The Marshall Islands, the Federated States of Micronesia and Palau

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A. Brief overview of the Asia-Pacific Trade Agreement

During the past decade the intraregional share of total Asia-Pacific exports increased from 44% in 2000 to 52% in 2013, with developing Asia-Pacific countries making the highest contribution.[1] In this regard, regional trade agreements such as APTA could be a very good platform for expanding intraregional trade under the agreement.

As APTA provides a good platform for South-South trade and has provisions for special and differential treatment for small Pacific Island countries with special needs, such as Micronesian Trade and Economic Community (MTEC) member countries - the Federated States of Micronesia (hereinafter referred to as Micronesia), the Marshall Islands and Palau, these three countries can reap the benefits from increasing trade in the region by joining APTA.[2]

This section discusses briefly how the study objective was conceived and provides an overview of trade among the Participating States of APTA. It also sets the objective, and discusses the methodology and data sources related to the study. In section B, the economic background, geographical condition, historical/political aspects and external trade structures as well as different preferential trade agreements of the Marshall Islands, Micronesia and Palau are discussed. Section C evaluates the export potential for the Marshall Islands, Micronesia and Palau by examining their exports under the existing concessions given by the Participating States of APTA (covering more than 10,000 items in the Fourth Round). The export potential at 6-digit Harmonized Commodity Description and Coding System (HS) level has been identified. Section D deals with possible opportunities of trade between the Participating States of APTA and the three island nations in services, investment and trade facilitation following the Framework Agreement of APTA and implementation. Section D also evaluates whether the three island countries can form linkages with APTA member countries on these sectors and whether this will be an opportunity for them to reduce their trade costs. Trade expansion needs better productive capacity, infrastructure and, above all, investment in certain industries. In this regard, foreign direct investment (FDI) from APTA countries to these MTEC countries could be beneficial. Section E provides relevant recommendations.

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[1] Asia-Pacific Trade and Investment Report, 2014 (p. 9).
[2] Prasad and Chen (2014). The study attempted to find the possible benefits for the PIFC (Pacific Island Forum Countries) members in acceding to APTA. They considered only six countries (out of 14 countries) due to their large economy size and noticeable trade with APTA country members. The left out countries includes the Marshall Islands, Federated States of Micronesia and Palau.

1. Objective

The Asia Pacific Trade Agreement provides a good platform for South-South and intraregional trade, and economic cooperation. In this regard, it could be very useful and timely for the Pacific Island countries to look at the possibility of regional integration, which could help them to develop their trade and economies as well as connect them to big economies in the Asia Pacific region. With this in mind, the main objective of this chapter is to examine the potential benefits for the Marshall Islands, Micronesia and Palau in their accession to APTA, not only in terms of goods but also in services, investments and trade facilitation measures following the framework agreements. In addition, this chapter attempts to examine the other areas of possible cooperation between APTA and the Marshall Islands, Micronesia and Palau, e.g. tourism, FDI and productive capacity.

2. Data source and methodology

A detailed analysis of trade potential requires disaggregated data on trade. For that purpose, data were obtained from the WITS COMTRADE database at the 6-digit disaggregation of HS classification. In addition, data on tariff concessions offered by each of the Participating States of APTA, required to identify the products under tariff concession, were obtained from the APTA Secretariat of ESCAP. Data were also collected on various economic indicators from the World Bank, ESCAP, the CIA World Fact Book and government reports by the Marshall Islands, Micronesia and Palau.

In some cases, data were not available on exports by these three island countries. To increase the probability of data availability, the mirror data method was used, i.e. world imports from the Marshall Islands, Micronesia and Palau were considered as the exports by these countries to the world. Similarly, imports from the Participating States of APTA by the Marshall Islands, Micronesia and Palau were considered as the exports of the Participating States of APTA to the three island countries.

