Comprehensive Adjustment Program Advisory Group

FINAL REPORT

Submitted to the Minister of Finance
Honorable Jack Ading

September, 2009

FOREWORD

This report has been prepared pursuant to a request of Cabinet as outlined in the terms of reference for the Comprehensive Adjustment Program (CAP) Advisory Group.

The report has been prepared and endorsed by the team appointed by Cabinet and working under the direction of the Minister of Finance. The group is chaired by Mr. Ben Chutaro and vice-chaired by Mr. Ben Graham. Private sector members include: Mr. Ben Chutaro, Mr. Ben Graham, Dr. Hilda Heine, Mr. Jack Niedenthal, Mr. Mike Slinger, and our advisor, Mr. Kevin O'Keefe. Public Sector members include: Mr. Tommy Kijiner, Jr. – Secretary of Resources and Development, Ms. Kino Kabua—Secretary of Foreign Affairs, Mr. Jefferson Barton—Secretary of Finance, Mr. Divine Waiti—Nitijela Legislative Counsel, and Ms. Marie Maddison—Director of National Training Council.

Special thanks are given to the Ministry of Finance and EPPSO for providing the documents and material necessary to prepare this report. Thanks also to Mr. Jason D. Aubuchon of the US Graduate School for his support and for his organization's funding for the trips of Mr. Kevin O'Keefe, the Advisory Group's macroeconomist and fiscal policy expert. Thanks are also given to Mr. Kiyoshi Nakamitsu of the Asian Development Bank for funding an office, Internet connections and other logistical support for the Advisory Group.

INTRODUCTION

The terms of reference and scope of work for the Comprehensive Adjustment Program (CAP) Advisory Group were approved by Cabinet on April 23, 2009 (C.M. 078, attached as Appendix II). The Advisory Group is hereby presenting its findings and recommendations to Cabinet in the form of a Framework for Comprehensive Fiscal and Economic Adjustment Options.

The Advisory Group is working in coordination with a second important undertaking approved by Cabinet, namely the Revenue and Tax Reform and Modernization Commission. As such the fiscal reform areas outlined in this Framework are limited to expenditure reforms. Ultimately, it is recommended that the work of the two bodies be integrated through Cabinet actions as part of a truly "Comprehensive Adjustment Program," to create both an improved fiscal position of the Government and a more supportive environment for economic development over the long-term.

While the timeframe to come up with these recommendations was short, the members of the Advisory Group have made every effort to honestly and objectively analyze the data and information received from the Ministry of Finance and other government-sourced documents. Similarly, the Advisory Group is operating under the assumption that the RMI will commit itself to its own internally-designed CAP to the full extent necessary to restore fiscal flexibility and to enable the Government to respond to emerging needs without being forced to operate in a persistent state of crisis management and cash-flow shortages.

To put the work of the Advisory Group and the Commission into an immediate context of cost savings, the approximate **size of the fiscal adjustment that we are recommending for consideration by the Cabinet is in the range of $7 to $8 million.** That level of fiscal adjustment would be achieved through a combination of expenditure cuts and revenue enhancements leading to a combined and sustained annual adjustment of $7 to $8 million. It is expected that the CAP would be implemented in phases over 1-3 years. It is further recommended that the implementation period be followed by rigorous fiscal discipline for an extended period of years.

As noted in the "SUMMARY MATRIX OF EXPENDITURE REFORM AREAS AND OPTIONS" near the end of this report, the range of expenditure reductions if the CAP reform areas are implemented would be **from a low of $4.0 million to a high of $10.5 million annually**. A mid-point reform effort would yield $7.25 million in annual savings. So with some revenue effort included, it is clear that the reform areas outlined and the "scope and scale" of the CAP to be implemented in phases could assuredly close the fiscal gap outlined above.

GOALS AND CHARACTERISTICS OF A PHASED CAP

There are two broad goals of the CAP, one internal and the other external:

The first goal is to provide the Government with a well-defined series of actionable measures to recover from the recent (and continuing) deterioration in the fiscal position of the RMI Government and, following a period of fiscal restraint, to put the Government on a path toward **long-term fiscal sustainability** while also placing the RMI economy on a similar path toward **sustained growth**.

The second goal is to provide the Government with an internally designed program that can better guide its relations with the external donor community. Here the measurable objectives will be (a) to **mobilize increased and better-targeted donor resources** to support the implementation of the CAP, (b) to **reduce the RMI's net external debt**, and (c) to direct those resources towards the best uses for the **RMI's long-term development**.

While the goals of the CAP are clear, it is also clear that such an adjustment program will require a concerted effort on the part of the nation's leadership and will, inevitably, require sacrifices in the short-to-medium-term. The Advisory Group recommends that the fiscal adjustment effort be undertaken with due consideration to the following characteristics:

- The larger share of the fiscal adjustment should be taken on **expenditure reductions**, with significant, but lesser, reliance upon revenue increases.
- The fiscal adjustments approved for implementation by Cabinet should be undertaken in two phases, with the items having the greatest fiscal savings/earnings prioritized for phase I. This **front-loading will enable the benefits of adjustment to be realized earlier**.
- The fiscal adjustment areas that require lengthy technical review and preparation should be considered for phase II implementation; however, the preparatory work should begin as part of phase I operations. Furthermore, **Cabinet's commitment to implementation for both phases should be explicit** from the outset.
- All of the RMI's commitments for implementing its own **internally-designed CAP** should be shared with its major donor partners so that the RMI can benefit from **coordinated and enhanced donor assistance** to:

  (a) provide technical assistance to support the CAP;
  (b) provide grant assistance for key elements of the CAP;
  (c) provide concessional lending for key elements of the CAP; and
  (d) provide grant and/or concessional lending to mitigate the negative impacts of the CAP.

- Finally, all of the elements of the CAP, and all of the RMI's future fiscal operations should be consistent with:

  (a) a "**Decrement Management Plan**" to be developed pursuant to JEMFAC Resolution No. 2009-1; and
  (b) an "**External Debt Management Strategy**" to be proposed by the Advisory Group and endorsed by Cabinet. The goal of that strategy will be to reduce the RMI's net-indebtedness over the period of CAP implementation and to ensure that the RMI never again subjects itself to unsustainable levels of external debt.

WHY THE CAP WAS ESTABLISHED

2008 was a particularly challenging year for the Marshall Islands. The world saw commodity and fuel prices surge rapidly and the spillover effects of the financial crisis triggered the global recession we are still experiencing today.

The Marshall Islands saw massive increases in food, commodity and, especially fuel prices. The impact on the main utility company, MEC, was especially traumatic and occurred at a time when MEC was already suffering from other factors that pushed it to the brink of insolvency. Simply put, MEC could not afford the fuel it needed to generate electricity and the Government was forced to offer financial support to avoid a nationwide blackout. The Government's fiscal reserves were already diminished and its need to enter into a variety of loan guarantee arrangements further weakened the ability of the RMI Government to address any potential emerging fiscal needs.

Late in FY2008, the Government declared an economic emergency. Some of the RMI's key donors came to the aid of the country's call for help. Taiwan, US, Japan and ADB all came in with varying degree of assistance enabling the RMI government to support MEC financially through the worst of the period. However, it must be noted that much of the support from our donor partners—while welcome and much needed—was injected in an ad hoc manner that was not part of a sustainable long-term approach to sound fiscal or economic management.

The surging commodity and fuel prices demonstrated once again, how the Marshall Islands continues to be vulnerable to external shocks and to the collateral effects that world economic events can have on the entire Marshall Islands economy and society. The CAP Advisory Group was established to take a more systematic and sustainable approach to addressing the RMI's fiscal and economic vulnerabilities.

