INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/349

REPUBLIC OF THE MARSHALL ISLANDS

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR REPUBLIC OF THE MARSHALL ISLANDS

October 2023

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with Republic of the Marshall Islands, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 18, 2023 consideration of the staff report that concluded the Article IV consultation with Republic of the Marshall Islands.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 18, 1023, following discussions that ended on July 5, 2023, with the officials of Republic of the Marshall Islands on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 30, 2023.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Republic of the Marshall Islands.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
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PRESS RELEASE

PR23/319

IMF Executive Board Concludes 2023 Article IV Consultation with the Republic of the Marshall Islands

FOR IMMEDIATE RELEASE

Washington, DC – **September 21, 2023:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of the Marshall Islands.

The Republic of the Marshall Islands (RMI) is in the midst of a post-pandemic recovery. Real GDP declined by 4.5 percent in the fiscal year ending September 2022 due to lower fisheries production arising from the sale of a fishing vessel by a domestic operator. However, excluding the sector, growth was 4.2 percent, confirming a recovery in domestic demand is underway. Inflation picked up to 7.9 percent in March 2023 on the back of higher food and fuel prices while the current account surplus narrowed on the back of a decline in export volumes and grants and an increase in import payments due to higher prices.

Growth is expected to strengthen to 3 percent over FY2023-24 as performance in the fisheries sector improves, with construction activity supported by the resumption of donor-financed projects and preparations for the 2024 Micronesian Games. Inflation is expected to moderate as commodity prices ease and supply disruptions recede. The current account surplus is expected to narrow further as COVID-related grants expire, though improved export performance is expected to lead to a narrowing of the trade deficit. The medium-term outlook is contingent on the successful renewal of the Compact of Free Association agreement with the United States. A new agreement would strengthen the RMI's fiscal and external positions while in its absence, the fiscal and current account balances are expected to slip into deficit over the medium term. Risks are tilted to the downside, reflecting the RMI's geographical isolation and vulnerability to climate change.

Executive Board Assessment[2]

Executive Directors commended the authorities' actions to spur the post-pandemic recovery, and welcomed that growth is expected to rebound in FY2023. They emphasized, however, that the outlook is subject to significant uncertainty and risks—in particular, related to the country's geographic isolation, vulnerability to climate change, volatility in fishing revenues and copra output, and fragile financial and trade links. Directors underscored the importance of steadfast reform implementation to secure fiscal sustainability, address structural vulnerabilities, and support private sector growth, while leveraging Fund technical assistance.

Directors emphasized the need for strong efforts to ensure fiscal consolidation in the near term, including through firm revenue mobilization and expenditure reprioritization. While

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

welcoming the progress toward a new Compact agreement with the United States—which would strengthen external and fiscal sustainability—Directors stressed that additional fiscal reforms are needed to build buffers, meet the significant investment demands, and safeguard long-term fiscal and debt sustainability. They encouraged complementing the ongoing modernization of the public financial management framework and the customs revenue system with reforms to enhance tax administration and policies. Gradually reducing subsidies to state-owned enterprises while replacing them with targeted support to the most vulnerable would also be important.

Directors encouraged the authorities to strengthen financial integrity and improve supervision. They urged a cautious approach to new FinTech initiatives, including related to the establishment of Decentralized Autonomous Organizations and the introduction of a stablecoin, and recommended ensuring that an appropriate supervisory framework is in place. Directors also encouraged repealing the Sovereign Currency Act and withdrawing the Digital Economic Zone for Rongelap Atoll Bill. Strengthening the AML/CFT framework is key, including to avoid the loss of correspondent banking relationships. Directors concurred that establishing a Monetary Authority—with an appropriately focused mandate—could strengthen financial stability and inclusion.

Directors emphasized the critical importance of building climate resilience, strengthening disaster management, and prioritizing climate-related investments. Completing the National Adaptation Plan would help guide the transition to climate resilience, identify critical investments, and attract the needed external financing. Directors also encouraged structural reforms to boost growth and investment by promoting economic diversification and addressing the lack of available land.

Table. Republic of the Marshall Islands: Selected Economic and Financial Indicators, FY2019 – 2028[1]

			Preliminary		Projection					
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028
Output and inflation										
Real GDP (percent change)	10.3	-2.9	1.0	-4.5	3.0	3.0	2.0	1.8	1.5	1.5
Consumer prices (percent change, period average)	-0.1	-0.7	2.2	3.2	5.2	2.8	2.3	2.0	2.0	2.0
Consumer prices (percent change, end of period)	-1.7	1.5	2.2	5.7	3.0	2.5	2.0	2.0	2.0.	2.0
Central government finances (in percent of GDP)										
Revenue and grants	64.0	70.7	70.4	66.4	62.8	69.5	67.8	68.9	71.6	70.1
Total domestic revenue	33.0	31.7	28.7	31.3	30.9	41.7	40.9	41.0	41.0	41.1
Grants	31.0	39.0	41.7	35.0	31.9	27.8	26.9	27.9	30.6	29.0
Expenditure	65.8	68.2	70.2	65.7	62.8	69.4	68.8	70.3	73.1	72.0
Expense	63.2	62.2	63.3	59.4	53.0	53.5	54.5	56.1	58.4	57.6
Net acquisition of nonfinancial assets	2.6	5.9	6.8	6.3	9.8	15.9	14.3	14.2	14.8	14.4
Net lending/borrowing	-1.8	2.5	0.2	0.7	0.0	0.1	-1.0	-1.4	-1.6	-2.0
Compact Trust Fund (in millions of US dollars; end of period)	434.7	514.4	668.9	567.6	621.1	620.9	622.5	623.7	624.3	624.4
Balance of payments (in percent of GDP)										
Current account balance	-31.3	15.0	22.6	8.2	4.1	-0.4	-4.8	-8.0	-12.0	-15.0
Goods and services balance	-79.3	-37.2	-24.9	-33.1	-27.3	-33.7	-35.6	-38.8	-43.0	-44.6
Primary income	21.4	18.9	9.7	11.1	9.7	20.1	18.2	17.2	16.1	15.1
Of which: fishing license fee	10.4	8.6	7.1	6.7	7.6	7.6	7.6	7.5	7.5	7.5
Secondary income	26.6	33.3	37.7	30.2	21.7	13.1	12.6	13.7	14.8	14.5
Of which: Compact current grants	16.0	14.8	12.7	12.2	12.7	3.5	3.4	3.3	3.3	3.2
Of which: other budget and off-budget grants	10.4	18.2	24.7	18.4	8.6	9.5	9.1	10.3	11.5	11.3
Current account excluding current	-16.4	-24.2	-18.4	-4.3	-9.0	-12.2	-16.4	-11.3	-15.3	-18.3
External PPG debt (in millions of US$; end of period)[2]	67.5	66.2	63.5	59.6	59.7	59.2	62.3	66.7	71.6	78.6
External PPG debt (Percent of GDP; end of period)[2]	29.1	27.5	24.6	22.8	21.6	20.2	20.5	21.1	21.9	23.2
Memorandum item:										
Nominal GDP (in millions of US dollars)	231.9	240.6	257.5	261.2	276.8	292.8	304.5	315.9	327.0	338.4

Sources: Republic of the Marshall Islands (RMI) authorities; and IMF staff estimates and projections.
[1]Fiscal year ending September 30.
[2]Assumption is that RMI will receive its MDBs financial assistance in a mix of grants and loans.

INTERNATIONAL MONETARY FUND

REPUBLIC OF THE MARSHALL ISLANDS

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

August 30, 2023

KEY ISSUES

Context. Real GDP declined by 4.5 percent in FY2022 due entirely to a decline in fisheries. However, excluding the sector, growth was 4.2 percent, fueled by a recovery in domestic demand. Inflation has picked up due to higher food and fuel prices, while the current account surplus narrowed as COVID-related grants declined and the trade deficit widened.

Outlook and Risks. Growth is expected to strengthen to 3 percent in FY2023 as fisheries improve, supported by the resumption of donor-financed projects and investment related to the 2024 Micronesian Games. The medium-term outlook is contingent on the renewal of the Compact agreement with the US, the largest source of government revenues since 2004: a new agreement would strengthen the fiscal and external positions and mitigate debt sustainability risks.

Policy recommendations.

- **Fiscal** reforms are needed irrespective of whether a new Compact agreement is reached. In a no-Compact baseline scenario, there is an urgent need for a significant and broad-based fiscal consolidation to avoid depleting the Compact Trust Fund. Even with a new Compact, revenue and expenditure rationalization and reprioritization reforms are needed to make space for necessary climate investment and build the fiscal buffers to address more frequent natural disasters.
- **Financial sector** policies should focus on mitigating risks to financial integrity, particularly from new FinTech initiatives where the supervisory framework is not yet fully in place. The authorities should impose a moratorium on the registration of new Decentralized Autonomous Organizations (DAOs) and proceed cautiously on other initiatives. While caution on past initiatives is welcome, steps should be taken expeditiously to close off remaining risks by repealing the Declaration and Issuance of the Sovereign Currency (SOV) Act and withdrawing the Digital Economic Zone for Rongelap Atoll (DEZRA) bill from the parliament.
- **Structural policies** should focus on strengthening climate resilience and addressing impediments to growth and investment. The National Adaptation Plan should be released as planned in 2023. A dedicated climate finance unit to identify, package and implement climate projects could facilitate access to climate finance. Addressing the availability of land and encouraging its efficient use would help support investment and growth.

Approved By
Abdoul Aziz Wane (APD) and Martin Čihák (SPR)

Discussions took place in Majuro between May 12-22, 2023, followed by virtual meetings between June 20-July 5, 2023. The mission team comprised Narayanan Raman (head), Muhammad Shamil Akbar, Shogo Takahashi (all APD) and Valeria Mensah (ICD). Neil Saker (Resident Representative in the Pacific), Seron Shivanjali (RRO) and Kathleen Kao (LEG) joined the meetings remotely. Mr. Yoo (OED) participated in discussions with the authorities. Ricardo Pinto Davico and Seble Abebe assisted in the preparation of this report.

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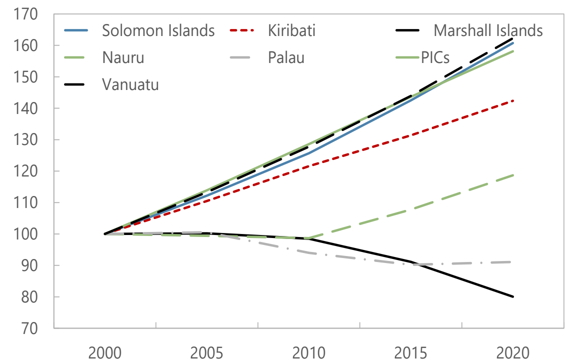
CONTEXT AND RECENT DEVELOPMENTS

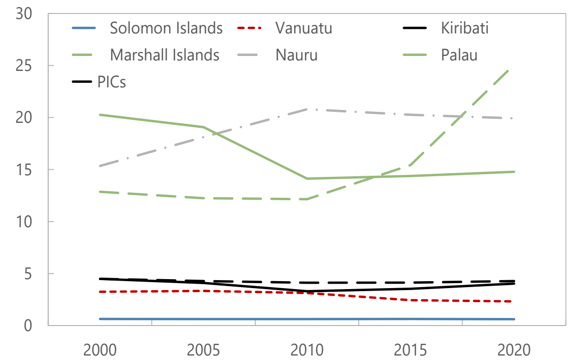
1. **The Republic of the Marshall Islands (RMI)'s vulnerability to climate change is compounded by its geographical isolation and adverse demographic trends.** Climate change is already resulting in rising sea levels, coastal erosion and a higher frequency of extreme weather events. These will endanger copra production and fisheries, the major economic activities in the RMI. Its isolation and sparse transport links raise shipping and business costs. Real GDP growth lags regional peers (Figure 1), while provisions of the Compact of Free Association allow Marshallese citizens by birth to move to and work in the United States without visas.[1] As a result, the population shrank by more than 22 percent between 2000-21 even as Pacific Island Countries (PICs) as a group experienced a nearly 28 percent increase over the same period. Parliamentary elections are scheduled to take place in November 2023.

Population Trends in the PICs
(Index Year 2000 = 100)



Source: United Nations

Migration Rates in the PICs
(Percent)



Source: United Nations

2. **RMI weathered the pandemic well, using stringent lockdowns and border closures to give time for the vaccine roll out.** The RMI reported no COVID cases until October 2020, and only sporadic individual cases thereafter until restrictions were lifted. In August 2022, after 70 percent of the population aged 6 and older were fully vaccinated, controls were eased. This resulted in a domestic outbreak and reported cases climbed from 1 case (7-day moving average) on August 2 to 1,298 by August 21, leading to a reimposition of restrictions and intensification of the vaccination campaign. Reported cases fell to 4 by September 8 and restrictions were lifted again in early September. To address the economic hardship due to lockdowns, the authorities rolled out a Coronavirus Preparedness and Response Plan, financed through a US$78 million grant from development partners, that was used to provide social protection and unemployment assistance,

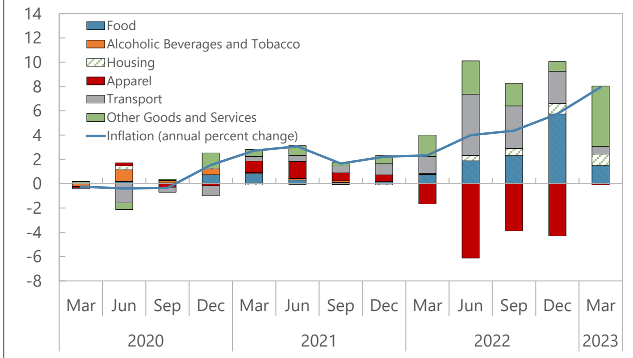
[1] The Compacts of Free Association are agreements covering security and strategic access to the territories of RMI, Palau and the Federated States of Micronesia (FSM), by the US, in return for financial assistance and provision of services, as well as other considerations. The other Compact countries enjoy a similar ease of migration to the US and experienced depopulation over the same period.

medical supplies and vaccines, and support for businesses. As of March 2023, about 83 percent of the eligible population were fully vaccinated.

3. Despite a contraction in real GDP in FY2022, the post-pandemic recovery in domestic demand remains intact while inflation picked up. After declining in FY2020, real GDP remained largely flat in FY2021. In FY2022, it declined by 4.5 percent, reflecting the 40 percent decline in the fisheries sector due to the sale of a fishing vessel by a domestic operator, which decreased production (Figure 1). Excluding the sector, real GDP expanded by 4.2 percent, buoyed by a recovery in domestic demand, partially offset by the temporary lockdowns in August 2022 and supply chain disruptions. Inflation picked up in 2H 2022 due to higher food and fuel prices and supply chain disruptions, reaching 7.9 percent by March 2023. To address the higher cost of living, the authorities reversed an electricity rate increase for domestic users that took effect in November 2022, though those on business and industrial users were retained. Payments to copra producers from the state-owned Tobolar Copra Processing Authority were increased to alleviate cost-of-living pressures.

Inflation Picked Up

(Percentage point contribution to CPI)



Source: National authorities and IMF staff estimates.

4. The current account surplus narrowed on account of lower export volumes and grant inflows, and rising import prices. In FY2021, exports of fish rose significantly while grant assistance was higher to address the pandemic, which raised the current account surplus to 22.6 percent of GDP. However, in FY2022, fish landings were significantly lower due to the westward migration of schools and the sale of a fishing vessel. The August lockdown may have also impacted fish production by impeding the mobility of workers. Lower grants reflected the decline in COVID-related support. Higher international commodities prices drove up import payments for food and fuel. As a result, the current account surplus narrowed to 8.2 percent of GDP. The External Sector Assessment suggests that the RMI's external position at the end of FY2022 was substantially stronger than the level implied by fundamentals and desirable policies (Annex I).

5. The FY2023 fiscal outcome is expected to be largely in line with the Budget. In FY2022, despite falling taxes and receding COVID-related grants, RMI recorded a fiscal surplus of 0.7 percent of GDP due to a contraction in expenditure of 4.5 percent of GDP as spending on goods and services, and investments fell. With the economic rebound in FY2023, tax collection should recover while fishing licenses and transshipment revenues are projected to improve from a low base. Despite pressures on spending owing to still-high fuel prices and subsidies to support state-owned enterprises (SOEs), overall expenditure is expected to keep pace with revenues to ensure broad adherence to the balanced budget rule under the Fiscal Responsibility and Debt Management Act (FRDMA).

6. The banking sector appears to be well-capitalized and liquid, partly reflecting weak credit growth, but non-performing loans (NPLs) rose at end-FY2022. The banking system's tier-1 risk-based capital ratio stood at 15 percent at end-2022, above the 8 percent statutory minimum, while total liquid assets (including short-term loans to the private sector) held stood at 75 percent of deposits, exceeding the 20 percent statutory requirement. Although the NPL ratio rose from around 2 percent at end-September 2022 to over 10 percent at end-2022 (Table 6), this was due to an idiosyncratic shock from the failure of a specific borrower rather than reflecting a larger deterioration in economic conditions or financial stability. The impacted bank continues to be in a position to meet statutory standards. Further, exposure to the external financial environment, such as the increases in the Fed funds rate and volatility in the US banking sector in early 2023, appears to be limited, with the low level of credit demand further limiting pressures on domestic interest rates.

7. Negotiations to renew the Compact of Free Association agreement with the United States are ongoing. The current Compact agreement, which expires at end-September, provides significant financial assistance in the form of grants (10.2 percent of GDP in FY2023) and access to the US Federal programs, which support key social expenditures such as health, education and communications. Other than financial support of the government, the Compact also makes payments to landowners, and communities impacted by weapons testing by the US military. In January 2023, the US and the RMI signed a Memorandum of Understanding (MoU) on the financing package for a new Compact, reported to amount to US$2.3 billion over 20 years starting from FY2024 alongside access to Federal programs such as postal services, and support for healthcare and education. However, negotiations on the details, including allocations for specific purposes and compensation for nuclear testing are still ongoing, with no timeline for a resolution.[2] Even when negotiations are successfully concluded, the Compact agreement cannot take effect until ratification by legislatures in both countries.

OUTLOOK AND RISKS

8. Growth is expected to strengthen to 3 percent in FY2023 as inflation moderates. The economy is projected to gain momentum on the back of improvements in copra production, fishing revenues and transshipment activities. While the westward migration of tuna is expected to continue in FY2023, there has been an increase in port activities and transshipments, suggesting conditions are gradually improving. The fisheries sector is expected to benefit from new investments in docks and canning facilities over the medium term. However, these will take time to come onstream, and are unlikely to offset the reduction in the domestic fishing fleet in the near term. The construction sector is expected to be boosted by the revival of donor-financed projects and investment for the

[2] Palau and FSM signed their new Compact agreements in May 2023.

Micronesian Games scheduled in 2024, including on new sporting venues and accommodation for visitors. Inflation is expected to moderate to 3 percent by end-FY2023 as the decline in global fuel prices alleviates price pressures (Table 1).

9. The current account surplus is projected to narrow further to 4.1 percent as COVID-related assistance expires in FY2023. While exports would improve by around 17.1 percent, largely due to recovery in fish production, this is expected to be outstripped by higher imports, reflecting the ongoing recovery in domestic demand and revival of infrastructure projects. Grants are expected to decline by 22 percent, reflecting the end of COVID-related assistance. Remittances are expected to grow by 2.7 percent in FY2023, primarily reflecting sustained income growth in the US (Table 3).

10. The medium-term outlook is contingent on Compact renewal. Real GDP growth is expected to be sustained at 3 percent in FY2024 on the back of improved export performance, as the tuna migration cycle turns, and sustained support from multilateral donors. Over the medium term, growth would gradually converge to the historical average of 1.5 percent in the absence of structural reforms. As the prospects and timeline for a renewal of the Compact are uncertain, staff's baseline does not include a resumption of Compact financial assistance but the shortfall in grants will be largely offset in the near term by drawings on the Compact Trust Fund (CTF). In the absence of a new Compact, the fiscal and current account balances are expected to slip into deficits in the medium term. In turn, these are expected to contribute to an increase in public borrowing. As a result, the RMI continues to be classified at high risk of distress on its public and publicly guaranteed debt (Debt Sustainability Analysis, DSA).

11. Risks to the outlook are mostly tilted to the downside (Annexes II and III). On the domestic front, the volatility in fishing revenues and copra output could impact economic growth and the current account. In addition, copra production could be impacted by the onset of El Niño, which has been associated with lower rainfalls in the past, particularly in the northern islands. The launch or revival of FinTech initiatives could have adverse implications for the RMI's access to the global financial system and payments networks. On the external front, the RMI is exposed to global commodity price volatility, with a high passthrough to domestic inflation. A deeper-than-expected slowdown in major trading partners could adversely impact exports and remittance inflows. The suspension of air cargo services due to the grounding of Asia Pacific Airlines in early 2023 demonstrated the RMI's ongoing vulnerability to sudden transport and supply chain disruptions. The RMI is vulnerable to extreme weather events due to climate change, as well as to geo-economic fragmentation.

Authorities' Views

12. The authorities largely agreed with the staff's assessment. They noted that economic activity has picked up gradually since the lifting of pandemic-related restrictions and are confident the revival of donor-financed infrastructure projects supports medium-term growth. In the fisheries sector, they pointed to ongoing private investment in docking and cannery facilities, which is expected to spur both higher fish catches in the future and a shift up the value chain in the sector.

While welcoming the recent moderation in commodity prices, the authorities stressed the importance of maintaining relief to households through lower electricity tariffs and higher payments to copra producers to alleviate cost-of-living burdens. The authorities stressed their commitment to finding a solution in the ongoing Compact negotiations and remain optimistic about reaching an eventual agreement.

POLICY DISCUSSIONS

A. Fiscal Policy: Planning for Near-term Risks and Long-term Uncertainty

13. Uncertainty around Compact negotiations has made formulating near-term fiscal policy challenging. The authorities do not prepare a medium-term fiscal framework; the annual budgetary framework is driven by the balanced budget requirements in the FRDMA. That said, the RMI faces a significant revenue shortfall when the Compact expires. In the near term, the loss of grants can be alleviated[3] by drawing on the CTF (Annex IV) though other forms of support such as access to US Federal programs and special grants for education will cease. However, the resources in the CTF are limited—as at end-May 2023, it had a net asset position of US$680 million (245 percent of GDP)—and could not substitute for the current level of grants indefinitely. Further, the design of the CTF envisages only using income earned in any given year to meet budgetary needs, with possible recourse to a limited buffer account. This places additional restrictions on how the CTF could be used. On the other hand, a successful completion of negotiations would strengthen RMI's fiscal and external positions over the longer term.

14. Fiscal pressures are expected to mount in a no-Compact scenario (Table 2). To ensure adherence with the FRDMA, and in the absence of revenue reform measures, some reduction in spending will be needed in FY2024. Over time, there will be an increasing need for fiscal consolidation to keep financing needs consistent with fiscal sustainability. Staff have assumed that over the medium term, some consolidation will take place by cutting subsidies from 6 percent of GDP in FY2022 to 0.7 percent of GDP by 2028. Subsidies rose by 68 percent y/y in nominal terms in FY2015 and by an average annual rate of 7.8 percent between FY2016-22. Staff have assumed that these past increases will be reversed by FY2025, with additional consolidation efforts toward the end of the medium-term horizon in an attempt to stay within the resource envelope. Nevertheless, without additional measures, these expenditure cuts will not be enough to offset the loss of Compact grants without significant cuts in core government spending. As a result, the fiscal balance is projected to slip into deficit from FY2025, and worsen over time, financed by greater borrowing,[4] mainly from multilateral development banks (MDBs). While drawings from the CTF will cushion the loss of grants, the use of

[3] For FY2024, the RMI could draw up to around US$40 million, which is the full amount of the FY2023 grant total, with an inflation adjustment.

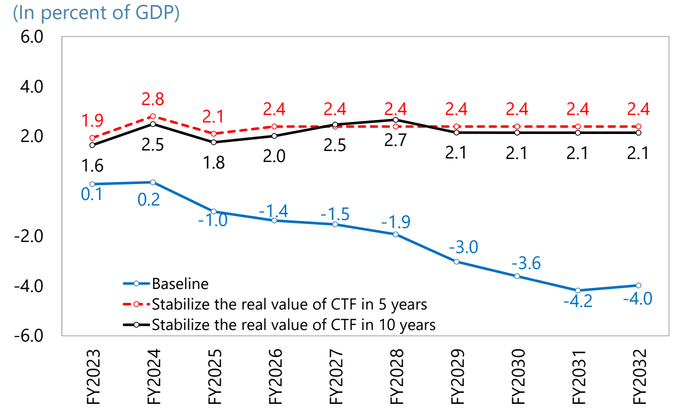
[4] The baseline assumes financing from the Asian Development Bank (ADB) will shift from all grants in FY2024 to an equal mixture of grants and loans by FY2028. World Bank (WB) financing will remain fully grants until FY2025 and then shift to a mix of grants and loans until FY2033, after which it will be fully on credit terms.

these resources will cause the fund to gradually decline in the fund to around 177 percent of GDP by FY2029.