The main objective on this study, therefore, is the identification of the principal export items from the Marshall Islands, Micronesia and Palau to the Participating States of APTA. After reviewing the revealed comparative advantage of these three countries in the world market, an analysis was carried out of the trade potential for exports by these countries to the Participating States of APTA. The revealed comparative advantage analysis helped to identify the sectors in which the three island nations have a comparative advantage in world market through a comparison of the country of interests' trade profile with the world average. In addition, a trade complementarity analysis between the Marshall Islands, Micronesia and Palau and the Participating States of APTA was made. This analysis helped to show the extent to which the export patterns of the three island countries match the import pattern of the APTA member countries.

The revealed comparative advantage index was constructed following Balassa (1965):

$$RCA = (\frac{X_{ij}}{X_{it}})/(\frac{X_{nj}}{X_{nt}})$$ ……………………………………………………………….. (1)

where x represents exports, i is a country, j is a commodity, t is a set of commodities and n is a set of countries (in this case it is world).

A Trade Complementarity Index (TCI) was constructed between the Marshall Islands, Micronesia and Palau and the Participating States of APTA. The TCI provides information on how well the export pattern of a country matches the import pattern of another country, thus indicating the prospect of trade between the two countries. The TCI between countries A and B is defined as:

$$TCI_{iB} = 100(1 - \Sigma \left(\frac{|m_{iA} - x_{iB}|}{2}\right))$$ …………………………………………………............. (2)

where x_{iB} is the share of good i in global exports of country B and m_{iA} is the share of good i in all the imports of country A. The value of the index is zero when there is no trade between the countries and 100 when the import and export share of the two countries match exactly.

To identify the potential for exports from the three MTEC member countries to the Participating States of APTA, the following analysis was undertaken, taking into consideration of the products that are under MoP concession:[3]

   (a) Individual MTEC member countries exports to individual APTA member countries;
   (b) Global imports of APTA member countries;
   (c) Individual MTEC member countries global exports;
   (d) MoP currently available for exports to APTA member countries.

The potential exports can be identified in two ways:
   (a) When an individual MTEC country's global exports of product X are greater than the global imports of the same product by an individual APTA Participating State (i.e., C > B) , then the scope for potential export gain by that MTEC country's export of product X to the individual APTA Participating State can be maximum by the value of 'B − A'. This value is assumed to be the potential market share that can be captured by the individual MTEC member countries through increased exports to the Participating States of APTA;
   (b) When an individual MTEC country's global exports of product X are less than the global imports of the same product by an individual APTA Participating State (i.e., C < B), then the scope for potential export gain by that MTEC country's export of product X to the individual APTA Participating State can be maximum by the value of 'C − A'. This value is assumed to be the potential market share that can be

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[3] Following Ratna, R.S. (2011). *Benefits of Joining APTA: Case of Nepal*, ESCAP, Bangkok.

captured by the individual MTEC member countries through increased exports to the Participating States of APTA.

The analysis considered the products that were exported by the Marshall Islands, Micronesia and Palau to the world during 2011, 2012 and 2013 and which come under the MoP list of each APTA Participating State.

As the MTEC member countries are geographically isolated and remote far from the Participating States of APTA, trade impediments such as cost of exporting/importing products and the time associated with trade activities become quite important. To address this issue the analysis attempted to find the time and cost of imports/exports by those countries. For this purpose data from the World Bank were utilized. In addition, FDI data from the UNCTAD database were used.

B. Overview of the Marshall Islands, Micronesia and Palau

1. Marshall Islands

The United Nations has classified the Marshall Islands as a Small Island Developing State.[4] It is one of only four atoll nations in the world (Others being Kiribati, Maldives and Tuvalu). As one of the most isolated, smallest and vulnerable nations in the world[5], it comprises five Islands and 29 coral atolls with a total land area of only 70 square miles.[6] The country shares its maritime boundaries with Micronesia, Wake Island, Kiribati and Narau in the Pacific. It has a hot and humid tropical climate, with an average rainfall of 160 inches per year.[7] The country is highly dependent upon foreign aid, primarily from the United States, from which it received around $1 billion between 1986 and 2001, and will receive a total financial package of around $1.5 billion for a 20-year period, from 2004 to 2024.[8] It is also not a WTO member or observer.

