Growth Trends and Development Issues

in the

Republic of Marshall Islands

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Abstract

This paper reviews the growth trends and development issues in the Republic of the Marshall Islands (RMI). It is found that economic conditions are weak and unpromising for sustainable growth. This is largely attributed to the economy’s dependence on foreign aid and grants leading to low productivity and competitiveness. It also highlights some strategies that may be useful in formulating short-medium term growth policies in RMI.

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1.0 Introduction

At the outset, knowing that the Republic of Marshal Islands (RMI) has strong ties with the US gives a perception that all must be well in the small Micronesian state\(^2\). However, this is short-lived when you spend sometime in RMI. Although the usual Pacific atmosphere is felt, the economy is weak, inefficient and lacks technical competency which translate into slow economic growth and a low quality of life. This paper surveys the recent trends in growth and development issues in RMI drawing from the national accounts data, the World Development Indicators (WDI) and other reports available for the Marshall Islands. It also recommends some strategies which may be useful in formulating short-medium term growth policies in RMI.

The Marshall Islands are a diverse group of atolls with a total land mass of around 180 square kilometers and are spread over 2.1m kilometers of the northern Pacific Ocean. The islands inhabit around 66,000 people of mixed descends reflecting their historical origins from Southeast Asia. The data from the RMI statistical office (EPPSO) indicate that the RMI

\(^2\) According to Stewart (2007) initially the Marshall Islands were under Spain administration. However, the trade influence led to a strong political dominance by German’s until the early 1900s. This came to an end in 1914 when Japan declared war on Germany to seal its strategic military and commercial interests in Micronesia. Unfortunately, in World War II, Japan lost the Marshall Islands to the US and after a brief period of administration, the Marshalls were declared a US Trust Territory. To support its nuclear testing program, the US installed a military base was on one of the atolls and within a short-period (1946-1958), around 70 nuclear tests were carried out which have had serious implications on the islands, some of which are still felt till this day. The US agreed on a compensation package called the “Compact Agreement” (we denote as US grants) which came into effect in 1986.
sustains an annual average population growth of 1.6% with an average per capita GDP (in US dollars) of around 2400. However, the populations growth has picked up pace since 2000 by an average rate of 2.8%.

The average income is tremendously low when compared to its neighboring small states but not entirely different from those of the larger PICs such as Fiji. The average growth in GDP since 2000 is around 3.2%. Its per capita GNI is 2800 despite the extent of US assistance other grants and aid. This is because the RMI is perhaps amongst the only few countries in the world which has an annual net outflow of around $12m or 10% of real GDP in private unrequited transfers. This figure reports official remittances, let alone a similar, if not larger undisclosed net outflow of remittances. This is because it is difficult for RMI workers to secure well paid jobs in foreign counties. Further, it is hard to imagine massive inflow of business profits in RMI because domestic investors are limited in foreign countries but there are many foreign workers and businesses serving the RMI which leads to remittance outflow.

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3 For example, other US trust territories of Micronesia enjoy higher per capita incomes. Guam’s per capita GDP is nearly 19,000 and the Republic of Palau enjoys an average income of 8,800, (ADB 2000).

4 In addition to the US, since 1990, the ADB approved loans amounting to around $80m and its technical assistance are around $20m. Japan, Taipei, China and recently Taiwan also provide annual grants at levels exceeding those of the ADB, see ADB (2007).
Nonetheless, the massive inflows of grants and aid have given the RMI a longstanding psychological and economic relationship with the US. Due to such dependency, there is no urgency for the Marshallese to learn efficient methods of production and become competitive in domestic and world markets. Sustainable growth requires security of income, skills, productivity and efficiency, all of which are unfortunately rare in the Marshallese. The entrepreneurial skills and scope are so limited that even the most basic items such as food and drinking water are imported.

Unfortunately, the Marshallese have failed to realize that although the external funding is huge, it is not endless. However, both sides have learnt some useful lessons. The donors have realized that there were inadequate accounting and control procedures and the recipient agree that it was poorly planned and managed. These issues have led to significant changes in the provisions of the revised grant.

