



Report and Recommendation of the President to the Board of Directors

Project Number: 50295-002
Grant Number: 0547-RMI
August 2019

Proposed Grant for Additional Financing Republic of the Marshall Islands: Public Financial Management Project

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Asian Development Bank

CURRENCY EQUIVALENTS

The currency of the Marshall Islands is the United States dollar.

ABBREVIATIONS

ADB	–	Asian Development Bank
COA	–	chart of accounts
CSO	–	community service obligation
DMF	–	design and monitoring framework
FMIS	–	financial management information system
GDP	–	gross domestic product
IMF	–	International Monetary Fund
MOF	–	Ministry of Finance
PAM	–	project administration manual
PFM	–	public financial management
RCU	–	reform coordination unit
SOE	–	state-owned enterprise

NOTES

- (i) The fiscal year (FY) of the Government of the Marshall Islands and its agencies ends on 30 September. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2019 ends on 30 September 2019.
- (ii) In this report, “\$” refers to United States dollars.

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PROJECT AT A GLANCE

1. Basic Data		Project Number: 50295-002	
Project Name	Public Financial Management Project (additional financing)	Department /Division	PARD/PASP
Country Borrower	Marshall Islands, Republic of Republic of the Marshall Islands	Executing Agency	Ministry of Finance
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=50295-002-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=50295-002-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Public expenditure and fiscal management		0.45
	Reforms of state owned enterprises		0.05
		Total	0.50
3. Operational Priorities		Climate Change Information	
✓ Accelerating progress in gender equality		Climate Change impact on the Project	Low
✓ Strengthening governance and institutional capacity			
Sustainable Development Goals		Gender Equity and Mainstreaming	
SDG 16.6		Some gender elements (SGE)	✓
		Poverty Targeting	
4. Risk Categorization: Low			
5. Safeguard Categorization		Environment: C Involuntary Resettlement: C Indigenous Peoples: C	
6. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.50	
Sovereign Project grant: Asian Development Fund		0.50	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		0.50	
Currency of ADB Financing: US Dollar			

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed grant to the Republic of the Marshall Islands for the additional financing of the Public Financial Management Project.¹

2. The Asian Development Bank (ADB) is supporting the Government of the Marshall Islands through a project grant to strengthen public financial management (PFM).² The additional financing will scale up and extend the benefits of the current project by further helping the Ministry of Finance (MOF) to prioritize and implement reforms to strengthen PFM in line with the scope of the current project. The proposed additional financing is consistent with ADB's Pacific Approach 2016–2020, which serves as the overall ADB country partnership strategy for the Marshall Islands.³ It is aligned with ADB's Strategy 2030 priority of strengthening governance and institutional capacity, particularly in small island developing countries.⁴

II. THE PROJECT

A. Rationale

3. **Development challenges.** The rationale of the current project remains valid. The Marshall Islands faces significant challenges stemming from its geographical remoteness and dispersion. Exposure to external shocks and heavy reliance on development assistance compound fragility.⁵ Economic provisions under the Compact of Free Association with the United States are scheduled to expire in 2023, and long-term fiscal sustainability amid substantially lower grant assistance inflows will be a major challenge. Weak PFM and inefficient state-owned enterprises (SOEs) are critical constraints to strengthening the fiscal position.

4. A 2012 public expenditure and financial accountability assessment (latest available) highlighted significant weaknesses in the PFM framework.⁶ Weaknesses in internal controls, cashflow planning, and commitment controls lead to pressure on spending beyond budgetary allocations. The tax revenue as a share of gross domestic product (GDP) (16.8% in FY2013–FY2017) is below the median of other Pacific small islands (17.4%), indicating room for improving tax policy and administration. The latest International Monetary Fund (IMF) assessment shows that the Marshall Islands remains at a high risk of debt distress, with the ratio of public sector debt to GDP projected to exceed 50% by 2023 and build up sharply thereafter.⁷ The performance of the SOE sector is weak in comparison with other Pacific economies. In 2014, the SOE sector owned 17%–20% of the total capital stock in the economy but contributed only 5.3% to GDP.⁸

¹ Asian Development Bank (ADB). 2017. *Report and Recommendation of the President to the Board of Directors: Proposed Grant to the Republic of the Marshall Islands for the Public Financial Management Project*. Manila.