In 1526, the Spanish navigator Alonso de Salazar was the first European to discover the island group. In 1788, it was named by a British naval captain, William Marshall. Between 1885 and 1914, the Marshall Islands were under German control. During World War I, Japan captured it and controlled it until the end of World War II, when the nation came under the control of the United States. In 1986, the Marshall Islands became an independent State, although it has a special political, economic and defence relationship with the United States under a Compact of Free Association agreement.

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[4] See www.rmiembassyus.org/Economy.htm#Econ (accessed on 24 February 2015).
[5] The Marshall Islands are vulnerable to climate changes and sea-level rise.
[6] See www.rmiembassyus.org/Geography.htm (accessed on 24 February 2015).
[7] Ibid.
[8] CIA World Fact Book, available at https://www.cia.gov/library/publications/the-world-factbook/geos/rm.html (accessed on 24 February 2015).

The fisheries sector is a major contributor to the overall development of the economy. The country is a resource rich nation in fisheries and has a large exclusive economic zone (EEZ). The economy of the Marshall Islands is a subsistence type but the country has only a few export products, e.g., fish (loins) which is a major export item. The major food crops are coconuts, breadfruit and pandanus. Meat production includes pigs and chickens. Industrial items such as handicrafts, fish (especially tuna) processing and copra are important. Hence, the country is heavily reliant on imports of food and fuel.

The small size and remoteness of this island nation poses many development challenges such as high transport costs for trade and higher costs of different economic activities, which hinder achievement of economies of scale and make the process of providing public service more complex.[9]

The Marshall Islands' economy was severely affected by the 2008 international financial crisis. In 2010, GDP growth was around 6%, which was much better than -2% recorded in 2009. From 2011 the annual growth rate of GDP remained positive and was 3% in 2013. According to the IMF, this positive trend can be attributed to a surge in fishery output, and higher copra and coconut production.[10] Fishery constitutes around 10% of the national GDP.[11] According to the latest available data in 2011, the agricultural sector constituted 28% of GDP whereas the services sector's share of GDP was 63% (figure 4.1). This implies that the Marshall Islands has a high dependence on the services sector compared with other sectors in the economy. However, in relation to services, almost 60% of Marshall Islands' budget is financed by the United States under the US-Compact grant. The public sector employs a large number of Marshallese citizens in comparison to the private sector. This also contributes to the 63% of services share in GDP.

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[9] World Bank Report No. 69510-MH, p. I; available at
http://documents.worldbank.org/curated/en/2013/02/17389687/marshall-islands-country-partnership-strategy-period-fy13-fy16 (accessed on 25 February 2015).
[10] See www.imf.org/external/np/sec/pr/2014/pr1441.htm (accessed on 25 February 2015).
[11] World Bank Report No. 69510-MH, p. I. Available at
http://documents.worldbank.org/curated/en/2013/02/17389687/marshall-islands-country-partnership-strategy-period-fy13-fy16 (accessed on 25 February 2015.