15. A fiscal consolidation aimed at maintaining the real value of the CTF would ensure long-term fiscal sustainability and reduce risks in the absence of a new Compact. This would ensure the CTF can be a viable source of revenues over the longer term by shoring up its financial position. An update of staff's 2021 analysis suggests that increasing annual surpluses to around 2.4 percent of GDP from FY2027 onwards would stabilize the real value of the CTF within 5 years. Similarly, a surplus of around 1.6 percent from FY2023, increasing gradually thereafter to around 2 percent, could allow stabilization within 10 years. In addition to ensuring the CTF remains a viable source of financing over the long term, the proposed reforms could also support a reorientation of expenditure to meet the challenges of adapting to climate change.

Fiscal Balance Path

(In percent of GDP)



Source: IMF staff estimates.

16. The renewal of the Compact would ensure fiscal surpluses in the medium term and strengthen the financial position of the CTF. Reports indicate that Compact grants could be between 50-100 percent higher in nominal terms over the 20 years under a new agreement relative to the current Compact. The overall fiscal balance will benefit with average surpluses of around 1.6 percent of GDP through FY2029. Public debt will decline to 16.7 percent of GDP by FY2028, while the CTF's net asset position is expected to be around 47 percent of GDP higher than the baseline, due to both the postponement of drawdowns to FY2043 and resumption of contributions. However, the improvement in the near-term fiscal balance under a Compact renewal scenario will be limited as there will be no drawings on the CTF in this scenario. Fiscal reforms will help complement the new Compact by creating space to accommodate investment in infrastructure and climate adaptation. Additionally, the authorities will need to accumulate fiscal buffers to support disaster management, and relief and recovery efforts, as natural disasters become more frequent.

17. Fiscal reforms would differ in size and sequence depending on the timing and outcome of Compact negotiations. Given the challenges in both Compact and no-Compact scenarios, staff recommend fiscal reforms, although the ambition and pace may differ in the two scenarios. Specifically, there needs to be:

- A reprioritization of expenditure away from recurrent spending to capital investments.[5] The subsidies provided to SOEs, some of which are intended to be channeled to households, should be reduced gradually and replaced by targeted assistance to the most vulnerable. There also needs to be strict control on other elements of current spending, particularly administration costs.

- Revenue reforms aimed at diversifying and strengthening collection would lower risks from relying on the narrow and volatile fisheries and copra sectors. There are several pending tax policy reforms,[6] including setting up a revenue authority, and implementing taxes on net profits, excises and consumption that are awaiting adoption. Further, revenue administration reforms such as strengthening filling and payment activities, improving arrears collections, and improving internal processes to better identify and manage risks should make the system more efficient and improve the investment climate.

Republic of the Marshall Islands: Potential Impact of Fiscal Reforms
(percent of GDP)

	FY 2022	FY 2028 Baseline	FY 2028 Active reform scenario
Taxes	**13.8**	**16.1**	**19.0**
Taxes on income, profits, and capital gains	6.4	7.5	8.9
Taxes on goods and services	3.1	3.4	4.4
Taxes on international trade and transactions	3.9	4.6	5.1
Expenditure	**65.7**	**72.0**	**71.2**
Of which: Subsidies	6.3	0.7	0.5
Of which: Transfers to households	2.8	2.2	1.6
Primary balance	**0.8**	**-1.8**	**1.9**
Net operating balance	**7.0**	**12.4**	**16.1**
Net lending/borrowing	**0.7**	**-1.9**	**1.7**

Source: IMF staff estimates and projections.

These reforms are estimated to deliver higher revenues of around 3 pp and lower expenditure by around 1 pp of GDP relative to the baseline by FY2028. This would be sufficient to achieve a fiscal surplus of 1.7 percent by the end of the medium-term window—close to the estimated 2 percent surplus that would be needed to preserve the real value of CTF in a no-Compact scenario.

Authorities' Views

18. The authorities largely agreed with the staff's assessment on the need for fiscal consolidation in the face of uncertainties around Compact renewal. They reiterated their commitment to meeting the balanced budget target under the FRDMA, while acknowledging the lack of clarity on a new Compact agreement has complicated their Budget planning process for FY2024 and beyond. On fiscal reforms, they highlighted the ongoing public financial management reform program to modernize the PFM framework through a new Financial Management and Information System (FMIS). When fully implemented, the FMIS is expected to strengthen budgetary control, improve transparency, enable timely audits of government bodies, and achieve their expenditure rationalization

[5] The WB's 2021 public expenditure review highlights significant under-investment in infrastructure, while SOE subsidies and transfers to non-profits and households grew rapidly in recent years.

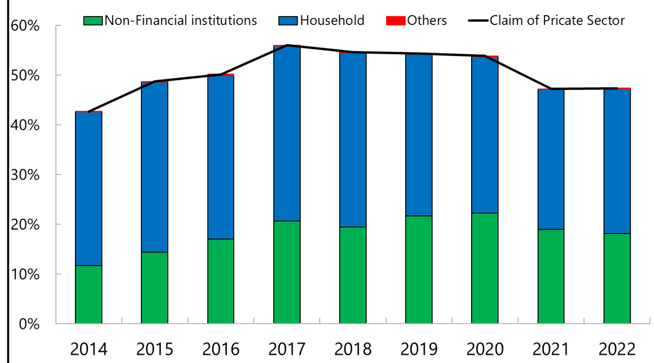
[6] Bills to set up a Revenue Authority, and implement net profits, excises and consumption taxes were prepared with PFTAC support.

goals. The authorities are also modernizing the Customs revenue management system by adopting an ASYCUDA system, which should strengthen revenue collection and provide important and timely data on imports. This is expected to be launched in FY2024.

B. Financial Sector: Addressing Risks to Maintain and Strengthen International Financial Links

19. Due to the low level of financial development, the financial system plays a limited role in supporting growth, while systemic risks remain contained. The RMI is a fully dollarized economy, with limited international financial links. The main domestic commercial bank has one remaining correspondent banking relationship (CBR) with a US bank while another US-based bank operates a branch in the RMI. There is a new domestic entrant into the system that started operations in 2023, and thus far it remains small. Banking sector claims on the private sector amounted to 47.4 percent of GDP at end-FY2022, and has been declining since FY2017. While more recent data is not available, anecdotal evidence suggests that loan growth picked up in FY2023, though it is not yet at pre-pandemic levels. The payments system is costly and slow, relying mainly on manual check clearing. Systemic risks remain contained: the banking system is well-capitalized and liquid, and notwithstanding the recent increase in NPLs, provisioning remains adequate, with the main foreign bank able to draw on the support of its parent (Table 6). RMI banks have limited exposure to offshore funding, relying on domestic deposits. The key systemic risk remains the potential loss of CBRs due to financial integrity concerns (see below).

Credit to Private Sector
(In Percent of GDP)



Sources: National authorities; and IMF staff calculations.
Note: Others include non-banking financial institutions and NonProfit Institution Serving Households

20. New FinTech initiatives have been launched, but the regulatory and supervisory framework to monitor them is not yet fully in place (Annex V). The Decentralized Autonomous Organization (DAO)[7] Act was passed in 2022, allowing for the registration of DAOs as onshore corporations in the RMI, and registrations have started. Through May 2023, 52 applications were received, and 25 entities were given their charters. The RMI is just one of a handful of jurisdictions registering DAOs. Globally, the high level of technical capacity; coordination between law enforcement, financial regulators and tax authorities; and understanding needed to effectively regulate and oversee them are still evolving. In the RMI, where capacity is constrained, regulation and oversight, including to address ML/TF risks, have been challenging to implement. The

[7] DAOs are entities that are algorithmically managed through smart contracts stored on a blockchain.

authorities are seeking technical assistance to develop safeguards, but there is no clarity on what specific measures could be implemented. Given this, the authorities should consider a moratorium on new registrations until the needed oversight can be implemented. A pilot project to introduce a stablecoin, run by a foreign private operator, to support domestic payments is also being explored. The introduction of a state-backed privately administered crypto asset may be in conflict with the Fund's policy advice[8] as this could adversely impact monetary stability and raises risks to financial integrity. In any event, the authorities would need to assess the ML/TF risks of the proposed stablecoin and develop appropriate mitigating measures prior to its launch. A more efficient payments system would be beneficial but implementation should be approached carefully. In particular, an adequate legal and regulatory framework, supervisory oversight and careful vetting of future costs are needed. The authorities could encourage interoperability of banks' payments and settlements systems, including by empowering an appropriate institution to set up the necessary infrastructure.

21. The new initiatives follow from past initiatives that staff had previously raised concerns over. The above-mentioned initiatives come on top of the passage of the SOV Act (2018)—which allows the issuance of a digital sovereign currency—and the proposal to set up the Digital Economic Zone for Rongelap Atoll (DEZRA). Following consultations with stakeholders, no new steps have been taken to move forward on either initiative. A SOV repeal bill has been prepared but not yet introduced in parliament. The authorities are strongly encouraged to take measures to expeditiously address these risks, including completing the SOV repeal and removing the DEZRA bill from parliamentary consideration. This would permanently close off the remaining risks from these initiatives.

22. Digital initiatives add to existing financial integrity concerns, necessitating urgent efforts to strengthen the AML/CFT framework. In addition to caution around FinTech initiatives, risks around the offshore services sector need to be adequately mitigated. The RMI is currently undergoing a mutual evaluation of its anti-money laundering and combatting the financing of terrorism (AML/CFT) framework and its effectiveness by the Asia Pacific Group on Money Laundering (APG). The authorities should commit to strengthening the AML/CFT regime in line with the APG's recommendations issued upon completion of the evaluation. Instituting a strong AML/CFT framework and ensuring its effective implementation should be complemented with efforts to strengthen the financial regulatory and supervisory regime for banks and other onshore financial institutions. Such measures could increase the confidence of foreign financial institutions to build and maintain financial ties with the RMI. After being removed from the EU's list of non-cooperative jurisdictions for tax purposes in 2019, the RMI was reinstated on the list in February 2023 due to concerns that it facilitates offshore structures and arrangements that avoid tax.

[8] In particular, relying on a privately-issued asset as a sovereign currency could entail a loss of control of a key macroeconomic policy lever (see Elements of Effective Policies for Crypto Assets, IMF Policy Paper, 2023).

Authorities' Views

23. The authorities agreed that caution in introducing new FinTech initiatives is warranted. They noted that the registration of DAOs relies on multiple levels of due diligence, including by the registrar, the Attorney General and the Financial Intelligence Unit, and that the Act requires periodic reviews of the status of registered entities. They also agreed that it was important to ensure the regulatory framework adequately mitigates risks and were confident that their engagement with experts should ensure a framework to address risks is put in place. On the stablecoin, they noted that only a limited pilot is being proposed to ensure risks can be identified and monitored. Nevertheless, the authorities see the new initiatives as having promise in diversifying government revenue and supporting financial development. On strengthening the AML/CFT framework, the authorities, alongside representatives of the offshore services sector, intend to continue working closely with the APG. The authorities are in communication with the EU to address concerns. The authorities confirmed also that no further work is envisioned to operationalize the SOV or DEZRA.

C. Exchange Rate Arrangements: Role of a Monetary Authority in a Fully Dollarized System

24. The authorities are considering setting up a monetary authority (MA) to strengthen financial sector development. Concerns around the level of financial development have spurred efforts to set up a MA that has access to the US Fed payment system. Staff has provided TA on setting up and operationalizing the MA, including the drafting of its organic law. The RMI could benefit from a MA with a focused mandate, tailored to its characteristics (Annex VI). As the RMI is a fully dollarized economy, the proposed MA would not be granted all powers commonly allocated to a conventional central bank such as issuing currency and conduct of monetary and exchange rate policies, and would have limited capability to act as a lender of last resort. However, a MA could provide stronger oversight over the financial system, take steps to modernize and manage the payments and settlements system, act as the financial agent for the fiscal authorities to ensure more effective cash management, and hold and manage the official international reserves of the RMI, all of which could support financial development and deepening.

25. The creation of the MA would not address the potential loss of CBRs on its own. The vulnerability of RMI's external financial links is largely driven by changes in the country risk profile. Policies that are perceived to weaken the regulatory and supervisory framework or the effectiveness of AML/CFT framework, could endanger CBRs. Conversely, stronger financial supervision, coupled with steps to reduce ML/TF risks, could preserve and strengthen international financial links. One option could be to place financial institutions in the RMI under a foreign financial supervisor such as the US Federal Deposit Insurance Corporation (FDIC), similar to the arrangement in the FSM. A longer-term approach would be to significantly strengthen the capacity of domestic financial regulators to adopt and implement international standards to achieve mutual recognition with foreign regulators. A MA could be useful in the second case, particularly if the new institution is provided with significantly stronger oversight powers and more resources.

Authorities' Views

26. The authorities agreed that the mandates of any potential MA will need to be focused, given capacity constraints. A final decision on setting up a MA has not yet been taken. The authorities confirmed that there are no plans to consider issuing a domestic currency, physical or digital, and felt the use of the US dollar has been beneficial to the RMI. On the options to address the potential loss of CBRs, the authorities noted work is underway to strengthen financial regulation and supervision, including with Fund TA. However, placing domestic banks under the supervision of the FDIC was not seen as a viable option given the onerous requirements in the US, which may not be suitable for the less complex financial institutions in the RMI.

D. Structural Issues: Building Resilience, and Boosting Growth and Investment

27. The RMI is one of the most climate vulnerable countries in the world, facing rising sea levels, coastal erosion, and ocean inundation (Annex VII). In addition, extreme weather events such as typhoons and droughts are expected to become more frequent. Climate change will affect land availability, freshwater supply, capacity to engage in economic activity and provision of critical services. Ocean warming and acidification, and damage to coral reefs could further impact the fisheries sector, a mainstay of the economy. To address this, the authorities are preparing the National Adaptation Plan (NAP), aimed at taking stock of climate resilience in the RMI, proposing strategies to address these risks, and setting out the framework for monitoring progress in implementing climate resilience actions. The NAP, which was delayed due to the pandemic, is scheduled to be completed in the second half of 2023. A well-articulated NAP is important to prepare for climate change and transition to climate resilience, identify critical climate investments and attract the needed external financing.

28. Significant financial support is needed to implement climate resilience projects. The WB projects that by the 2040s, adaptation costs for coastal protection could be in the range of 4-13 percent of GDP,[9] depending on the climate change scenarios, while the cost of protecting infrastructure is projected at 3.7 percent of GDP. The bedrock of the needed investments will come from the RMI's budgetary resources, including grants, which calls for fiscal reforms to create space for these investments. Borrowing to support climate investments would need to be considered carefully, given the high risk of debt distress. The RMI has access to climate financing from a variety of sources but faces challenges in meeting the technical requirements to identify and package climate projects for donors' consideration. The authorities are working towards acquiring accreditation for accessing the Green Climate Fund (GCF) but this will be challenging and take time. In the meantime, the authorities could consider setting up a dedicated climate finance unit to manage the pipeline of projects. As climate projects are likely to be multiyear investments, a dedicated unit would also help with recruitment, training, and retention of skilled staff. Investing in renewable energy can helpfully lower fuel imports and

[9] Pacific Possible: Long-term Economic Opportunities and Challenges for Pacific Island Countries (2017)

operating costs. The deployment of smaller-scale renewable energy infrastructure such as rooftop solar, together with distributed grids and storage, can support the electrification of sparsely populated atolls, thereby spreading the fruits of economic development more widely.

29. A well-functioning disaster management framework can limit the damage from natural disasters and speed up recovery. The National Disaster Management Office (NDMO) has an appropriately wide-ranging mandate to provide early warnings, coordinate disaster response and support awareness and preparedness in quieter times. However, the NDMO has limited resources with a small staff and lacks key prerequisites to effective disaster risk management such as a national evacuation contingency plan. The NDMO also administers the disaster recovery Contingency Fund, which can be used to support initial disaster recovery efforts once a State of Emergency has been declared. However, the Fund is small (US$200,000) and insufficient for large scale disasters. There is an urgent need to strengthen the Fund by creating fiscal buffers so that resources are available when needed. The authorities are working to integrate the various pieces of the legislative framework in disaster management and recovery, including the Disaster Assistance Act and the Contingency Fund Act, with a view to streamline the framework and make it more effective.

30. Availability of land is the key impediment to higher investment and growth. The scarcity of land in the RMI reflects the limited land mass but also the complex traditional landholding system that is codified into law. The lack of land hampers the government's ability to invest in infrastructure, affects urban planning and stymies private investment. Rising sea levels and coastal erosion have prompted inward migration to the major urban centers of Majuro and Ebeye, further putting land supply under pressure, which will likely to worsen. Land reclamation, which could increase the supply of land, has been discouraged by legal rulings that give rights over reclaimed land to existing landowners rather than the parties undertaking reclamation. As a first step, it would be useful to clarify how to designate public land, particularly reclaimed land. Efforts to diversify the economic base, either by investing in higher value-added activities in fisheries and copra, or in exploring new industries and markets such as tourism, could boost growth and living standards. These will require access to land but also the availability of critical infrastructure including power, water, and modern telecommunications services. The National Investment Policy Statement helpfully identifies both the priority areas to promote public investment and impediments that need to be addressed. The next step would be to strengthen the investment climate and to support private sector development.

Authorities' Views

31. The authorities emphasized the existential threat from climate change as a key element of their planning. The NAP is expected to be finalized in the coming months and published in October. The formation of a dedicated climate team is under consideration and could draw from staff in the Ministry of Finance and the Climate Change Directorate among others. They acknowledged the need to further boost the NDMO. As part of their review of the disaster management framework, the authorities are looking to increase the size of the natural disaster contingency fund. While acknowledging the importance of land reform, the authorities noted that land ownership and rights are constitutional issues in the RMI, and wide-ranging dialogue and consensus building are needed to make changes. On economic diversification and accessing new markets, the authorities have pointed to recent progress in using regional arrangements to expand the market for tuna caught in the RMI. There is an ongoing partnership with Nature Conservancy, an international non-governmental organization, to certify the sustainability of the tuna catch, which in turn will be critical to access new markets. There are also ongoing private investment projects in the fisheries and copra sectors to enable the RMI to move up the value chain. These projects are expected to strengthen growth and exports once they are completed in the coming years.

STAFF APPRAISAL

32. The RMI is in the midst of a post-pandemic recovery. With borders fully reopened and a gradual easing of disruptions, the recovery is expected to continue in the near term. However, there are significant risks from RMI's geographical isolation, vulnerability to climate change, and weak and fragile trade and financial links. On the upside, continued strong support from development partners provides the opportunity to address risks and support development. While the current account surplus narrowed in FY2022, the overall external position of the RMI is substantially stronger than the level implied by medium-term fundamentals and desirable policies.

33. In the absence of a new Compact agreement, strong fiscal actions will be urgently needed. Without these, the fiscal balance is projected to slip into deficit, which will cause public debt to rise, keeping the RMI at high risk of debt distress. Fiscal reforms should aim to strengthen revenue mobilization and prioritize critical expenditures. There is an urgent need to reduce, and eventually eliminate, SOE subsidies while channeling assistance directly to vulnerable households. Revenue reforms should address both tax administration and policies, building on ongoing efforts to upgrade the PFM and Customs administration systems. In a baseline with no Compact renewal and partial fiscal adjustment, the RMI would continue to be at high risk of debt distress.

34. A new Compact agreement would strengthen the medium- and long-term fiscal and external outlook. The financing envelope under the MoU signed with the US implies a significant increase in financial support and could provide the basis to address risks and meet long-standing social and development needs. That said, the likelihood and timeline to achieve a successful conclusion of negotiations is not clear. Further, the ratification process may take time. A delay could be bridged through the use of the CTF but the resources available for this are limited. While a successful agreement would strengthen the fiscal position, the significant investment demands and the need to build buffers to address climate change call for an ambitious fiscal and structural reform agenda.

35. A MA with a focused mandate could be beneficial to the RMI. A new institution focused on strengthening financial sector supervision, modernizing the payments and settlements infrastructure, acting as the government's financial agent, and holding and managing the RMI's official international reserves could address risks, enhance economic and financial efficiency, and improve financial stability and inclusion. However, a MA in the RMI could not fulfill all the functions of a conventional central bank given country-specific circumstances. Critically, the MA by itself could not safeguard against the potential loss of CBRs, which need to be addressed by adequately mitigating financial integrity risks.

36. **The launch of new FinTech initiatives could adversely affect financial integrity and a cautious approach is warranted.** The world's understanding of the risks engendered by new institutions, such as DAOs, and new technologies, such as stablecoins, and a consensus on how best to regulate and supervise them, are still evolving. The authorities should move forward carefully given the capacity limitations in the RMI and place a moratorium on the further registration of DAOs until effective oversight can be implemented. The caution in implementing past initiatives such the SOV and DEZRA is welcome, and steps should be taken expeditiously to permanently close off the risks from these.

37. **Strengthening financial integrity and improving financial supervision could help build and maintain international financial links.** Focus should be given to strengthening the RMI's financial integrity framework and effectiveness and upgrading financial supervision to facilitate mutual recognition by foreign regulators. Where appropriate, consideration could be given to allowing oversight of Marshallese financial institutions by foreign regulators to reassure counterparts that financial integrity and stability risks are being managed.

38. **Enhancing the process to identify and prepare climate investment projects could help attract climate financing.** A well-articulated NAP would inform the transition to climate resilience, identify critical climate investments, and attract the needed external financing. Given the significant effort needed to prepare climate proposals for donors' consideration, building a pipeline of climate projects would be useful. A dedicated government climate finance unit to manage this pipeline would also help the authorities recruit, train, and retain the skilled staff to oversee project identification and implementation. The authorities' priorities in strengthening disaster preparedness and management are appropriately wide-ranging, and efforts to integrate the legislative framework are welcome. Efforts should focus on ensuring the NDMO has the resources and operational capacity able to deliver on its mandates.

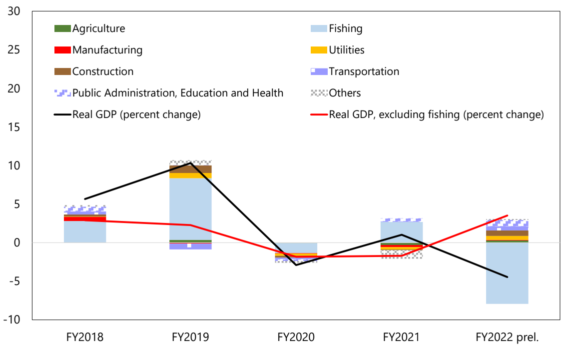
39. **Land availability remains the most critical impediment to investment and economic development.** The complexity of RMI's traditional land ownership system makes it difficult to acquire and develop land. Moreover, rising sea levels, coastal erosion and inward migration has led to urban sprawl and inefficient land use. A useful first step would be to clarify how to designate public land, particularly reclaimed land. Efforts to diversify the economic base, either by investing in higher value-added activities in fisheries and copra, or in exploring new industries and markets such as tourism, could boost growth and living standards. These will require access to land but also critical infrastructure including power, water, and modern telecommunications services. The National Investment Policy Statement helpfully identifies both the priority areas to promote public investment and impediments that need to be addressed. The authorities should continue their efforts to strengthen the investment climate and to support private sector development.

40. **It is recommended that the next Article IV consultation be held on a 24-month cycle.**

Figure 1. Marshall Islands: Real Sector Developments

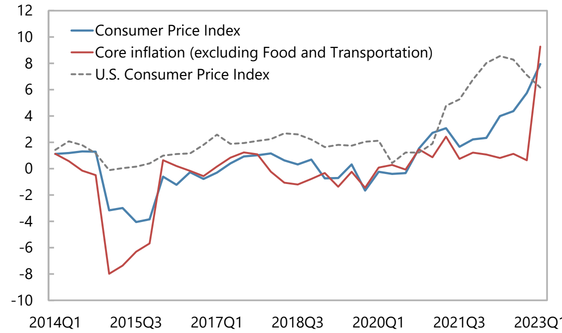
Modest recovery in domestic demand underway

Contribution to Real GDP Growth
(Percentage points)



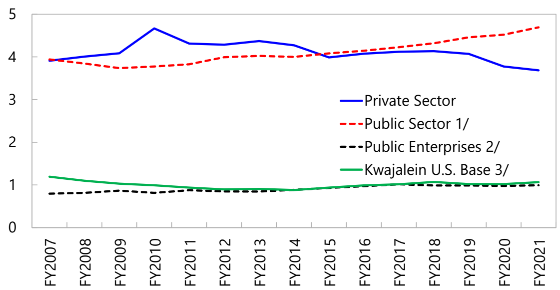
Uptick in inflation driven by food and fuel price increases

Inflation
(y/y percent change)



Private sector employment declined during lockdown…

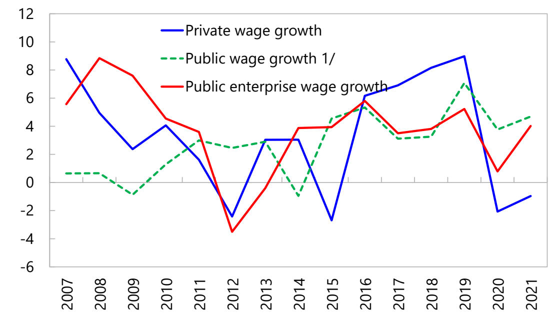
Employment
(Workers, in thousand)



1/ Central and local government.
2/ State-Owned Enterprises
3/ U.S. military base hired workers

…which put downward pressure on private sector wages

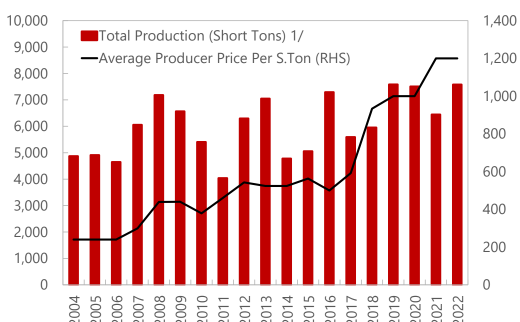
Average Public and Private Sector Wages
(In percentage point)



1/ Average wage growth of central, local and government agencies.