² The current project was prepared under ADB. 2013. *Technical Assistance for Strengthening Public Sector Management in the North Pacific*. Manila (TA 8581-REG).

³ ADB. 2016. *Pacific Approach, 2016–2020*. Manila. The Pacific Approach supports PFM improvements to achieve resilience to external shocks.

⁴ ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

⁵ Sector Assessment (Summary): Public Sector Management (accessible from the list of linked documents in Appendix 2).

⁶ Government of the Marshall Islands. 2012. *Public Financial Management Performance Report and Performance Indicators (Final Report)*. Majuro.

⁷ IMF. 2018. Republic of the Marshall Islands: 2018 Article IV Consultation—Press Release; Staff Report; and Statement by the Executive Director for Republic of the Marshall Islands. *IMF Country Report*, No. 18/270. Washington, DC.

⁸ ADB. 2016. *Finding Balance 2016: Benchmarking the Performance of State-Owned Enterprises in Island Countries*. Manila.

5. The Marshall Islands lacks the institutional capacity to implement PFM and SOE reforms effectively. The MOF experiences high turnover and loss of senior staff, and junior staff are often underqualified or lack experience to perform their functions adequately. Expertise in SOE monitoring and reforms needs to be built further within the MOF. While several development partners (including the World Bank, the Pacific Financial Technical Assistance Centre, and the Graduate School USA) are assisting PFM reforms, the MOF requires long-term support on the ground to coordinate this assistance.⁹

6. **Current project.** An Asian Development Fund grant of \$2 million for the current project was approved on 15 October 2017 and became effective on 19 October 2017. The project closing date is 31 December 2020. The current project provides technical support through a reform coordination unit (RCU) comprising long-term consultants based in Majuro to build the MOF's capacity to implement PFM and SOE reforms. It is considered to be performing well.¹⁰

7. The RCU envisaged under the current project is established and fully staffed. It acts as the implementing agency reporting to the MOF, under the oversight of the PFM Reform Steering Committee chaired by the chief secretary. The RCU comprises four international consultants: (i) an advisor, (ii) two financial management specialists (accounting), and (iii) an SOE monitoring and community service obligation (CSO) expert. The CSO expert has combined the responsibilities originally outlined for two international consultants because of difficulty finding suitable qualified candidates willing to be based in Majuro for extended periods. Additionally, the RCU includes two national consultants: (i) a budget specialist and (ii) a human resources specialist. The RCU is now a recognized and fully functional unit based in Majuro and reporting to the MOF, providing advice and technical assistance to the government.

8. The RCU provides timely biannual reports on project activities and performance, as expected under the implementation arrangements. Implementation results against output indicators in the design and monitoring framework (DMF) of the current project suggest that it is on track to meet its expected outcomes.

- (i) The RCU has updated the PFM Reform Roadmap 2014–2016,¹¹ and has contributed to various aspects of 10 (of 30) broader reform components in the updated Roadmap (against a target of six in the DMF): (a) a strengthened PFM legal and policy framework, (b) improved cash management, (c) improved local government financial management, (d) enhanced PFM reform communications and training, (e) better management of Government of the Republic of the Marshall Islands embassy imprest accounts, (f) an improved budgeting framework, (g) the introduction of a performance-based management framework, (h) regular annual reporting by line ministries, (i) better payroll management, and (j) improved SOE oversight (footnote 10).
- (ii) The RCU has prepared a training plan, and conducted 12 trainings and workshops in 2018 against a DMF target of at least three a year. Of the 281 attendees, 126 (or 45%) were female, which exceeds the DMF target of 35%. Training has been provided for grant monitoring procedures, new planning and budgeting templates linking planning and budgeting, SOE monitoring, calculating and costing of CSOs, the role of SOE boards, SOE business planning and statements of corporate intent, and human resources planning for the MOF, among others.
- (iii) As of May 2019, the share of MOF male staff with an accounting, computing, or business administration degree and/or diploma has reached 43.1% (22 out of 51)

⁹ Development Coordination (accessible from the list of linked documents in Appendix 2).

¹⁰ Summary of Project Performance (accessible from the list of linked documents in Appendix 2).