Nonetheless, the dependency psychology together with other constraints to growth is shaping lives of a fast growing Marshallese population. Their combined effects now introduce a new set of

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5 Details of US assistance under the Compact can be obtained from the ABD (2000) and EPPSO (2007). In brief, it is estimated to be close to 50%–70% of gross domestic product of RMI annually being given over the last 17 years. The Compact agreement is expected to expire by 2020.

6 See the ADB (2000) for details of Compact II. The revisions aim to increases productive use and require better accountability.

7 MIR faces similar growth constraints as others in the region. Some significant ones include; remoteness and isolation, susceptibility to natural disasters, limited economic
challenges to the uncertain future of the small island state. The rest of the paper is structured as follows: The next section provides a review of trends in major macroeconomic variables. Section 3 discusses some of the most pressing problems faced by the Marshall Islands and some growth enhancing factors for short-medium development strategies are discussed in section 4. The conclusions are stated in the final section.

2.0 Economic Performance

Notwithstanding the deficiencies in national accounts and other statistical estimates available in RMI, EPPSO (2007) data shows that RMI’s economic performance has been modest. Real output was slightly less than 130m for 2006 and is anticipated to have declined to an average rate of 1.7% since 2004. Data from 2000 to 2003 show an annual average growth rate of 3.2% with a trend average rate of 2% since 1990. The lower pace of activity in the recent years is attributed to decline in fishing activities and low aggregate demand due to restrained government expenditure which has led to a sharp reduction in household incomes.

The low growth scenario is not surprising as there is no major economic activity that seems to be driving the RMI economy, except for fisheries, small scale retail trade and transport. The services sector contributes base, low economic growth, high employment rate, high import penetration, fiscal budgetary constraints and an inefficient and weak fiscal management.
around 70% to GDP while agriculture and manufacturing combined account for no more than 30%. Recent developments include a convention centre, the parliament complex, airport upgrade and other commercial and private building and construction activities.\(^8\) Efforts are being made to enhance the tourism sector but its major beneficiaries (airlines, hotels and food and catering) are mostly foreign owned limiting value-added by the domestic economy.

2.1 Consumption

Data from the WDI indicates that consumption patterns in the Marshals follow similar trends as in the other PICs. On average the ratio of consumption to GDP is high over 90% yielding a high marginal propensity to consume. This is because grants and aid allow the government to employ a large proportion of workforce assuring a sustained flow of household incomes which are incessantly spent on consumer and luxurious white goods imported from the US, Hawaii and other Asian countries. With low levels of domestic production and capacity, many if not all goods are imported in the islands. Studies now suggest that excessive consumption with a lack of physical exercise are causing serious health problems in RMI, see for example Emi (2003). In addition, there is a strong demand for imported foods such as frozen meat, pre-packed and low value foods items although RMI has potential for self sufficiency in some of these goods.

\(^8\) Plans are underway for setting up a larger shipyard and a soap factory.
2.2 Employment

Data shows there has been slow growth in employment, but employment in retail trade, fishing and public services had shown some improvement. ADB (2000) estimates that around 30% of workforce are in self-employment. This would be in small farms, markets and small retail activities, transport and fisheries. The 1999 census data show that the ratio of working age to total population is 40% but recent estimates, see for example EPPSO (2007), indicates that only around 20% of the population is in paid employment. The 2006 employment survey indicates that there are large income disparities in most of the employment types, with females being grossly underpaid. Although migration to the US and Hawaii has increased, a significant number of emigrant teachers, technical and professional personnel, health and community workers and small business owners in RMI mainly from the USA, China, India and other PICs. On a net basis, migration has reached from a negotiable level in 1990 to over 1000 people in the 2000-2005 period.