LEAD UP TO THE ESTABLISHMENT OF THE CAP

The Graduate School (formerly affiliated with USDA) sent a team in July 2008 to the Marshall Islands at the request of the Chief Secretary comprised of Mr. Jason Aubuchon and Mr. Kevin O'Keefe to assess the fiscal crisis then being faced by the RMI.

Their assessment painted a bleak but realistic picture of RMI's current fiscal position and presented the concept of an internally designed and adopted adjustment program. In addition to some immediate measures to stabilize the situation, a longer-term and more comprehensive approach was recommended. Of significant importance was the recommendation that donor support be better coordinated and more targeted toward the nation's long-term sustainability and that the external debt situation be addressed proactively through dialogue with RMI's major donors.

The Minister of Finance, Hon. Jack Ading, responded to this call. The Cabinet formed the CAP on April 22, 2009 comprised of a group of professionals to assess the extent of the fiscal crisis and to return to Cabinet with recommendations for further discussion or action.

The terms of reference called for the following:

- To deliver to Cabinet a broad and well-specified framework for comprehensive fiscal and economic adjustment so that Government will be sufficiently informed and enabled to determine the appropriate size, specific elements, phasing of elements, and timing of any fiscal and economic adjustment program that Government may implement on its own or in beneficial coordination with donor partners; and
- On approval of the Cabinet of an internally conceived and designed program, to undertake public consultations, support donor partner mobilization and coordination efforts, and advance the process of implement the Republic's Comprehensive Adjustment program.

OUR METHODOLOGY

In conducting its assessment, the CAP Advisory Group relied primarily on government audits, budget documents, P-132 and P-134 reports from Finance, Public Service Commission documents, and data from the Economic Policy, Planning and Statistics Office.

Kevin O'Keefe and Jason Aubuchon provided intermittent assistance (in Majuro) and helped craft this final report.

OUR FINDINGS

The CAP agrees with earlier analysis by the ADB, IMF, World Bank, USDOI and others that the RMI is facing a fiscal crisis. The most severe impacts of this crisis were brought about by the surge in global fuel prices combined with the indirect effects of the global recession on the RMI economy. However, and perhaps more important in the long-run, the strongest factors leading to the RMI's deteriorating fiscal position have been self-inflicted. Specifically, through loose and unconstrained fiscal policies over an extended period of time the RMI has been left with diminished reserves, increased external and internal debt and unsecured debt guarantees, and an emerging structural fiscal problem that must be addressed.

There are two types of fiscal imbalance that any Government may face from time-to-time. One is a **cyclical deficit**. This type of deficit is considered temporary and is caused by a temporary misalignment of revenues and expenditures. In an economic recession, for example, it is expected that revenues may fall while certain expenditures requirements may increase. If a deficit is truly cyclical—the advisable policy response will typically involve financing of short term deficits. Certainly, the fiscal crisis in the RMI that peaked in late FY2008 was, in part, a classical version of a cyclical deficit. It was certainly appropriate for the Government to undertake **some** borrowing (including loan guarantees) to manage its way through the worst period of the fuel price crisis.

However, the second—and more serious—form of fiscal imbalance is a **structural deficit**. In this case, and irrespective of temporary shifts in revenues or expenditures, a Government faces PERSISTENT deficits because its core revenue base is insufficient to support its core (and growing) expenditure obligations. The RMI is now surely facing a significant STRUCTURAL fiscal deficit. This is not a temporary situation and borrowing is NOT the appropriate response to the long-term needs of the RMI. The appropriate response is to close the fiscal gap by a combination of expenditure cuts and revenue enhancements. In fact, the RMI needs to "over-adjust" in the medium-term toward a fiscal surplus in order to restore fiscal reserves that have been depleted and to prepare for the continued impacts of Compact funding decrements and partial inflation adjustments on an annual basis. If there is any borrowing to be involved in the recommended CAP measures, Cabinet will note that it would be done in a strategic manner to utilize the benefits of concessional lending sources to (a) consolidate higher cost loans, and (b) reduce the total "net external debt" position through the coordination of donor grants and donor loan projects.

The Cabinet may want to receive a thorough presentation of the structural deficit position of the RMI, but for the purposes of this report the CAP Advisory Group wishes to simply highlight the estimated size of the fiscal adjustment required over the next 1-3 years:

specifically it is recommended that Cabinet adopt a combination of the proposed measures so that a fiscal adjustment of $7 to $8 million annually can be achieved.

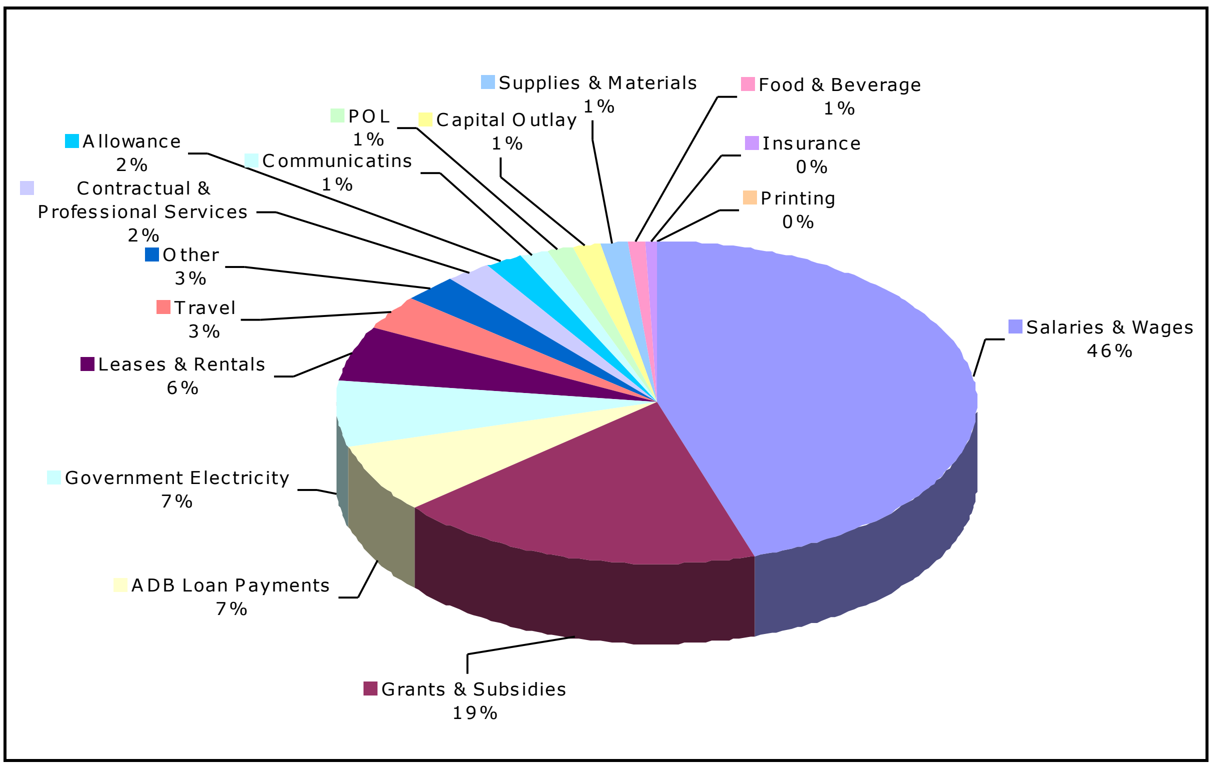
ANALYSIS OF THE RMI GOVERNMENT'S FINANCES (GENERAL FUND)

The CAP Advisory Group reviewed past government audits starting from FY2000 to FY2008 and noticed some notable trends.