Rise in copra price offset decline in production in FY2021

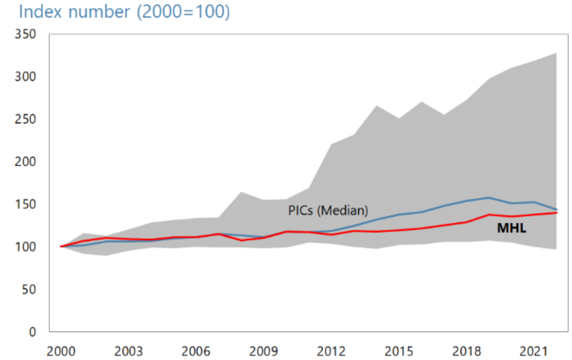
Copra Production and Producer Price



1/ Short Ton=0.984, Metric Ton=907.2 Kgs.

Income growth below PICs median over last 2 decades

Pacific Island Countries: Real Gross Domestic Product
Index number (2000=100)

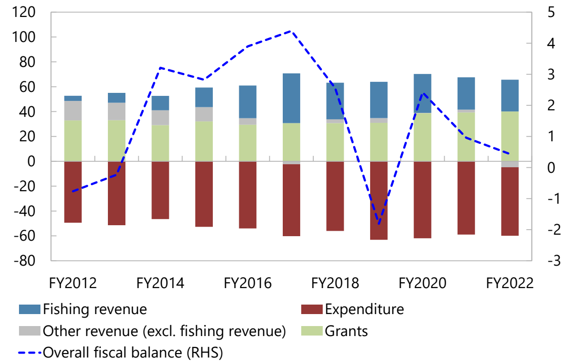


Sources: National authorities, World Economic Outlook, World Bank World Development Indicators, and staff estimates.

Figure 2. Marshall Islands: Fiscal Developments

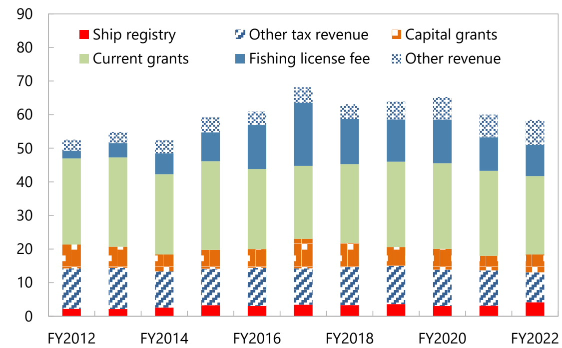
Lower revenues in FY2022 caused the fiscal surplus to narrow as expenditure levels were largely unchanged

Fiscal Balance
(In percent of GDP)



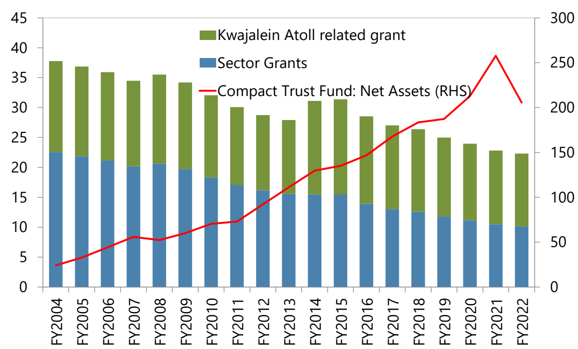
Grants, including to address COVID, filled the gap as other revenues have not recovered to pre-pandemic levels

Government Revenue and Grants
(In percent of GDP)



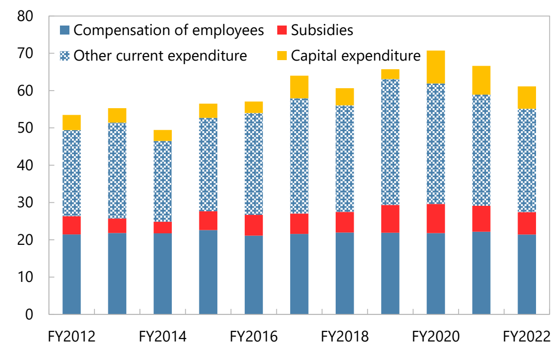
Compact grants declined as percentage of GDP, while Compact Trust Fund suffered valuation losses in FY2022

Compact Agreement Grants and Compact Trust Fund
(In percent of GDP)



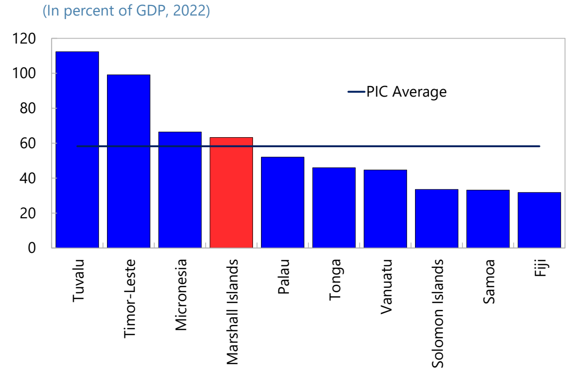
Uptick in healthcare and capital spending drove higher spending during pandemic but these have moderated

Government Expenditure
(In percent of GDP)



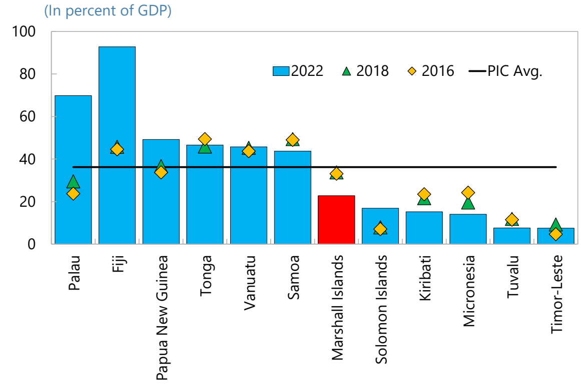
Current government spending higher than PIC average...

Current Government Expenditure
(In percent of GDP, 2022)



...but public debt is declining and below regional peers

Pacific Islands: Total Public Debt
(In percent of GDP)



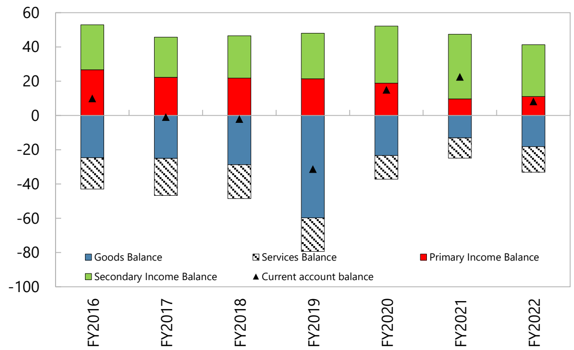
Source:s National authorites, World Economic Outlook, staff estimates.

Figure 3. Marshall Islands: External and Credit Developments

Current account surplus narrowed in FY2022 due to a widening of the trade deficit

Current Account Balance

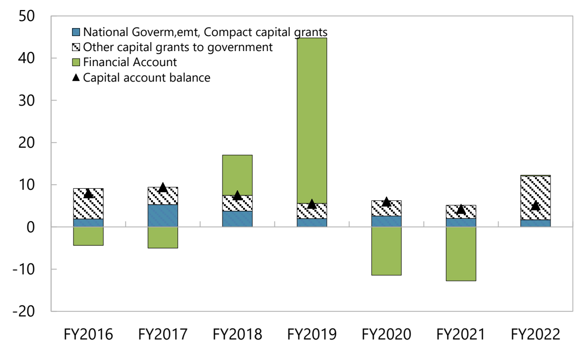
(In percent of GDP)



Financial outflows since FY2020 reflect increase in residents' offshore deposits

Capital and Finance Account Balance

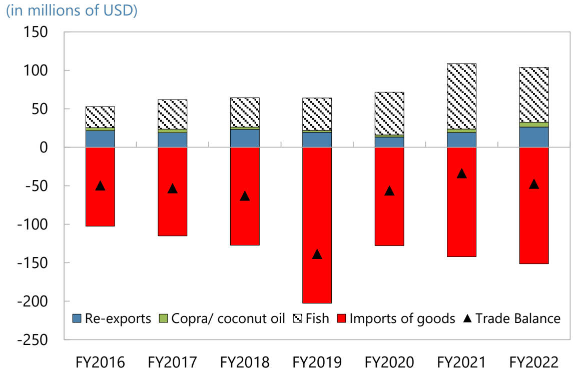
(In percent of GDP)



Goods deficit widened in FY2022 as exports declined and imports rose on the back of higher prices

Total Exports and Imports of Goods

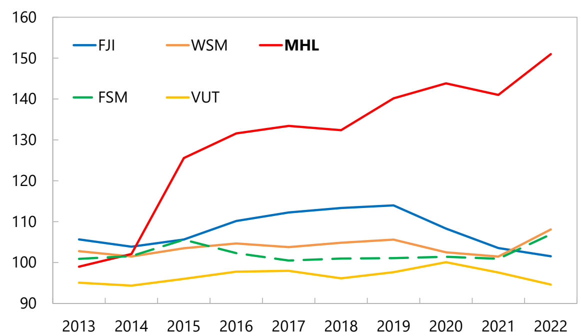
(in millions of USD)



Real exchange rate appreciation reflects USD strength

Real Effective Exchange Rates

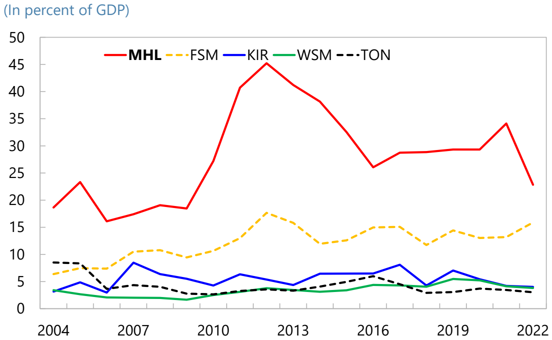
(Index 2010=100)



RMI's export performance has been volatile relative to peers, and has deteriorated in recent years...

Total Merchandise Exports

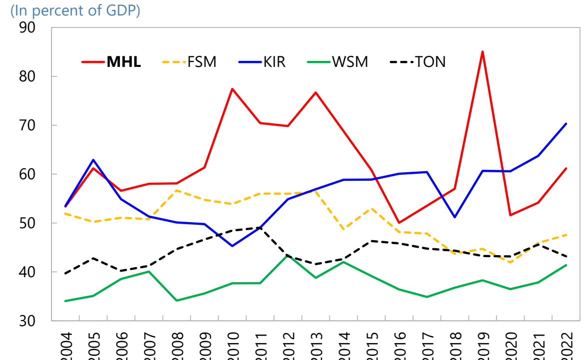
(In percent of GDP)



....while imports have picked up since FY2020

Total Merchandise Imports

(In percent of GDP)



Source: National authorities, IFS, staff estimates.

Table 1. Marshall Islands: Selected Economic Indicators, FY2019–28[1]

Nominal GDP: US$261 million (FY 2022) | GDP per capita: US$6,295 (FY 2022)
Population: 44,722 (FY 2022) | Quota: SDR 4.90 million

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY2026	FY2027	FY2028
			Prel.		Proj.					
Real sector										
Real GDP (percent change)	10.3	-2.9	1.0	-4.5	3.0	3.0	2.0	1.8	1.5	1.5
Consumer prices (percent change, average)	-0.1	-0.7	2.2	3.2	5.2	2.8	2.3	2.0	2.0	2.0
Consumer prices (percent change, end of period)	-1.7	1.5	2.2	5.7	3.0	2.5	2.0	2.0	2.0	2.0
Central government finances (in percent of GDP)										
Revenue and grants	64.0	70.7	70.4	66.4	62.8	69.5	67.8	68.9	71.6	70.1
Total domestic revenue	33.0	31.7	28.7	31.3	30.9	41.7	40.9	41.0	41.0	41.1
Grants	31.0	39.0	41.7	35.0	31.9	27.8	26.9	27.9	30.6	29.0
Expenditure	65.8	68.2	70.2	65.7	62.8	69.4	68.8	70.3	73.1	72.0
Expense	63.2	62.2	63.3	59.4	53.0	53.5	54.5	56.1	58.4	57.6
Net acquisition of nonfinancial assets	2.6	5.9	6.8	6.3	9.8	15.9	14.3	14.2	14.8	14.4
Net lending/borrowing	-1.8	2.5	0.2	0.7	0.0	0.1	-1.0	-1.4	-1.6	-2.0
Compact Trust Fund (in millions of US$; end of period)	434.7	514.4	668.9	567.6	621.1	620.9	622.5	623.7	624.3	624.4
Balance of payments (in percent of GDP)										
Current account balance	-31.3	15.0	22.6	8.2	4.1	-0.4	-4.8	-8.0	-12.0	-15.0
Goods and services balance	-79.3	-37.2	-24.9	-33.1	-27.3	-33.7	-35.6	-38.8	-43.0	-44.6
Primary income	21.4	18.9	9.7	11.1	9.7	20.1	18.2	17.2	16.1	15.1
Of which : fishing license fee	10.4	8.6	7.1	6.7	7.6	7.6	7.6	7.5	7.5	7.5
Secondary income	26.6	33.3	37.7	30.2	21.7	13.1	12.6	13.7	14.8	14.5
Of which : compact current grants	16.0	14.8	12.7	12.2	12.7	3.5	3.4	3.3	3.3	3.2
Of which : other budget and off-budget grants	10.4	18.2	24.7	18.4	8.6	9.5	9.1	10.3	11.5	11.3
Current account excluding current grants	-16.4	-24.2	-18.4	-4.3	-9.0	-12.2	-16.4	-11.3	-15.3	-18.3
External PPG debt (in millions of US$; end of period)[2]	67.5	66.2	63.5	59.6	59.7	59.2	62.3	66.7	71.6	78.6
External PPG debt (Percent of GDP; end of period)[2]	29.1	27.5	24.6	22.8	21.6	20.2	20.5	21.1	21.9	23.2
Memorandum item:										
Nominal GDP (in millions of US$)	231.9	240.6	257.5	261.2	276.8	292.8	304.5	315.9	327.0	338.4

Sources: RMI authorities; and IMF staff estimates and projections.

[1]Fiscal year ending September 30.

[2]Assumption is that RMI will receive its MDBs financial assistance in a mix of grants and loans.

Table 2. Marshall Islands: Statement of Government Operations, FY2018–28[1]

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
				Prel.[2]				Proj.			
	(In millions of U.S. dollars)										
Revenue	138.6	148.4	170.1	181.2	173.4	173.9	203.6	206.4	217.7	234.0	237.1
Taxes	32.1	34.9	33.5	35.4	35.9	41.0	43.9	46.8	49.5	51.8	54.6
Taxes on income, profits, and capital gains	15.1	16.3	16.4	17.4	16.7	19.4	20.9	21.8	23.1	23.9	25.2
Taxes on goods and services	7.3	7.8	6.9	7.4	8.2	8.7	9.6	10.5	10.9	11.2	11.6
Taxes on international trade and transactions	8.4	9.4	9.3	9.3	10.1	11.2	11.7	12.6	13.6	14.6	15.7
Other taxes	1.4	1.5	0.9	0.8	0.9	1.7	1.8	1.8	1.9	2.0	2.0
Grants[3]	67.3	71.9	93.9	107.3	91.5	88.3	81.5	81.8	88.2	100.2	98.1
Of which: Covid-related grants				42.0	14.3						
Of which: U.S. Compact Sector Grants	27.6	27.4	27.0	27.3	28.0	28.2	0.0	0.0	0.0	0.0	0.0
Of which: U.S. Supplemental Education Grant	4.8	5.6	5.6	5.6	5.6	5.6	0.0	0.0	0.0	0.0	0.0
Other revenue	39.2	41.5	42.6	38.3	45.9	44.6	78.2	77.7	79.9	82.1	84.5
Of which: drawdown of the Compact Trust Fund	0.0	0.0	0.0	0.0	0.0	0.0	31.3	29.4	30.0	30.5	31.1
Of which: fishing license fee	29.4	29.1	31.3	26.0	25.6	30.8	32.5	33.5	34.6	35.7	36.9
Expenditure	133.0	152.6	163.9	180.7	171.6	173.7	203.2	209.5	222.0	239.1	243.6
Expense	122.9	146.5	149.7	163.1	155.2	146.7	156.6	165.8	177.1	190.8	195.0
Compensation of employees	48.2	50.8	52.7	57.6	58.7	60.8	64.2	66.8	69.3	71.7	74.3
Use of goods and services[4]	36.8	50.0	43.5	56.5	44.5	44.7	55.2	62.4	71.3	81.8	84.6
Interest	0.6	0.6	0.7	0.6	0.5	0.6	0.6	0.6	0.6	0.7	0.8
Subsidies	13.7	14.9	15.5	13.5	16.5	9.3	9.4	6.2	5.0	4.7	2.3
Grants	12.1	11.5	16.4	17.3	16.6	16.7	11.3	11.7	12.1	12.6	13.0
Other expense[4]	11.5	18.7	19.2	12.3	17.8	14.6	15.9	18.0	18.7	19.3	20.0
Net acquisition of nonfinancial assets	10.1	6.1	14.3	17.6	16.5	27.0	46.5	43.6	45.0	48.3	48.7
Primary balance	**6.1**	**-3.8**	**6.7**	**0.9**	**2.1**	**0.7**	**0.9**	**-2.7**	**-3.9**	**-4.5**	**-6.0**
Net operating balance[5]	**15.7**	**1.9**	**20.4**	**18.1**	**18.2**	**27.2**	**47.0**	**40.5**	**40.6**	**43.3**	**42.1**
Net lending/borrowing	**5.6**	**-4.2**	**6.1**	**0.5**	**1.7**	**0.2**	**0.5**	**-3.1**	**-4.4**	**-5.0**	**-6.5**
	(In percent of GDP)										
Revenue	**63.2**	**64.0**	**70.7**	**70.4**	**66.4**	**62.8**	**69.5**	**67.8**	**68.9**	**71.6**	**70.1**
Taxes	**14.6**	**15.0**	**13.9**	**13.8**	**13.8**	**14.8**	**15.0**	**15.4**	**15.7**	**15.8**	**16.1**
Taxes on income, profits, and capital gains	6.9	7.0	6.8	6.8	6.4	7.0	7.1	7.2	7.3	7.3	7.5
Taxes on goods and services	3.3	3.3	2.9	2.9	3.1	3.1	3.3	3.4	3.4	3.4	3.4
Taxes on international trade and transactions	3.8	4.0	3.9	3.6	3.9	4.0	4.0	4.2	4.3	4.5	4.6
Other taxes	0.6	0.7	0.4	0.3	0.3	0.6	0.6	0.6	0.6	0.6	0.6
Grants[3]	**30.7**	**31.0**	**39.0**	**41.7**	**35.0**	**31.9**	**27.8**	**26.9**	**27.9**	**30.6**	**29.0**
Of which: Covid-related grants				16.3	5.5						
Of which: U.S. Compact Sector Grants	12.6	11.8	11.2	10.6	10.7	10.2	0.0	0.0	0.0	0.0	0.0
Of which: U.S. Supplemental Education Grant	2.2	2.4	2.3	2.2	2.1	2.0	0.0	0.0	0.0	0.0	0.0
Other revenue	**17.9**	**17.9**	**17.7**	**14.9**	**17.6**	**16.1**	**26.7**	**25.5**	**25.3**	**25.1**	**25.0**
Of which: drawdown of the Compact Trust Fund	0.0	0.0	0.0	0.0	0.0	0.0	10.7	9.7	9.5	9.3	9.2
Of which: fishing license fee	13.4	12.6	13.0	10.1	9.8	11.1	11.1	11.0	10.9	10.9	10.9
Expenditure	**60.6**	**65.8**	**68.2**	**70.2**	**65.7**	**62.7**	**69.4**	**68.8**	**70.3**	**73.1**	**72.0**
Expense	56.0	63.2	62.2	63.3	59.4	53.0	53.5	54.5	56.0	58.4	57.6
Compensation of employees	22.0	21.9	21.9	22.4	22.5	21.9	21.9	21.9	21.9	21.9	21.9
Use of goods and services[4]	16.8	21.6	18.1	21.9	17.0	16.1	18.9	20.5	22.6	25.0	25.0
Interest	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Subsidies	6.3	6.4	6.4	5.2	6.3	3.4	3.2	2.1	1.6	1.4	0.7
Grants	5.5	4.9	6.8	6.7	6.3	6.0	3.8	3.8	3.8	3.8	3.8
Other expense[4]	5.3	8.1	8.0	4.8	6.8	5.3	5.4	5.9	5.9	5.9	5.9
Net acquisition of nonfinancial assets	4.6	2.6	5.9	6.8	6.3	9.8	15.9	14.3	14.2	14.8	14.4
Primary balance	**2.8**	**-1.6**	**2.8**	**0.4**	**0.8**	**0.2**	**0.3**	**-0.9**	**-1.2**	**-1.4**	**-1.8**
Net operating balance	**7.2**	**0.8**	**8.5**	**7.0**	**7.0**	**9.8**	**16.0**	**13.3**	**12.9**	**13.2**	**12.4**
Net lending/borrowing	**2.6**	**-1.8**	**2.5**	**0.2**	**0.7**	**0.1**	**0.2**	**-1.0**	**-1.4**	**-1.5**	**-1.9**
Memorandum items:											
Compact Trust Fund (in millions of US$)	402.4	434.7	514.4	668.9	567.6	621.1	620.9	622.5	623.7	624.3	624.4
Compact Trust Fund (in percent of GDP)	183.4	187.4	213.9	259.8	217.3	224.3	212.1	204.5	197.4	190.9	184.5
Outstanding central government debt (in millions of US$)	72.8	67.5	61.5	55.6	53.9	53.7	53.2	56.4	60.7	65.7	72.3
Outstanding central government debt (in percent of GDP)	33.2	29.1	25.6	21.6	20.6	19.4	18.2	18.5	19.2	20.1	21.4
Nominal GDP (in millions of US$)	219.4	231.9	240.6	257.5	261.2	276.8	292.8	304.5	315.9	327.0	338.4

Sources: RMI authorities; and IMF staff estimates and projections.

[1] Fiscal year ending September 30.

[2] Based on administrative data. The data will be finalized when the audit is completed and are subject to change.

[3] Does not include Compact funds earmarked for Kwajalein rental payments and Trust Fund contributions. Assume that RMI will continue to receive 100 percent of its MBDs financial assistance in the form of grants.

[4] COVID-19 related expenditure are classified under use of goods and services, and other expenses depending on the budget classification.

[5] Net operating balance is the difference between revenue and expense.