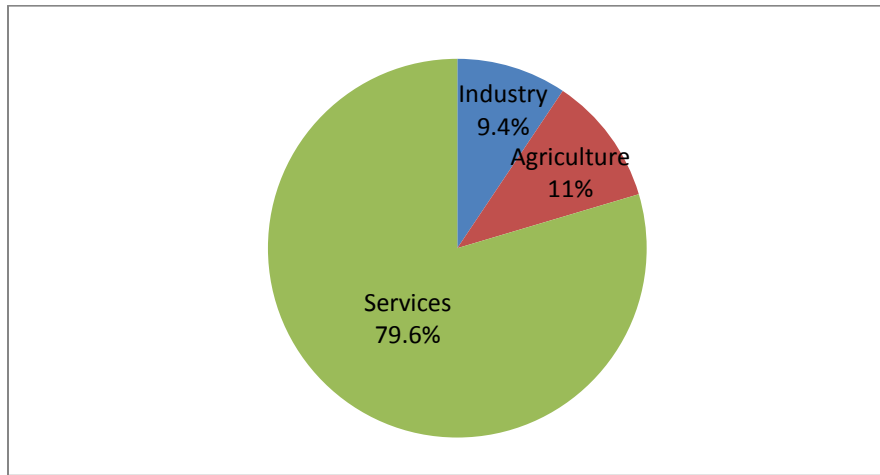**Figure 4.1. GDP share of major sectors in Marshall Islands, 2011**
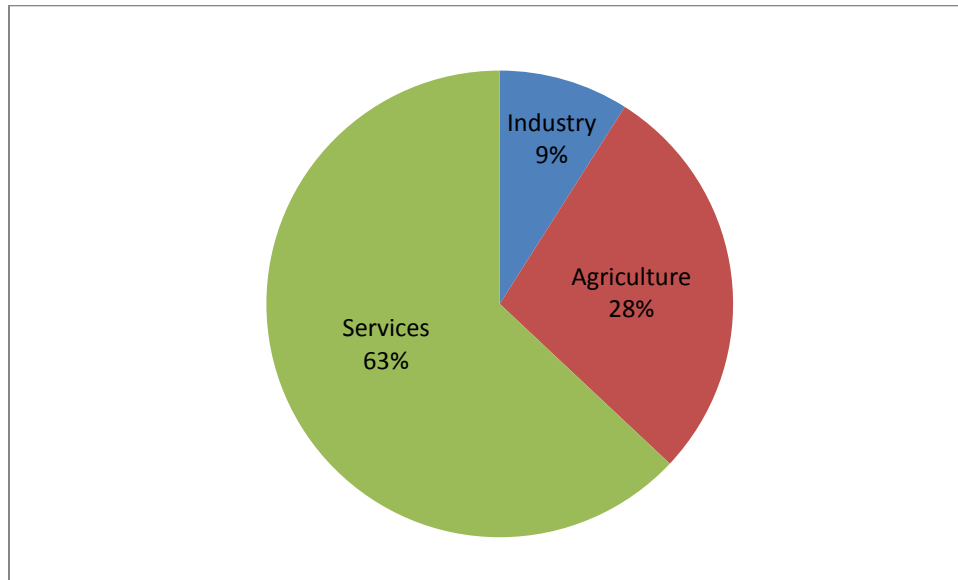
The Marshall Islands depend very much on external aid and finance to support the country's public services system, e.g., health care, food security, infrastructure development, etc. According to the World Bank, the external debt of the Marshall Islands was around 57% of GDP in 2012, which left the economy vulnerable to debt distress and macroeconomic instability. The United States is a major contributor of financial aid, 60% of the Government budget is financed by the United States under the US-RMI compact arrangement.

According to the RMI 2011 Census,[12] the current population is around 53,000. More than 74% of that population lives in Majuro (capital city) and Ebeye. The Marshall Islands workforce comprises 12,924 people. The national workforce participation rate in 2011 was 41.3% (65% male and 34.9% female). The unemployment rate among the economically active population was just 4.7%. However, the workforce is experiencing a change as it is shifting from subsistence agriculture and fishing to more specialized types of activities. According to ILO data, 79.6% of total workforce was engaged in services sector, 11% in agricultural sector and 9.4% in industrial sector during 2011 (figure 4.2).

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[12] RMI 2011 Census, p.17. Available at www.doi.gov/oia/reports/upload/RMI-2011-Census-Summary-Report-on-Population-and-Housing.pdf (accessed on 25 February 2015).