In total, expenditures in the General Fund were over $34 million in FY2008. General Fund expenditures increased by 17% from FY2004. General Fund expenditures grew on average 11% per annum. FY2009 appears to be on trend.

Salaries & Wages accounts for 46% of the General Fund expenses, followed by Grants & Subsidies at 19%, ADB Loan Payments and Government Electricity at 7% respectively, Government Leases and Rentals at 6% and everything else at less than 3%.

Grants and subsidies included subsidies mainly to State Owned Enterprises (MEC, AMI, Tobolar). This also includes over $1 million in landowner electricity bills. There are other smaller subsidies to MIVA, LRA, EPA, etc.



The ADB is the RMI's major creditor. Total outstanding loans are over $60 million. Current loans payments are already well over $2 million annually. Loan payments are expected to increase as the grace period on some loans become due. RMI is expected to make $3.2

million in annual loan repayments to ADB in FY2010. This will heavily impact the General Fund, unless the RMI develops a strategy—including significant donor coordination efforts—to make repayment of its debt to the ADB more sustainable.

The government has guaranteed loans to various SOE's and a church. Government deposits in the banks guarantee some of the loans. There is no contingency funding if any of the loans are declared to be in default. The CAP Advisory Group has not yet undertaken a risk-based assessment of the loan guarantee portfolio of the Government; however, this should be done as a part of the CAP phase I implementation and should inform the External Debt Management Strategy described below.

The main underlying cause of the emerging structural fiscal deficit is rather simple. The RMI is facing stagnant or declining revenues at the same time as expenditures have continued to grow unsustainably.

Since FY2000 the RMI has seen its salaries and wages expenditures increased by two-fold from $16.4 million to nearly $34 million annually. The early years of the second Compact have seen a one-time increase in Compact sector grant revenues, which enabled the Public Service, especially in Health and Education, to add more staff and raise wages.

The CAP Advisory Group did not perform a comprehensive civil service and institutional review. This will require a TA and more time, which the CAP Advisory Group recommends be undertaken as a priority element of the CAP phase I implementation. While some reductions in personnel could proceed without a comprehensive review, a civil service and institutional review will be necessary to address longer-term budgetary issues, especially when decrements in the Compact are factored in.

FISCAL POLICY

The Medium Term Budget and Investment Framework (MTBIF) is the basis for fiscal policy. The framework lays out a schedule of expenditures tied to a specific set of program outcomes. In recent years however, the MTBIF has not been fully implemented resulting in *ad-hoc* fiscal policy decisions that are reactive rather than proactive. The timing of the MTBIF process needs to be accelerated on an annual basis to fully inform the budget formulation and approval process and the elements of any adopted CAP need to be fully incorporated.

BUDGETARY PROCESS IN THE RMI

The budgetary process should provide information for the optimization of returns from government expenditures. During times of fiscal crises it is more important than ever to rely on a sound budgetary process for management information. It is crucial, therefore, that the

MOF gets into the position of being able to identify potential areas of over-expenditure at an early stage so that appropriate action can be taken. By the same token, the MOF should be able to identify revenue areas that are under-performing so that corresponding measures to lower expenditures can be taken at an early stage to avoid crisis-management.

The RMI budgetary process should perform a number of functions. These include:

- provide sufficient management information to policy makers on the current performance of the budget for planning the overall mobilization and allocation of resources and for appropriate cash-flow management;
- maintain effective controls over expenditures and highlight areas which threaten to overspend;
- provide information which relates budgetary inputs to activity outputs;
- establish an appropriate link between planned capital expenditures and their recurrent implications; and
- establish procedures which result in decisions with respect to expenditure planning and revenue generation which utilize the above information.

FOR FURTHER DISCUSSION AND ANALYSIS

The discussion in this section is complementary to the core recommendations in the Expenditure Reform Area Matrix. The CAP Advisory Group feels it is necessary to raise the issue here because of the interaction between external aid and the economy directly impacts fiscal policy both in the short- term and longer-term.

COMPACT AND EXTERNAL AID

The CAP Advisory Group will not elaborate on the Compact as amended. However, it raises issues related to future fiscal policy.

While Compact sector grants expire in FY2023, it is not guaranteed that the Trust Fund will have grown sufficiently to sustainably generate the funding needed to replace the grants. To address the long-term problem of a shortfall, the RMI has two options, increase revenues or cut expenditures to the point of running a persistent budget surplus. While the CAP Advisory Group would hope that the Cabinet will adopt a formal and comprehensive reform program, there is a clear and compelling need to undertake immediate fiscal adjustment. Thus, the primary time horizon of the CAP is the next 1-5 years with an eye to the longer term. When fiscal reserves are restored, pursuant to the implementation of the CAP in phases, those reserves will help address the longer term fiscal balance issues.

TAXES

The CAP Advisory Group did not consider revenue reform matters. The RMI Tax Reform and Modernization Commission established by Cabinet in 2008 will recommend those reform measures to government. However, the CAP Advisory Group will coordinate with the commission to ensure any revenue measures they may be considering will be in line with and supportive of the CAP. However, the CAP Advisory Group would like to make some comments on taxes.

Obviously, tax collections have been historically weak and the Ministry of Finance is not capturing the full potential of the taxes. However, even if there was full compliance in tax collections, it is unlikely that tax revenue will cover all expenditures in the general fund. The Ministry of Finance will have to rely on fees, licenses and grants to support the General Fund.

There is in some circles the belief that it is inevitable that it will be necessary to raise taxes to cover future shortfalls. The CAP Advisory Group does not support raising revenues simply by raising the rates on the existing range of taxes; rather, the Advisory Group supports revising the current tax structure so that it broadly captures all activities as opposed to singling out a small group of tax payers as the current system does. A tax system with a broader base and perhaps even lower rates would be preferred. Currently tax revenues are equivalent to 17-18% of GDP and the IMF suggests the optimal range should not be above 20% of GDP. Raising taxes beyond this could further weaken the economy.

For this reason, the CAP Advisory Group reiterates that the majority of the fiscal adjustment undertaken through the CAP should occur through expenditure reductions.

CRITICAL IMBALANCES IN THE RMI ECONOMY

The CAP Advisory Group would like to note briefly the current macroeconomic environment, because it has a significant impact on the depth and breadth of reforms to the RMI's fiscal and economic policies that will be required in the coming years.

The CAP primarily addresses the present and looming fiscal problems of the Republic which is the matter of major immediate concern. However, other reforms are needed and recommended as part of the phased program in order to deal with longer-term aspects of the need to incrementally restructure of the economy.

There is a marked difference in size of the government and the non-traded services sectors, on the one hand, and the foreign exchange earning and/or saving sectors on the other; and the recurring balance of trade deficits in which the values of the import and export of goods and services are seriously and persistently out of balance.

These imbalances are closely related. Thus, in addition to the immediate problem of fiscal reform, there is a need for the RMI to develop foreign exchange earning activities that addresses the following:

- declining Compact revenues,
- increasing population of working age,
- creating reserves to insulate from external shocks, and
- the potential shortfall in sustainable income from the Compact Trust Fund.

The recommendation section of our report follows. Please recall the focus of our effort to-date is limited to expenditure areas.

EXPENDITURE REFORM AREAS AND OPTIONS

The Advisory Group recognizes that the RMI faces challenges on two distinct fronts.

