

REPUBLIC OF THE MARSHALL ISLANDS –
EUROPEAN COMMUNITY

JOINT ANNUAL REPORT
2007

1.1 EXECUTIVE SUMMARY

The RMI is composed of 29 coral atolls and low-laying islands located in the Central Pacific Ocean. The land area is 181 square kilometers spread over 1.94 million square kilometers. Neither the EU nor its member states has permanent representation in RMI; the country is served by the EC Delegation in Suva (over 5,000 km to the south). In 1986, the RMI became an independent nation and established a bilateral agreement with the USA, known as the Compact of Free Association. RMI has maintained a stable and democratic government since independence. RMI has a small population (57,405¹) living on tiny low-lying atolls and islands scattered over a large part of the central Pacific, with few accessible natural resources to sustain the population. This combination of limited accessible resources and vast distances results in high economic and development costs. The principal feature of the small RMI economy is the predominance of a semi-subsistence sector, still based primarily on copra production, alongside a limited, modern service-oriented sector which is mainly sustained by the expenditures of the government and the U.S. military base on Kwajalein. Recent statistics indicate no real growth in national income per capita since independence and little change in the structure of the economy. GDP stood at US \$ 133m in 2005 (\$2,441 per capita).

Despite having one of the highest per capita GDP among the Pacific ACP, the RMI has some of the worst social indicators. Among other things, infectious and lifestyle diseases are at close to epidemic proportions, the rate of infant and child mortality is high albeit improving slowly, teenage pregnancies are increasing, alcohol and tobacco use are high, and the rate of suicide is alarming. The national budget is highly dependent on foreign assistance to sustain even basic administrative and operational costs. Current estimates are that ODA comprises approximately 48% of the national budget.

The 10th EDF Country Strategy Paper and National Indicative Programme (NIP) for the Republic of the Marshall Islands (RMI) was signed in Tonga on 18th October 2007. The NIP provides for an indicative financial allocation of €5.3m for the “A” Envelope, and € 0.5m for the “B” envelope. The focal sector is the energy sector, to which 85% of the A envelope will be allocated.

1.2 UPDATE ON THE POLITICAL, ECONOMIC, SOCIAL and ENVIRONMENTAL SITUATION

1.2.1 Update of the political situation

In 1986, the RMI became an independent nation and established a bilateral agreement with the USA, known as the Compact of Free Association, which outlines the economic and political ties between the two countries. Additionally the Compact grants the U.S. exclusive military access to Kwajalein atoll for the U.S. Army strategic missile test range. It also provides for settlement of all claims for nuclear injury compensation following the nuclear testing programme, which the U.S. conducted from 1946 to 1958. By treaty, the national currency is the US dollar. Compact ‘Two’ was approved in 2003 and will last through to 2023.

RMI has maintained a stable and democratic government since independence, however, weak rule of law and low levels of public service productivity remain priority concerns. The

¹ 2006 estimate

Government has to overcome a lack of systems of accountability, traditions of gift-giving as a means of social cohesion, a culture of welfare from the United States (US) over the past 50 years, a political structure that has integrated traditional customary leadership with the legislature, low skill levels, and a lax business environment.

The key political development in 2007 was the General elections held in November - an election marked with controversy and recounts. Two months after polling, in January 2008, Parliament elected a new government and national leaders.

Wotje Senator Mr. Litokwa Tomeing was elected the new RMI President winning 18 votes to 15 over United Democratic Party's candidate, Kessai Note, who had served the past two terms. Tomeing is the former speaker of the Nitijela who defected from the left-leaning United Democratic Party (UDP) before the election of the conservative United People's Party (UPP).

The UPP is in a coalition with the main opposition Aelon Kein Ad (Our Islands) party and together they have ousted the UDP, which has ruled since 2000.

The new Speaker is Majuro Senator Jurelang Zedkaia and Vice Speaker is Majuro Senator Alik Alik. Senator Alik Alik was the only United Democratic Party member chosen for leadership, taking the new Vice Speaker seat with a vote of 17 to 16 over Aelon Kein Ad's Kaibuke Kabua.