Table 3. Marshall Islands: Balance of Payments, FY 2018–28[1]

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027	FY 2028
				Prel.		Proj.					
	(In millions of U.S. dollars)										
Current account balance	-4.5	-72.5	36.1	58.1	21.5	11.4	-1.1	-14.5	-25.2	-39.3	-50.8
Goods Balance	-63.0	-138.6	-56.2	-33.7	-47.5	-34.2	-53.1	-63.44	-76.02	-92.16	-100.87
Exports, f.o.b.	64.3	64.1	71.6	108.6	103.9	121.7	124.8	129.9	135.0	139.8	144.7
Imports, f.o.b.[2]	-127.3	-202.7	-127.8	-142.3	-151.4	-155.9	-177.9	-193.3	-211.0	-231.9	-245.6
Services Balance	-43.6	-45.4	-33.3	-30.4	-39.0	-41.3	-45.5	-45.01	-46.70	-48.33	-50.02
Exports of Services	22.1	21.2	13.7	11.1	13.5	13.9	14.3	14.6	15.1	15.6	16.2
Imports of Services	-65.6	-66.6	-47.0	-41.5	-52.5	-55.2	-59.8	-59.6	-61.8	-64.0	-66.2
Primary Income Balance	47.9	49.7	45.4	24.9	29.0	26.9	59.0	55.5	54.3	52.8	51.0
Of which: Kwajalein atoll related inflows	44.0	45.5	49.7	48.1	42.0	43.1	43.8	44.4	20.8	21.1	21.4
Of which: fishing licence fees inflows	22.2	24.2	20.6	18.3	17.6	21.2	22.4	23.0	23.8	24.6	25.4
Secondary Income Balance	54.2	61.7	80.2	97.2	78.9	60.0	38.5	38.4	43.3	48.4	49.0
Inflows	66.1	74.4	93.9	110.9	94.0	73.5	52.7	53.3	58.6	64.3	65.5
o/w Government grants	53.2	61.2	79.6	96.2	79.8	58.9	37.9	38.1	43.1	48.4	49.3
Of which: Compact current grants	31.8	37.0	35.7	32.6	31.8	35.1	10.1	10.3	10.5	10.7	10.9
Of which: other budget and off-budget grants	21.4	24.2	43.9	63.6	48.0	23.8	27.8	27.8	32.6	37.7	38.3
Current account excluding current grants	-43.5	-38.1	-58.3	-47.4	-11.2	-24.8	-35.7	-50.1	-61.8	-94.6	-127.4
Capital account balance	16.5	13.0	20.0	16.2	19.4	30.5	46.0	46.1	47.5	50.8	51.2
Of which: Compact capital grants	8.2	4.6	6.3	5.2	4.0	5.6	2.9	2.9	5.5	5.1	5.1
Of which: other capital grants to government	8.2	8.3	13.7	11.0	15.5	24.9	43.1	43.2	42.0	45.7	46.1
Financial account balance	20.9	90.9	-27.5	-32.9	-40.9	-42.0	-44.9	-31.7	-22.3	-11.4	-0.3
Errors and ommisions	-32.9	-31.1	-23.1	-36.1	~	~	~	~	~	~	~
	(In percent of GDP)										
Current account balance	-2.1	-31.3	15.0	22.6	8.2	4.1	-0.4	-4.8	-8.0	-12.0	-15.0
Goods Balance	-28.7	-59.8	-23.4	-13.1	-18.2	-12.4	-18.1	-20.8	-24.1	-28.2	-29.8
Exports, f.o.b.	29.3	27.6	29.8	42.2	39.8	44.0	42.6	42.7	42.7	42.8	42.8
Imports, f.o.b.[2]	-58.0	-87.4	-53.1	-55.3	-58.0	-56.3	-60.8	-63.5	-66.8	-70.9	-72.6
Services Balance	-19.9	-19.6	-13.8	-11.8	-14.9	-14.9	-15.5	-14.8	-14.8	-14.8	-14.8
Exports of Services	10.1	9.1	5.7	4.3	5.2	5.0	4.9	4.8	4.8	4.8	4.8
Imports of Services	-29.9	-28.7	-19.5	-16.1	-20.1	-19.9	-20.4	-19.6	-19.6	-19.6	-19.6
Primary Income Balance	21.8	21.4	18.9	9.7	11.1	9.7	20.1	18.2	17.2	16.1	15.1
Of which: Kwajalein atoll related	20.1	19.6	20.7	18.7	16.1	15.6	14.9	14.6	6.6	6.4	6.3
Of which: fishing licence fees	10.1	10.4	8.6	7.1	6.7	7.6	7.6	7.6	7.5	7.5	7.5
Secondary Income Balance	24.7	26.6	33.3	37.7	30.2	21.7	13.1	12.6	13.7	14.8	14.5
Of which: Compact current grants	14.5	16.0	14.8	12.7	12.2	12.7	3.5	3.4	3.3	3.3	3.2
Of which: other budget and off-budget grants	9.8	10.4	18.2	24.7	18.4	8.6	9.5	9.1	10.3	11.5	11.3
Current account excluding current grants	-19.8	-16.4	-24.2	-18.4	-4.3	-9.0	-12.2	-16.4	-19.6	-28.9	-37.6
Capital account balance	7.5	5.6	8.3	6.3	7.4	11.0	15.7	15.2	15.0	15.5	15.1
Of which: Compact capital grants	3.7	2.0	2.6	2.0	1.5	2.0	1.0	1.0	1.7	1.6	1.5
Of which: other capital grants to government	3.7	3.6	5.7	4.3	5.9	9.0	14.7	14.2	13.3	14.0	13.6
Financial account balance	9.5	39.2	-11.4	-12.8	-15.7	-15.2	-15.3	-10.4	-7.1	-3.5	-0.1
Errors and ommisions	-15.0	-13.4	-9.6	-14.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nominal GDP	219.4	231.9	240.6	257.5	261.2	276.8	292.8	304.5	315.9	327.0	338.4

Sources: RMI authorities; and IMF staff estimates and projections.

[1] Fiscal years run October 1-September 30. Refers to the fiscal year ending September 30 of year.

[2] Imports of goods in FY2019 include the purchase of 3 boats that amounted to US$61.8 million.

Table 4. Marshall Islands: Deposit Money Banks, FY2017–22[1]

	FY 2017	FY 2018	FY2019	FY2020	FY2021	FY2022
	(In millions of U.S. dollars)					
Assets and Liabilities						
Assets	261.8	257.0	245.9	293.8	324.8	353.0
Foreign assets	135.7	129.2	113.6	155.3	193.2	221.1
Total Credit/loan	120.8	122.1	127.6	131.0	122.5	124.4
Claims on central and local governments	0.1	0.3	0.0	0.3	0.0	0.2
Claims on public enterprises	1.8	1.3	0.8	0.5	0.2	0.0
Claims on private sector	118.9	120.6	126.8	130.2	122.3	124.2
Consumer	75.0	76.9	75.4	75.7	72.6	76.0
Commercial	44.0	43.7	51.5	54.5	49.8	48.2
Unclassified assets	4.5	5.7	4.8	7.5	9.0	7.5
Liabilities	261.8	257.0	245.9	293.8	324.8	353.0
Deposits	227.2	219.7	208.9	254.4	284.1	310.4
Central government deposits [2]	13.6	11.8	9.1	18.6	13.8	13.1
Foreign liabilities	4.1	4.4	4.3	5.7	6.2	6.5
Capital accounts	29.1	30.3	31.5	32.3	33.4	34.8
Unclassified liabilities	1.3	2.6	1.3	1.4	1.1	1.4
Memorandum items:						
Loan/deposit ratio (in percent)	53.5	55.6	61.1	51.5	43.1	40.1
Deposits (percent change)	-1.9	84.8	36.6	38.8	25.0	41.3
Loans (percent change)	3.5	38.1	33.2	26.2	0.8	1.9
Consumer loans (in percent of total loan)	62.7	63.8	59.4	58.2	59.3	61.2
Income and expense						
Interest Income	12.9	14.7	15.3	12.9	13.1	13.2
Interest and fees on loans	11.9	12.7	13.0	9.7	12.9	11.9
Deposits with banks	1.0	2.0	2.3	3.2	0.2	1.3
Interest Expense	1.3	1.1	1.3	1.3	1.4	1.6
Deposits	1.3	1.1	1.3	1.3	1.4	1.6
Net interest income	11.7	13.6	14.0	11.7	11.7	11.6
Provision for loan losses	0.5	0.2	1.1	-0.1	1.0	0.3
Net interest income after loan loss provisions	11.2	13.5	12.9	11.7	10.8	11.3
Net Income (Loss)	7.5	9.5	8.8	7.2	6.4	7.0
Interest rates (in percent) [3]						
Deposit rates						
Checkable savings	1.5	1.4	0.2	0.2	0.1	0.1
Savings deposits	0.2	0.2	0.2	0.2	0.2	0.4
Time deposits	3.0	2.6	2.1	2.1	2.9	2.5
All interest bearing deposits [4]	1.3	1.1	0.9	0.8	0.7	0.7
Loan rates						
Businesses	5.3	6.8	6.5	6.3	6.1	6.0
Individuals	12.7	12.7	12.8	8.3	13.6	11.9
All loans [4]	10.7	12.1	12.0	9.9	10.7	10.6

Sources: RMI authorities; and IMF staff estimates.

[1] Fiscal year ending September 30.

[2] Includes deposits of social security administration and other trust funds.

[3] Yearly average.

[4] Actual interest paid divided by relevant deposit or loan balances.

Table 5. Marshall Islands: Financial and External Vulnerability Indicators, FY2017–22[1]

	FY 2017	FY 2018	FY2019	FY2020	FY2021	FY2022
Financial indicators:						
Commercial bank deposits (12-month percent change)	23.9	-3.3	-4.9	21.8	11.7	9.3
Private sector credit (12-month percent change)	18.3	0.8	5.2	2.7	-6.1	1.5
Foreign assets/total assets (percent)	51.8	50.3	46.2	52.9	59.5	62.6
Consumer loans (in percent of total private sector loans)	62.7	63.8	59.4	58.2	59.3	61.2
External indicators:						
Exports (percent change)	17.0	3.9	-0.3	11.7	51.7	-4.3
Imports (percent change)	12.4	10.5	59.2	-37.0	11.3	6.4
Current account balance (percent of GDP)	-0.9	-2.1	-31.3	15.0	22.6	8.2
Capital and financial account balance (percent of GDP)	4.4	17.0	44.7	-5.4	-8.5	-204.9
Of which: FDI (percent of GDP)	3.5	3.7	30.0	2.1	4.1	90.6
Gross official reserves (in millions of U.S. dollars) [2]	13.6	11.8	9.1	18.6	13.8	13.1
Gross official reserves (in months of imports of goods and services)	0.9	0.8	0.4	1.2	0.8	0.7
Debt indicators:						
External debt service (in millions of US$)	7.9	7.1	7.6	6.7	6.7	7.0
External debt service (In percent of exports of goods and services)	9.6	8.3	8.9	5.6	5.7	5.2
External PPG debt (percent of GDP) [3]	36.6	33.1	29.1	27.5	24.6	22.8
External PPG debt (in percent of exports of goods and services) [3]	94.4	84.0	79.1	77.6	53.0	50.7

Sources: RMI authorities; and IMF staff estimates and projections.

[1] Fiscal year ending September 30.

[2] Measured by the end-of-period stock of government financial assets held in commercial banks.

[3] Public and publicly-guaranteed external debt.

Table 6. Marshall Islands: Financial Soundness Indicators, FY 2021–22

(In Percent)

	2021	2022			
	Dec.	Mar.	Jun.	Sep.	Dec.
Assets Quality					
Target ALLL to Gross Loans	2.63	2.30	3.08	2.43	4.09
Actual ALLL to Gross Loans	4.91	5.11	5.25	5.45	6.77
ALLL to Non-performing Loans (NLPs)	215.02	243.89	200.04	282.83	65.42
NPLs to Gross Loans	2.29	2.10	2.62	1.93	10.34
Non - Current Loans to Gross Loans	5.91	8.24	3.57	12.93	6.63
Recoveries to Write-Offs	91.29	86.81	81.54	94.55	60.65
Net Loan Losses(Recoveries) to Average Gross Laons	0.09	0.03	0.09	0.03	0.53
Related Party Exposures to Gross Laons	0.25	0.29	0.30	0.49	0.51
Earnings					
Return on Asset(ROA)	1.62	1.86	1.82	2.01	1.56
Net Interest Income Average Earning Assets(NIM)	3.07	2.86	2.96	3.24	3.41
Total Overhead Expense to Average Assets	1.89	1.66	1.87	1.98	1.71
Net Operating Profit after Tax to Average Captial (ROE)	62.38	19.71	18.81	20.11	59.77
Non-Interest Income to Average Assets	0.96	0.22	0.95	0.96	0.98
Liquidity					
Liquid Asset Ratios(Statutory)	75	75	75	74	75
Statutory Requirement-Minimum Threshold 20%	20	20	20	20	20
Loans (Net) to Total Deposits	35	34	35	36	35
Loans (Gross) to Total Deposits	37	37	38	39	38
Top 20 Depositors to Total Deposits	71	66	70	69	69

Source: RMI authorities.

ALLL: allowance for loan losses.

Fiscal year ending Septemner 30.

Annex I. External Sector Assessment

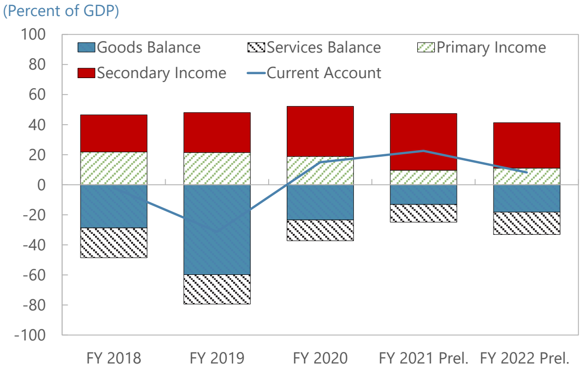
Overall Assessment: *The RMI's external position was substantially stronger than the level implied by fundamentals and desirable policies in FY2022 but remains highly vulnerable to external shocks and heavily dependent on external grants. The external current account remained in surplus as the decline in exports and grants, and the increase in imports was partly offset by smaller outflows on the primary income account. The real effective exchange rate is assessed to be undervalued, although it is subject to uncertainty, data gaps, frequent data revisions and high dependence of the determination of the current account on exogenous and volatile factors.*

Potential Policy Responses: *Structural policies that encourage private sector participation and diversify the exports base through higher value-added activities and accessing new markets could strengthen the resilience of the external position and support needed investments to address climate change. Structural reforms in the financial sector and reducing the risks associated with financial integrity by strengthening the AML/CFT framework, including revisiting initiatives in digital finance, would lower risks to capital inflows and the loss of correspondent banking relationships (CBRs). If signed, a new Compact of Free Association with the United States could provide a significant and reliable increase in financial support, further strengthening the RMI's external position.*

Current Account

Background: The current account remained in surplus in FY2022 despite a 4.3 percent decline in exports and a 6.4 percent increase in the import bill; widening the trade deficit from 13.1 percent of GDP in FY2021 to 18.2 percent in FY2022. Exports declined on the back of lower fish production,[1] while imports increased due to higher freight charges coupled with a rising trend in global food and fuel prices. In addition, grant inflows were also lower as COVID-related grants expired. However, the primary income account surplus increased due to lower outflows of FDI-related dividends and compensation of employees, the latter reflecting the impact of border closures on the movement of foreign workers.

Current Account Performance
(Percent of GDP)



As a result, the current account surplus has declined from 22.6 percent of GDP in FY2021 to 8.2 percent in FY2022. In FY2023, the trade deficit is expected to narrow due to higher exports in the fisheries sector, supported by the commissioning of a new fishing vessel. Nevertheless, the current account surplus is expected to narrow due to lower grant inflows.

[1] Fish exports are estimated to have declined by 16 percent in FY2022 due to sale of a fishing vessel by a domestic operator as well as fish migration to the west.

Assessment: The EBA-lite Current Account (CA) model estimates the RMI's cyclically adjusted CA balance is about 8.0 percent of GDP, after taking adjustments for COVID-19 and natural disasters into account. The CA norm is estimated to be -0.5 percent of the GDP (table). The gap of 8.5 percent of the GDP for FY2022 indicates a stronger external position than suggested by fundamental and desirable policies.

Marshall Islands: EBA-lite Model Results, 2022

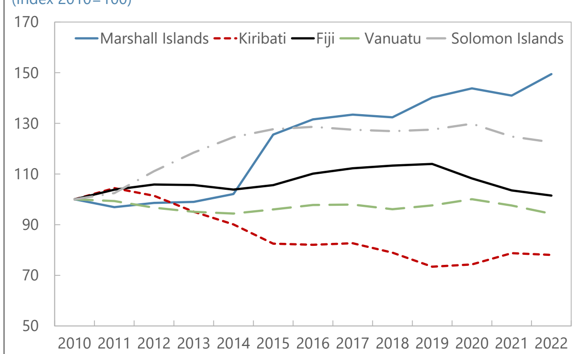
	CA model 1/ (in percent of GDP)
CA-Actual	**8.2**
Cyclical contributions (from model) (-)	0.6
COVID-19 adjustors (-) 2/	0.08
Additional temporary/statistical factors (-)	0.0
Natural disasters and conflicts (-)	-0.5
Adjusted CA	**8.0**
CA Norm (from model) 3/	**-0.5**
Adjustments to the norm (-)	0.0
Adjusted CA Norm	**-0.5**
CA Gap	**8.5**
o/w Relative policy gap	1.0
Elasticity	-0.4
REER Gap (in percent)	**-22.5**

1/ Based on the EBA-lite 3.0 methodology
2/ Additional cyclical adjustment to account for the temporary impact of the pandemic.
3/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background: The US dollar is used as legal tender and official currency in the RMI, and there is no central bank. The RMI has maintained an open and free financial account without restrictions on international payments and transfers. During FY2022, the real effective exchange rate (REER) of the RMI appreciated by 6 percent, driven by the strength of the US dollar, while other Pacific Island Countries (PICs) have experienced a real depreciation.

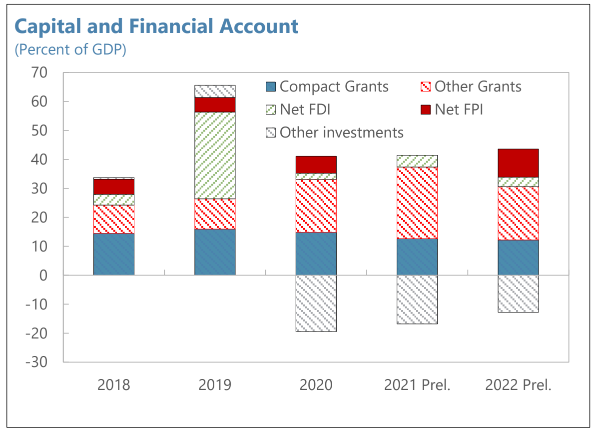
Rising Trend of REER in Marshall Islands
(Index 2010=100)



Assessment: Given data limitations and large statistical variations, the REER and external sustainability approaches under EBA-lite were not used. Based on the CA model, the real exchange rate is assessed to be undervalued. However, the assessment is subject to uncertainty and the external position could weaken, particularly if grant financing is reduced in the absence of a new Compact agreement. Improving value added in fish and copra/coconut oil exports, including through investments in technology, could strengthen export competitiveness, which would generate external financing flows to support needed investments, including to address climate change while ensuring the external position remains sustainable.

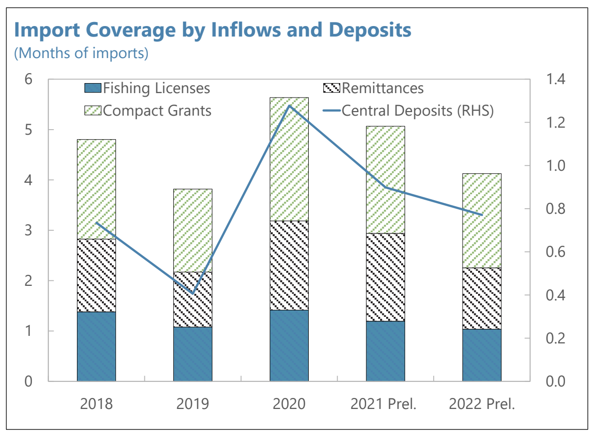
Capital and Financial Account

Background: The capital account inflows consist of contributions to the Compact Trust Fund (CTF) and grants from development partners. Current and other budgetary grants declined from 37.7 percent of GDP in FY2021 to 30.2 percent in FY2022, reflecting the expiry of COVID-19 support. Meanwhile, Compact grants have remained stable and provided a reliable source for funding the external balance. The financial account recorded a net outflow in FY2020—FY2022, mainly driven by an increase in bank deposits held abroad. Capital and financial inflows from multilateral partners are likely to be maintained over the medium term. A renewal of the Compact agreement would see a significant increase in potential inflows over the longer term.



FX Intervention and Reserves Level

Background: As the RMI does not have a central bank, this assessment treats government deposits held with commercial banks as reserves as they can be used to meet short-term liquidity requirements. The import coverage of government deposits contracted slightly from 0.9 months of imports in FY2021 to 0.8 months in FY2022. In the RMI, these deposits were bolstered by other inflows, including fishing license fees, workers' remittances and Compact grants, which provided significant resources to shield against liquidity stress and offset the trade deficit. Looking ahead, while the loss of Compact grants is assumed under the baseline, these will be partly replaced by drawings from the CTF. Similarly, the growth in remittances has also been a supportive factor: the average annual growth in remittances has been around 4.7 percent during 2017-21 and this can be expected to continue given the presence of a large Marshallese diaspora in the US. In the event a new Compact is signed, grants are expected to resume at a higher level, which will further bolster FX availability.



Assessment: While government deposits, together with reliable flows, can meet domestic needs for US dollar liquidity to effect external transactions, the loss of Compact grants assumed under the baseline reduces buffers going forward, though this is partly offset by drawdowns on the CTF. The authorities could consider accumulating higher deposits so as to meet the domestic liquidity needs of banks. This would require stronger fiscal consolidation efforts. Conversely, successful Compact negotiations and higher current account inflows through strong inflows of remittances are expected to boost the government's reserves and meet eternal sector needs.

Annex II. Risk Assessment Matrix

Source of Risks	Relative Likelihood/ Time Horizon	Expected Impact if Realized	Recommended Policy Response
External Risks			
Agreement on new Compact with the US	**High**	**High**	• Strengthen fiscal institutions to ensure additional resources are well spent. • Re-orient fiscal expenditure to meet urgent climate adaptation and other infrastructure needs.
	Short Term	Upside risk to fiscal and debt sustainability, potentially significant increase in financial support	
Commodity price volatility	**High**	**Medium**	• Provide targeted fiscal assistance to the most affected sectors and groups.
	Short to Medium Term	A succession of supply disruptions (e.g., due to conflicts, uncertainty and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, contagion effects, and social and economic instability.	
Abrupt global slowdown or recession	**Medium**	**High**	• Intensify structural reforms to support private sector growth. • Provide targeted fiscal assistance to the most affected sectors and groups. • If possible, expedite critical investment projects (e.g., for climate adaptation) to support economic activity and jobs.
	Short to Medium Term	Global and idiosyncratic risk factors combine to cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and markets fragmentation causing sudden stops in EMDEs.	
Intensification of regional conflict(s)	**High**	**Medium to High**	• Provide targeted fiscal assistance to the most affected sectors and groups. • If possible, expedite critical investment projects (e.g., for climate adaptation) to support economic activity and jobs.
	Short to Medium Term	Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, FDI and financial flows, and payment systems, and lead to refugee flows.	
Deepening geo-economic fragmentation	**High**	**High**	• Intensify structural reforms to support private sector growth. • Provide targeted fiscal assistance to the most affected sectors and groups.
	Short to Medium Term	Broader and deeper conflict(s) and weakened international cooperation result in more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	
Domestic Risks			
Disruptions to transport and supply links intensify	**High**	**High**	• Urgently identify alternate carriers to ensure provision of service. • Address the FAA's concerns to ensure critical air carriers are able to continue with operations.
	Short Term	Exports and critical imports do not flow as a result of a prolonged disruption to air transport links, such as when Asia Pacific Airlines was grounded by the US Federal Aviation Administration in 2023, impacting trade flows and adversely impacting domestic inflation.	

Source of Risks	Relative Likelihood/ Time Horizon	Expected Impact if Realized	Recommended Policy Response
Extreme climate events	**Medium** **Short, Medium and Long Term**	**High** Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	• Strengthen the early disaster warning system • Seek cost-effective insurance or contingent financing plans with donors. • Invest in climate resilient infrastructure.
Implementation of policies that generate risks to financial integrity	**High** **Short to Medium Term**	**Medium to High** Policies such as moving forward with the DEZRA or introduction of the SOV or other crypto assets by private actors, and hurried implementation of the DAO Act will generate significant risks to financial integrity in the absence of effective regulation and supervision.	• Strengthen regulatory and supervisory capacity before rolling out approved initiatives. • Take a measured approach to drafting and rolling out implementing regulations. • Maintain control of critical state functions.
Withdrawal of CBR	**Medium** **Short to Medium Term**	**High** The termination of the last USD CBR for the Bank of Marshall Islands (BOMI) due to adverse findings by the ongoing APG mutual evaluation could impact access to USD clearing services and disrupt trade and remittance flows	• Strengthen the AML/CFT framework by implementing the recommended actions identified in the upcoming mutual assessment. • Work with US authorities to give BOMI access to USD windows. • Avoid actions that weaken the financial integrity framework, including on digital initiatives.

Annex III. Global Downside Scenario in the April 2023 World Economic Outlook[1]—Impact on the Marshall Islands

1. The global downside scenario contained in the April 2023 WEO suggests that global growth could fall below 2 percent in 2023-24 with a 15 percent probability. This scenario builds on shocks in the financial system due to a squeeze in credit supply that impacts confidence and equity prices and consequently growth, inflation and exchange rates globally. The United States, the RMI's most important partner, would see its GDP level fall by 1.8 percent relative to the baseline scenario in 2023 and 2024, leading to declines in inflation and commodity prices, and among emerging markets, contribute to exchange rate depreciations.

2. The RMI has limited trade and financial linkages with the rest of the world. Exports are limited in both volume and variety, with major inflows largely coming from the official sector (bilateral and multilateral grant assistance,[2] 48 percent of GDP in FY2022) and remittances from Marshallese citizens living abroad, mainly in the US (7.9 percent of GDP in FY2022). While the RMI is assessed at high risk of debt distress, its external public and publicly guaranteed debt is composed entirely of concessional borrowing from multilateral development banks, protecting it from interest rate volatility. The RMI is also insulated from exchange rate effects as it uses the US dollar as its currency.

3. In the event of a downside shock, the RMI could be impacted through the commodity price and remittances channels, but the effects are not expected to be large. Preliminary analysis suggests that the prices for tuna, the RMI's most important commodity export, could be 18 percent lower than in the baseline, which would reduce the current account surplus from 4.1 percent of GDP in FY2023 to 0.2 percent of GDP. A larger reversal equivalent to the 2021 price level would lead to a more pronounced deterioration, bringing the current account deficit to 4.2 percent of GDP.

4. In addition to the direct price impact, lower fish prices could also impact volumes by reducing output, and income from fishing license fees. Remittances could be impacted by job losses or other adverse income developments facing Marshallese citizens in the US, or because of financial system stress that impedes the flow of remittances. At the onset of the Global Financial Crisis in 2008, remittances declined by about 12 precent, which if replicated would reduce the current account surplus to 2.7 percent of the GDP.