- The first is the more immediate and urgent need for fiscal rebalancing, to restore and strengthen the basic solvency, flexibility, and overall sustainability and integrity of the budget and public finance system. This is a crucial and urgent matter given the current and near-term challenges brought forth by a combination of fiscal and economic factors.
- The second set of challenges, which are perhaps less urgent but more important, relates to the fundamental and structural issues which affect the overall efficiency and effectiveness of the civil service, the public sector and, ultimately, the broader economy.

This section provides the group's recommendations on expenditure reform options targeting the former issue – the more immediate and urgent need to adjust. A separate exercise should be undertaken, following soon after this report, to analyze and consider some of the broader and longer-term changes that are required to improve the overall structure and efficiency of the public sector and to address broader economic restructuring policy issues.

The group has identified thirteen specific expenditure reform areas that Cabinet should consider (covering the General Fund only). These reform areas relate to:

1. The Civil Service
2. Nitijela Member Compensation
3. Housing Allowances
4. Electricity Allowances
5. Leased and Rental Housing
6. Utility Bills
7. Communications
8. Vehicles
9. Fuel
10. Travel and Per Diem
11. Professional Services
12. Grants and Subsidies
13. Organization/Facilities Consolidation

Each of these areas is described in detail below, with reform options for consideration included within each sub-section. While this list includes some of the largest and fastest-growing expenditure areas, the list is (of course) not an exhaustive, and it is highly recommended that Cabinet instruct the Secretary of Finance, the Finance staff, and the fiscal officers of all ministries and agencies to also conduct their own independent analysis of possible expenditure reform items.

REFORM AREA # 1 - THE CIVIL SERVICE

TRENDS AND CURRENT SITUATION

Both the size and cost of the civil service have grown rapidly and uninterrupted for nearly a decade now. At the conclusion of the Public Sector Reform Program in FY2000, the national Government had reduced its employment to just fewer than 1,500 whereas today the number had surpassed 2,400. While part of this growth is accounted for by the transfer of teachers from the former Head Start program (to the national Government payroll) and the addition of new teachers and other education administration staff, most other ministries and the agencies that fall under the national payroll have also seen their numbers grow over time. The FY2008 audit showed annual expenditure on salaries/wages of $34.6 million, almost doubling the FY2000 amount of $17.5 million. General Fund salary/wage expenditure has grown over this period by over $3 million annually, from $12.2 million to $15.4 million.

The official FY2008 Budget Statement introduced into Nitijela on 13 September 2007 asserted that:

Government payroll has been an area of concern in recent years though this is expected to level out in FY 2007… The increase in recent years has been supported by the inflow of funds under the Compact, as amended. This has included the commencement of the Ministry of Education kindergarten program in FY 2005 to replace the former Head Start program. This led to the significant growth in Ministry of Education staff between FY 2005 and FY 2006 (in the region of 200 teachers) since the Head Start program was previously managed outside of the Government payroll… Despite this the Government recognizes that this growth is not sustainable and will place additional emphasis on restraining employment and wage growth in FY 2008.

In direct contradiction to this official statement, government employment continued to grow in FY2008, pushing annual salary/wage expenses up by another $625,113 to $34,600,914 (compared to $33,975,801 in FY2007). There is widespread consensus that this rapid and uncontrolled growth in the size and cost of the civil service is unsustainable and must be dealt with immediately.

Moreover, every year a number of vacant positions are budgeted for, but most have yet to be filled. Going into FY2009, some 71 positions remained vacant, totaling around $1.2 million in the budget.

REFORM AREA #1 OPTIONS

The annual wage bill is determined by three basic factors: the total number of employees, total hours worked, and wage levels. Thus, reforming the civil service will have to consider one or more of these factors. Also, consideration should be given to reducing most of the vacant positions.

Reduction In Force (RIF). This can be done through a variety of means:

- Enforce the mandatory retirement age for all replaceable positions
- Establish a voluntary early retirement program (with compensation) for those who are 55 and older
- Establish a targeted Reduction-in-Force (RIF) program across all ministries and agencies

A RIF program should be well targeted and should only be carried out after a carefully planned and deliberated process is agreed upon. Different methods can be considered for identifying positions that can be eliminated within each organization with minimal impact on the delivery of basic public services.

The following table illustrates the estimated annual savings that would be realized with a RIF program that eliminates anywhere between 50 and up to 400 positions. The savings estimates assume an average annual wage of $14,417 per civil servant. A RIF of 50 employees, or roughly 2 percent of the civil service, would yield around $700,000 in annual savings. A RIF of 200 would yield a savings of $2.8 million and a RIF of 400 would save some $5.6 million.

OPTION 1(A): COST SAVINGS FOR A REDUCTION IN FORCE

RIF Target (# employees)	% of Civil Service	Annual Savings
50	2%	$700,000
100	4%	$1,400,000
150	6%	$2,100,000
200	8%	$2,800,000
250	10%	$3,500,000
300	13%	$4,200,000
350	15%	$4,900,000
400	17%	$5,600,000

Note: savings estimates *based on average annual wage of $14,417*

The Public Sector Reform Program (PSRP) in 1997 to 2000 reduced the government personnel to under 1,500.

Eliminate Most Vacant Positions. There are approximately 71 positions budgeted for this year but which remain vacant. In recent years, consistently over $1 million is budgeted for positions that are not ultimately filled (for various reasons). The Advisory Group has been told that the appropriations for these positions can be re-appropriated mid-year towards other activities, but this has not been verified. Elimination of 50 of these positions (roughly 75 percent) would yield an annual savings of over $720,000. Only those positions that are deemed critical and essential should not be eliminated and more effective efforts must be made by the PSC to fill these important vacancies.

OPTION 1(B): COST SAVINGS FOR ELIMINATING VACANT POSITIONS

Vacant Positions	% of Civil Service	Annual Savings
25	2%	$360,000
50	4%	$720,000
71	6%	$1,024,000

Note: savings estimates *based on average annual wage of $14,417*

Reduce Work Hours. A reduction in the work week by some hourly increment is another option for reducing the wage bill, although there are three key issues to consider: 1) Reducing work hours is often considered a quick and easy way to reducing wage costs, but this is often considered to be an interim and temporary measure; 2) Not all employees can have their hours reduced – essential service workers such as nurses, doctors, police officers, and customs/quarantine/immigration staff should not necessarily be included; 3) Some workers have allotments on their paychecks that require them to maintain a certain number of work hours per pay period or month – for these employees some special arrangements may need to be made with the banks to extend terms, etc. The table below provides 20 scenarios for annual savings depending on the number of employees affected (from a notional range of between 500 to 2,400) and the number of hours reduced per work week (between 1 to 4 hours). For example, if 500 employees are forced to reduce their weekly hours by 1 hour, the estimated annual savings will be around $180,000. At the opposite extreme, if all 2,400 employees are forced to reduce their week by 4 hours, that would yield around $3.5 million in savings.

OPTION 1(C): COST SAVINGS FOR HOURLY EMPLOYEE REDUCTIONS

	Hours reduced			
Employees	**1**	**2**	**3**	**4**
500	$180,208	$360,417	$540,625	**$7**20,833
1000	$360,417	$720,833	$1,081,250	$1,441,667
1500	$540,625	$1,081,250	$1,621,875	$2,162,500
2000	$720,833	$1,441,667	$2,162,500	$2,883,333
400	$865,000	$1,730,000	$2,595,000	$3,460,000

Reduce Wage Scale. A reduction in the work week by some hourly increment as described above can often be seen as a purely temporary response that may lead to rapid reversal, in the event that a longer-term solution is desired, it may be advisable to consider modest reductions in the wage scale so that impacts of wage hour reductions on health, education and emergency services do not need to be factored into the implementation. With a total wage bill of approximately $35 million each 1% in wage scale reduction would yield $350,000 in savings.