Tomeing is only the fourth elected RMI Head-of-State.

President Tomeing and Speaker Zedkaia are both traditional high ranking chiefs in the Marshalls.

The election also resulted in a change in National Authorising Officer.

1.2.2 Update of the economic situation

GDP growth edged up to 2.0% in FY2007 (ended 30 September 2007). The economy is dominated by the public sector, which accounts for 45% of GDP and employment, and the 2007 expansion was driven primarily by an increase in government capital expenditures from United States (US) \$14.5 million in FY2006 to US\$21 million in FY2007. Emigration has accelerated over the past decade or so, but private transfer receipts fell from 0.5% of GDP in 1997 to 0.3% in 2006.(Asian Development Outlook)

A significant proportion of the budget remains externally funded, primarily by the United States (US). For some key sectors, reliance on US funding has even increased in recent years, especially with new funding under the amended Compact. For example, the US funded 68 percent of the recurrent Education budget in FY1999 and in FY2006 this increased to 88 percent. For Health, the US' share has increased from 42 to 53 percent over the same period.

The International Monetary Fund considers the economy to be at high risk of debt distress, with a ratio of net present value debt to GDP of 75% in 2007, and debt service as a share of exports at 32.3% in 2006. Scheduled debt service obligations are under-budgeted and repayments sometimes delayed. Furthermore, additional loans, albeit on concessional terms,

fall due for repayment over the next 5 years. One option to reduce the fiscal pressures would be to reform and downsize the public sector.

All Pacific ACP states, including RMI, continued their participation throughout 2007 in the EPA regional negotiation process through the established negotiating machinery. Progress in the Pacific negotiations was, however, slower than might have been hoped for, a reflection both of the very limited capacity of certain PACP states and of the varying levels of interest on the part of the states in a EPA (only a small number of smaller PACP perceive an interest in an agreement on goods).

1.2.3 Update of the social situation

Despite having one of the highest per capita gross domestic products (GDP) among the Pacific ACP, the RMI has some of the worst social indicators. Among other things, infectious and lifestyle diseases are at close to epidemic proportions, the rate of infant and child mortality is high albeit improving slowly, teenage pregnancies are increasing, alcohol and tobacco use are high, and the rate of suicide is alarming. A lack of employment opportunities is leading to a sense of futility and is eroding people's self-worth. In recent years poverty and hardship appear to have worsened in RMI, in both urban and rural areas. The United Nations Development Programme (UNDP) 1999 Pacific Human Development Report ranked RMI 9th (down from 4th in 1994) among the 14 Pacific developing member countries (DMCs), with a human development index (HDI) of 0.563. The RMI also ranked 9th in terms of poverty, with a human poverty index (HPI) of 19.5. In 1999 35 an estimated 20% of all households fell below the international poverty benchmark of \$1-a-day.

The poor are not uniformly distributed across the atolls and islands. ADB (2002) drawing on census data for 1999, reports that some two-thirds of the outer-island population had an income level that was below the \$1/day (purchasing power parity adjusted at 1993 prices). However, there are pockets of extreme poverty within the two major urban centres.

Declining social conditions, including environmental hazards related to poor housing and waste disposal, as well as weakening social organization in the expanding urban centers of Majuro and Kwajalein Atolls, are evident. Other pressing environmental concerns are the quality and security of supply of drinking water and accelerated rates of coastal erosion.

RMI is highly vulnerable to extreme climatic events and to sea-level rise. These can have an adverse impact on socioeconomic development, with resources diverted to support emergency response and disaster rehabilitation. Future changes in climate will likely worsen social and economic conditions and increase social and economic costs, particularly in climate-sensitive sectors such as water and sanitation, infrastructure and access to inshore marine resources.

1.2.4 Update of the environmental situation

RMI is dependent on the continued health of ecosystems and uninterrupted functioning of the biological and oceanic processes that lead to atoll formation and modification. A high priority for economic and development planning in RMI is to ensure that there is minimal impact on the natural ecosystems and oceanic processes that sustain the fragile atoll- and island-associated marine systems. This means not only sustainable harvesting of living resources and extraction of non-living resources, but also ensuring that the discharges of wastes to land, sea

and the air are at a rate, and of a form, that is well within the assimilative capacity of the environment. Regrettably in recent decades neither of these requirements has been met. Environmental quality has declined, many living terrestrial and marine resources have been depleted, and there has been unsustainable and environmentally unsound extraction of non-living resources.