¹¹ Government of the Marshall Islands. 2014. *Public Financial Management Reform Roadmap 2014–2016*. Majuro.

- against a fiscal year (FY) 2017 baseline of 38.2%, while the share for female staff has reached 58.8% (or 20 out of 34) against an FY2017 baseline of 45.1%.
- (iv) In line with the DMF targets, two women have been appointed to management positions: the assistant secretary of tax and revenues and the assistant secretary of the Division of International Development Assistance.
 - (v) An SOE monitoring unit was established in May 2018, with two staff in place. The staff are working with the RCU to gain expertise. In March 2019, the position of assistant secretary was created to oversee the monitoring unit (among others), and the position was filled in June 2019.
 - (vi) A CSO process and framework has been approved, and work to identify and assess the legitimacy and cost for four SOEs is ongoing for completion by December 2019.

9. Cumulative contract awards totaled \$1.715 million (85.8% of ADB financing) as of 30 June 2019 and cumulative disbursements totaled \$0.843 million (42.1% of ADB financing). The current project is classified *category C* for environment, indigenous peoples, and involuntary resettlement because it includes only advisory inputs. Each safeguard covenant item is being complied with. The risks identified in the report and recommendation of the President of the current project have been managed well. Major risks do not threaten successful project implementation. The risk of recruitment delays was managed because the MOF delegated the recruitment process for international consultants to ADB, while making the final hiring decisions and engaging the consultants. Advance contracting was used to speed up the process. As a result, the RCU international consultants were mobilized within 3 months of project approval. The MOF subsequently recruited two national consultants, with assistance from the RCU international consultants. The project is rated *on track*. The FY2018 audited annual financial statements have been received with an unqualified opinion from the independent auditor, and publicly disclosed.

10. **Proposed additional financing.** The additional financing will build on the work undertaken through the current project and allow further PFM and SOE reforms to be implemented. Given its successful performance, the government has requested additional financing to scale up and consolidate activities under the current project, while maintaining its overall scope of improving the MOF's institutional capacity to implement the PFM Reform Roadmap and SOE reforms.¹² All activities and outputs proposed under the project will contribute to the effective implementation of PFM and SOE reforms (paras. 16–18), as outlined in the updated PFM Reform Roadmap (para. 8).

11. Additional financing for the project complies with ADB eligibility criteria. The project remains technically feasible and economically viable (paras. 26–28). Proposed activities and outputs are aligned with the project's development objectives of strengthening overall PFM. The government accords the planned reforms high priority.

12. Additional financing is considered a suitable modality since the proposed activities are strongly linked to the design of the current project, and contribute to the same outputs and outcomes regarding improved PFM. Implementation arrangements remain unchanged, with additional individual consultants expected to be recruited as part of the RCU, under the oversight of the MOF.

¹² The proposed additional financing is in the Memorandum of Understanding between ADB and the government for the 2019 country programming mission, and is signed by ADB and the government. ADB's vice-president (operations 2) approved the back-to-office report of the country programming mission on 27 May 2019. The additional financing will be included in the country operations business plan for the 11 small Pacific island countries, expected to be circulated to the ADB Board of Directors in August 2019.

13. The additional financing incorporates lessons learned from the current project. ADB engagement has demonstrated the importance of providing on-the-ground support for development partner coordination and capacity enhancement. The additional financing is designed to provide further locally based support through qualified consultants, and also allows flexibility in reform implementation. Delegating the consultant recruitment process to ADB allowed international consultants to be mobilized quickly (para. 9). Similar processes will be followed for consultant recruitment under the additional financing.

B. Impact and Outcome

14. The additional financing project is aligned with the following impact: more effective governance achieved.¹³ The project will have the following outcome: PFM improved.¹⁴ The impact and outcome of the additional financing project, as well as those of the overall project, remain the same as for the current project.¹⁵ The outcome indicators are also unchanged.

C. Outputs

15. The outputs of the additional financing will remain the same as the current project: (i) the MOF's institutional capacity to implement the PFM Reform Roadmap strengthened and (ii) the MOF's institutional capacity to implement SOE reforms strengthened. Additional activities will be undertaken under the two outputs to scale up project benefits, as outlined below (paras. 16–18).