OPTION 1(D): COST SAVINGS FOR A REDUCTION IN WAGE SCALE

Wage reduction (%)	% of Civil Service affected	Annual Savings
1%	100%	$350,000
2%	100%	$700,000
3%	100%	$1,050,000
4%	100%	$1,400,000
5%	100%	$1,750,000

Note: savings estimates *based on total civil Service wage bill of $35 million annually.*

REFORM AREA #2 - NITIJELA SALARIES AND ALLOWANCES

TRENDS AND CURRENT SITUATION

The Nitijela Members (Compensation) Act sets the base salaries and establishes a Lump Sum Allowance and a Session Allowance for the 33 members of Nitijela (including the President and Cabinet ministers). Salaries and allowances for Nitijela members (including allowances not shown in this section) have continued to grow over time, with the Nitijela Members Compensation Act amended more than a dozen times since the mid 1980s. The salaries and allowances authorized by this Act are as follows:

	Number	Salary	Lump Sum Allowance per Member	Session Allowance per Member	Salary + Allowance Per Member	Total Allowances all Members	Total Salaries all Members	TOTAL SALARIES + ALLOWANCES
President	1	60,000	50,000	5,000	115,000	55,000	60,000	115,000
Cabinet Ministers	10	35,000	5,000	5,000	45,000	100,000	350,000	450,000
Speaker	1	35,000	5,000	5,000	45,000	10,000	35,000	45,000
Vice Speaker	1	30,000	5,000	5,000	40,000	10,000	30,000	40,000
Committee Chairs	7	28,000	8,000	5,000	41,000	91,000	196,000	287,000
Senators	13	26,000	8,000	5,000	39,000	169,000	338,000	507,000
	33	--	--	--	--	**435,000**	**1,009,000**	**1,444,000**

Note: housing, electricity and other allowances established outside of the Nitijela Members Compensation Act not shown

Annual base salaries range from $26,000 for regular Senators (those without Chairmanships) up to $60,000 for the President. Lump sum allowances range from $5,000 for Ministers, the Speaker and the Vice Speaker, up to $50,000 for the President. Session allowances are fixed for all members at $5,000. The total annual package (including the base salary and two allowances) ranges from $39,000 for Senators up to $115,000 for the President. Altogether, annual Nitijela member compensation is costing the Government $1,444,000, or roughly between 4 to 5 percent of total General Fund expenditures (and this excludes other benefits received by Nitijela members which were set outside of the Nitijela Members Compensation Act).

The Nitijela Members (Compensation) Act also states:

- In Section 402, that "Notwithstanding the above, and in the final year of each term of the Nitijela, salaries of those members described under sub-section (2) (e) and (f) above shall be increased by an amount equal to 25% of their respective salaries." This section essentially creates a 25 percent raise in the base salaries of the seven Committee Chairs and 13 senators, and pushes up the total cost of Nitijela compensation by another $133,500 every fourth year to a total of $1,577,500.00.
- In section 405, that "Members of the Nitijela shall not be paid any compensation, expense or allowance with public funds, except as provided by Act." There are several other benefits and allowances received by Nitijela members not clearly provided for in any Act.
- In section 406, that with respect to the session allowances, "For each sitting day a member is not present due to unexcused absence or suspension the session allowance shall not be paid," but it is known that all Nitijela members receive the entire $5,000 allowance regardless of their attendance records.

REFORM AREA #2 OPTIONS

OPTION 2: NITIJELA SALARY AND ALLOWANCE REFORM COST SAVINGS

Action	# of members affected	Annual Savings
Cut lump sum allowances	33	$165,000
Rationalize with 10% savings target	33	$144,000

The CAP recommends a reduction in lump sum allowances. Except for the President, each member shall receive a lump sum of $2,500 (regardless of office). The President will receive a $25,000 lump sum allowance (instead of the current $50,000 allowance). Total annual savings $165,000.

REFORM AREA #3 - HOUSING ALLOWANCES

TRENDS AND CURRENT SITUATION

Housing allowances[1] are direct cash payments made to certain government employees for the intended purpose of helping to cover their accommodation costs. Housing allowances have been a standard expense on the budget for many years, and were traditionally given to expatriate workers who do not have accommodation in the RMI. Over time, however, a number of non-expatriate workers (both elected officials and civil servants) have been granted housing allowances, to the point where it is now a relatively significant budget expense (particularly on the General Fund).

There are currently 30 known recipients of the $9,000 annual housing allowance, as indicated in the table below. The vast majority of these individuals are Marshallese, have been long-term residents of Majuro, and own their own homes.

[1] "Housing allowances" are treated separately from "Leased and Rental Housing"; housing allowances constitute direct payments of $9,000 annually to individuals for the intended purpose of defraying their housing costs, while leased and rental housing is the provision of housing accommodation to government workers (expatriates) paid for directly by the government.

HOUSING ALLOWANCE (KNOWN) RECIPIENTS AS OF 2009

Recipients	Number	Annual Cost
President and Cabinet Ministers	11	$99,000
Chief Secretary/Deputy Chief Secretary	2	$18,000
Chairman/Vice Chairman Council of Iroij	2	$18,000
Nitijela Speaker/Vice Speaker/Legal Counsel	3	$27,000
Auditor General	1	$9,000
Judges and Justices	5	$45,000
PSC Chairman and Commissioners	3	$27,000
Attorney General	1	$9,000
Civil Aviation Operation Inspector	1	$9,000
Ambassador At Large	1	$9,000
TOTALS	**30**	**$270,000**

REFORM AREA #3 OPTIONS

Eliminate all housing allowances for all public officials (elected or otherwise) who are known residents of Majuro and who own their own homes; housing allowances must only be granted to officials whose true residences are outside of the RMI and who have incurred a cost of living adjustment by their relocation to the RMI. These would then be subject to individual contract terms and conditions and would not be a separate entitlement item.

If these principles are applied, then almost all of the current recipients of housing allowances will be disqualified; this would yield an **annual savings in excess of $250,000**.

REFORM AREA #4 - ELECTRICITY ALLOWANCES

TRENDS AND CURRENT SITUATION

In 1992 Cabinet passed the original authorization for an electricity allowance for Majuro landowners. The allowance was based on the premise that landowners deserve some form of compensation for the use of their land for the power distribution system. The electricity allowance covered the first 1,000 kWh of monthly electricity consumption per landowner. In the original Cabinet authorization in 1992, an estimated 150 landowners on Majuro were eligible for the allowance; the estimated annual cost to the budget at that time was $180,000 [(150 landowners) x ($.10/kWh) x (1000 kWh) x (12 months)].

Over the ensuring 17 years to 2009, the official list of landowners who receive this allowance (this list is kept by the Ministry of Internal Affairs) has grown nearly four-fold, from 150 to 565. At the prevailing residential electricity rate of $.24 per kWh, the annual expenditure for this allowance to Majuro landowners will now total $1.627 million, nearly ten times the originally estimated amount. But in addition to the rapid growth seen in the landowner list, at least 24 known public officials have also been added to the list in recent years, including: the President and Cabinet Ministers, Chairman and Vice Chairman of Council of Iroij, Speaker and Vice Speaker, Chief Secretary, Auditor General, Judges/Justices, and PSC officials.

In the first eight months of FY2009 (October through May), $677,000 was spent on landowners' allowance, suggesting that by fiscal year-end well over $1 million will be spent. For public officials, around $28,000 was spent in the first eight months of FY2009, meaning for the entire year it will total $42,000.