The vulnerability to waves and storm surges is at the best of times precarious. The Marshallese would become among the first of many environmental refugees should climate change predictions prove accurate. This would be a devastating disruption not only for the culture and the people of the island countries, but also for the countries that would need to accommodate the refugees. For these reasons, the RMI has participated actively in negotiations for the United Nations Framework Convention on Climate Change and its protocols.

The RMI has in place a commendably comprehensive and appropriate array of policy, legal, institutional and budgetary frameworks for environmental management and sustainable development. However, despite some recent notable improvements in environmental performance, in many areas and respects practical reality falls far short of the potential the above frameworks allow and should facilitate.

The government of RMI recognizes that the provision of a cost-effective and a sustainable source of electricity to its outer islands is a key to the improvement of the standard of living of its people. Providing good public services such as clean water, power and telecommunications to these populations is also viewed as a major tool to reduce urban drift from the outer islands into Majuro and Ebeye and its impact on the countries welfare. The RMI government, in its commitment to the global effort to reduce GHG emission while ensuring sustainable development for its people believes that for the remote and scattered outer islands populations, stand alone solar systems represent the best technical and economic solution to supply electricity on the outer islands.

2.1 Overview of Past and on-going co-operation

9th EDF

Under the 9th EDF RMI was allocated a total of €3.5 million ('A' envelope) and €1.1 million ('B' envelope).

Focal sector: Renewable Energy Programme (REP5) Total 9th EDF investment in the sector is €3.0 million, which amounts to 85% of envelope 'A'. The first major supply contract (provision of individual household solar systems for Ailinglaplap atoll) was signed on 15 November 2007. Challenges remain significant: since it was deemed impossible to find companies that would bid on a supply contract that included delivery and installation on outer islands a separate contract will have to be awarded for this purpose. Equipment is expected to arrive in Q1 2008. As regards a second supply contract (solar power equipment for outer island schools) AIDCO failed to publish the tender forecast in December 2007 despite correct submission by the Delegation. This was discovered only in mid-January 2008 and will result in a significant delay in this tender; it could even lead to an impossibility of getting the contract signed prior to the d+3 deadline. A possible solution is to reduce the tender period.

Projects and programmes outside focal sectors

NSA Programme

Significant delays were experienced in formulating proposals for NSA capacity building (€500,000). These delays were due largely to the lack of in-country EC representation, no dedicated TA attached to the NAO office and difficult communication links with the Suva-based Delegation. Consequently, it was not until 2006 that a financing proposal for the NSA programme was finalised and forwarded to HQ for a financing decision. The Financing Agreement was signed in February 2007.

The Marshall Islands Council of NGOs, is contracted by the NAO to manage the Call for Proposals under the **Marshall Islands Non State Actors Capacity Building Programme** (MINSAP). Progress regarding the CfP was initially hampered due to the NAO's inability to nominate two imprest account holders. This problem has now been solved and the CfP was published 3 January 2008.

Utilisation of Envelope B

RMI has not been subject to disasters, and is not eligible for FLEX or HIPC, so the 'B' envelope has remained untouched. Along with seven other Pacific ACP countries RMI has decided to utilise its 'B' envelope funding through a multi-country disaster preparedness programme, to be implemented by SOPAC. The Financing Agreement for this project was signed in October 2007. The project will effectively commence operations in Q1 2008 and will run for a four-year period. RMI's project component (€1.1m) will be coordinated with SOPAC by the Office of the President, with input from Economic Policy Planning & Statistics Office (EPPSO). The major activity under the RMI programme will be the supply and installation of water tanks and micro-bacterial testing.