The national unemployment rate is estimated at 36%, of which nearly two-thirds are youths. It is estimated that over 1000 young persons enter labour force each year but the absorption rate is low due to limited education and training and the slow pace of economic expansion. Estimates by the ADB (2006) show that around 15% of youths are illiterate but those in the school systems also find difficult to comprehend even the basic analytical skills.
2.3 Investment

With slow growth, investment has been low but notable in private dwellings, commercial apartments, public buildings and retails shops. Data for private investment could not be obtained, but trade data shows that foreign direct investment is around 5% of GDP. Public investment which has averaged around 9% in the recent years is low due to the tight fiscal stance. On average it is expected that total investment to GDP ratio is not more than 20% and this is not much different from the trends in the other PICs. However, the major impediments to private investment is the high cost of doing business which is largely due to unclear and inefficient tax system, high wage costs, remoteness from major markets and institutional weakness following official corruption and inefficiency. Stewart (2007) argues that impartiality of legal processes adds to the perceived risks of investment in RMI. However recently, important improvements have been made in approving foreign direct investment; see ADB (2000, 2006) and RMI (2001) for details.

2.4 Fiscal Performance

Data shows that total government expenditure is around 80% of GDP but this may a little over stated because fiscal year ends in September. Public expenditure is high because first, there is no role for monetary policy and second the grants and aid provide an easy access to funds. Recently, the government has acknowledged substantial problems in
fiscal management and control procedures. The government expenditure mix is 20% capital and 80% for current spending. Major components of government’s current expenditure are wage and salaries (39%), government purchase of goods and services (38%) and subsidies and current transfers (23%). The major sources of revenue excluding grants comes are income tax (48%), gross revenue tax (18%) and import duty (32%). Fishing licensing and social contributions account for most of the non-tax revenue. But these combined make only 36% of all government income and the rest comes from aid and grants- the US grants alone contributes two-thirds of this balance. With government’s financial problems, external debt outstanding is now around 90m or 73% of GDP. The debt is 280% of total RMI exports and 360% of the general fund reserves.

2.5 Trade

The economy trades mostly with the US, Hawaii, Taiwan and China. Except for tourism, where Japan and Korea also important players, domestic exports are limited mainly to the aforesaid countries in copra and fish and their related products. The re-exports of diesel fuel for fishing and trans-shipment activities are also significant. Trade data from

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9 These include weaknesses in accounting and governance. In response, the government is now committed to establish a clear and robust system of financial management and reporting procedures which require detailed estimates of income and spending together with the policies and legislations empowering the collection and use of funds. It also requires plans and specific performance targets.
the EPPSO (2007) indicates that merchandise export makes just over 10% of GDP but the import penetration is over 40%. The net services trade is negative, a marginal 5% of GDP. Growth in imports has been higher than that of personal incomes. Imports grew at around 10% per annum leading to trade deficits which now stand at around 60m. Accounting for net income and transfers (excluding aid and grants) the current account balance is in deficit of 20% of the GDP. Trade is undermined by lower productivity and high unit cost of production leading to uncompetitive relative prices. Further, there are concerns that the use of the US dollar limits any useful trade policy for RMI\textsuperscript{10}.

Nonetheless, without the grants and aid, there would have been serious balance of payments problems because although capital account borrowing or running down reserves is limited, the aid and grants are useful buffer funds, at least until 2020. So as long these are available, the decade long perception is that neither trade and nor fiscal deficits are worrisome is hard to change.

\textsuperscript{10} This is too unrealistic because many countries using independent currencies have shown evidences of adapting inappropriate policy targets, excessive monetization of budget deficits and protection of overvalued currencies. This has led to highly regulated domestic financial systems, large devaluations and collapse of their financial institutions. For such a small economy as the RMI, the use of an established international currency is beneficial.
3.0 Development Issues

The Marshall Islands faces some serious socio-economic problems. First, it is evident that traditional and modern structures of authority co-exist but in friction. This makes policies and procedures confusing to an average Marshallese. Further, the shift away from subsistence to monetary economy requiring reciprocity nature of transactions is unacceptable, particularly in the rural centers. Therefore, mutual dependence, informal safety nets and family structures are slowly collapsing.

Second, health hazards are on a raise. There are evidences of increasing prostitution and fears that a growing number of young females are carrying HIV and Hepatitis-B viruses. The incidence of diabetes which is directly related to over-nutrition, alcohol abuse and lack of physical exercise is becoming a major health problem.

Third, despite deteriorating economic and social conditions, population growth is high. A teenage female carrying kids is not uncommon in RMI. While this is related to breaking family structures and low education standards, it may also be linked to the child care financial assistance provided in the US grant.