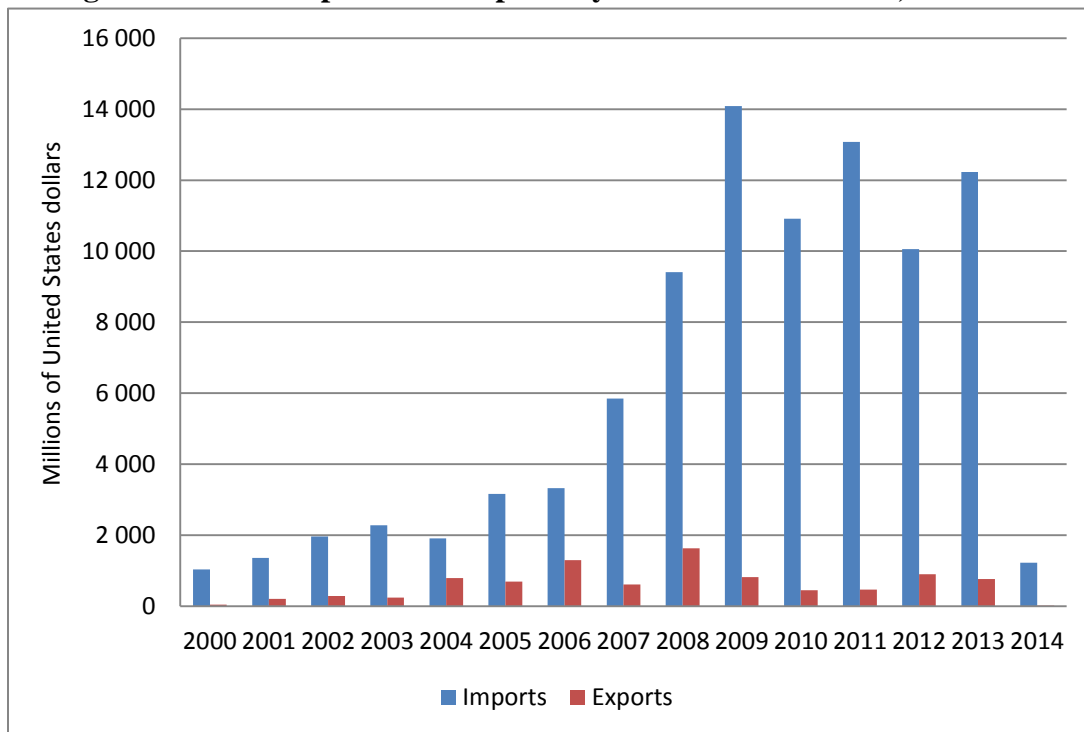**Figure 4.2. Workforce share in the major sectors of the Marshall Islands, 2011**

External trade of the Marshall Islands

Imports are much higher than exports, which has resulted in a high negative trade balance over the years (figure 4.3). During 2013, exports and imports of merchandise amounted to 30% and 69% of GDP, respectively (ESCAP, 2014b).

**Figure 4.3. Total exports and imports by the Marshall Islands, 2000-2014**

Figure 4.3 also shows that the country had a huge trade deficit after 2006 resulting from an increase in imports. The trade deficit was highest during 2009 and exports showed a decline post 2008, indicating a negative effect possibly due to the global economic recession.

An interesting picture emerges when looking at the destinations of exports from the Marshall Islands (figures 4.4 to 4.7). The United States is a good market, which may be due to the colonial history. In 2000, ASEAN and the United States were the major markets, accounting for 63.6% and 15.2%, respectively, of total exports by the Marshal Islands. The APTA market accounted for a negligible share of 0.1%. After 2010, the Marshall Islands exports to APTA member countries started to increase. During 2013, the APTA market share of the Marshall Islands exports increased to 32%, which was a significant rise from 3.5% in 2010.

Figure 4.4. Destinations of exports from the Marshall Islands, 2000
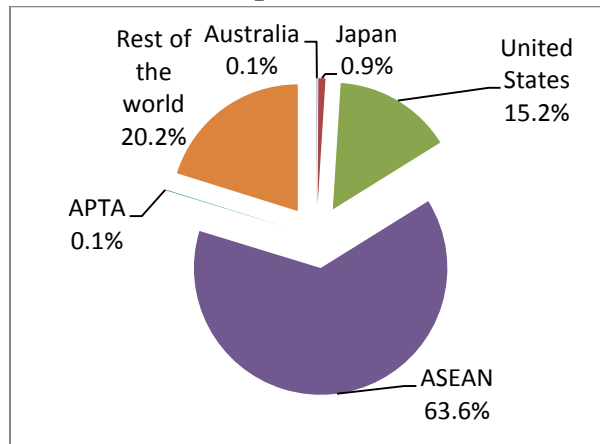
Source: Author's calculation based on WITS COMTRADE data.