5. Combining both a tuna fish price (-18 percent) decline and remittance shock would lead to a current account deficit of 0.9 percent of GDP in FY2023. Similarly, combining the tuna fish price prevailing in 2021 and remittance shock would further worsen the current account deficit to 4.2 percent of the GDP. Offsetting this, however, would be lower imports due to a

[1] World Economic Outlook, April 2023.

[2] Total of both current and capital grants, including off-budget transfers for participation in US Federal programs.

decline in import prices, particularly for oil. The data to assess the impact on other imports is not available. Finally, there could be a terms-of-trade effect but again, there is insufficient data to assess both the direction and magnitude of the impact.

Annex IV. Compact Trust Fund

1. **The Compact Trust Fund (CTF) was created under the second Compact Agreement in 2004 and is intended to safeguard the long-term fiscal sustainability of the RMI once Compact payments end.** The US, Taiwan Province of China and, since FY2015, the Marshallese authorities contribute to the CTF, which is invested in a diversified portfolio consisting mainly of other investment funds. At end-FY2022, the CTF had a net asset position of US$568 million (207 percent of GDP). As at end-May 2023, the CTF had increased to US$679.9 million (245 percent of GDP).

2. **The CTF cannot be used by the Marshallese authorities until Compact grant payments end.** Under the current Compact agreement, the Marshallese authorities may begin drawing from the CTF from FY2024, after grant payments cease in FY2023. The CTF is structured as follows:

- The *A Account* holds the capital contributions from all three governments and reinvested earnings accumulated since its inception in FY2004.
- The *B Account* will hold all income earned after FY2023 and may be channeled to the budget to compensate for the loss of Compact grants. In the event earnings from the CTF are insufficient to meet the budgetary needs of the RMI government, funds in the C Account may be used to top up withdrawals (see below).
- The *C Account* is a buffer account that holds any earnings in excess of 6 percent, subject to a limit, and may be used to supplement shortfalls in the B Account.

As at end-FY2022, the A Account held US$485.5 million while the C Account held US$82.1 million. The B Account will not be operational until the Compact payments end. The separation between the A and C Accounts is maintained for record-keeping: both accounts are pooled when invested, and the asset allocation is identical.

3. **The CTF is administered by an independent committee that exercises oversight and fiduciary responsibility over the Fund.** The US nominates four voting members, the RMI appoints two and Taiwan, POC nominates one member. A private fund manager (Vanguard) acts as investment advisor and custodian for the Fund.

4. **The CTF has returned 5.6 percent annually on average since its inception.** The yearly performance varies, based on market movements and the asset allocation structure: in FY2021, the CTF's weighted annual return after discounting for contributions from the governments, fees and expenses was 23.7 percent but in FY2022, it was -18.6 percent.

Annex V. Updates on Financial Integrity Issues[1]

1. The country's anti-money laundering and combating the financing of terrorism (AML/CFT) is currently being evaluated by the Asia/Pacific Group on Money Laundering (APG).[2] The mutual evaluation will assess the extent to which the RMI has implemented the FATF Standards on AML/CFT in its legal, regulatory, and operational framework. The assessment will focus primarily on establishing how effective the RMI is in mitigating its money laundering and terrorism financing (ML/TF) risks and identify any systemic weaknesses in the country's AML/CFT system. This exercise notably includes examination of the country's understanding of ML/TF risks and the implementation of appropriate risk mitigation measures; application of AML/CFT preventive measures by financial institutions (FIs), designated non-financial businesses and professions (DNFBPs), and virtual asset service providers (VASPs); AML/CFT supervision of FIs, DNFPs and VASPs; transparency of beneficial ownership of legal persons and legal arrangements; quality and use of financial intelligence; ML/TF investigations and prosecutions; and international cooperation. Achieving effectiveness is a challenge for all countries, particularly those with limited resources and capacity constraints.

2. Ahead of the mutual evaluation, the authorities have been taking steps towards strengthening the AML/CFT regime. Since 2020, they have introduced or amended AML/CFT-related laws and regulations with a view to bringing the legal and regulatory framework in closer alignment to the FATF Standards. To support risk-based supervision by the Financial Intelligence Unit, the authorities have increased the number of staff, arranged training on AML/CFT supervision, and revised the onsite examination manual. In the context of the assessment, the country will have to demonstrate to assessors that in practice its AML/CFT system is effective in protecting the financial system and broader economy from ML/TF. The authorities also recently introduced measures to regulate VASPs for AML/CFT purposes through amendments to the Banking Act (in 2020) and AML Regulations (in 2021),

3. The 2018 SOV Act has not been repealed. Staff previously raised concerns that issuance of the SOV, a decentralized digital currency based on blockchain technology, as a second legal tender of the RMI, would pose significant risks to macroeconomic and financial stability, as well as to financial integrity, which the RMI did not appear equipped to mitigate effectively.[3] In 2020, a Bill to repeal the Declaration and Issuance of the Sovereign Currency Act (the "SOV Act") was introduced in

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[1] Prepared by Stephanie Forte (LEG).

[2] The APG is a "Financial Action Task Force-Style Regional Body" (FSRB) that notably assesses the AML/CFT regimes of its members and supports their implementation of the FATF Standards. The last assessment of the country's AML/CFT regime was conducted by the APG in 2011. The onsite visit for the current assessment is scheduled to take place in October 2023.

[3] Republic of the Marshall Islands, 2021 Article IV Consultations – Staff Report, ¶17; IMF, Republic of the Marshall Islands – Selected Issues Paper, September 2018, pages 7-19.

the Nitijela (Parliament).[4] However, repeal of the SOV Act has not been completed, and the law remains in force though not implemented.

4. The proposed Digital Economic Zone of Rongelap Atoll (DEZRA) appears to be halted. Staff previously recommended a cautious approach to the DEZRA initiative as it could expose the country to a host of new ML/TF risks.[5] The DEZRA Bill proposed in 2021 would establish a framework for provision of virtual asset services, including exchange services and custodial wallet services. DEZRA was proposed as a tax-exempt zone targeting primarily (if not exclusively) non-resident entities with no physical presence in the jurisdiction, which could prove highly susceptible to illicit financial flows and activity. Under the DEZRA Bill, the Banking Commissioner's responsibilities for AML/CFT supervision would be delegated to a DEZRA Commissioner whose capacity to effectively supervise activities in the DEZRA was unclear. While the authorities maintain that they have assessed the ML/TF risks presented by the DEZRA, the Bill in its current form does not describe ML/TF risks mitigating solutions such as preventive measures and meaningful AML/CFT supervision mechanisms. the interaction between the regime for VASPs and the DEZRA regime would need to be clarified. The authorities have not announced any new plans regarding the DEZRA.

5. The authorities are exploring establishing a stablecoin as a national digital currency. The introduction of the stablecoin appears to be another effort to address the cost of cash management and distribution, and the lack of penetration of banking and payment services in the RMI. Additionally, the authorities are looking at the stablecoin as a possible solution to the high cost of international transfers and addressing risks related to the possible loss of CBRs. At this stage it is unclear whether the authorities are considering issuance of a state-backed stablecoin or a privately issued stablecoin. If the authorities are planning the latter, this would not be in line with Fund advice against granting official currency or legal tender status to unbacked crypto assets and privately issued stablecoins.[6] In any event, the authorities would need to assess the ML/TF risks of the proposed stablecoin and develop appropriate mitigating measures prior to its launch.

6. Inadequate AML/CFT regulation and supervision of the RMI's offshore corporate services sector presents ML/TF risks. Formation and registration of Marshall Islands companies is carried out by private companies with limited oversight by the Banking Commission or other government agencies. As previously noted by staff, corporate services provided to foreign entities registered in the RMI are not subject to the AML/CFT framework, undermining the authorities' ability to properly understand and oversee the sector, obtain accurate information, and combat illicit activity linked to offshore activities.

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[4] Declaration and Issuance of the Sovereign Currency (Repeal) Act, 2020.

[5] Republic of the Marshall Islands, 2021 Article IV Consultations – Staff Report, ¶18.

[6] IMF, Policy Paper: Elements of Effective Policies for Crypto Assets (2023).

7. **ML/TF risks arising from the operation of decentralized autonomous organizations (DAOs)[7] is another source of concern.** In 2022, the RMI enacted legislation allowing for the operation of DAOs.[8] The DAO Act provides that a DAO may register as a resident domestic limited liability company. DAOs may be non-profit or for-profit. All DAOs are required to engage a registered agent. A subsidiary of a Delaware-incorporated entity (MIDAO Directory Services) acts as the DAO registrar under the oversight of the Attorney General. To date, 25 DAOs (all of which are non-profits) have been registered, although regulations for the DAO sector are still under development. At present, the application process includes a criminal history background check by a third-party vendor and a due diligence check of initial members by the Financial Intelligence Unit (FIU). According to the authorities, all DAO transactions are required to take place on public blockchain, and any crypto wallets linked to tokens issued to DAO members must be visible. MIDAO has also reportedly committed to using blockchain analytics to detect any illicit activity. However, these requirements have not yet been codified and the authorities cannot confirm whether they are being followed. While the authorities are intended to have access to the DAO portal maintained by MIDAO, such access has not yet been granted, and, as such, the authorities have extremely limited information on the sector. Further, the RMI has yet to undertake an assessment of TF risks of non-profit organizations, including DAOs, and it is unclear whether any of the non-profit DAOs are among the subset of non-profit organizations in RMI likely to be at risk of TF abuse. Finally, while the DAO Act requires the identification and reporting of beneficial owners (as defined by the Limited Liability Company Act), how such provisions are applied to DAOs remains to be seen. In addition to the MF/TF risks from DAOs, the authorities confirmed that commercial DAOs would attract RMI taxation but the systems for filing tax returns, verifying revenues and other financial information and taking tax enforcement measures are not yet in place.

8. **The RMI was added to the European Union (EU) list of non-cooperative jurisdictions for tax purposes in February 2023.** The list identified the RMI as facilitating "offshore structures and arrangements aimed at attracting profits without real economic substance by failing to take all necessary actions to ensure the effective implementation of substance requirements."[9] The authorities have stated that they are working closely with the EU and the Code of Conduct Group on Business Taxation to address concerns with respect to economic substance enforcement, with a view to being removed from the list.

[7] While no universal definition for DAOs yet exists, they are generally recognized as being decentralized entities with code-based governance and/or operations.

[8] Decentralized Autonomous Organization Act, 2022.

[9] Council of the European Union, Conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes, February 14, 2023.

Annex VI. Establishing Monetary Authority in the Republic of the Marshall Islands—Considerations on Design and Mandate[1]

Background

1. The Republic of the Marshall Islands (RMI) is characterized by a relatively low level of financial development along several dimensions:

- **Absence of a monetary authority that can issue currency.** The RMI has adopted the US dollar as its currency and issues no currency of its own. There is also no central bank or monetary authority. The primary responsibility for managing the financial system falls to the Office of the Banking Commission, which is primarily concerned with setting banking regulations, undertaking supervisory activities and is the AML/CFT regulator (through the Financial Intelligence Unit).

- A cash- and check-based system with an unsophisticated payments and settlement system: The RMI's financial sector is heavily cash- and check-based. The level of digitalization is very low and dominated by few instruments,2 with limited availability of mobile banking services and products. The financial system also lacks financial market infrastructure: interbank clearing and settlement arrangements are voluntarily undertaken by the two main commercial banks—the Bank of the Marshall Islands (BOMI) and Bank of Guam (BOG) and this is done manually, which is inefficient and risky.3

- Limited links to the international financial system (IFS): RMI maintains links with the IFS through two channels. The BOG, which is a foreign bank, is a member of Fed wires in the Federal Reserve System. BOMI on the other hand relies on a correspondent banking relationship (CBR) with one US-based bank. Both these links could be adversely impacted by a perceived increase in risks, particularly around observance of AML/CFT regulations and standards. Should either or both these links be disrupted, there could be a significant impact on the economy by curtailing access to US dollars.

- Highly concentrated: Most government payments are handled by BOG, particularly external transactions, while BOMI handles public sector payrolls and transacts on behalf of the government on the atolls where BOG is not present. The reliance on a single commercial bank to execute critical government financial transactions represents a concentration risk, and could raise confidentiality concerns. The lack of competition may also contribute to the high cost of international transactions.

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[1] Prepared by Shogo Takahashi (APD).

[2] For example, credit and debit cards, domestic bank cards and about 200 points of sales (POS) terminal.

[3] Although checks are cleared every day, the exchange and settlement of obligations are done every week where both banks go to each other's locations to physically present all the checks that are to be cleared.

2. The risks of a loss of access to the IFS are exacerbated by several initiatives that raise financial integrity concerns. First, there are ongoing concerns about the role and nature of transactions related to the offshore shipping registry and services sector. Registrations are carried out by private companies with limited oversight by the Banking Commission or other government agencies. Second, the government has initiated several fintech initiatives that could introduce significant risks to macroeconomic and financial stability, as well as financial integrity, and would also adversely affect the RMI international reputation (Annex V).

The Role of a Monetary Authority (MA) in a Fully Dollarized Economy

3. A MA in a fully dollarized economy would not fulfill many of the typical functions of a central bank. In the Marshallese context, a MA would not be able to formulate and implement monetary and exchange rate policies, and the ability to fulfill other financial stability functions such as being a lender of last resort (LOLR) would be inherently limited given the lack of a sovereign currency issued by the Authority. Nevertheless, even in this context, a MA could be a valuable institution in other respects and support financial and economic development. In particular,

- A MA could be designed to address economic and financial stability concerns even in a fully dollarized economy by giving it the mandate to manage liquidity in the financial system, which could also contribute to price stability.

- A MA could be given the role to hold and manage the RMI's international reserves, which could play a critical role in mitigating economic and financial shocks, allowing international financial transactions to continue being carried out during adverse shocks.

- Notwithstanding the limits on the ability to function as a LOLR in the absence of the ability to issue its own currency, a MA could still perform this role on a more limited scale, drawing on international reserves and, where feasible, utilizing external credit lines.

- A MA could take over the oversight of the payments and settlement infrastructure and indeed operate critical infrastructure such as check and electronic fund clearing between domestic financial institutions. Such an arrangement would free up commercial banks from the cost of operating the current system and allow for a more rapid and efficient clearance system that could better support economic activity. A MA could also set up wholesale payments and settlements systems, which would be critical to the creation of a well-functioning financial market. Finally, a MA would also be able to oversee the systems operating in its jurisdiction to safeguard financial stability, fair competition, and protection of end-users.

- A MA could provide deposit and payment services for the government's transactions. In some jurisdictions where government may accumulate reserves arising from funds collected that are not immediately needed to meet near-term obligations, a MA could invest these on behalf of the government. In a few jurisdictions, MAs provide similar transaction and investment management services to other public administration entities (local governments, social security or pension funds, other statutory entities).

- Particularly in emerging market and developing countries, some MAs are mandated to promote financial inclusion. These could be achieved through the introduction and enforcement of community service obligations on banks, encouraging the rollout of mobile money and banking services, or oversight over public savings entities (e.g., savings or postal banks, agent banking, mobile money and banking). Greater financial inclusion would support financial development and long-term economic growth, leading to poverty reduction. In addition, financial inclusion would have positive impact on financial stability as banks would have access to a larger and more diverse deposit base.

Features of a MA in the RMI

4. **A MA would be best served by a focused and clear mandate, which would inform its functions.** Given the inherent constraints imposed by the Marshallese context discussed above, an effective MA should focus on strengthening its mandate to safeguard financial stability by upgrading its regulatory and supervisory capacity and ensuring sufficient domestic liquidity and international reserves, functioning as the financial agent of the government, and modernizing and overseeing the payments and settlements system. Given the limited capacity in terms of human capital in RMI, the current Banking Commission would likely need to be integrated into the MA once it is set up.

5. **Policy instruments would need to be built up over time.** Reserve requirements are likely to be the initial primary policy instrument for the new MA, but over time, these could be supplemented by open market and credit operations to maintain adequate liquidity in the financial system. To enable it to undertake even a limited LOLR function, the MA would need to have access to US dollar liquidity, whether through the accumulation of sufficient international reserves or the establishment of suitable offshore liquidity lines. Relatedly, the MA would need to hold sufficient international reserves to support both RMI's domestic and external liquidity needs in the event of a disruption.

6. **In other respects, the MA should draw from generally accepted good practices for all such entities.** These include autonomy to allow it to operate independently of political and private interests and accountability to ensure it meets its objectives. Even with a focused mandate, a MA would be expected to develop research and analytical capacity to help it formulate sound and effective policies to safeguard macroeconomic and financial stability, and to communicate these to the public.

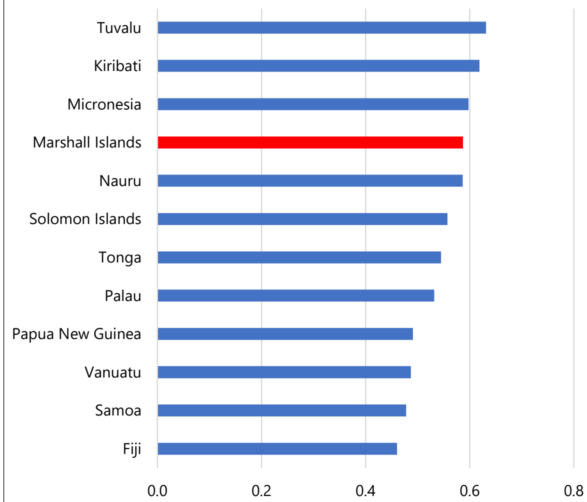
7. **While a focused institution would be equipped to address key constraints to economic and financial management, a MA would not be a silver bullet to raise the level of financial development.** In particular, the establishment of the MA itself is unlikely to alleviate the risk to CBRs and access to the IFS. The appropriate solution to these concerns is to address initiatives that raise risks to the RMI's financial integrity framework. The establishment of the MA would also need to be coordinated carefully with the US authorities to ensure it is able to access the Fed payment system, thereby allowing it to fulfill its role as financial agent for the government.

8. **The lack of adequate resources and capability is a major challenge to setting up a MA in the RMI.** A MA, even one with as focused a mandate as discussed above, would require enormous resources in terms of qualified staffing, capabilities, and capital in an environment of limited capacity and financial resources. Further, the RMI faces other economic and development challenges that may call for an examination of tradeoffs (e.g., strengthening the functions of other ministries and agencies instead of focusing on establishing a MA). Given the current limited capacity and the expectation that acquiring staff with expertise will not be achieved immediately, the authorities need to make the policy priorities of the MA extremely clear to reduce operational risks as much as possible.

Annex VII. Accessing Climate Finance—Key Issues and Policy Options[1]

1. RMI is vulnerable to climate change and natural disasters, with implications for long-term development. It is estimated that in the next 100 years, average annual temperatures in the Pacific region will rise 1.4–3.7 degrees Celsius, while sea levels increase by an additional 120–200 cm—7 to 10 times more than in the past 100 years.[2] At only around 2 meters above sea level, RMI's low-lying atolls are among the most vulnerable to the adverse effects of climate change—including rising sea levels and higher risks of extreme weather. Authorities' estimates suggest a 50-cm rise in sea level could be the tipping point for the small developing state (SDS). The impact of Climate change in RMI will include the loss of eco-systems that will affect the macro-critical fisheries sector, coastal erosion, wave-driven flooding, submergence, change in land use, damage to physical infrastructure and the loss of life and livelihoods. In addition, RMI is also susceptible to natural disaster risks, such as droughts and floods. Historical data from the Emergency Events Database indicate that the average likelihood of a severe natural disaster is 5.4 percent per year, with about 25 percent of total population being affected by a severe disaster event. Together, climate and disaster vulnerabilities in RMI put macroeconomic stability and long-term growth at risk.

Exposure to Climate Change



Source: Notre Dame Global Adaptation Index (2020)

2. The National Adaption Plan (NAP) is expected to set out a roadmap to strengthen physical, economic, and social resilience. The National Strategic Plan (2030-2040) mandated the preparation of a National Adaption Plan as early as possible but work on this has been delayed due to the pandemic. Now expected in around October 2023, authorities note that the NAP will be anchored on self-preservation and guided by scientific data as well as land tenure constraints. The NAP is expected to lay out strategies for addressing sea level rise, including construction of sea walls and climate proofing infrastructure, and coping with internal migration, informed by the data on the atolls most vulnerable to submergence. The authorities also intend to highlight measures to address risks, including the protection of mangroves, greater uptake of dryland agriculture, and better management of water resources and weather information in the NAP.

[1] Prepared by Muhammad Shamil Akbar (APD) and Valeria Mensah (ICD).

[2] Fouad, M., N. Novta, G. Preston, T. Schneider and S. Weerathunga: Unlocking Access to Climate Finance for Pacific Island Countries (IMF Departmental Paper, 2021)

3. Adaptation to climate is costly, and the external funding environment is constrained. The United Nations Environment Program estimates show developing countries require around US$70 billion annually to meet the financing needs and that the global demand for climate funds may increase up to US$300 billion. Pacific Island Countries (PICs), face a large climate finance gap—with the average additional annual spending needs estimated at 6½ to 9 percent of GDP, or almost $1 billion for the region.[3] These costs partly reflect the disproportionately higher public sector investment costs in the region due to the due to their expansive coastal protection infrastructure needs. In the RMI alone, early estimates in the RMI suggest it will cost around US$35-40 billion in total to elevate the atolls. Similarly, the WB estimates[4] that the cost of coastal protection for the RMI could range between 4-13 percent of GDP by the 2040s, the highest among the Pacific Island Countries, while protecting infrastructure is expected to cost 4.7 percent of GDP, only exceeded by Kiribati and the FSM. Yet, while global demand for climate finance continues to increase, the supply of funds faces increasing pressures. Climate funding from advanced countries, extended in form of bilateral and multilateral support, export credits and private financing fell significantly short of the US$100 billion pledged annually.[5] In 2020, approximately US$83.3 billion was disbursed by advanced countries[6] and following the COVID-19 outbreak and the subdued economic growth in 2020-21, disbursements are expected to be significantly lower.

Accessing even this limited climate funding is challenging for countries in the Pacific, including the RMI. Like other PICs, the RMI has access to Climate Funds including the Green Climate Fund (GCF), Adaptation Fund and the Global Environment Facility, to support Climate priorities, but actual financing has been limited (Table). For instance, out of an estimated US$55 million GCF allocation to RMI, only about US$1.5 million has been earmarked for projects. Accreditation requirements for direct access to climate funds are often complex—with requirements on financial strength, technical expertise, governance structures, social and environmental safeguards that are often beyond the capacities of domestic institutions in many PIC countries. As a result, most countries in the region, including RMI, rely on multilateral agencies such as the World Bank and Asian Development Bank as their Accredited Entities (AEs). This makes the process for

Table: Climate Financing in the Pacific Island Countries

USD Millions	No. of Projects	Grants	Loans	Co-Financing	Total
Green Climate Fund	16	405	74	685	1,164
Adaptation Fund	11	47		-	47
Global Environment Facility	215	630		2,904	3,534
Total	242	1,082	74	3,589	4,745

Source: South Pacific Regional Economic Program (2022)

[3] Fouad, et al (2021).

[4] Pacific Possible: Long-term Economic Opportunities and Challenges for Pacific Island Countries (2017).

[5] During the United Nations Conference in 2009, advanced countries pledged US$100 billion annually to finance climate related projects in developing countries. The pledge was reiterated at COP16 in Cancun, and at COP21 in Paris and was extended till 2025.

[6] OECD: Aggregate Trends of Climate Finance Provided and Mobilized by Developed Countries in 2013-2020 (July 2022).

accessing funds lengthy. challenges that constrain access to climate funds include project design challenges—including the need to adhere to specific project approval criteria, high transaction costs and general capacity constraints.

4. Fiscal reforms will play a critical role in climate financing for RMI. The main source of funding for climate financing in RMI will come from budgetary resources, including grants provided by traditional donors. While the risk of a fiscal cliff would recede if negotiations on a new Compact are successful, fiscal reforms will remain critical to creating fiscal buffers and unlocking fiscal space for priority climate investments—even in under a Compact scenario. Without these reforms, the sustained investments for such an extended period needed to address climate pressures will significantly elevate fiscal pressures. Additional financing in the form of loans—even on concessional terms—will need to be integrated into a sustainable fiscal and debt management framework, given the RMI's high risk of debt distress.

5. Unlocking access to Climate Funds will require innovations in strengthening institutions. Direct accreditation for the RMI and other Pacific countries will eliminate the need to go through another accredited entity to access climate funds. This will, however, require RMI to, among other things, develop policies specialized institutions for Climate Change, strengthen public financial management systems and capacity, as well as presenting detailed evidence of institutional effectiveness.[7] These hurdles will take time to overcome, and as RMI in the interim continues to work with AEs, some innovation will be necessary to improve the efficiency of the process. This would include setting up a dedicated team that take a whole portfolio view of projects—to speed up identification, appraisal, and preparation of projects, as well as leveraging existing capacities—which will require approving projects sequentially to enable the retention of personnel. In addition, regional initiatives—including through the Pacific Islands Forum Secretariat can help strengthen capacity and promote pear learning among the countries, while lowering costs in accessing funds. At the same time, improvements in the accreditation process are needed, as this will help reduce the transaction costs for SDS like the RMI.