16. **Output 1: The MOF's institutional capacity to implement the PFM Reform Roadmap strengthened.** To achieve the first output, the RCU will focus on three reform components in the revised Roadmap (footnote 11) under the additional financing.

- (i) **Improved tax administration.** The current tax system has several loopholes, as evident from tax arrears that have accumulated over time but cannot be accurately estimated. A tax reform commission was formed in 2008 and prepared a report on reform requirements in 2010.¹⁶ The RCU will review and update the report for phased implementation. In addition to assisting with a focus on tax arrears, the RCU will work with the MOF to explore the introduction of value-added taxes to bring in new tax revenue. This is expected to lead to tax reform legislation, which can help improve tax revenue collection.
- (ii) **Strengthened accounting systems.** In 2018, the Marshall Islands secured financing from the World Bank for a new financial management information system (FMIS), which has the potential to significantly improve major government processes such as budgeting, procurement, performance monitoring, and reporting.¹⁷ A critical component of the new FMIS will be a well-designed chart of accounts (COA). Although the current FMIS (4Gov) had some elements of a COA, allowing for the generation of automated reports such as basic financial statements and program-level reports, these were not pursued fully during the initial setup or as part of the maintenance process over the years. The RCU will ensure the integrity of financial data as the Marshall Islands moves from 4Gov to the new FMIS, including by mapping the old COA codes to the new COA codes and by conducting investigations to support the changeover.

¹³ Government of the Marshall Islands. 2014. *National Strategic Plan, 2015–2017*. Majuro. The plan is being updated.

¹⁴ The design and monitoring framework is in Appendix 1.

¹⁵ This reflects that the additional financing does not lead to a change in scope for the overall project.

¹⁶ Government of the Marshall Islands. 2010. *Republic of the Marshall Islands: A Holistic Approach to Reforming the Tax and Revenue System*. Majuro.

¹⁷ International Development Association. 2018. *Marshall Islands: Project to Strengthen Budget Execution and Financial Reporting Systems*. Washington, DC.

- (iii) **Strengthened public financial management legal and policy framework.** The MOF requires technical expertise to support the planning and management of reform measures, with a focus on fiscal planning. With assistance from the Graduate School USA, the Marshall Islands is preparing a long-term fiscal strategy for sustainable economic development. In coordination with this strategy, the Marshall Islands needs assistance to draft legislation for a fiscal responsibility act. The current legislation is outdated and does not consider the present economic conditions. Under the supervision of the MOF, the RCU will prepare an updated fiscal responsibility bill to improve fiscal transparency. The proposed legislation will include a focus on the fiscal management of disaster risk, as well as the assignment of fiscal responsibility for contingent liabilities borne by the government.¹⁸

17. Human resources capacity is another cross-cutting enabler of Roadmap implementation. The RCU has moved forward with PFM-related organizational reforms, and has undertaken a review of MOF positions and related job descriptions. The MOF needs to build capacity to complete timely and results-oriented performance reviews, linking personnel performance to organizational performance. It also seeks to move toward a performance-based management framework, which is one of the Roadmap reform areas. The RCU will improve the performance management process, including through the introduction of standardized performance criteria and performance evaluation tools for MOF employees, and capacity building of the MOF human resources staff to conduct performance reviews.

18. **Output 2: The MOF's institutional capacity to implement SOE reforms strengthened.** Under the second output, the RCU will help empower women to serve on SOE boards. While women are well represented in government, with the first female president of the Marshall Islands in office since 2016 and several female heads of ministries, only 12 out of 57 SOE board directors are women. The government seeks to introduce a more balanced gender representation at board level (subject to qualifications), and women's representatives have asked for boardroom training so that they are better placed to compete, as the implementation of the SOE Act, 2015, calls for skills-based selection of directors.¹⁹ The RCU will provide additional training, using customized tools to focus on SOE governance skills for women. This will be undertaken in coordination with gender champions in the Office of the Chief Secretary and the Ministry of Culture and Internal Affairs (Gender Development Division).

19. **Performance indicators.** Although the outputs remain unchanged under the additional financing, performance indicators have been added to reflect the new reforms (footnote 14). These new performance indicators relate to tax reform legislation and fiscal responsibility legislation expected to be approved by the PFM Reform Steering Committee, and to female representation on SOE boards.