Other instruments

The 9th EDF Pacific Regional Indicative Programme funded and extended a number of existing projects to the six new Pacific ACP countries, including RMI. These consisted of:

Pacific ACP Regional Economic Integration Programme (PACREIP)

Development of Sustainable Agriculture in the Pacific (DSAP)

Pacific Regional and OCT Fisheries Programme (PROCFISH)

Plant Protection Programme (PPP)

Pacific Regional Initiatives for the Development of (basic) Education (PRIDE)

Reducing Vulnerability in PACP States – SOPAC

Development of Fisheries in the Pacific (DEVFISH)

Pacific Environmental Information Network (PEIN)

Additionally RMI has benefited from training provided through the Technical Support to RAO Project and EPA related technical assistance under a FORSEC implemented intra-ACP funded programme.

10th EDF

The total amount of funds allocated for RMI's 'A' envelope is €5.3 million of which 85% is earmarked for the further development of renewable energies. In this context the Delegation launched an identification mission in October 2007 in order to have a first round of discussions with all countries regarding initiatives that could be suitable for funding. The final report of the identification mission is expected in April 2008.

The remaining 15 percent (€0.8 million) will be to establish a Technical Co-operation Facility from which necessary local Technical Assistance, studies and essential EDF-related activities will be funded. The TCF may also be used to finance necessary measures in support of governance issues. The TCF/PIF was approved in October 2007. The AAP drafts together with all annexes have been approved by QSG. Project commencement is expected to follow quickly after 10th EDF funding becomes available.

2.2 Policy Coherence for Development (PCD)

Climate change is an important cross-cutting issue, in particular for the Pacific region and major regional initiatives are being considered in the context of the RIP. Additionally, the Global Climate Change Alliance is likely to bolster RMI's ability to effectively address mitigation and adaptation measures.

Although RMI has not yet demonstrated much enthusiasm regarding EPAs, since the country has little to trade in goods, there are some EPA discussions which could be of interest. These include the discussions on services, regional integration, investment and fisheries, much of which is vital to the sustainable expansion of the tourism industry. RMI can request technical assistance from the Forum Secretariat or under the various EDF ACP facilities.

2.3 EU Strategy for the Pacific

During the discussion in the programming process for the 10th EDF, key strategic directions contained in the EU Pacific Strategy have been taken into account while agreeing on the development response strategy for the European Community support. In this framework, the EU Strategy's focus on the sustainable management of natural resources in the Pacific provides a clear, result-oriented opportunity for the RMI-EU development cooperation under the 10th EDF renewable energy focal sector.

2.4 Donor coordination and harmonization

None of the EC member states have resident missions or programmes of any great size in RMI. Therefore, the issue of harmonisation and common programming is not as significant or as pressing as is experienced in other countries. The biggest single donor continues to be the U.S, which provides resources through the Compact II agreement, and also through Federal grants. As with FSM and Palau the EU maintains cordial relations with other donors, both resident and 'off-island', in particular with the Asian Development Bank and the U.S. Taiwan/ROC has provided USD3 million to the outer island renewable energy programme with implementation undertaken by the Marshall Islands Electricity Authority (MEC). EC coordination with Taiwan/ROC needs to be strengthened in 2008.

As stated, the US is by far the largest contributor to the national budget providing on average EUR 87.3 million or 82% of total annual ODA. These funds are made up of Compact II disbursements and various Federal Grants. The majority of these funds are directed at

supporting Health and Education but in recent years a significant amount has been used to upgrade the airport on Majuro. Next comes the ROC (Taiwan) which provides EUR 11.3 million or 11% of total ODA, EUR 3.5 million goes into direct budget support with the remainder financing a range of national programmes. Japan currently provides around EUR 4.5 million p.a (4% of total ODA) for water and sanitation projects. Total EU support (bilateral) amounts to around EUR 1.2 million per annum or 1% of total ODA. Other international donors include Australia, ADB, and the UN.

3 Dialogue in country with the NAO and NSAs

RMI-EC dialogue remains cordial despite communication difficulties due to the vast distance between Majuro and Suva. A change in the deputy NAO position in the middle of 2007 followed by a change in NAO post-election had the effect of slowing down progress to some extent but communication has improved since.