6. RMI should continue to leverage available donor funding, especially for disaster response. With the limits to fiscal space, and the inability to generate funds from domestic and international financial markets, bilateral and multilateral partners will continue to play a key role in the RMI's climate financing architecture. RMI can leverage donor funding particularly for disaster preparedness and response. As part of the RMI's IDA-19 allocation, the country will have access to around US$3 million from the WB's Catastrophe Deferred Drawdown Option (Cat DDO), which provides immediate liquidity following a natural disaster, and/or health related event[8])—with the available amount going up to $12 million due to additional financing from regional and global funds. The ADB Disaster Contingency Fund—currently under negotiation—will also provide around

[7] The Ministry of Finance is currently undergoing the accreditation process for the GCF. Maintaining accreditation will also likely be a challenge given the underlying capacity constraints.

[8] Under the Cat DDO, funds become available for disbursement after the drawdown trigger—typically the member country's declaration of a state of emergency—is met.

S$6 million for RMI in the case of disasters.[9] The RMI may also be eligible to access support from bilateral donors including the United States,[10] Australia, Japan, and Taiwan POC.

[9] The disbursement of the allocation in the last ADB program was triggered by COVID and was fully utilized.

[10] As part of the soon-to expire Compact, the RMI has access to the US Federal Government Disaster Response Instrument which includes funding from the US Agency for International Development and the Federal Emergency Management Agency (FEMA). Continued access will depend on the outcome of the negotiations on the new Compact

Annex VIII. Main Recommendations From the 2021 Article IV Consultation

	Fund Recommendations	Policy Actions
Fiscal Policy	• Supportive fiscal measures should remain in place until a recovery is underway but over time, should be reprioritized and targeted. • Gradual fiscal consolidation is needed to avoid a fiscal cliff scenario in the event of a delayed or unsuccessful Compact negotiation.	• COVID-19 support measures have been lifted as the authorities have fully utilized the donor-provided funds in the COVID Preparedness and Response Fund. • Fiscal consolidation has not taken place: the fiscal surplus narrowed from 2.5 percent of GDP in FY2020 to 0.7 percent in FY2022. While some elements of recurrent spending, particularly the use of goods and services, declined, current subsidies to SOEs and untargeted transfers to households and non-profits institutions serving households remained large at an estimated 9.8 percent of GDP in FY2022.
Climate Change	• A National Adaptation Plan should be prepared.	• A NAP is expected to be completed and expected to be presented before cabinet for approval in 2H 2023.
State-Owned Enterprises	• Strong commitment to SOE commercialization would reduce fiscal pressures and strengthen economic efficiency.	• SOE subsidies remain in place and were 6.3 percent of GDP in FY2022, almost at the same level as in FY2020.
Financial Sector	• Financial integrity risks to the non-resident corporate and shipping (offshore) sectors should be mitigated.	• A risk assessment of the offshore services sector was commissioned by the Banking Commission. • No changes to the legal and regulatory framework have been implemented.

	Fund Recommendations	Policy Actions
Digital Currency	• Authorities should proceed with caution on the SOV and DEZRA. The SOV repeal bill should be passed.	• SOV Repeal Bill has not been passed and the SOV Act remains in force. • A risk assessment of the DEZRA initiative was commissioned by the Banking Commission. • The DEZRA Bill has not been introduced in parliament, and no timeline for its progress has been proposed. • The DAO Act passed in 2022, which raises financial integrity concerns. The authorities have appointed a private company to be the registrar (MIDAO Directory Services) and have started registering entities.
Encourage Private Sector Growth	• Private sector growth will require structural reforms	• Through a joint-venture with The Nature Conservancy, the RMI has been able to receive Marine Stewardship Council certification on the sustainability of its catch, thereby accessing new retail partners (Pacific Island Tuna) in the US.

Annex IX. SDGs Identified in the 2020-30 National Strategic Plan

Key development objectives identified by the NSP	Corresponding Sustainable Development Goals [1]		Role of the IMF
Sustained and inclusive economic growth	1. No Poverty 2. Zero Hunger 5. Gender Equality	8. Inclusive Economic Growth & Decent Work 10. Reduced Inequality	Surveilance and policy advice on macroeconomic policies; Technical assistance on domestic revenue mobilization; Techinical assistance on financial sector stability to support financial deepening and inclusion; Technical assistance on developing a sound medium-term macoreconomic framework and improve macroeconmic analysis for policy making
Infrastructure	6. Clean Water & Sanitation	9. Resilient Infrastructure & Innovation	Surveilance and policy advice on public investment management
Access to quality social services and culture	3. Good Health and Well Being	4. Quality Education	Coordination with ADB, World Bank and development partners
Resilient and environmental sustainable development	7. Affordable and Clean Energy 11. Sustainable Cities & Communities 14. Sustainable Use of Oceans	12. Responsible Consumption 13. Climate Action 15. Life on Land	Surveillance and policy advice on climate change adaptation; Capacity development
Governance	16 Peace, Justice, and Strong Institutions	17. Partnerships for the Goals	Technical assistance on revenue administration, focusing on compliance improvement; Technical assistance on PFM with a focus on improving the budget document and devloping a medium term fiscal framework; Surveilance, policy advice and technical assistance on improving AML/CTF

[1]IMF staff compilation.

INTERNATIONAL MONETARY FUND

REPUBLIC OF THE MARSHALL ISLANDS

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 30, 2023

Prepared By: Asia and Pacific Department (In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of July 31, 2023)

Membership Status: Joined May 21, 1992; Article VIII

General Resources Account:

	SDR Million	Percent Quota
Quota	4.90	100.00
IMF's Holdings of Currency	4.55	92.86
Reserve Tranche Position	0.35	7.15

SDR Department:

	SDR Million	Percent Allocation
Net Cumulative Allocation	8.02	100.00
Holdings	7.71	96.06

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Overdue Obligations and Projected Payments to Fund[1]

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2023	2024	2025	2026	2027
Principal					
Charges/Interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

Exchange Rate Arrangements.

The U.S. dollar is legal tender and the official currency. The Marshall Islands maintains an exchange system that is free of restrictions on the making of international payments and transfers for current and capital transactions.

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Article IV Consultation:

The Marshall Islands is on a 24-month consultation cycle. The 2021 Article IV Consultation discussions were held during March 1-18, 2021. The Executive Board discussed the staff report and concluded the consultation on May 27, 2021.

Technical Assistance: Fund CD has been closely integrated with policy priorities. Recent Fund CD has included support in several areas, including setting up a monetary authority, macroeconomic programming and analysis, public financial management, revenue administration, financial sector surveillance, and macroeconomic statistics. CD support in many of these areas is expected to continue, with expected TA and training focusing on the compilation and dissemination of external sector (ESS) and government financial statistics (GFS); modernizing financial supervision; and strengthening revenue administration. Technical assistance has been provided mainly through PFTAC.

Marshall Islands: Capacity Development Activities

Year	TA Area	Activities	Advisors
FY2023	Financial Sector	Regulatory Framework for MIDB and other NBFI's Prudential Standards- Impact Study & Industry consultation	PFTAC
		Establishing Monetary Authority	LEG/MCM
	GFS	Expand coverage to public nonfinancial corporations and for public sector debt statistics (PSDS). Source data provide sufficient detail to allow consolidation of GFS for the various levels of the general government (or public) sector.	PFTAC
	Real Sector	Balance of Payments GDP Deflators/ PPI	
	Macro Analysis	Macro-Fiscal Modelling	
	PFM	Strengthening Budget Preparation	
	Revenue	Review reform progress Improve Taxpayer Service Process and Skills Development	
FY2022	Financial Sector	Assisting RMI BC in the finalization of prudential standards by reviewing the industry feedback on draft prudential standards (Prudential Standards - Development of Impact Study Templates)	PFTAC
	GFS	Refine compilation techniques for using various administrative data sources to reduce statistical discrepancies Compile, review and disseminate data to the IMF Statistics Department.	
	Real Sector	Provide training on the compilation of non-market value-added Quality control and data editing for BGRT Implementing non-market production	
	Macro Analysis	Support the use of the Marshall Islands Fiscal Model (MI_FM) and Medium-Term Budget and Investment Framework (MTBIF) in budget preparations and policy analysis	
	PFM	Increase transparency in the presentation of the budget	

Marshall Islands: Capacity Development Activities (concluded)			
Year	**TA Area**	**Activities**	**Advisors**
FY2021	Financial Sector	Review revised draft banking law and regulations and propose final amendments. Training on risk-based supervision	PFTAC
	GFS	Refine compilation techniques for using various administrative data sources to reduce statistical discrepancies Compile, review and disseminate data to the IMF Statistics Department.	
	Real Sector	Review progress in independent compilation of GDP. Training of new staff on GDP compilation and national specifics of data sources.	
	Macro Analysis	Economic Forecast COVID19 Update	
	PFM	Assist with the compilation of a manual for the Marshall Islands Fiscal Model (MI-FM) and Medium-Term Budget and Investment Framework (MTBIF)	
	Revenue	Review of Tax Reforms and Core Tax Functions	

Resident Representative: The resident representative office in the Pacific Islands was opened in September 2010 in Suva, Fiji. Mr. Neil Saker is the current Resident Representative.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

Relations with other IFIs:

- World Bank Group: http://projects.worldbank.org/search?lang=en&searchTerm=&countrycode_exact=MH
- Asian Development Bank: https://www.adb.org/countries/marshall-islands/main
- Pacific Financial Technical Assistance Center: https://www.pftac.org/content/PFTAC/en1.html

STATISTICAL ISSUES

(As of June 2023)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is broadly adequate for surveillance and the authorities willingly share available data, though some shortcomings tend to constrain policy analysis, including limited coverage and timeliness of data releases. The Economic Policy, Planning and Statistics Office (EPPSO) was established in February 2003 and took efforts in building local capacity to collect and disseminate economic and social statistics. Through the close collaboration of EPPSO and various ministries, an external consultant team in the Pacific Islands Training Initiative (www.pitiviti.org), funded by the U.S. Department of Interior, prepares a comprehensive set of annual statistics covering key areas beginning FY2008. Pacific Financial Technical Assistance Center (PFTAC) also assists in preparation of the national accounts, government finance (GFS) and external sector statistics (ESS).
National Accounts: National income accounts (the latest data through FY2022) have been prepared by the external consultants dating back to FY1997, though the official website lags behind in presenting what is available. PFTAC is assisting EPPSO in developing a framework for compiling GDP by production. For this purpose, recent TA work in 2022 continued the training of deriving Gross Value-Added of non-market producers and applied this knowledge together with the EPPSO staff in peer-to-peer compilation. The price base year of CPI for GDP is 2004, which is expected to be updated using the latest results of the Household Income and Expenditure Survey (HIES) 2019/2020.
Employment: Data on employment and wages are available and classified by sectors based on the filings to Social Security Administration. However, no unemployment data are available.
Price Statistics: A quarterly consumer price index (CPI) based on expenditure weights from the Household Income and Expenditure Survey (HIES) 2002 is available. CPIs are published for nine expenditure categories in the capital city Majuro and in the island of Ebeye.
Government Finance: Fiscal data are regularly compiled for budget control, and with the help of external consultants, are consolidated into a format suitable for analysis. Annual financial audits on the central government and component units are regularly published which serves as the source for GFS compilation and dissemination. The RMI presents fiscal data using the Government Finance Statistics Manual 2014 (GFSM 2014). Data have been submitted to the annual Government Finance Statistics database for 2008–19. Recent TA work conducted a review of the GFS compilation process, confirmed the robustness of GFS data on an annual basis, and implemented an assessment on the adequacy of dissemination. .
Monetary and Financial Statistics: A reporting system was established for domestic banking institutions based on monthly reporting forms and guidelines developed by a STA mission in 1993. Though data are reported by banks to the Banking Commissioner, they are not published or reported to the Fund. The Financial Soundness Indicators (FSIs) are also not compiled or reported to the STA. For the Financial Access Survey (FAS), data is reported for some key series and indicators including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults), which are adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs), and the other two indicators on outstanding deposits and loans with/from commercial banks.
External Sector Statistics: The EPPSO has made important progress in the improvement of Marshall Islands' ESS during the Japan Subaccount (JSA) ESS Project ended in 2016. The sixth edition of the Balance of Payments Manual (BPM6) was adopted for the compilation of balance of payments and international investment position (IIP) statistics. There are some data weaknesses, including a poor quality of private external debt data in ESS and incomplete coverage of trust funds, which needs to be enhanced for improvement of portfolio investment data in the IIP. Recent TA work assisted the authorities in improving data collection and compilation practices for BOP and IIP needs and assisted the ESSPO in preparing a compilation guide as guidance on data collection, compilation, and dissemination processes.
II. Data Standards and Quality
Marshall Islands began participating in the IMF's General Data Dissemination System (now the enhanced GDDS) in 2014 providing only metadata. However, it has not implemented the e-GDDS as yet, which would imply dissemination of its data on a National Summary Data Page. No data ROSC is available.
III. Reporting to STA (Optional)
BOP data is reported to STA by EPPSO.

Marshall Islands: Table of Common Indicators Required for Surveillance
(As of June 2023)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	June 2023	June 2023	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	FY2022	May 2023	A	A	A
Reserve/Base Money	NA	NA	NA	NA	NA
Broad Money	NA	NA	NA	NA	NA
Central Bank Balance Sheet	NA	NA	NA	NA	NA
Consolidated Balance Sheet of the Banking System	FY2022	May 2023	A	A	A
Interest Rates[2]	FY2022	May 2023	A	A	A
Consumer Price Index	Q1 2023	May 2023	Q	Q	Q
Revenue, Expenditure, Balance/Composition of Financing[3] General Government[4] and Central Government	FY2022	May 2023	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	FY2022	May 2023	A	A	A
External Current Account Balance	FY2022	May 2023	A	A	A
Exports and Imports of Goods and Services	FY2022	May 2023	A	A	A
GDP/GNP	FY2022	May 2023	A	A	A
Gross External Debt	FY2022	May 2023	A	A	A
International Investment Position [6]	FY2022	May 2023	A	A	A

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).

INTERNATIONAL MONETARY FUND

REPUBLIC OF THE MARSHALL ISLANDS

August 31, 2023

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
Abdoul Aziz Wane (APD, IMF), Martin Čihák (SPR, IMF), Manuela Francisco (MTI, WB), Lalita M Moorty (EEADR, WB)

Prepared by the staff of the International Monetary Fund and the International Development Association (IDA).

The 2023 Debt Sustainability Analysis (DSA)[1, 2] indicates that the Republic of the Marshall Islands (RMI)'s debt is sustainable but remains at high risk of debt distress. The ratios of the present value (PV) of public and publicly guaranteed (PPG) external debt to GDP, and PV of total PPG debt to GDP are projected to increase after FY2023 due to larger financing needs arising from the expected expiry of the Compact grants from the United States in FY2023 and an assumption that new financing from multilateral development banks (MDBs) will include more loans starting in FY2025—with World Bank financing becoming fully loans from FY2033. While the two indicators remain below their respective thresholds in the 10-year forecast horizon in the DSA baseline scenario, they continue to rise and breach their respective thresholds over the 20-year forecast horizon and remain above them at the end of the horizon, indicating that the risk of debt distress remains high. The standardized stress tests and customized scenario also highlight the vulnerability of the debt position to other non-debt flows, exports, depreciation and commodity price shocks. Notwithstanding, there are good prospects that the RMI will maintain its grant-only status in the near term, which mitigates the risk of debt distress. Further, RMI does not currently face debt servicing risks. While a renewal of the Compact agreement is not in the current baseline, negotiations are ongoing and there are good prospects of an agreement. The implementation of fiscal and structural reforms, alongside gradual adjustment, would promote long-term fiscal sustainability and growth—including building in buffers in the event of emergencies and creating space for investment in climate adaptation.

[1] The DSA follows the IMF and World Bank Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework (DSF) for Low Income Countries (LICs) (February 2018).

[2] The Composite Indicator (CI) of 1.65 is based on the latest available CI information—April 2023 IMF World Economic Outlook (WEO) and the World Bank's Country Policy and Institutional Assessment (CPIA) for 2021 indicating a "weak" capacity to carry debt (see ¶7).

Marshall Islands: Joint Bank-Fund Debt Sustainability Analysis	
Risk of external debt distress	High
Overall risk of debt distress	High
Granularity in the risk rating	Sustainable
Application of judgement	Yes

PUBLIC DEBT COVERAGE

1. **The DSA for the RMI covers central government debt and government-guaranteed debt.** The DSA classifies domestic and external debt based on the residency criteria, as the RMI uses the US dollar as its legal tender. The RMI's debt is entirely denominated in US dollars, and the bulk is held by non-residents, primarily on concessional terms from development partners. Data availability limits debt coverage, especially the lack of timely information on balance sheets for all other subsectors except the central government,[3] reflecting capacity constraints that result in long time lags in the preparation of audited financial statements for state-owned enterprises (SOEs). The risk from the limited data coverage is mitigated by the measures highlighted in the Box, as well as the inclusion of contingent liability and financial market risks in the DSA. The settings on these have been maintained at the default levels specified in the LIC-DSF template (see table below). There are no Public-Private Partnerships (PPP) in the country at present.

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	
8	Non-guaranteed SOE debt	

1	The country's coverage of public debt	The central government, government-guaranteed debt		
		Default	Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0 percent of GDP	0	
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2	
4	PPP	35 percent of PPP stock	0.00	
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5	
	Total (2+3+4+5) (in percent of GDP)		7.0	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

BACKGROUND ON DEBT

2. **The RMI's debt is mainly PPG external debt, which has been declining since the early 2000s.** The PPG external debt in percent of GDP has been on a downward trajectory, declining from 74 percent of

[3] Official government finance statistics compiled by the RMI Government, and the Graduate School of the United States only covers government and government-guaranteed debt.

GDP in FY2002 to about 22.8 percent in FY2022.[4] RMI's external debt is mainly made up of concessional loans by the Asian Development Bank (ADB) to the central government—accounting for over 70 percent of existing PPG external debt, with the remainder being government-guaranteed debt owed to the U.S. Rural Utilities Services—contracted by a SOE —and debt owed to the International Cooperation Fund of Taiwan Province of China (ICDF).[5] Private external debt accounts for about 10 percent of total external debt. The U.S. dollar is the dominant currency in central government debt. Total debt service amounted to US$7 million in FY2022 and remains broadly stable over the medium term. Currently, RMI's only domestic loan is a US$2 million government guaranteed facility contracted in 2022 from the Marshall Islands Development Bank (MIDB) by the Marshall Islands Resort to fund renovation works.

UNDERLYING MACRO-ECONOMIC ASSUMPTIONS

3. The key assumptions are consistent with the baseline macroeconomic projections. The DSA makes the following assumptions, which are in line with the macroeconomic framework:

- **Real sector:** Following a downturn in FY2022—where real GDP declined by 4.5 percent[6]—the economy is expected to grow by 3 percent in FY2023. This is mainly driven by a projected recovery in the fisheries sector (constituting 12.7 percent of GDP). The growth in wholesale and retail trade (13.7 percent of GDP) and construction (6.1. percent of GDP) reflect the continuing recovery in domestic demand, with the latter benefitting from the revival of donor-financed projects and investment associated with preparations for the Micronesian Games scheduled in 2024. The outlook for medium-term growth is slower relative to the projections in the last DSA mainly due to a delayed pass-through effect of the pandemic on the RMI economy. In the long term, growth is projected to be around 1.5 percent—in line with previous DSA projections, consistent with potential growth. The continued emigration to the United States and the impact of climate change contribute to the slow long-term growth path. Inflation is expected to moderate to 3 percent by end-FY2023 as the decline in global fuel prices alleviates price pressures. Over the medium term, the inflation rate is expected to converge to the projected U.S. inflation rates of around 2 percent.

- **Fiscal sector:** The primary balance is expected to slip into deficits from FY2025, reaching 4 percent of GDP in FY2032. Fiscal developments that account for this include (i) the expiry of U.S. Compact grants at end-FY2023 that are partially substituted by disbursements from the Compact Trust Fund (CTF); [7] (ii) revenues from fishing licenses stabilizing at around 11 percent of

[4] FY2022 data is based on data received from the Graduate School on behalf of the authorities. These are estimates and are subject to change.

[5] This facility is to finance the construction of a Track and Field Stadium for the 2024 Micronesian Games.

[6] This reflects 40 percent decline in the fisheries sector due to the sale of a fishing vessel by a domestic operator, which decreased production. Excluding the sector, real GDP expanded by 4.2 percent, buoyed by a recovery in domestic demand post-COVID, though its strength was diminished by the temporary lockdowns in August and supply chain disruptions.

[7] The baseline macroeconomic framework assumes Compact grant funding will be replaced by drawings on the CTF from FY2024.

GDP over the projection period; (iii) tax collection that stabilizes at around 15.7 percent of GDP in the medium to long term in the absence of revenue reforms; and (iv) a greater reliance on borrowing, which reduces grant revenues and increases interest expenditure. These factors are partly offset by the assumption that current expenditure on subsidies to SOEs gradually decline by around 5.6 pp of GDP by FY2028 relative to the FY2022 but not sufficiently to prevent the fiscal balance from slipping into deficits.

- **External sector:** In the near term—FY2023 the non-interest current account is projected to attain a surplus of 4.2 percent of GDP as exports increase by 3 percentage points of GDP with a recovery in fish production, while imports drop by about 2 percentage points of GDP as global food and fuel prices pressures subdue (Table 1). In the medium term, however, the non-interest current account balance turns into deficits, starting FY2024 as imports outgrow stagnant exports and inflows decline—notably grants, with the expiry of the Compact. As a result, the non-interest current account deficit reaches 37 percent of GDP by FY2032 (Table 1).[8] Net FDI inflows are projected to stabilize around 3.3 percent of GDP.

- **External financing**: In the absence of access to international capital markets and a because of a very shallow domestic market, any remaining financing gap is assumed to be closed by a combination of bilateral and multilateral loans, all on concessional terms.[9] The baseline assumes that future financing from MDBs will move from all grants currently to a mix of grants and loans, with World Bank (WB) financing assumed to be fully on credit terms after FY2033. Under these financing assumptions, total grants decline from 31.9 percent of GDP in FY2023 to 12.5 percent of GDP in FY2042. Over the 20-year period from FY2023-FY2042, new external borrowing flows are assumed to total US$545.6 million. Of this total, MDBs are expected to account for around 39 percent, with the WB accounting for around 24 percent of the total, while bilateral borrowing is expected to make up the rest. WB credit is expected to be on standard IDA small-economy terms (interest rate of 0.75 percent, 10-year grace period, 40-year maturity). ADB financing is similarly expected to be on standard terms (zero interest, 6-year grace, 12-year maturity). Bilateral support is expected to be from the ICDF, which is expected to carry a 2 percent interest rate with a 7-year grace period and 33-year maturity. The new borrowing flows-to-GDP ratio is expected to rise gradually from around 2 percent in FY2023 to peak at 10.5 percent in FY2041. Over the 20 years, the new borrowing flows are expected to average around 6.2 percent of GDP annually.

4. Relative to the last DSA however, the primary deficits over the projection period are narrower mainly due to a slightly improved fiscal outlook and more favorable financing

[8] The shift in the current account balance from historical surpluses to deficits in the projection period is due to the decline in current grants following the expiry of payments under the Compact. The deficit is financed in part by an increase in capital (project) grants, mainly from the World Bank. Capital grants are projected to increase from 1.9 percent of GDP in FY2022 to an average of 8.1 percent between FY2024-30 before declining as financing increasingly shifts to loans (see bullet on External Financing). This change in the financing pattern also largely accounts for the swing in the residuals in Table 1.

[9] Debt that has a grant element of 35 percent or higher, based on the difference between the discounted present value (PV) of debt service payments (including any fees or other charges) and the face value of the debt, is defined as being concessional. The PV is calculated using a discount rate of 5 percent.

assumptions (Text Table 1). The previous DSA projected the primary balance to turn into deficits from FY2022,[10] rapidly expanding to an average of 7.7 percent of GDP over the medium term. In the current DSA, however, the expansion of the primary deficit, starting FY2025 is more gradual. Further, the previous DSA assumed that all MDB grants are replaced by loans unless they are already committed. This DSA assumes that other than grant financing that has already been committed, ADB financing in the projection period will shift from all grants in 2024 to mixture of grants and loans by FY2028. World Bank financing will remain fully grants until FY2025, then a mix of grants and loans until FY2033, after which it is fully loans. The loans are assumed to be on regular concessional credit terms for small economies.

Text Table 1. Marshall Islands: Macroeconomic Projections

	DSA AIV 2021					DSA AIV 2023				
	2020	2021	Average 2022-25	2030	2040	2022	2023	Average 2024-27	2032	2042
	Percent of GDP, unless otherwise indicated									
GDP Growth (percent)	-3.3	-1.5	2.5	1.5	1.5	-4.5	3	2.1	1.5	1.5
GDP deflator (percent)	1.1	1.5	2	2	2	6.2	3	2.2	2	2
Non-interest CA deficit	-2.9	-3.2	6.5	13.6	15.4	-8.8	-4.2	6.4	37	49.3
Primary deficit	-1.6	-1.9	7.7	14	16.2	-0.9	-0.3	0.7	3.7	6
Exports	26.7	33.3	30.5	30.2	30.2	45	47.9	45.3	45.3	45.3
Revenues and grants	67.7	86.8	62.2	49.7	46.2	66.4	62.8	69.5	57.6	51.4

Source: National authorities, staff's projections.