D. Investment and Financing Plans

20. The project is estimated to cost \$0.55 million (Table 1).²⁰ The major expenditure item is consulting services. Detailed cost estimates by expenditure category and by financier are included in the updated project administration manual (PAM).²¹

¹⁸ This activity will have synergies with the disaster resilience program presently under preparation for presentation to the ADB Board of Directors in 2019.

¹⁹ Government of the Marshall Islands. 2015. *State-Owned Enterprises Act, 2015*. Title 52 – Associations Law. Majuro.

²⁰ The amount refers to the additional financing.

²¹ Project Administration Manual (accessible from the list of linked documents in Appendix 2).

Table 1: Project Investment Plan

Item		Current Amount ^a	Additional Financing ^b	Total
A.	Base Cost^c			
	1. Roadmap implementation	1,784,356	502,646	2,287,002
	2. State-owned enterprise reforms	405,200	26,323	431,523
	Subtotal (A)	2,189,556	528,969	2,718,525
B.	Contingencies^d	110,444	21,031	131,475
	Total (A+B)	2,300,000	550,000	2,850,000

^a Includes taxes and duties of \$108,000 to be financed from government resources as part of its contribution through exemptions.

^b Includes taxes and duties of \$30,000 to be financed from government resources as part of its contribution through exemptions.

^c In mid-2019 prices. The currency of the Marshall Islands is the United States dollar.

^d Physical contingencies are estimated at 3.0% for consulting services. Price contingencies computed at 1.5%–1.6% on foreign exchange costs and 0.5%–1.1% on local currency costs; includes provision for potential exchange rate fluctuation under the assumption of purchasing power parity exchange rate.

Source: Asian Development Bank estimates.

21. The government has requested a grant not exceeding \$0.5 million from ADB's Special Funds resources (Asian Development Fund) to help finance the project. The government will provide counterpart support in the form of staff time, office space and supplies, taxes and duties, secretarial assistance, and other in-kind contributions estimated at \$50,000 (Table 2). No cofinancing is envisaged.

Table 2: Financing Plan

Source	Current ^a		Additional Financing		Total	
	Amount (\$)	Share of Total (%)	Amount (\$)	Share of Total (%)	Amount (\$)	Share of Total (%)
Asian Development Bank Special Funds resources (ADF grant)	2,000,000	87.0	500,000	91.0	2,500,000	87.7
Government (in-kind contributions)	300,000	13.0	50,000	9.0	350,000	12.3
Total	2,300,000	100.0	550,000	100.0	2,850,000	100.0

ADF = Asian Development Fund.

^a Refers to the original amount.

Source: Asian Development Bank estimates.

E. Implementation Arrangements

22. Project implementation arrangements established for the current project will be used to implement the additional financing, and the PAM has been updated (footnote 21). The MOF will continue to be the executing agency, and the RCU will be the implementing agency. The PFM Reform Steering Committee will provide strategic oversight and guidance. The consultant recruitment process will be delegated to ADB, but consultants will be engaged by and report to the MOF.

23. The additional financing is expected to mobilize five new short-term intermittent individual international consultants for Roadmap implementation, who will be part of the RCU during their work. The new consultants will include (i) a tax expert (technical) to prepare a tax administration reform plan (120 days); (ii) a tax expert (legal) to work on the tax administration reform plan and prepare the requisite legislation (75 days); (iii) an accountant to work on the integrity of the financial data for the change in the FMIS (90 days); (iv) a fiscal expert to draft the fiscal responsibility legislation (60 days); and (v) a human resources expert to work on the performance evaluation system in the MOF (40 days). In the selection of consultants, preference will be given

to qualified women. In addition, 70 days will be added to the contract of the RCU advisor to enable the advisor to contribute across the full work stream, and coordinate activities.

24. Existing RCU staff will undertake the SOE reform implementation activities under the additional financing. The contract of the SOE reform expert has already been extended, using funds under the current project, to continue the work stream. Supported by the RCU advisor and the RCU human resources specialist, in consultation with gender champions in the government (para. 18), the SOE reform expert will develop special training sessions targeting women for SOE boards.