Electricity allowance spending has essentially doubled in the past five years because of both rising electricity tariffs and the growth in the number of recipients of this allowance. In the early 2000s total spending on this allowance was below $500,000 but in FY2008 it approached $800,000, in FY2008 it exceeded $900,000 and by end of FY2009 it will exceed $1 million. The table below summarizes the original (1992) situation versus the situation today.

ELECTRICITY ALLOWANCE (KNOWN) RECIPIENTS AS OF 2009

Recipients	Original # Recipients	Original Cost (a)	Current # Recipients	Current Cost (a)
President, Ministers, Chief Sec.			12	$ 34,560
Chair & Vice Chair Council of Iroij			2	$ 5,760
Nitijela Speaker/Vice Speaker			2	$ 5,760
Auditor General			1	$ 2,880
Judges and Justices			4	$ 11,520
PSC Chairman and Commissioners			3	$ 8,640
Majuro Landowners	150	$180,000	565	$1,627,200
TOTALS	**150**	**$180,000**	**589**	**$1,696,320**

Note: Based on $.10 per kWh, (b) based on $.24 per kWh

REFORM AREA #4 OPTIONS

OPTION 4: ELICTRICITY ALLOWANCE COST SAVINGS

Action	# of individuals affected	Annual Savings
Cut all electricity allowances for public officials (effective Oct. 1, 2010)	34	$69,120
Return Landowner list to max. of 150 (effective Oct. 1, 2010)	415	$1,195,200
Shift to monthly limit of $100 (effective Oct. 1, 2010)	150	$252,000

Note: Assumes average landowner usage of $2,880 per year.

REFORM AREA #5 – LEASED AND RENTAL HOUSING

TRENDS AND CURRENT SITUATION

Expatriate government workers who do not receive housing allowances directly (and possibly some non-expatriate, resident workers) are provided leased and rental housing. Over the past five years (between FY2004 and FY2008), this expense has more than doubled, jumping by 101 percent. In fact, in years FY2006 and FY2007 it actually exceeded $1.3 and $1.1 million, respectively. The table below summarizes growth in this expense since FY2004 from the General Fund only. In the last five years alone, well over $4 million was spent out of the General Fund only on leased housing (not counting larger amounts spent from other funds).

ANNUAL GENERAL FUND EXPENDITURE ON LEASED/RENTAL HOUSING

FY2004	FY2005	FY2006	FY2007	FY2008
$358,032	$678,797	$1,365,178	$1,161,161	$718,917

In FY2008, another $1.6 million was spent on leased and rental housing from all other funds (non-General Fund). This means that nearly $2.4 million was spent in total on leased and rental housing in FY2008. So far in FY2009 (through early July 2009), over $400,000 has been spent out of the General Fund and nearly $1.1 million from all other funds.

REFORM AREA #5 OPTIONS

No CAP phase I savings are proposed, however, it is expected that total costs could be reduced by **$70,000** within three years and by **$150,000** within five years.

REFORM AREA #6 – UTILITY BILLS

TRENDS AND CURRENT SITUATION

As electricity tariffs have grown rapidly in the past four years, so too has the Government's electric utility billings. General Fund spending on utilities has more than doubled (113 percent), jumping from $1,070,146 to $2,279,218 from FY2004 to FY2008. Part of the large increase in FY2008 could be explained by the advances to MEC from the national Government to help cover fuel supply payments (these advances are now being offset against electricity billings in FY2009, which suggests that the amount expended in FY2009 will be far lower than that in FY2008).

In FY2008, in addition to the General Fund spending on utility bills of $2,279,218, spending from all other funds totaled around $1.6 million. In FY2009, as of early July, around $373,000 was expended from the General Fund while around $1.1 million was expended from all other funds.

Government electricity consumption has been falling steadily over the past several years. In calendar year 2005, average monthly Government electricity consumption (inclusive of all Government entities) was 862,171 kWh, translating into annual electricity billings for that year of just under $2 million. In the 12 months leading to April 2009, monthly Government electricity consumption averaged 5,107 kWh, but with much higher tariffs total billings were nearly $3 million.

Much more can be done to further reduce Government electricity consumption and more aggressive measures must be pursued as soon as possible to improve electricity efficiency, given the likely rise in electricity tariffs over the near to medium term.

REFORM AREA #6 OPTIONS

OPTION 6: UTILITY BILLS – POTENTIAL

Action	% reduction in kWhrs	Annual Savings
Demand reduction phase 1	10%	$250,000
Extended demand reduction	20%	$500,000
Further demand reduction	30%	$750,000

Note: Assumes government utility billing average of $2.5 million annually

At a minimum, the Government can undertake a program of rapid conversion of all public building lighting systems to high-efficiency lighting systems, installation of motion sensor light switches, and much more aggressive program to reduce consumption and improve efficiency across all departments of government. With phased implementation, it is estimated that the 10 percent reduction could be achieved in the first year, the 20 percent reduction within three years and the 30 percent reduction within 5 years.

REFORM AREA #7 – COMMUNICATIONS

TRENDS AND CURRENT SITUATION

Spending on communications has grown by 30 percent in the past five year period and is now in excess of half a million a year (in FY2007 it actually peaked at over $650,000). Details on the exact composition of this spending are not available, but it is expected that internet charges are the primary cost driver (a number of national government organizations have established dedicated “leased lines” with NTA for higher speed internet access, but these usually come at a minimum $600 monthly price tag).

ANNUAL GENERAL FUND EXPENDITURE ON COMMUNICATIONS

FY2004	FY2005	FY2006	FY2007	FY2008
$392,909	$470,138	$479,781	$650,870	$506,130

Communication expenses from other funds have also grown rapidly over the years. In FY2008, nearly $850,000 was spent on communications from Compact and other funds, and with the half a million spent from the General Fund, the total spent on communications in FY2008 was over $1.3 million.

So far in FY2009 (through early July), $396,066 has been expended out of the General Fund and around $280,000 from all other funds, suggesting that by FY2009 year-end the total will again reach the $1 million mark.

REFORM AREA #7 OPTIONS

No CAP phase I savings are proposed, however, it is expected that total costs could be reduced by **$50,000** within three years and by **$100,000** within five years.

REFORM AREA #8 – VEHICLES

TRENDS AND CURRENT SITUATION

Spending on new vehicles is another area where notable growth has taken place. In FY2008, $66,346 was spent from the General Fund on new vehicles, while another $684,524 was spent from all other funds, totaling three-quarters of a million dollars. In FY2009, as of early

July, the General Fund trend had doubled, totaling $126,223 while all other funds have reached $356,816.

REFORM AREA # 8 OPTIONS

No CAP phase I savings are proposed, however, it is expected that total costs could be reduced by $50,000 within three years and by $100,000 within five years.

REFORM AREA #9 – FUEL

TRENDS AND CURRENT SITUATION

Spending on fuels (petroleum, oils and lubricants or "POL" in the budget) has crept upwards in recent years as gasoline and diesel prices have steadily risen.

ANNUAL GENERAL FUND EXPENDITURE ON FUEL

FY2004	FY2005	FY2006	FY2007	FY2008
$441,313	$445,408	$704,679	$514,313	$484,405

In FY2008, in addition to the $484,405 spent from the General Fund, another $1.5 million was spent on fuels from all other funds. Through early July 2009, nearly $300,000 was expended out of the General Fund for fuels and another $500,00 was expended from all other funds; in all of FY2009 the total will exceed the $1 million mark.

REFORM AREA #9 OPTIONS

No CAP phase I savings are proposed, however, it is expected that total costs could be reduced by **$70,000** within three years and by **$100,000** within five years.