5. **Issues flagged in the realism tools largely reflect changing context. (Figures 3 and 4).** The large reduction in nominal PPG external debt relative to the previous DSA is mainly due to a relatively lower primary deficit projection in the current DSA for reasons discussed above. The shifts in debt-creating flows in the current DSA mainly highlight the changing macroeconomic context; notably the transition from current account surpluses to deficits.[11]

6. **Successful completion of the negotiation of a new Compact agreement with the United States[12] should improve the medium- to long-term fiscal outlook.** In the near term, a delay in completion of negotiations could be bridged by drawing on the Compact Trust Fund (CTF). However, the limited resources in the CTF—which stood at around US$680 million as at end-May 2023—would not allow these drawings to be a durable long-term replacement for the absence of new Compact grants. In any event, even if the Compact is successfully renewed, RMI's significant development needs over the long term—including investments needed for climate adaption—will increase fiscal pressures and necessitate fiscal reforms.

[10] The outturn for FY2022 and projection for FY2023 are now surpluses.

[11] In the past, relatively large current account surpluses were significantly debt reducing. This effect is minimized as the current account surplus gradually reduces and turns into deficits.

[12] Reports indicate the U.S. has agreed to provide US$2.3 billion in grant assistance over 20 years. This will be split between budget support grants, contributions to the CTF and compensation for landowners on Kwajalein Atoll, which hosts a U.S. naval base and weapons testing facilities.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

7. The debt-carrying capacity of the RMI continues to be classified as weak. The Composite Indicator (CI) for the RMI, which is used to assess the debt carrying capacity in the LIC-DSF stood at 1.65, and the classification of weak capacity remains, like in the last DSA.[13] Accordingly, the DSA thresholds applicable for the RMI are 30 percent for the present value (PV) of external debt-to-GDP ratio, 140 percent for the PV of external debt-to-exports ratio, 10 percent for the external debt service-to-exports ratio, 14 percent for the external debt service-to-revenue ratio, and 35 percent for the PV of public debt-to GDP ratio.

8. There are six standardized stress tests in the DSF, each applied to both the external and the public DSA. These standard stress tests capture shocks to real GDP growth, the primary fiscal balance, exports, other external flows (include official and private transfers and FDI), exchange rate depreciation, and a combination of these shocks. In standardized stress tests, a variable is subject to a shock, and the post-shock values of the stressed variables are set to the baseline projection minus one standard deviation. However, if the historical average is less favorable than the baseline projection, then the post-shock values are instead set to the historical average minus one standard deviation.

9. The DSA incorporates the costs and risks of natural disasters. Given RMI's susceptibility to natural disasters and climate change, staff's analysis of the baseline explicitly reflects their impact in the long run., RMI's long-term growth projections are adjusted downward by 0.1 percentage points to around 1.5 percent, compared with a non-disaster potential growth rate of 1.6 percent.[14] In addition, the near-term risk of a one-off extreme natural disaster is incorporated in the DSA analysis through a customized scenario (see Figures 1 and 2). The shock assumes that a one-off extreme natural disaster would decrease real GDP growth and export growth in the second year of projection by 2 and 3.5 percentage points respectively.[15]

[13] Based on the April 2023 WEO and 2021 CPIA.

[14] The 2018 Article IV staff report estimated that based on a 5.4 percent probability of a severe natural disaster in any given year, long-run growth is around 0.1 pp lower than in a non-disaster scenario.

[15] This is larger than the default setting in the DSA template (1.5 percentage points). This estimate, however, is subject to significant uncertainty and climate change may have much larger adverse impact on growth, which the natural disaster scenario of the DSA aims to capture.

Calculation of CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	2.615	1.01	61%
Real growth rate (in percent)	2.719	2.101	0.06	3%
Import coverage of reserves (in percent)	4.052	0.000	0.00	0%
Import coverage of reserves^2 (in percent)	-3.990	0.000	0.00	0%
Remittances (in percent)	2.022	9.955	0.20	12%
World economic growth (in percent)	13.520	2.856	0.39	23%
CI Score			1.65	100%
CI rating			Weak	

Composite Indicators

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Weak	Weak 1.65	Weak 1.70	Weak 1.70

DEBT SUSTAINABILITY

External Debt Sustainability

10. Under the baseline scenario, RMI's PPG external debt trajectory is projected to breach the indicative threshold in the medium to long term. The external debt-to-GDP ratio is projected to rise to 34 percent in FY2032, reaching 89.4 percent in FY2042 under the baseline projection. The PV of PPG external debt-to-GDP ratio is projected to rise, breaching the threshold in FY2035, while the PV of PPG external debt to exports is projected to remain below the threshold in the projection period. The ratios of PPG debt service to revenue and exports remain below its thresholds over the forecast horizon. Compared with the 2021 DSA, which projected external debt-to-GDP ratio to reach 114.1 percent in FY2030 and 238.7 percent in FY2040, the accumulation of debt is slower mainly due to the revision in the assumption on MDB financing,[16] and to some extent, an improved outlook for the medium term.[17]

11. Stress tests indicate the vulnerability of external debt dynamics to a combination of shocks. Among the standardized tests, other non-debt flows[18] shock would result in the highest PV of external PPG debt-to-GDP ratio, breaching the threshold in FY2029. In addition, the exports shock results in a breach in the threshold from FY2030. The PV of external PPG debt to GDP continues to rise after both of these shocks. Shocks to exports and other non-debt flows also cause the PV of external PPG debt-to-exports ratio to breach the threshold in FY2037 and FY2042, respectively. An exports shock results in the highest external

[16] The previous DSA assumed that MDB financial assistance would be fully on credit terms (see ¶4).

[17] This is mainly due to a more favorable fiscal outturn for FY2021 and FY2022 compared to what had been previously projected.

[18] These include official and private transfers, and FDI.

debt service-to-exports ratio, breaching the threshold from FY2041. For the external debt service-to-revenue ratio, none of the shocks examined resulted in a breach of the threshold, with the exports shock having the most significant impact. The natural disaster shock raises the PVs of external debt-to-GDP ratio above the baseline, crossing the threshold from FY2035.

Public Debt Sustainability

12. **Public sector debt follows similar dynamics as external debt.** The ratio of PPG debt to GDP is projected to rise to 38.9 percent in FY2032 and 98.8 percent in FY2042. The PV of PPG debt-to-GDP ratio breaches the threshold in FY2035. Stress tests also indicate the vulnerability of public debt dynamics to most shocks, breaching the threshold for a growth shock in FY2027 and non-debt flows and exports shocks in FY2030 and FY2031 respectively. Among the standardized tests, commodity price shock would result in the highest PVs of external PPG debt-to-GDP ratio, breaching the threshold in FY2026. The debt dynamics are similar to that of PPG external debt since public financing needs are met by external sources.

RISK RATING AND VULNERABILITIES

13. **The DSA indicates that RMI's debt continues to be sustainable but at high risk of distress, in line with past assessment.** Under the baseline scenario, the PV of PPG external debt-to-GDP ratio and the PV of total public-debt-to-GDP ratio will breach their indicative thresholds toward the end of the projection horizon. However, the RMI currently does not face issues servicing its debt and has good prospects for continued access to grant financing under a possible new Compact agreement with the US. Further, while the DSA assumes MDB lending will shift to a mix of grants and loans—with loans only for IDA from FY2034, there are good prospects that the RMI will maintain its grant-only status in the near term. The risks of debt distress can also be mitigated by a sustained gradual fiscal consolidation program. Other factors including the RMI's access to the CTF assets do not change the assessment by mechanical rating since access to the Fund are limited to income earned by the CTF during the year. As a current IDA-only country at a high risk of external debt distress, RMI is required to prepare Performance and Policy Actions (PPAs) under the Sustainable Development Finance Policy (SDFP). The Box highlights the progress and challenges with the PPAs.

Box 1. Performance and Policy Actions (PPAs)

The World Bank's Sustainable Development Finance Policy (SDFP) seeks to incentivize IDA countries to move towards transparent, sustainable financing and to promote coordination between IDA and other creditors in support of recipient countries' efforts.[1] The policy has two pillars:

- The Debt Sustainability Enhancement Program (DSEP) to help IDA countries address debt vulnerabilities through incentives and policy actions; and
- The Program for Creditor Outreach (PCO) to facilitate information sharing, dialogue, and coordination among creditors to help address debt-related risks, building on IDA's global platform and convening role.

The SDFP framework builds on the lessons learned during the Non-Concessional Borrowing Policy (NCBP) implementation and adapts to the new debt and creditor landscape. Starting from July 1, 2020, it replaced the NCBP and differs from it in several important aspects. While the new policy explicitly recognizes that efforts by IDA alone will not be enough to change the current debt landscape of IDA-eligible countries, its design seeks to maximize the policy's development impact.

It is in this context that the government of RMI enacted a series of legislation to address fiscal vulnerabilities and comply with the requirements of the SDFP. As per the SDFP, the Government of the Republic of the Marshall Islands (GoRMI) is required to implement two PPAs each fiscal year, one of which is a zero non-concessional borrowing ceiling on contracting new external public and publicly guaranteed debt as the country is at high risk of external debt distress. In addition, the government enacted legislations and regulations to enhance fiscal and debt sustainability - Fiscal Responsibility and Debt Management Regulations; Financial Management Bill; and Procurement Bill (see Table below for more details). The need for, and critically of these legislations were highlighted in various analytical reports; The 2012 PEFA, the 2021 Country Economic Memorandum/Public Expenditure Review (CEM/PER), the 2021 IMF AIV, and GoRMI's PFM Roadmap identified outdated and weak financial management and procurement frameworks and processes are key bottlenecks to efficient service delivery and a risk to fiscal and debt sustainability.

However, implementation challenges remain. With pandemic related-border closures, staff and consultants could not easily travel to RMI to provide technical assistance to the government. In addition, key positions at the Ministry of Finance continue to remain vacant, eroding an-already weak capacity. Nonetheless, the adoption of these legislations is a step in the right direction to enhance fiscal and debt sustainability in RMI.

[1] https://ida.worldbank.org/en/financing/debt/sustainable-development-finance-policy

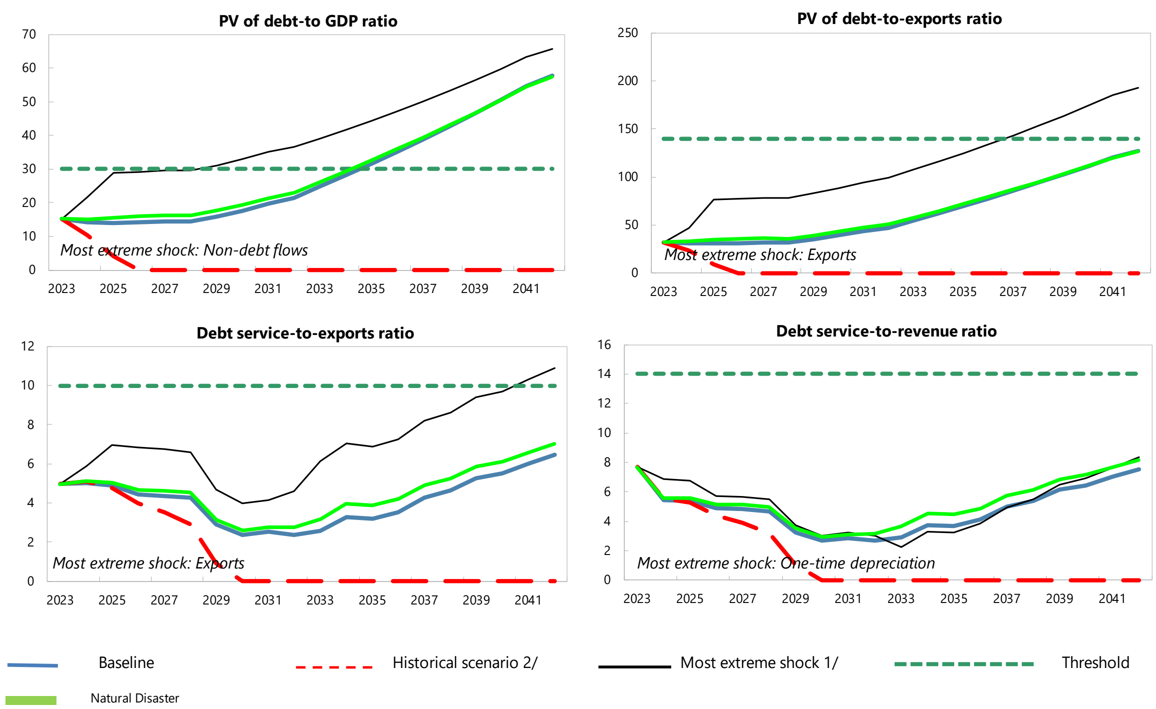
Box 1. Performance and Policy Actions (PPAs) (concluded)

Fiscal Year	Description
2021	**PPA1**: The Cabinet has approved the Fiscal Responsibility and Debt Management Regulations to strengthen debt management and medium-term fiscal sustainability and has published them on the MoF website by end-May 2021. **PPA2**: The Republic of the Marshall Islands has complied with a zero non-concessional borrowing ceiling on contracting new external public and publicly guaranteed (PPG) debt in FY21.
2022	**PPA 1:** To strengthen fiscal oversight, the Cabinet has approved a Financial Management Bill for submission to the Nitijela (RMI Parliament) that: (i) facilitates implementation of a new electronic public financial management practice; and (ii) establishes a legal framework for internal audit functions and a Treasury Single Account. **PPA 2:** To improve debt sustainability, the Government will not enter into any contractual obligations for new external public and publicly guaranteed (PPG) non-concessional debt in FY22, except if the non-concessional debt limit is adjusted by the World Bank to a) reflect any material change of circumstances or b) in coordination with the IMF, in particular in line with adjustments in the IMF Debt Limit Policy (DLP).
2023	**PPA1:** To strengthen fiscal sustainability by improving the efficiency of public spending, the Cabinet has approved and submitted to the Nitijela (RMI Parliament), a Procurement Bill that introduces a new and modernized legal framework that facilitates the use of electronic procurement arrangements among other enhancements to the procurement system. **PPA 2:** To improve debt sustainability, the Government will not enter into any contractual obligations for new external public and publicly guaranteed (PPG) non-concessional debt in FY23, except if the non-concessional debt limit is adjusted by the World Bank to a) reflect any material change of circumstances or b) in coordination with the IMF, in particular in line with adjustments in the IMF Debt Limit Policy (DLP).

AUTHORITIES' VIEWS

14. **The authorities broadly agreed with the DSA assessment.** They acknowledged the need to contain expenditure and debt accumulation–in line with the Fiscal Responsibility and Debt Management Act, while also building buffers to create fiscal space for priority investments including climate infrastructure. They remain optimistic about the prospects for the new Compact and are committed to working toward a balanced and mutually acceptable agreement. The authorities are seeking to continue implementing the PFM reforms, including reducing SOE subsidies and implementing Community Service Obligations in several SOEs. They will also continue to explore increasing revenue mobilization—including through increasing the manpower of the tax office and implementing existing recommendations for improving revenue collection.

Figure 1. Marshall Islands: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2023-2041



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	n.a.	n.a.
Commodity price	No	No
Market financing	n.a.	n.a.

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	1.4%	1.4%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	7

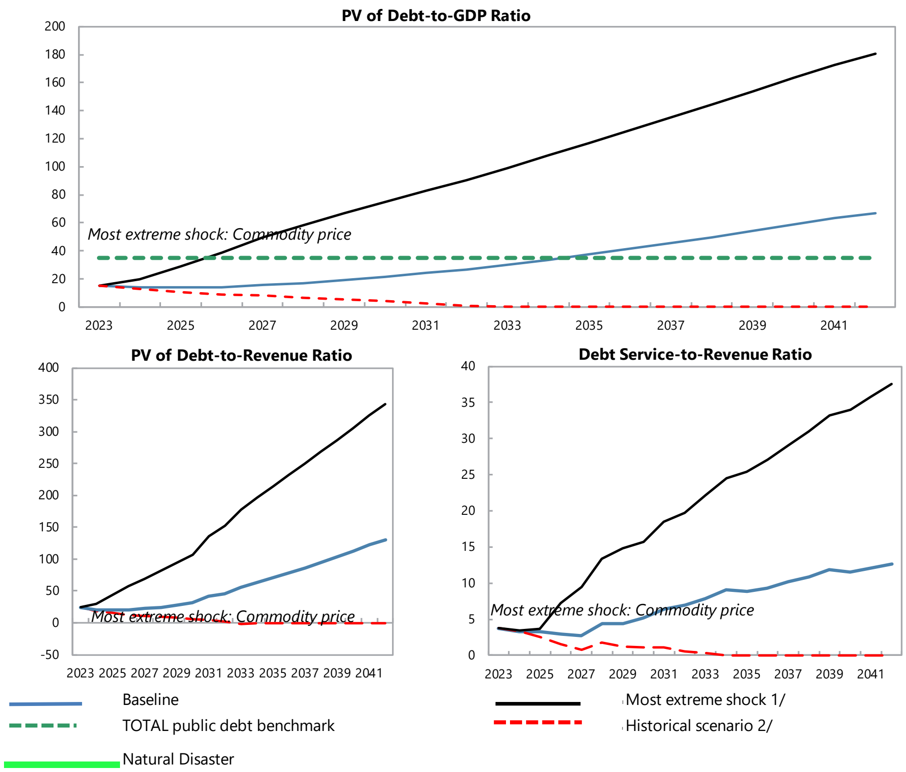
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2033. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ Because of RMI's large surpluses in the past and the projected deterioration of the current account, the historical scenario does not produce meaningful results to assess risk of debt distress and therefore its results have been trucated at zero.

Figure 2. Marshall Islands: Indicators of Public Debt Under Alternative Scenarios, 2023-2041



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	78%	65%
Domestic medium and long-term	8%	12%
Domestic short-term	15%	22%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	1.4%	1.4%
Avg. maturity (incl. grace period)	29	29
Avg. grace period	7	7
Domestic MLT debt		
Avg. real interest rate on new borrowing	7.2%	7.2%
Avg. maturity (incl. grace period)	3	3
Avg. grace period	2	2
Domestic short-term debt		
Avg. real interest rate	12.2%	12.2%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

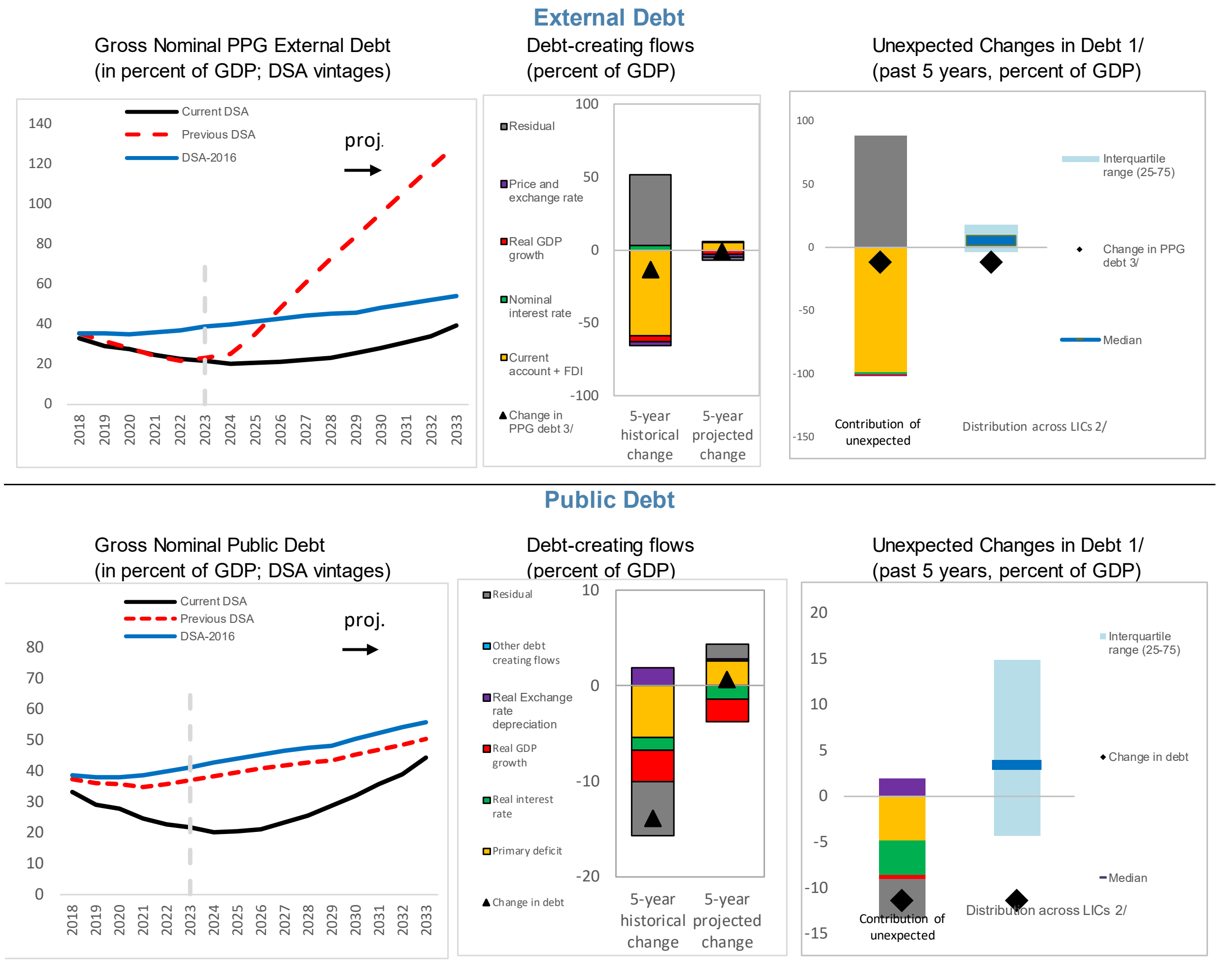
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2033. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ Because of RMI's large surpluses in the past and the projected deterioration of the current account, the historical scenario does not produce meaningful results to assess risk of debt distress and therefore its results have been trucated at zero.

Note: The Natural Disaster shock was considered as part of this Debt Sustainability Analysis but is not dispalyed in this figure as it is close to the values for, and indistinguishible from, the baseline.