25. The implementation arrangements are summarized in Table 3 and described in detail in the PAM (footnote 21).²²

Table 3: Implementation Arrangements

Aspects	Arrangements		
Implementation period	October 2019–December 2020		
Estimated completion date	31 December 2020		
Estimated grant closing date	30 June 2021		
Management			
(i) Oversight body	Public Financial Management Reform Steering Committee Chief secretary (chair) Secretary for Finance, auditor general, attorney general, chair of the Public Service Commission (members)		
(ii) Executing agency	Ministry of Finance		
(iii) Implementing agency	Reform coordination unit		
(iv) Implementation unit	Reform coordination unit, five long-term staff (i) advisor, (ii) public finance specialist, (iii) two financial management specialists, and (iv) human resources specialist.		
Consulting services	Individual consultant selection	385 person-days	\$476,600
Advance contracting	Advance contracting for consultants		
Disbursement	The grant proceeds will be disbursed in accordance with the Asian Development Bank's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed upon between the government and the Asian Development Bank		

Source: Asian Development Bank.

III. DUE DILIGENCE

A. Economic and Financial

26. The economic analysis for the overall project was revised to incorporate the additional project costs, using the same methodology as under the current project.²³ Direct benefits under the current project will come from the effective use of fiscal space created through a reduction in SOE subsidies—as CSOs will be identified and their costs determined, and financing for SOE inefficiencies reduced. The benefit–cost ratio of the current project was estimated at 2.2:1.0. Benefits from the additional financing will come from the effective use of fiscal space resulting from improved tax administration, which will reduce leakages. Under conservative reform scenarios, the Marshall Islands' tax–GDP ratio is assumed to rise gradually to generate additional revenues equivalent to 0.1% of GDP by the end of FY2024. The benefits of the additional financing are estimated to total \$1.5 million, of which \$1.0 million is from the effective use of increased fiscal space from higher tax revenues and \$0.5 million is from multiplier effects. Against a cost of \$550,000, a benefit–cost ratio of 2.8:1.0 is estimated for the additional financing project.

²² The implementation arrangements refer to the additional financing.

²³ Economic and Financial Analysis (accessible from the list of linked documents in Appendix 2).

27. Therefore, the overall project (including the additional financing) is expected to generate substantial economic benefits, with a benefit–cost ratio of 2.3:1.0. The resulting increased fiscal space can be channeled to more productive uses (e.g., additional resources for essential government services such as health and education, which should contribute to steady gains in labor productivity). More public resources can also be channeled to ensuring sufficient funding of annual operation and maintenance of infrastructure assets, to preserve and prolong their productivity-enhancing benefits. This analysis excludes other efficiency gains in government expenditure through PFM improvements that are more difficult to quantify.

28. Thus, the project is considered economically beneficial, particularly given potentially large second-round effects on broader economic growth and social welfare from improvements in the quality and efficiency of public expenditure. Integrated benefits and impacts are expected to outweigh the costs. Ensuring that reforms are sustainable may require further development partner assistance after project closure, given the low capacity in the MOF.

B. Governance

29. **Financial management.** A project financial management assessment was prepared for the MOF before the approval of the current project, which indicated that the overall pre-mitigation financial management risk is *substantial*. With the RCU already established, qualified staff are working closely with the MOF to implement PFM reforms and provide institutional support to the MOF, helping to address some of the risks. This is indicated in the updated financial management assessment in the PAM (footnote 21).

30. Under the additional financing, ADB will continue to pay international consultants using direct payment procedures established under the current project. The RCU will prepare invoices and withdrawal applications for MOF review before ADB endorsement. An advance account will be set up for the additional financing project, to be administered by the MOF with RCU assistance. The advance account ceiling will not exceed \$100,000 and it will be used for small payments (e.g., training materials, workshops, project operational expenses, and remuneration of national consultants).

31. The MOF will cause detailed consolidated project financial statements to be audited by an independent auditor acceptable to ADB, and in accordance with international standards on auditing and the government’s audit regulations. The MOF will submit the audited project financial statements, together with the auditor’s opinion, to ADB within 6 months of the end of the fiscal year. The audited project financial statements for FY2018 have been submitted with an unqualified opinion (and a minor delay of 3 days as one of the key signatories was not in Majuro just before the submission).