In general terms the present government has shown a welcome readiness to encourage funding for Non-Governmental organizations, probably as a result of increased NSA calls for improvements in delivery of education and health services.

Good NSA contacts, if distant, have been established by the Delegation with the Marshall Islands Council of NGOs, an umbrella NGO established in October 2003, and this organization is well aware of the EC-RMI programme.

4 CONCLUSIONS

ADB reports that poverty and hardship have increased, and 20% of the population now lives on less than \$1 per day. Unemployment and social stress have contributed to increases in violent crime, youth suicides, and substance abuse. If these circumstances continue, many Marshallese might opt to leave the country to seek better opportunities elsewhere. The opportunity to migrate to the US provides a valuable safety net for the Marshallese.

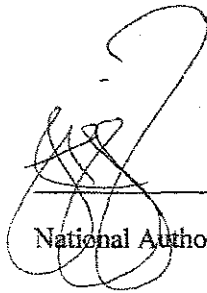
Compact payments to RMI have led to substantial increases in Government expenditures. The higher spending has gone into infrastructure investments, as well as increases in public sector employment, wages, and salaries. The 2005 International Monetary Fund (IMF) Article IV mission was critical of the increased public spending, and again called for urgent fiscal reform and structural adjustment. Recently, higher fuel and electricity costs have undermined the Government's fiscal position, with debts accruing to MEC. The Government has guaranteed these debts to help MEC cope with increasing energy costs and to keep electricity tariffs affordable.

Results in the focal sector will only be apparent after the supply and installation of PV equipment in Q1 2008.

The signing of the Financing Agreement for the Disaster Risk Reduction Programme has resulted in 100% total commitment of RMI's 9th EDF programme.

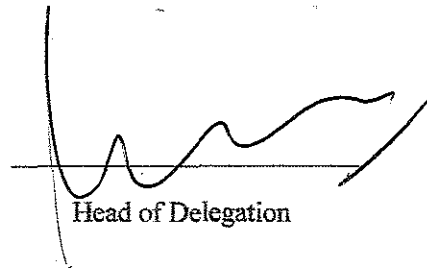
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SIGNED



National Authorising Officer

Date: 12/01/08



Head of Delegation

Date: 12/02/08

ANNEXES

A) General annexes

Annex 1 :

KEY SOCIAL DEVELOPMENT INDICATORS

Type	Indicator	2000	2001	2002	2003	2004	2005	2006	2007
Impact	1. Proportion of population below \$1 per day ²	20 (1999)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	2. Prevalence of underweight children (under-five years of age)	27	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	3. Under-five mortality rate	68	n/a	n/a	n/a	59	58	n/a	n/a
Outcome	4. Net enrolment ratio in primary education	n/a	87.5	89.6	89.6	n/a	n/a	n/a	n/a
	5. Primary Completion Rate	n/a	n/a	125.1	125.0	n/a	n/a	n/a	n/a
	6. Ratio of girls to boys in: - primary education - secondary education - tertiary education	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	7. Proportion of births attended by skilled health personnel	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	8. Proportion of 1 year old children immunised against measles	94	89	80	90	70	86	n/a	n/a
	9. HIV prevalence among 15-24 year old pregnant women	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	10. Proportion of population with sustainable access to an improved water source	n/a	n/a	n/a	n/a	87	n/a	n/a	n/a

Source: UN Millennium Development Goals Statistical Website/ <http://mdgs.un.org/unsd/mdg/Data.aspx?cr=583>

² An equivalent indicator based on national poverty lines can replace indicator 1, as appropriate.