Figure 3. Marshall Islands: Drivers of Debt Dynamics – Baseline Scenario



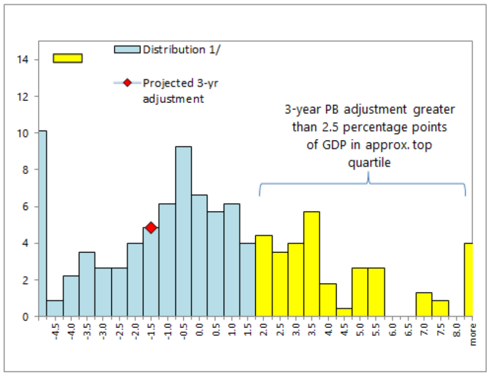
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

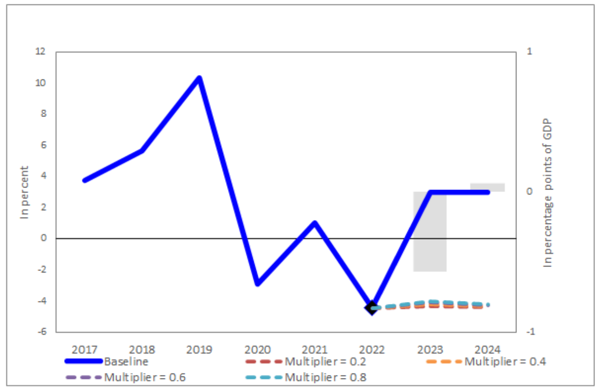
Figure 4. Marshall Islands: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



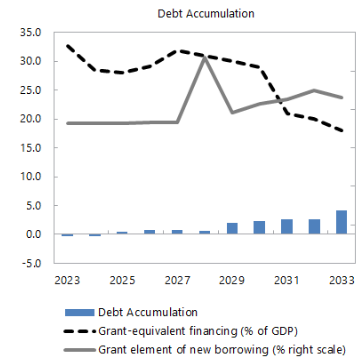
1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

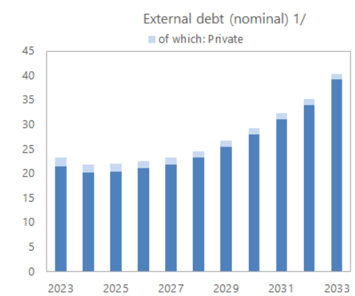
Table 1. Marshall Islands: External Debt Sustainability Framework, Baseline Scenario, 2022-2042

(In percent of GDP, unless otherwise indicated)

	Actual	Projections										Average 8/	
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2042	Historical	Projections
External debt (nominal) 1/	25.3	23.2	21.8	22.0	22.6	23.3	24.6	26.7	29.3	32.4	35.2	89.4	38.9	27.4
of which: public and publicly guaranteed (PPG)	22.8	21.6	20.2	20.5	21.1	21.9	23.2	25.4	28.0	31.2	34.0	89.4	36.7	26.0
Change in external debt	-1.8	-2.0	-1.4	0.2	0.6	0.8	1.3	2.1	2.6	3.1	2.8	4.3		
Identified net debt-creating flows	-11.9	-7.8	-2.9	1.2	4.5	8.8	13.3	19.3	27.1	31.1	33.4	45.9	-9.7	15.0
Non-interest current account deficit	-8.8	-4.2	0.9	4.7	7.9	12.2	16.7	22.8	30.6	34.7	37.0	49.3		
Deficit in balance of goods and services	33.1	28.3	35.8	37.8	41.1	45.3	46.9	54.2	60.7	62.4	63.7	69.7	47.1	49.2
Exports	45.0	47.9	45.4	45.2	45.2	45.2	45.2	45.3	45.3	45.3	45.3	45.4		
Imports	78.1	76.2	81.2	83.1	86.4	90.5	92.1	99.4	106.0	107.7	109.0	115.0		
Net current transfers (negative = inflow)	-30.2	-21.7	-13.1	-12.6	-13.1	-13.3	-10.7	-12.3	-11.5	-9.4	-8.8	-5.2	-28.9	-12.1
of which: official	-30.6	-21.3	-12.9	-12.5	-13.7	-14.8	-14.6	-14.3	-13.9	-12.2	-12.0	-8.9		
Other current account flows (negative = net inflow)	-11.7	-10.8	-21.8	-20.5	-20.1	-19.8	-19.5	-19.0	-18.7	-18.3	-18.0	-15.1	-21.5	-18.6
Net FDI (negative = inflow)	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	-5.9	-3.3
Endogenous debt dynamics 2/	0.1	-0.4	-0.4	-0.2	-0.2	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1		
Contribution from nominal interest rate	0.5	0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2	1.1		
Contribution from real GDP growth	1.2	-0.7	-0.7	-0.4	-0.4	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-1.2		
Contribution from price and exchange rate changes	-1.6	...	...	...	...	...	...	...	...	...	...	...		
Residual 3/	10.1	5.8	1.4	-1.0	-3.9	-8.0	-12.0	-17.2	-24.5	-28.0	-30.6	-41.6	6.7	-13.7
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators														
PV of PPG external debt-to-GDP ratio	16.5	15.3	14.1	14.0	14.1	14.5	14.5	15.9	17.7	19.7	21.5	57.7		
PV of PPG external debt-to-exports ratio	36.7	31.9	31.1	30.9	31.3	32.0	32.1	35.1	39.0	43.4	47.4	127.2		
PPG debt service-to-exports ratio	6.0	5.0	5.0	4.9	4.4	4.4	4.3	2.9	2.4	2.5	2.4	6.5		
PPG debt service-to-revenue ratio	9.8	7.7	5.4	5.4	4.9	4.8	4.7	3.3	2.7	2.9	2.7	7.5		
Gross external financing need (Million of U.S. dollars)	-24.4	-14.1	-0.4	10.9	21.0	35.5	51.9	73.1	102.9	122.0	134.9	268.1		
Key macroeconomic assumptions														
Real GDP growth (in percent)	-4.5	3.0	3.0	2.0	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5	2.0	1.8
GDP deflator in US dollar terms (change in percent)	6.2	2.9	2.7	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	1.9	2.1
Effective interest rate (percent) 4/	2.0	1.5	1.0	0.9	0.9	0.9	0.8	0.6	0.6	0.7	0.7	1.4	2.2	0.9
Growth of exports of G&S (US dollar terms, in percent)	-1.9	13.0	0.1	3.7	3.7	3.5	3.5	3.5	3.5	3.5	3.5	3.5	2.7	4.1
Growth of imports of G&S (US dollar terms, in percent)	10.9	3.5	12.6	6.4	7.9	8.5	5.4	11.7	10.4	5.1	4.8	3.5	2.7	7.3
Grant element of new public sector borrowing (in percent)	...	36.4	36.4	36.4	36.5	36.6	53.5	39.3	41.4	42.7	45.0	42.0	...	40.7
Government revenues (excluding grants, in percent of GDP)	27.6	30.9	41.7	40.9	41.0	41.0	41.1	40.2	40.0	39.9	39.7	38.9	31.5	39.6
Aid flows (in Million of US dollars) 5/	101.2	94.1	87.1	91.1	98.3	110.9	110.9	113.7	114.2	89.7	87.8	117.3		
Grant-equivalent financing (in percent of GDP) 6/	...	32.7	28.5	28.0	29.1	31.8	31.0	30.0	28.9	21.0	20.0	16.2	...	27.2
Grant-equivalent financing (in percent of external financing) 6/	...	96.1	95.9	93.6	93.5	93.9	94.6	92.3	91.7	87.9	88.5	75.7	...	91.8
Nominal GDP (Million of US dollars)	261	277	293	304	316	327	338	350	362	375	388	548		
Nominal dollar GDP growth	1.4	6.0	5.8	4.0	3.7	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.8	4.0
Memorandum items:														
PV of external debt 7/	19.0	16.9	15.7	15.5	15.6	15.9	15.9	17.2	18.9	20.9	22.7	57.7		
In percent of exports	42.2	35.4	34.6	34.2	34.5	35.1	35.1	38.1	41.8	46.1	50.1	127.2		
Total external debt service-to-exports ratio	6.0	5.0	5.0	4.9	4.4	4.4	4.3	2.9	2.4	2.5	2.4	6.5		
PV of PPG external debt (in Million of US dollars)	43.1	42.3	41.3	42.5	44.7	47.3	49.1	55.7	64.0	73.7	83.4	315.9		
(PVt-PVt-1)/GDPt-1 (in percent)		-0.3	-0.4	0.4	0.7	0.8	0.6	1.9	2.4	2.7	2.6	5.1		
Non-interest current account deficit that stabilizes debt ratio	-7.0	-2.1	2.3	4.5	7.4	11.4	15.5	20.7	28.0	31.6	34.2	45.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g) + Εα (1+r)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, Ε=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

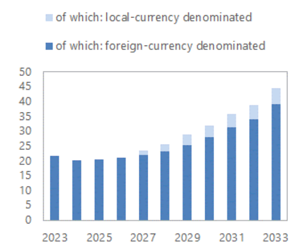
Table 2. Marshall Islands: Public Sector Debt Sustainability Framework, Baseline Scenario, 2022-2042

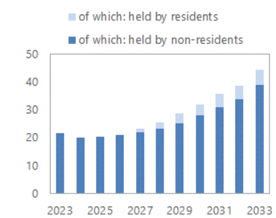
(In percent of GDP, unless otherwise indicated)

	Actual	Projections											Average 6/	
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2042	Historical	Projections
Public sector debt 1/	22.8	21.6	20.2	20.5	21.1	23.4	25.6	28.8	32.0	35.7	38.9	98.8	36.8	28.4
of which: external debt	22.8	21.6	20.2	20.5	21.1	21.9	23.2	25.4	28.0	31.2	34.0	89.4	36.7	26.0
Change in public sector debt	-1.9	-1.2	-1.3	0.2	0.6	2.3	2.2	3.2	3.2	3.7	3.2	4.8		
Identified debt-creating flows	-0.7	-1.5	-1.3	0.2	0.6	0.8	1.3	2.4	2.9	3.4	3.2	4.8	-2.6	1.6
Primary deficit	-0.9	-0.3	-0.4	0.8	1.2	1.3	1.7	2.8	3.4	3.9	3.7	6.0	-2.2	2.2
Revenue and grants	66.4	62.8	69.5	67.8	68.9	71.6	70.1	68.6	67.1	58.7	57.6	51.4	63.1	65.2
of which: grants	38.8	31.9	27.8	26.9	27.9	30.6	29.0	28.4	27.1	18.9	17.9	12.5		
Primary (noninterest) expenditure	65.5	62.5	69.2	68.6	70.1	72.9	71.8	71.4	70.5	62.6	61.3	57.4	60.9	67.4
Automatic debt dynamics	0.2	-1.2	-0.9	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4	-0.5	-0.5	-1.2		
Contribution from interest rate/growth differential	0.0	-1.2	-0.9	-0.6	-0.5	-0.5	-0.4	-0.4	-0.4	-0.5	-0.5	-1.2		
of which: contribution from average real interest rate	-1.2	-0.5	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.2		
of which: contribution from real GDP growth	1.1	-0.7	-0.6	-0.4	-0.4	-0.3	-0.3	-0.4	-0.4	-0.5	-0.5	-1.4		
Contribution from real exchange rate depreciation	0.2	...	...	...	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	-1.2	0.2	-0.1	0.0	0.0	1.5	0.9	0.9	0.3	0.3	0.0	0.0	-0.6	0.4
Sustainability indicators														
PV of public debt-to-GDP ratio 2/	16.5	15.3	14.1	14.0	14.1	16.0	16.9	19.4	21.6	24.2	26.4	67.0		
PV of public debt-to-revenue and grants ratio	24.8	24.3	20.3	20.6	20.5	22.3	24.1	28.2	32.2	41.2	45.8	130.4		
Debt service-to-revenue and grants ratio 3/	4.1	3.8	3.3	3.3	2.9	2.8	4.4	4.5	5.1	6.5	7.0	12.7		
Gross financing need 4/	1.8	2.1	1.9	3.0	3.2	3.3	4.8	5.8	6.8	7.7	7.7	12.5		
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	-4.5	3.0	3.0	2.0	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5	2.0	1.8
Average nominal interest rate on external debt (in percent)	2.2	1.6	1.0	1.0	1.0	1.0	0.8	0.7	0.6	0.7	0.8	1.4	2.3	0.9
Average real interest rate on domestic debt (in percent)	-5.8	-1.3	-1.6	-0.9	-0.9	-1.0	11.1	9.6	9.4	9.1	9.0	7.7	-0.8	4.6
Real exchange rate depreciation (in percent, + indicates depreciation)	0.9	...	...	...	...	...	...	...	...	...	...	...	0.7	...
Inflation rate (GDP deflator, in percent)	6.2	2.9	2.7	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	1.9	2.1
Growth of real primary spending (deflated by GDP deflator, in percent)	-10.5	-1.7	14.0	1.1	4.0	5.6	-0.1	0.9	0.2	-9.8	-0.7	-1.9	4.7	1.2
Primary deficit that stabilizes the debt-to-GDP ratio 5/	1.0	0.9	1.0	0.6	0.5	-1.0	-0.5	-0.4	0.2	0.2	0.5	1.2	0.7	0.2
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**Yes**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.
1/ Coverage of debt: The central government, government-guaranteed debt . Definition of external debt is Residency-based.
2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.
4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Table 3. Marshall Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2023-2032

(In percent)

	Projections 1/									
	2023	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**
PV of debt-to GDP ratio										
Baseline	15	14	14	14	14	15	16	18	20	21
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2023-2033 2/	15	10	4	-4	-14	-27	-43	-62	-84	-107
A2. Alternative Scenario: Natural disaster	15	15	16	16	16	16	18	19	21	23
B. Bound Tests										
B1. Real GDP growth	15	15	16	16	17	17	19	21	23	25
B2. Primary balance	15	15	16	16	17	17	18	20	22	24
B3. Exports	15	19	28	28	28	28	30	**32**	**34**	**36**
B4. Other flows 3/	15	22	29	29	29	30	**31**	**33**	**35**	**37**
B5. Depreciation	15	18	10	10	11	11	13	15	17	19
B6. Combination of B1-B5	15	22	24	24	25	25	26	28	**31**	**32**
C. Tailored Tests										
C1. Combined contingent liabilities	15	17	17	18	18	19	20	22	24	26
C2. Natural disaster	15	15	16	16	16	16	18	19	21	23
C3. Commodity price	15	21	27	26	24	21	19	17	14	11
Threshold	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio										
Baseline	32	31	31	31	32	32	35	39	43	47
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2023-2033 2/	32	23	9	-8	-31	-60	-94	-137	-185	-236
A2. Alternative Scenario: Natural disaster	32	33	34	35	36	36	39	43	47	51
B. Bound Tests										
B1. Real GDP growth	32	31	31	31	32	32	35	39	43	47
B2. Primary balance	32	33	35	36	37	37	40	44	49	53
B3. Exports	32	47	76	77	78	78	83	88	95	100
B4. Other flows 3/	32	47	64	64	65	65	69	73	77	81
B5. Depreciation	32	31	18	18	19	19	22	26	30	34
B6. Combination of B1-B5	32	48	46	55	56	56	59	64	69	73
C. Tailored Tests										
C1. Combined contingent liabilities	32	37	38	39	41	41	44	49	53	57
C2. Natural disaster	32	33	34	35	36	36	39	43	47	51
C3. Commodity price	32	57	71	66	59	50	44	38	33	26
Threshold	140	140	140	140	140	140	140	140	140	140

Table 3. Marshall Islands: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2023-2032 (concluded)

(In percent)

	Projections 1/									
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Debt service-to-exports ratio										
Baseline	5	5	5	4	4	4	3	2	3	2
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2023-2033 2/	5	5	5	4	4	3	1	0	-1	-3
A2. Alternative Scenario: Natural disaster	5	5	5	5	5	5	3	3	3	3
B. Bound Tests										
B1. Real GDP growth	5	5	5	4	4	4	3	2	3	2
B2. Primary balance	5	5	5	5	4	4	3	2	3	3
B3. Exports	5	6	7	7	7	7	5	4	4	5
B4. Other flows 3/	5	5	5	5	5	5	4	3	3	4
B5. Depreciation	5	5	5	4	4	4	3	2	2	2
B6. Combination of B1-B5	5	5	6	6	5	5	4	3	3	4
C. Tailored Tests										
C1. Combined contingent liabilities	5	5	5	5	5	4	3	3	3	3
C2. Natural disaster	5	5	5	5	5	5	3	3	3	3
C3. Commodity price	5	6	7	6	6	6	4	3	3	3
Threshold	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio										
Baseline	8	5	5	5	5	5	3	3	3	3
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2023-2033 2/	8	6	5	4	4	3	1	0	-1	-3
A2. Alternative Scenario: Natural disaster	8	6	6	5	5	5	4	3	3	3
B. Bound Tests	8	6	6	5	5	5	4	3	3	3
B1. Real GDP growth	8	6	6	6	6	5	4	3	3	3
B2. Primary balance	8	5	5	5	5	5	3	3	3	3
B3. Exports	8	6	6	6	6	6	4	4	4	4
B4. Other flows 3/	8	5	6	6	6	5	4	3	4	5
B5. Depreciation	8	7	7	6	6	6	4	3	3	3
B6. Combination of B1-B5	8	6	7	6	6	6	4	3	4	4
C. Tailored Tests										
C1. Combined contingent liabilities	8	5	6	5	5	5	3	3	3	3
C2. Natural disaster	8	6	6	5	5	5	4	3	3	3
C3. Commodity price	8	6	7	7	6	6	4	3	3	4
Threshold	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

Table 4. Marshall Islands: Sensitivity Analysis for Key Indicators of Public Debt, 2023-2032

	Projections 1/									
	2023	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**
					PV of Debt-to-GDP Ratio					
Baseline	15	14	14	14	16	17	19	22	24	26
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2023-2033 2/	15	13	11	9	8	6	6	4	3	1
A2. Alternative Scenario: Natural disaster	15	14	14	14	16	17	20	22	25	27
B. Bound Tests										
B1. Real GDP growth	15	18	24	29	**35**	**41**	**48**	**55**	**62**	**69**
B2. Primary balance	15	16	17	17	19	20	22	24	27	29
B3. Exports	15	18	25	25	27	28	31	33	**36**	**38**
B4. Other flows 3/	15	22	29	29	31	32	35	**37**	**40**	**41**
B5. Depreciation	15	17	14	12	12	10	10	10	10	10
B6. Combination of B1-B5	15	15	15	15	17	18	20	23	25	27
C. Tailored Tests										
C1. Combined contingent liabilities	15	19	19	19	21	21	24	26	29	31
C2. Natural disaster	15	14	14	14	16	17	20	22	25	27
C3. Commodity price	15	20	29	**39**	**50**	**58**	**67**	**75**	**83**	**90**
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35
					PV of Debt-to-Revenue Ratio					
Baseline	24	20	21	21	22	24	28	32	41	46
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2023-2033 2/	24	19	16	12	11	9	8	6	4	2
A2. Alternative Scenario: Natural disaster	4	3	3	3	3	4	5	5	7	7
B. Bound Tests										
B1. Real GDP growth	24	25	33	39	46	55	65	77	100	114
B2. Primary balance	24	22	25	25	26	28	32	36	46	50
B3. Exports	24	26	37	37	38	40	45	49	61	65
B4. Other flows 3/	24	31	43	42	43	46	50	55	67	72
B5. Depreciation	24	25	22	19	17	15	16	16	18	18
B6. Combination of B1-B5	24	22	22	21	23	25	29	33	43	47
C. Tailored Tests										
C1. Combined contingent liabilities	24	28	28	27	29	31	35	39	49	54
C2. Natural disaster	4	3	3	3	3	4	5	5	7	7
C3. Commodity price	24	29	44	58	69	82	95	107	136	152
					Debt Service-to-Revenue Ratio					
Baseline	4	3	3	3	3	4	4	5	6	7
A. Alternative Scenarios										
A1. Key variables at their historical averages in 2023-2033 2/	4	3	3	2	1	2	1	1	1	1
A2. Alternative Scenario: Natural disaster	4	3	3	3	3	4	5	5	7	7
B. Bound Tests										
B1. Real GDP growth	4	3	5	6	7	10	11	12	15	16
B2. Primary balance	4	3	4	4	3	5	5	5	7	7
B3. Exports	4	3	3	3	3	5	5	5	7	8
B4. Other flows 3/	4	3	4	3	3	5	5	6	7	8
B5. Depreciation	4	4	4	3	4	5	5	5	6	6
B6. Combination of B1-B5	4	3	3	3	3	5	5	5	7	7
C. Tailored Tests										
C1. Combined contingent liabilities	4	3	6	4	4	5	5	6	7	7
C2. Natural disaster	4	3	3	3	3	4	5	5	7	7
C3. Commodity price	4	3	4	7	9	13	15	16	19	20

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Statement by Robert Bruce Nicholl, Executive Director for Republic of the Marshall Islands, Eunji Choi, Advisor to the Executive Director, and Eugene Wase, Advisor to the Executive Director September 18, 2023

RMI Article IV Buff

On behalf of the authorities in the Republic of Marshall Islands (RMI), we thank Mr. Raman and his team for their constructive engagement and candid assessment of the country's economy and challenges. Our authorities highly value the Fund's continuous engagement and broadly agree with staff's assessment on the economic outlook and policy recommendations. They also expressed their appreciation for the Fund's capacity development support and requested a set of technical assistances during the Article IV consultation.

RMI consists of small, thinly populated atolls and islands spanning over 750,000 square miles in the Pacific Ocean. Its extreme remoteness, declining population, limited private sector and narrow production base means that the country is highly dependent on external aid, with grants making up a substantial portion of government revenue. RMI is extremely vulnerable to climate change as it faces rising sea levels, coastal erosion and ocean inundation.

The Compact at an advanced stage

In July, the Cabinet and the Compact Negotiation Committee in RMI accepted the Compact agreement as described in the memorandum of understanding (MoU) which was signed in January by the US and the RMI. By agreeing to accept the earlier-disputed MoU, negotiations on the Compact have reached an advanced stage. Even though the RMI parliament's review and decision is still pending, the authorities remain optimistic about reaching an eventual agreement. The forthcoming Compact agreement, which will ensure the fiscal and external sustainability of RMI, includes significant financial support; The MoU outlines an allocation of approximately US$ 2.3 billion for RMI spanning 20 years, starting from FY2024. It also includes access to US Federal programs like postal services, along with support for healthcare and education. While there might be a brief delay in finalizing and ratifying the agreement, it can be bridged effectively by accessing funds from the Compact Trust Fund which was established to offset grants losses following the Compact's expiration.

The Recent Economic Developments

RMI is showing signs of economic recovery following COVID-induced lockdowns. In FY2022, the real GDP unexpectedly declined by 4.5 percent, mainly due to the impact of a domestic operator's sale of a vessel in the fisheries sector which disrupted production. The growth excluding the fisheries sector was a positive 4.2 percent, indicating a clear recovery in domestic demand. The 2024 Micronesian Games will present an opportunity to enhance investment and promote tourism. Over the medium term, the authorities expect growth to be further bolstered by the resurgence of donor-financed infrastructure projects and current private investments in docking and cannery facilities. Inflation picked up in FY2022 but is expected to moderate to 3 percent at the end of FY2023 due to the decline in global fuel prices. The banking sector is well-capitalized and liquid, and the impact of the increases in the Fed funds rate and volatility in the US banking sector is limited.

Fiscal policy

Fiscal pressures are expected to become mitigated once the Compact is renewed. Staff presents that the expected fiscal surpluses under the renewed Compact will be around 1.6 percent of GDP on average until FY2029, and public debt is projected to decline to 16.7 percent of GDP by FY2028. Nevertheless, the authorities agree with the staff's assessment on the need for fiscal consolidation, reiterating their commitment to achieving the balanced budget target set by the Fiscal Responsibility and Debt Management Act (FRDMA).

The authorities recognized the necessity of fiscal reforms regardless of whether a new Compact agreement is reached. They agree that the fiscal reforms should aim to strengthen revenue mobilization and prioritize critical expenditures. Public financial management reform program which aims to modernize the Public Financial Management framework through the implementation of a new Financial Management and Information System (FMIS) are underway. The authorities are also modernizing the Customs revenue management system to strengthen revenue collection and provide data on imports. Progress on several reforms has been sluggish on the administrative front mainly due to limited capacity, but the authorities remain committed to seeking out appropriate capacity-building opportunities.

Financial Sector Stability and Fintech Initiatives

The authorities remain committed to enhancing correspondent banking relationship (CBR), mitigating risks to financial integrity. The RMI currently has only one remaining US dollar CBR and the authorities are dedicated to preserving this relationship. The authorities recognize that the effectiveness of the AML/CFT framework as well as the regulatory and supervisory system influences CBRs, actively exploring ways to enhance them. RMI is currently under a mutual evaluation of its AML/CFT framework and implementation by the Asia Pacific Group (APG), the regional affiliate of the FATF. Following the evaluation, the authorities plan to bolster the AML/CFT regime in line with the APG's recommendations. They are also engaging with the EU and the Code of Conduct Group to be removed from the EU list of non-cooperative jurisdictions for tax purposes. To strengthen financial sector development, the authorities are considering setting up a monetary authority (MA). The authorities appreciated the recommendations from staff on the design of a potential monetary authority, agreeing that the mandates of any MA should be focused. The decision to set up a MA is expected to be made considering potential benefits a MA could offer, including enhanced financial system oversight and the payment and settlement system.

While seeking additional opportunities from digitalization to broaden RMI's economic base, the authorities are exercising caution when introducing new fintech initiatives. Previous FinTech initiatives, such as SOV (introducing a private cryptocurrency as a second legal tender) and DEZRA (digital economic zone), that had raised concerns in the past lost momentum, with no signs of revival. A new initiative to develop a national digital payment system based on a digital US dollar coin backed by government reserves is only in the stage of a pilot study. To diversify the fiscal revenue and take advantage of the growing enthusiasm of blockchain technology, the authorities started allowing for the registration of Decentralized Autonomous Organizations (DAOs). DAOs are a new organizational model enabled by blockchain and ruled by programming code, being governed through various smart contracts functioning autonomously without a central authority. The most frequently used foreign jurisdictions for registering the DAO so far include Cayman Islands, Wyoming (The US), and RMI. By allowing DAO registration, the government benefits from additional revenue through registration fees and taxes from for-profit entities. The authorities are working to establish safeguards, including rigorous due diligence during the registration phase and regular reviews of the status of registered entities. MIDAO, the registrar, will provide a digitized portal which allows the authorities to conduct real-time monitoring since all transactions take place on public blockchain, and has committed to using blockchain analytics to identify any suspicious activities. Nonetheless, the authorities acknowledge the concerns raised by staff and uncertainty surrounding this initiative and are carefully monitoring the progress. They are also keen on strengthening their oversight and regulatory capabilities, seeking support from the Fund and other development partners.

Climate Change and Structural Reforms

Climate change poses a significant threat to the country, prompting the authorities to devise climate strategies while seeking financial backing. They are preparing the National Adaptation Plan (NAP), which is expected to be finalized and published in the second half of 2023. The authorities anticipate that the completed NAP will play a key role in enhancing climate resilience, identifying essential climate investments, and attracting the needed external funding. The authorities are engaging with development partners, including the Green Climate Fund (GCF), to explore diverse funding sources. The establishment of a dedicated climate-focused team is under discussion, which could include staff from different departments such as the Ministry of Finance, Banking & Postal Services and the Climate Change Directorate.

The authorities acknowledge the importance of strengthening the National Disaster Management Office and its associated fund. The authorities aim to expand the size of the natural disaster contingency fund as part of their review of the disaster management framework. To simplify and enhance the effectiveness of this framework, they are trying to consolidate various elements of the legislative framework related to disaster management and recovery, including integrating the Disaster Assistance Act and the Contingency Fund Act.

On structural reforms to achieve inclusive and diversified growth, the authorities are tackling impediments to growth and investment. They acknowledge that the lack of available land is a major hurdle for both private and public investment while addressing this challenge has been politically complicated. Ongoing projects are anticipated to bolster growth and exports upon their completion in the upcoming years. Using regional arrangements will broaden the market for tuna caught in the RMI. A collaboration with Nature Conservancy, an international NGO, aims to certify the tuna catch's sustainability, which will be pivotal for entering new markets. Private investment projects in the fisheries and copra industries are set to elevate the value chain. The authorities expressed their appreciation for the insights provided on the Fund’s Fragile and Conflict-Affected States (FCS) Strategy by the mission team and expressed their willingness to engage in the Country Engagement Strategy (CES) development process around mid-2024.