REFORM AREA #10 – TRAVEL AND PER DIEM

TRENDS AND CURRENT SITUATION

While travel and per diem spending in FY2008 dropped markedly, it has grown sharply over the long term (since the late 1990s) and is now a significant expense. In FY2008, General Fund spending dropped to $1,135,305, the lowest level seen since FY2002 when $1,134,136 was spent.

ANNUAL GENERAL FUND EXPENDITURE ON TRAVEL AND PER DIEM

FY2004	FY2005	FY2006	FY2007	FY2008
$1,417,384	$1,448,365	$1,760,941	$1,473,227	$1,135,305

Through early July 2009, around $617,000 was spent out of the General Fund and another $1 million from all other funds. This suggests that FY2009 might be another year of lowered spending on travel and per diem, but the total will still be around $1 million for the General Fund (if the trend through early July continues).

REFORM AREA #10 OPTIONS

No CAP phase I savings are proposed, however, it is expected that total costs could be reduced by **$100,000** within three years and by **$200,000** within five years.

REFORM AREA #11 – PROFESSIONAL SERVICES

TRENDS AND CURRENT SITUATION

Professional services spending from the General Fund has increased by 27 percent between FY2004 and FY2008 and has exceeded $600,000 in FY2008 and FY2006. This consists of special contracts with short-term consultants (need more info on this).

ANNUAL GENERAL FUND EXPENDITURE ON PROFESSIONAL SERVICES

FY2004	FY2005	FY2006	FY2007	FY2008
$480,768	$418,411	$668,652	$375,025	$612,926

Spending on professional services from all other funds in FY2008 totaled around $1.2 million, a total of around $1.8 million for all of FY2008. In FY2009,

REFORM AREA #11 OPTIONS

No CAP phase I savings are proposed, however, it is expected that total costs could be reduced by **$30,000** within three years and by **$60,000** within five years.

REFORM AREA #12 – GRANTS AND SUBSIDIES

TRENDS AND CURRENT SITUATION

Grants and subsidies (including "transfers out" from the General Fund) to public enterprises and other entities have grown markedly over the recent five years, exceeding $6 million from the General Fund in both FY07 and FY08. Overall, this expense category has grown by 43 percent since FY04.

ANNUAL GENERAL FUND EXPENDITURE ON GRANTS AND SUBSIDIES

FY2004	FY2005	FY2006	FY2007	FY2008
$4,458,911	$5,371,188	$5,741,805	$6,393,028	$6,366,073

REFORM AREA #12 OPTIONS

RMI should conduct an in-depth review of State Owned Enterprises with the aim of improving their financial and operational viability and to rationalize subsidies and transfers.

No CAP phase I savings are proposed, however, it is expected that total costs could be reduced by **$600,000** within two years and by **$1,800,000** within five years.

REFORM AREA #13 – ORGANIZATION/FACILITIES CONSOLIDATION

TRENDS AND CURRENT SITUATION

Previous efforts to consolidate organizations (e.g. Ministry of Public Works and the Ministry of Resources and Development) have since been reversed, and recommendations made in several reports for the consolidation of certain organizations have not been seriously considered. Consolidation of organizations with duplicative functions may yield significant savings.

REFORM AREA #13 OPTIONS

Several consolidation options should be re-considered.

Merging ministries and other government agencies. The previous merging of the Public Works and Resources and Development ministries may warrant reconsideration, with the role and function of the current Public Works entity re-organized so as to emphasize contracting and monitoring only (versus direct participation in works activities).

Merge EPA and OEPPC. The Office of Environmental Policy, Planning and Coordination (OEPPC), established in the early 2000s as a new government agency, was set up with the intention of improving environmental planning and coordination. While these intentions are admirable, in reality this entity and the existing EPA have overlapping functions and should be consolidated.

Merge UN and DC missions. The RMI United Nations mission can also be considered for consolidation into the Washington, DC embassy, with one dedicated staffer resident in DC appointed to cover UN issues and the DC Ambassador accredited to cover both the UN and the US. Such a move would reduce Ambassador and staff numbers, reduce office lease and other expenses, etc. Moreover, sale of the RMI Ambassador's residence in New Rochelle, New York would yield at least several hundred thousand dollars to the General Fund.[2]

Centralize facilities. In the longer term, there should be consideration to centralize and consolidate government facilities on Majuro, moving ministries and agencies into a single area to reduce lease and other costs.

No specific CAP phase I savings are proposed, however, it is expected that total costs could be reduced by **$150,000** within three years and by **$300,000** within five years.

[2] The medium price for homes for sale in the New Rochelle area as of July 13, 2009 was $525,000 (source: Yahoo RealEstate)

SUMMARY MATRIX OF EXPENDITURE REFORM AREAS AND OPTIONS

REFORM AREAS	MINIMUM SAVINGS ($m)	MAXIMUM SAVINGS ($m)
The Civil Service	1.7	4.9
Nitijela Member Compensation	.14	.17
Housing Allowances	.25	.27
Electricity Allowances	.5	1.52
Leased and Rental Housing	.07	.15
Utility Bills	.25	.75
Communications	.05	.1
Vehicles	.05	.1
Fuel	.07	.1
Travel and Per Diem	.1	.2
Professional Services	.03	.06
Grants and Subsidies	.6	1.8
Organization/Facilities Consolidation	.15	.3
TOTAL	**3.96**	**10.42**

Mid-point average = **$7 million**

OTHER EXPENDITURE REFORM AREAS

As already mentioned, while the above list constitutes the largest and fastest-growing expenditures under the General Fund, other expenditure areas should also be targeted for reform and rationalization. These include: Representation; Contractual Services (aside from Professional Services); Rentals (aside from Leased/Rental Housing); Printing and Reproduction; Repairs; Office/Computer Supplies; Food Stuff; Equipment and Tools (non-capitalized); Other Supplies/Materials; and Other Charges and Expenses. Altogether, these expenditures total around $2 million from the General Fund.

NEXT STEPS

While the “Summary Matrix of Expenditure Reform Areas and Options” shows a minimum savings level of $3.96 million annually and a maximum savings level of $10.42 million, the CAP Advisory Group is prepared to work collaboratively following Cabinet general endorsement of the “scope and scale” of the CAP measures and also following a full round of public education and outreach on the need for and the elements of the CAP.

Clearly the next step is for the Cabinet to endorse the CAP concept or to consider an alternative to the CAP proposal to fully address the RMI’s looming fiscal and economic imbalances. The CAP Advisory Group and our macroeconomic advisor stand ready to provide a full technical and conceptual briefing and dialogue session with Cabinet upon invitation. Through such a session—perhaps spanning over a 2 day period to allow for collaboration and consideration—it is expected that Cabinet could have all or most of its questions and concerns addressed in a closed-door, open dialogue session.

If and when Cabinet endorses moving the CAP concept toward full “action-planning” and pre-implementation phase, we would strongly recommend bringing all or most of our external development partners into a process of dialogue. If Cabinet endorsement is EXPLICIT and the general “scope and scale” of the CAP is agreed, we have tremendous potential to mobilize extensive donor support for our internally-designed program.

At a minimum we would recommend a policy and action **roundtable meeting**, perhaps in Washington, DC, with the US Government hosting, the ADB participating and the IMF and World Bank participating or observing. The Minister of Finance would play the leading role in leading that meeting to achieve the RMI’s objectives for technical assistance, grant projects and loan-financed projects to:

(a) support reform design and implementation,
(b) finance reform measures,
(c) finance infrastructure requirements with concessional loans that can also be repaid using donor (including Compact) grants to thereby reduce net external debt, and
(d) finance RIF payments and otherwise finance other measures to mitigate the short-term impacts of CAP measures, and (e) support longer-term institutional reform and efficiency improvements.