Fourth, the level of poverty is increasing. According to ADB (2000), 20% of all households were below the international poverty line. Data from 2006 employment survey paints a similar picture. The UN’s
Human Development Report (1999) ranked RMI as 9th amongst 14 PICs. This is contrary to expectations despite the massive inflow of grants.

Fifth, worsening of natural environment is becoming apparent. Improper disposal of wastes, low quality of drinking water and the risk of sea level rise are serious issues. The low altitudes of its major atolls make the RMI vulnerable to large tidal waves.

Sixth, due to lack of technical know-how and investment security, productive assets such as buildings, machinery, vehicles and ships are deteriorating, shortening their economic lives. This will soon require replacement investment which will be hard in the short-medium terms, except for assets that require less funding. There is a common view in the Marshalls that it is cheaper to buy a new car than get one repaired!

Seventh, poor performance of schools and training institutions is alarming. The government authorities are not clear on how the funds should be allocated and do not have a long term education plan. The students lack motivation and urgency to study. This pushes educational standards to a low and below others in the region. The local institutes produce graduates who are ill-equipped to gain access to local and foreign workplaces. The performance of public schools based on failure is worrisome, see EPPSO (2007). The regional USP centre lacks financial support.
Nonetheless, against this background and dominant US influence, the policy makers are in search of sound and manageable macroeconomic policies to steer the remote island economy into prosperity.

3.0 Improving Future Prospects

In this section, we identify some areas where the RMI government should focus when drafting its development plans. First, the grants should be used as adjustment and adaptation funds in order to build capacity in the growth enhancing sectors. In the fisheries sector, for example, a locally owned processing plant and a cannery can easily be installed targeting the major Asian markets. A new fleet of fishing vessels that can service this facility should be invested into. This is far more beneficial than giving licenses to others to mine the fisheries resources.

Funds should be diverted to develop the tourism industry with greater local ownership and participation. The major areas would be airline and hotels. Linking and opening up airlines services to major destinations such as Kiribati, Fiji, Hawaii and other Asian countries can be useful.

Funds should be spent on education, training and skills development, but carefully. Expertise from Pacific neighbors, US and Asian nations should be sorted to run short applied training courses for students and government official. The local USP centre is an easy option but needs
funding support. Primary and secondary education must be made compulsory targeting higher standards and requirements. More of important vocational and technical institutes should be developed, may be useful to see what the Fiji Institute of Technology is doing in Fiji. The RMI in conjunction with the US can also lobby the regional universities to open-up training centers in fisheries and military, for example.

Short-term immigration regulations should be simplified and some of the provisions in the regulation should be revisited to allow freer flow of temporary workers. For, example, provisions to claim their superannuation at the end of the contract period should be instituted for temporary workers.

There is a need for small and micro enterprise development in RMI. Entertainment centers, poultry farms, hydroponic vegetables farms, copra processors, road side vendors and goods, vegetable and fish markets in the major centers should be developed. Domestic investment in export-oriented ventures should be supported and the issues of land should be quickly resolved to support business and commerce development.

Investment must be made in RMI telecommunication and internet services. The local telecom authority can outsource internet provisions and look into wireless services. The local newspaper and TV channels
should introduce more educational programs rather than advertisement on entertainment and food outlets.

It is important to educate the public to care for and take pride in their natural environment. Legislations for littering, for example should be instituted and disaster management systems with inputs from Hawaii and SOPAC would be useful.

4.0 Conclusion

With a limited scale of economic activity that is highly dependent on domestic expenditure based on grants and aid one cannot expect sustainable development. There is an urgent need to re-consider growth enhancing policies in RMI. The dependence mindset which is having serious implications on productivity, growth and competitiveness needs to be changed. Using the grants as adaptation funds, the economy should develop capacity and educate its workforce to enhance competition in its potential growth enhancing sectors. The RMI should also attract technical assistance and simplify procedural requirements to allow freer flow of workers and investment funds. The government should also improve its efficiency, transparency and technical competency to help lower the cost of doing business in RMI. It must be noted that all grants will eventually cease, therefore it is important for the government to reduce domestic expenditures and develop competitive domestic economy for a better future.
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