Key Economic Development Indicators

	2000	2001	2002	2003	2004	2005	2006	2007	
Basic data									
1	Population (in 1000)	51,730	52,635	53,556	54,493	55,447	56,417	57,405	58,403
	- annual change in %	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
2a	Nominal GDP (in millions €)	107	110	121	126	133	137		
2b	Nominal GDP per capita (in €)	2084	2101	2260	2324	2406	2441		
2c	- annual change in %	1.7	0.8	7.5	2.9	3.5	1.5		
3	Real GDP (annual change in %)	5.6	2.6	4.5	4.2	4.7	1.4		
4	Gross fixed capital formation (in % of GDP)								
International transactions									
5	Exports of goods and services (in % of GDP)	6.8	7.9	8.6	9.2	11.1	11.6	11.4	
	- of which the most important: ... (in % of GDP)								
6	Trade balance (in % of GDP)	-58.5	-67.1	-59.6	-47.7	-49.4	-42.4	-48	
7	Current account balance (in % of GDP)	10	14.6	14.4	20.5	12	6.2		
8	Net inflows of foreign direct investment (in % of GDP)	0.1	0.1	0.1	-1.5	0.1	1.5		
9	External debt (in % of GDP)								
10	Service of external debt (in % of exports of goods and non-factor services)								
11	Foreign exchange reserves (in months of imports of goods and non-factor services)								
Government									
12	Revenues (in % of GDP)	65.2	68.4	62.7	63.7	55.1	57		
	- of which: grants (in % of GDP)	43.7	48.6	41.1	41.8	30.9	32.4		
13	Expenditure (in % of GDP)	57.2	60.3	71.2	65.3	56.4	59.7		
	- of which: capital expenditure (in % of GDP)	10.7	16.2	13.4	10.5	8.1	8.5		
14a	Deficit (in % of GDP) including grants								
14b	Deficit (in % of GDP) excluding grants								
15	Debt (in % of GDP)								
	- of which: external (in % of total public debt)								
Other									
16	Consumer price inflation (annual average change in %)	0.9	1.9	-0.4	-0.9	2.0	3.5		
17	Interest rate (for money, annual rate in %)								
18	Exchange rate (annual average of national currency per 1 €)	As per USD							
19	Unemployment (in % of labour force, ILO definition)								
20	Employment in agriculture (in % of total employment)								

B) Annexes with a retrospective character :

Annex 2: 9th EDF Financial situation

		TOTAL ALLOCATION (in Million EURO)	COMMITTED	UNCOMMITTED	RATE OF COMMITMENT %
9th	Envelope 'A'	3.5	3.5	0.0	100
EDF	Envelope 'B'	1.1	1.1	0.0	100
10th	Envelope 'A'	5.3	0	5.3	0
EDF	Envelope 'B'	0.5	0	0.5	0

C) Annexes with a prospective character:

Annex 3a: 10th EDF global commitments

	Indicative allocation	2008		2009		2010→	
		1	2	1	2	1	2
1st FOCAL SECTOR – WATER AND ENERGY (RENEWABLE ENERGY)	M €4.5						
- Project 1 : MULTI-COUNTRY PROGRAMME	M €4.5			4.5			
	M €						
2nd FOCAL SECTOR – NONE	M €						
- Project 1	M €						
- Project 2	M €						
NON FOCAL SECTORS	M €						
- Institutional support for non state actors.	M €						
- Technical cooperation facility	M €0.8		0.5				
- Contribution to regional programmes	M €						
-<optional> Support for EPA	M €						
-<optional> Support for Governance	M €						
-Other	M €						
Total Commitments:	M €						
Total Cumulative Commitments :	M €		0.5	5.0			

Annex 3b: Indicative timetable of disbursements

	Indicative allocation	2008		2009		2010→	
		1	2	1	2	1	2
1ST FOCAL SECTOR – WATER AND ENERGY (REWABLE ENERGY)	M€4.5						
- Project 1 : MULTI-COUNTRY PROGRAMMING	M€4.5			0.15		4.0	0.35
- Project 2 : NONE	M€						
2nd FOCAL SECTOR – <name>	M€						
- Project 1	M€						
- Project 2	M€						
NON FOCAL SECTORS	M€						
- Institutional support for non state actors.	M€						
- Technical cooperation facility	M€0.8		0.1		0.2		0.2
- Contribution to regional programmes	M€						
-<optional> Support for EPA	M€						
-<optional> Support for Governance	M€						
-Other	M€						
Total Commitments :	M€		0.1	0.15	0.2	4.0	0.55
Total Cumulative Commitments :	M€		0.1	0.25	0.45	4.45	5.0