32. **Procurement.** A procurement capacity assessment of the MOF, undertaken before the current project was approved, found *substantial* overall pre-mitigation procurement risk. Issues that could affect project procurement include (i) weak external aid coordination, (ii) the MOF’s inadequate experience with the international procurement of consultants, (iii) the absence of reliable data on procurement contracts, (iv) insufficient capacity of staff to carry out procurement, and (v) inadequate documentation and monitoring on procurement.

33. With the RCU established, qualified staff are working closely with the MOF to provide institutional support, helping to mitigate risks. The government will continue to delegate consultant recruitment to ADB for the additional financing project, as this has worked very successfully for the current project (para. 9). Only individual consultants will be procured under the project, and

contracts are not complex or high value. All procurement will follow ADB's Procurement Guidelines (2015, as amended from time to time) and Guidelines on the Use of Consultants (2013, as amended from time to time).²⁴

34. **Anticorruption.** ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the MOF. The specific policy requirements and supplementary measures are described in the PAM (footnote 19). ADB will conduct integrity due diligence for consultants. Anticorruption issues will continue to be built into the training sessions provided by the RCU, as appropriate.

C. Poverty and Social

35. The overall project (including additional financing) will contribute to poverty reduction through (i) better PFM systems, which will align budget allocations with sectoral priorities, reduce fiscal deficits, and improve government capacity to deal with external shocks (including natural disasters); (ii) increased efficiency of SOEs, which will reduce the fiscal burden of transfers and free up resources for priority development expenditures; and (iii) more transparent identification and funding of CSOs, which will help the government minimize the costs of inefficiencies, adjust subsidies, and contract out CSOs. Additional financing will enable the government to meet the poverty-related objectives in the National Strategic Plan, and improve the quality of education and health care, which currently absorb half the budget. Greater resilience to shocks will benefit the poor.²⁵

36. The current project is classified *some gender elements*, as it promotes women's empowerment through targets for women's participation in project training activities and MOF management positions. Good progress has been made against DMF targets (para. 8). The MOF remains committed to raising the proportion of women in management, subject to qualifications. Of the six RCU consultants presently in position, four are women, including both national consultants.

37. The additional financing project is also classified *some gender elements*. In recruiting new RCU consultants, the project will encourage the selection of qualified women. The additional financing project includes activities and targets to raise the share of women on SOE boards above the current baseline of 21.5% (para. 18). Biannual progress reports prepared by the RCU presently include sex-disaggregated data and reporting on gender actions, and this practice will continue.

D. Safeguards

38. In compliance with ADB's Safeguard Policy Statement (2009), the additional financing project is *category C* for environment, indigenous peoples, and involuntary resettlement because the project incorporates only advisory inputs.²⁶ No civil works are planned, and there is no potential for involuntary land acquisition resulting in physical and economic displacement. The dominant population of the Marshall Islands is indigenous to the islands, and project activities are designed for the entire economy, with no differentiation in benefits accruing to any group. In the absence of any civil works, there will be no environmental impacts.

²⁴ The ADB norm is to apply the same procurement policy for the current project and any additional financing.

²⁵ The National Strategic Plan themes include empowering people and communities to reduce the incidence of "access related" poverty through social, economic environment, governance, and infrastructure improvements; and the provision of necessary services to outer island residents to enable all Marshall Islands citizens to enjoy a high quality of life.

²⁶ ADB. Safeguard Categories. <https://www.adb.org/site/safeguards/safeguard-categories>.

E. Risks and Mitigating Measures

39. Major risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.²⁷

Table 4: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
External shocks divert political and administrative attention and capacity away from reforms.	The project supports the government in building fiscal resilience. However, external shocks (economic and/or climatic) can disrupt reforms. ADB will respond in a timely manner and in coordination with development partners to government requests for assistance, if unforeseen events occur.
Unavailability of qualified consultants on time for the RCU undermines reform efforts.	The government has delegated consultant selection to ADB, and suitable candidates with appropriate experience will be encouraged to apply for RCU positions. RCU remuneration under the project will be set to attract good quality consultants. Advance contracting will be undertaken.
Lack of or delays in development partner TA delivery impede reforms.	Timely TA from development partners is critical to support the government in reform identification, design, and implementation. Regular TA coordination meetings will be organized through the RCU to mobilize and deploy resources.

