

COUNTRY REVIEW

Marshall Islands



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EULER HERMES COUNTRY RISK GRADE: D

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

COUNTRY PROFILE

Capital city:	Majuro
GDP:	USD 156 mn (FY2009e; Fiscal Year ending 30 September)
Population:	54,065 (July 2009e)
GDP per capita:	USD 2,890 (FY2009e)
Currency:	US dollar (USD)
Form of state:	Constitutional government in free association with the US (since 1986)
Head of government:	President Jurelang ZEDKAIA (since November 2009)
Next elections:	Legislative: November 2011 / Presidential: 2012

The Marshall Islands, a small island group in the North Pacific Ocean, gained independence from US-administered UN trusteeship in 1986. A Compact of Free Association (Compact) with the US entered into force, designed mainly to promote self-government and economic self-sufficiency of the Marshall Islands, as well as to protect the national security interests of both countries. The Marshall Islands hosts the US Army Kwajalein Atoll Reagan Missile Test Site, which is a key installation in the US missile defence network. In 2003, the Compact was amended and renewed for 20 years. The main economic provisions include a temporary increase in total grants, mainly to help finance the creation of an Intergenerational Trust Fund which is supposed to replace grant funding after 2023. However, budgetary support from grants will decline steadily in real terms during the 20-year period.

Elections in late-2007 led to a new administration under a new president, Litokwa Tomeing. The new government was thought to be less US-friendly as it was unhappy with the Compact and more outspoken about continued claims for compensation for the US nuclear testing on some of the country's atolls between 1947 and 1962. They were also considering shifting diplomatic relations from Taiwan to China, provoking US resentment. However, in office Tomeing expressed continued support for ties with Taiwan. But Tomeing was removed from office by a vote of no confidence in October 2009, following a power struggle between him and his predecessor, Kessai Note, who was vying to return to power. However, Jurelang Zeckaia, the parliamentary speaker in the Tomeing government, defeated Note by a slender 17-15 margin in the subsequent vote. Overall, expect broad foreign policy continuity. After all, the Marshall Islands remains heavily dependent on foreign assistance, especially from the US, with grants exceeding 40% of GDP and 70% of government revenue in recent years, and most of that has been provided by the US under the Compact. Unemployment in the islands is estimated at over 30% and the income distribution is uneven. Nonetheless, political instability and social unrest have not been serious problems.

The economic base is narrow and economic activity consists primarily of subsistence farming and fishing, which is sometimes subject to bad weather conditions. The islands have few natural resources and small-scale industry is limited to copra, handicrafts, and tuna processing. Tourism accounts for less than 10% of formal employment. The government is the largest employer and will continue to dominate around two thirds of the economy. Generally, economic information is sparse and there is very little up-to-date data readily available.

With aid flows declining in real terms and the need to retire external public debt in the 1990s, economic growth in the Marshall Islands weakened. During 1992-1999, real GDP and real per-capita GDP contracted by nearly 22% and 30 percent, respectively, i.e. they fell below the pre-independence level. Real GDP growth recovered moderately to an average annual 2.3% in 2000-2009, but output declined by 2% in 2008 and was flat in 2009. The economy is projected to grow only slightly by 0.5-1.5% annually in 2010-2012; and medium-term growth prospects remain subdued.

Annual fiscal deficits of more than 30% of GDP (excluding official transfers) are usual. While these deficits have been largely covered by transfers (grants) so far, there are no signs that the government attempts to bring public finances towards more sustainable levels. Indeed, there are concerns that the government is using aid money to finance its expenditure, rather than to promote private-sector economic growth. Public sector wage expenditure has doubled since 2000 to 22% of GDP in 2004-2008, which is significantly higher than in peer countries in the region. Public debt is estimated at USD60mn or so, equivalent to about 40% of GDP. The value of non-usable assets in the Compact Trust Fund declined in the wake of the global financial crisis, but is estimated to have recovered since mid-2009 to around USD100mn.

The Marshall Islands usually record annual current account deficits between 25% and 45% of GDP (excluding official transfers) as imports far exceed exports. While the external deficits have been largely covered by transfers (grants) until 2003, they have risen thereafter and reached an estimated 12% of GDP in 2009. Moreover, foreign exchange reserves have declined to about USD2mn in 2008, sufficient to cover less than one week of imports.

The country remains burdened with a large external debt stock. According to the IMF, total external debt account for nearly 60% of GDP or more than 400% of export earnings and the corresponding external debt service was nearly 60% of export earnings in 2009-2010.

On a positive note, transfer and convertibility risk is relatively low thanks to the US dollar being legal tender. The later has also helped to keep inflation largely in check, despite a fuel and food price-related one-off hike to 14.8% in 2008.

Overall, however, the Marshall Islands' heavy dependence on foreign assistance (with grants set to decline in real terms), the narrow economic base, the relatively low level of development and the large external debt burden suggest a highly fragile medium-term economic outlook.

The Structural Business Environment is adequate, but below average in our assessment overall, and information is incomprehensive. The Marshall Islands ranks 111th in our assessment of 212 countries. Particular areas of weakness are the legal framework, the banking system and the transparency of corporate balance sheets.

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