDP	124.2	131.3	138.3	145.6	149.7	158.4

Sources: Data provided by the RMI authorities; and Fund staff estimates.
1/ The fiscal year ends on September 30.
2/ Does not include Compact funds earmarked for Kwajalein rental payments and trust fund contributions.
3/ For FY2003, transfers include operating transfers amounting 16 million to the Compact Trust Fund.
4/ Cash and cash equivalents that are not reserved for specific uses.

Table 9. Marshall Islands: Central Government Current Expenditure, FY2003–08[1/]

(In millions of U.S. dollars)

	FY2003	FY2004	FY2005	FY2006	FY2007 Est.	FY 2008 Proj.
Government	22.2	15.3	13.9	7.2	5.2	8.3
President and Cabinet	1.5	1.6	1.7	1.9	1.8	1.8
Advisory Council of High Chiefs (Iroij)	0.4	0.4	0.4	0.4	0.4	0.4
Legislature (Nitijela)	1.6	1.5	1.7	1.8	1.7	1.7
Commissions, agencies, and offices	0.4	0.8	0.4	0.5	0.5	0.5
Special/Other	18.4	10.9	9.7	2.6	0.8	3.9
Ministries	34.1	50.2	63.9	73.7	74.0	71.7
Health and Environment	7.3	7.4	17.2	21.1	18.8	22.0
Education	7.4	7.2	19.8	21.8	26.1	24.9
Transportation and Communications	1.7	2.6	3.6	2.6	2.2	1.8
Interior and Social Welfare	1.9	2.6	2.5	2.1	2.5	2.4
Public Works	1.3	1.2	1.2	1.3	1.4	1.4
Social Services	0.0	0.0	0.0	0.0	0.0	0.0
Resources and Development	0.7	1.1	2.0	0.8	0.8	0.8
Foreign Affairs	2.7	2.9	3.0	2.5	2.5	2.8
Finance	1.8	2.4	3.7	6.5	2.6	3.2
Justice	2.5	2.7	3.7	3.9	3.9	4.1
Auditor General	0.8	0.6	0.8	0.7	1.0	1.0
Chief Secretary	0.6	0.7	0.7	0.8	0.7	0.7
Other	5.4	18.9	5.7	9.2	11.5	6.6
Interest payments	0.8	0.9	0.9	0.9	1.0	0.8
Subsidies to public enterprises	4.8	4.8	6.2	5.1	4.8	4.8
Total	65.5	69.9	77.8	80.8	79.2	80.0

Sources: Data provided by the RMI authorities; and Fund staff estimates.
1/ Fiscal year ending September 30.

Table 10. Marshall Islands: Assets and Liabilities of Deposit Money Banks, FY2003–07[1/]

(In millions of U.S. dollars)

	FY2003	FY2004	FY2005	FY2006	FY2007 Est.
Assets	89.1	94.3	95.6	98.3	112.8
Foreign assets	48.3	51.0	53.6	57.6	60.9
Claims on central and local governments	1.4	1.3	0.5	0.3	0.6
Claims on private sector	40.4	43.4	43.6	43.2	53.6
Consumer	36.9	38.5	38.2	35.2	40.6
Commercial	3.5	4.9	5.4	8.0	13.1
Unclassified assets	-1.0	-1.4	-2.1	-2.7	-3.3
Liabilities	89.1	94.3	95.6	98.3	112.8
Deposits	72.2	74.9	74.3	75.5	89.6
Demand deposits	23.6	27.0	26.1	25.7	25.5
Time deposits	22.0	20.0	17.7	16.2	20.6
Savings deposits	17.6	18.1	22.7	26.6	35.5
Central government deposits[2/]	9.0	9.8	7.8	7.0	7.9
Foreign liabilities	3.5	4.1	3.8	3.7	1.3
Capital accounts	12.9	14.8	17.0	18.6	21.2
Unclassified liabilities	0.5	0.5	0.5	0.6	0.7
Memorandum items:					
Loan/deposit ratio (in percent)	57.8	59.7	59.3	57.6	59.8
Deposits (12-month percent change)	9.1	3.6	-0.8	1.6	18.7
Loans (12-month percent change)	-1.5	7.0	-1.4	-1.3	24.1
Consumer loans (in percent of total loans)	88.4	86.2	86.6	81.0	75.6
Commercial loans (in percent of total loans)	8.3	10.9	12.3	18.4	24.4
Nonperforming loans (in percent of total loans)[3/]	1.5	2.0	2.0	2.0	2.0

Source: Data provided by the RMI authorities.

1/ Calendar-year basis 4 quarter average to 2000. The deposit money banks comprise the Bank of Hawaii (until 2002), the Bank of Guam, and the Bank of the Marshall Islands.
2/ Includes the deposits of social security administration and other trust funds.
3/ Nonperforming loans are defined as those with arrears in excess of 90 days.

Table 11. Marshall Islands: Interest Rates of Deposit Money Banks, 2003–07[1/]

(In percent per annum)

	2003	2004	2005	2006	2007
Deposit rates					
Savings accounts[2/]	1.5	1.1	1.2	1.7	1.7
Time deposits[3/]					
Three months	1.8	1.3	2.2	2.5	2.5
Six months	2.0	1.6	2.9	3.2	3.2
One year or more	2.6	2.1	3.5	4.0	4.0
Loan rates[4/]					
Consumer loans	17.7	17.4	18.5	18.5	18.5
Commercial loans	9.8	9.7	11.0	11.0	11.0

Source: Banking Commission, RMI.
1/ Year average.
2/ Average of rates offered by deposit money banks.
3/ Average of minimum rates offered by deposit money banks.
4/ Average of maximum rates charged by deposit money banks.