ADB = Asian Development Bank, RCU = reform coordination unit, TA = technical assistance.

Source: Asian Development Bank.

IV. ASSURANCES

40. The government and the MOF have assured ADB that implementation of the project shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and draft grant agreement.

41. The government and the MOF have agreed with ADB on certain covenants for the project, which are set forth in the draft grant agreement.

V. RECOMMENDATION

42. I am satisfied that the proposed grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the grant not exceeding \$500,000 to the Republic of the Marshall Islands from ADB's Special Funds resources (Asian Development Fund) for the additional financing of the Public Financial Management Project, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Takehiko Nakao
President

27 August 2019

²⁷ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

REVISED DESIGN AND MONITORING FRAMEWORK

Impact the Project is Aligned with			
Current project More effective governance achieved ^a Overall project Unchanged			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Current project PFM improved Overall project Unchanged	Current project By the end of 2021: a. Country performance assessment score for quality of budgetary and financial management increased by 0.5 points (2016 baseline: 3.0) b. Number of D/D+ scores in PEFA falls by six or more ^b (2012 baseline: 21 of 35) c. Fiscal transfers to SOEs decline to 5.9% of GDP (2015 baseline: 6.4% of GDP) Overall project Unchanged	a. ADB annual report on the country performance assessment exercise b. PEFA report or equivalent assessment c. International Monetary Fund Article IV reports	External shocks (economic and/or climatic) divert political and administrative attention and capacity away from reforms.
Outputs Current project 1. MOF's institutional capacity to implement the PFM Reform Roadmap strengthened	Current project By the end of 2020: 1a. At least six Roadmap reforms implemented, as per updated Roadmap action plan (2017 baseline: Not implemented) 1b. At least three training sessions per year provided by the RCU, with women comprising at least 35% of trainees (2017 baseline: Training not provided) 1c. Shares of MOF male and female staff in position holding accounting, computers, or business administration degree and/or diploma increases (2017 baseline: 38.2% of male staff and 45.1% of female staff in position)	1a. Certification by the MOF (by cabinet orders, government decisions, as appropriate), and corroborated by development partners 1b.–1d. Biannual progress reporting by the RCU	Lack of timely availability of good consultants for the RCU undermines reform efforts. Lack of or delay in partner technical assistance to support implementation of PFM Reform Roadmap or MOF human resources upgradation plan undermines reform pace.

2. MOF's institutional capacity to implement SOE reforms strengthened

- 2.1. Prepare report on community service obligation costs and legitimacy by Q3 2018
- 2.2. Establish SOE monitoring unit within the MOF by Q3 2018
- 2.3. Provide SOE training targeted at women through the RCU (Q4 2019–Q4 2020)

Project Management Activities

Continue regular monitoring and supervision until Q4 2020 (ADB and MOF)
 Manage contracts from Q4 2017 to Q4 2020 (MOF, with ADB support)
 Provide timely biannual progress reports until Q4 2020 (RCU to the MOF, and to ADB through the MOF)
 Carry out regular accounting and annual audits (MOF)

Inputs**ADB**

Grant
\$2,000,000 (current)
\$500,000 (additional)
\$2,500,000 (overall)

Government (in-kind contributions):

Grant
\$300,000 (current)
\$50,000 (additional)
\$350,000 (overall)

Assumptions for Partner Financing

Not applicable

ADB = Asian Development Bank, GDP = gross domestic product, MOF = Ministry of Finance, PEFA = public expenditure and financial accountability, PFM = public financial management, Q = quarter, RCU = reform coordination unit, SOE = state-owned enterprise.

^a Government of the Marshall Islands. 2014. *National Strategic Plan, 2015–2017*. Majuro.

^b For the PEFA assessment and scoring methodology, please visit the PEFA resource center. <https://pefa.org/>.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=50295-002-2>

1. Grant Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Project Administration Manual
4. Summary of Project Performance
5. Contribution to the ADB Results Framework
6. Development Coordination
7. Economic and Financial Analysis
8. Country Economic Indicators
9. Summary Poverty Reduction and Social Strategy
10. Risk Assessment and Risk Management Plan