Alternatively—but still requiring Cabinet endorsement—the RMI might request a full donor “Consultative Group” Meeting (CGM) hosted by the ADB. The participation in such a meeting would be broader—including all donor partners and multi-lateral agencies—however, the focus might be less targeted to some of the RMI’s most pressing and urgent needs.

APPENDIX I: WORK IN PROGRESS AND OTHER REFORM AREAS FOR CONSIDERATION

FISCAL CONTROL AND ENFORCEMENT OF APPROPRIATIONS LAW

There are numerous examples of spending above and beyond the legally set limits in the appropriations bill.

In the FY2008 Budget Appropriations Bill, $725,620 was budgeted for the Majuro Landowner subsidy, but this was exceeded by $203,651 (totaling $929,271).

As previously discussed in this report, there needs to be a more structured way of approaching the budget process utilizing the MTBIF and performance based budgeting for all funds and not just the ones affecting Compact.

LOAN GUARANTEES

The government has guaranteed numerous loans to various entities, including non-government entities.

The long-term impacts of these guarantees need to be evaluated and determine if some of these entities are at risk of defaulting on their loans. Recently, Bank of Marshall Islands liquidated a government TCD to pay off a loan outstanding by Air Marshall Islands.[3]

Some of these loan guarantees were made to entities outside the government. The government guaranteed a $178,000 loan for the Assembly of God Church with MIDB.[4] The details of the guarantee are not known, but guaranteeing a loan for a church is outside the scope of what the government should be doing.

Not included in these guarantees are liabilities owed by State Owned Enterprises (SOE's) and Statutory Authorities. For some SOE's and authorities, in order to continue to pay on these loans, subsidies are needed from the government.

The government has committed and guaranteed loans in excess of $50 million.

If liabilities of the all the SOE's and Authorities are added, then direct and indirect RMI government commitment is substantial. The combined exposure (loans, loan guarantees and other liabilities) of the government is well over a $100 million.

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[3] Marshall Islands Journal Friday, September 25, 2009 page 14

[4] FY2008 Audit Report, page 68

IMPROVING THE CIVIL SERVICE

During the late 1990's, the PSRP concluded and the government of the time accepted that the civil service was overstaffed and there existed a serious shortage of technically qualified staff. Government organizational structures were excessively fragmented, resulting in functional duplication of ministries and statutory authorities and agencies, which suffered from both waste and paralysis of the public service management system. Inability to enforce personnel procedures was a major contributor to the high cost of the civil service.

The RMI continues to be plagued by the same issues today and recent studies confirm this. [5]

The structural deficit faced by the RMI government today is largely a result of the way the national policies are formulated and implemented (inconsistencies often have developed between goals and mission statements and the policy tools that are meant to help development, but are often in conflict both between and even within ministries). How financial resources are allocated and the way the civil service is managed compound the structural deficits.

The result of a combination of factors has created a situation where we now face persistent budgetary shortfalls and economic decline. Thus, the greater questions are: can the government continue to afford the current levels of service and more importantly, should the government be the sole provider of these services, and finally where does the private and NGO sector fit into all of this?

The CAP recommends that Cabinet endorse and initiate a systematic review of how government prioritizes and provides essential services to the public.

This will require a revisit of the Vision 2018 policy document, which was endorsed by the Nitijela in 2001 as a statement of national goals and objectives of the Marshall Islands. All of the development sectors (i.e. health, education, transportation, environment, fisheries, tourism and agriculture) need to be revised, updated and incorporate new development sectors (i.e. energy, infrastructure and others) into a new national development strategy or National Policy Matrix Framework (NPMF).

The NPMF then needs to be costed and tied to the Medium Term Budget and Investment Framework (MTBIF) and a proposed Long Term Budget and Investment Framework (LTBIF).

In order to implement the national development objectives and the budgets that support those objectives, the public personnel service and government institutions need to be

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[5] ADB TA 4458 revealed widespread inconsistencies in the personnel system at the Ministry of Education.

aligned. This will require a comprehensive review first aligning the institutions with the stated policy and second allocating the personnel needed to staff those institutions.

The CAP recommends that the Cabinet seek Technical Assistance (TA) from its development partners that should be packaged in a Consultative Group Meeting (CGM).

The TA should focus on the following areas:

a. assist the Public Service Commission conduct a government wide personnel audit and improve personnel management generally;

b. assist the Office of the President/Chief Secretary/Economic Planning, Policy and Statistics Office develop a new National Policy Matrix Framework that will be costed and tied to the MTBIF and LTBIF;

c. assist the Office of the President/Chief Secretary conduct an institutional review with the aim of reorganizing the public sector that are inline with the NPMF;

d. assist the Office of the President/Chief Secretary conduct an institutional review of existing State Owned Enterprise with the aim of rationalizing of subsidies and transfers and where appropriate, privatize;

e. assist the Office of the President/Chief Secretary conduct a feasibility study on outsourcing government public services (i.e. contracting out hospital services, government maintenance etc.)

f. assist the Ministry of Finance, Procurement and Supply Division improve procurement processes that include bulk/volume purchasing and bidding processes;

g. assist the Economic Planning, Policy and Statistics Office improve economic planning, external aid coordination and statistics capabilities;

h. finally, assist the RMI Government to generally improve governance structures and procedures that include building capacity within the Auditor General's Office (in addition to financial audits, assist in building capacity to conduct performance and program audits), the Attorney General's Office, Nitijela's Public Accounts Committee and the establishment of an independent Ombudsman Commission.

IMPROVING DONOR AID COORDINATION

Often, institutional developments within the government have responded to funding sources rather than to the priorities of the nation (i.e. donors pushing grants and or projects on the recipient nation). The RMI needs to be in a position to accept or deny grants when those grants are not inline with national priorities or those that have the potential of creating duplication or those that override existing priorities.

There is a cost to the RMI when accepting grants that are not inline with national priorities.

One of the functions of the Economic Policy, Planning and Statistics Office (EPPSO) is donor aid coordination as required under statute. All external aid activities by all ministries, authorities and agencies should be coordinated by EPPSO.

All aid sources should be aligned with the national development strategies or NPMF that are tied to the MTBIF and LTBIF. There should be an external aid component of the budget/appropriations bill.

APPENDIX II: TERMS OF REFERENCE OF CAP ADVISORY GROUP

The CAP Advisory Group will be responsible to the Minister of Finance to complete the following within the specified timeline**:**

(a) An initial progress report of *The Advisory Group* to be completed no later than May 15, 2009;

(b) A fully specified Framework of Fiscal and Economic Adjustment options to be completed in draft form no later than May 30, 2009;

(c) Completion of a Cabinet briefing, incorporating participatory measures to capture both generalized and detailed feedback from Cabinet members with respect to the appropriate size, specific elements, phasing of elements, and timing of any fiscal and economic adjustment program that Government may implement on its own or in beneficial coordination with donor partners. To take place at Cabinet's invitation following May 30, 2009;

(d) Subject to Cabinet approval to proceed, additional reports and deliverables as required; and

(e) Prior to dissolution of *The Advisory Group*, a Final report to Cabinet by June 30, 2009.

In order to provide for timely completion of its responsibilities *The Advisory Group* shall convene meetings at least on a monthly basis and as called by the Chairman when necessary to conduct the businesses of *The Advisory Group*. In order to conduct the business of *The Advisory Group,* a quorum of at least [four or five] members (excluding non-member advisors) of *The Advisory Group* must be present.

Where there are a requirement for certain individuals or organizations to make presentations or provide information before *The Advisory Group*, under such mandate, it is also proposed that the Cabinet authorize *The Advisory Group* the "power" to call for parties to appear before the Commission.