



Public Sector Reform Road Map

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Asian Development Bank

PUBLIC SECTOR REFORM ROAD MAP

A. Sector Situation and Key Issues in the Sector

1. The public sector remains a dominant feature in the political economy of Palau. An effective public sector, supporting the Palauan's achieve the medium-term development strategy (MTDS), is essential to Palau's medium-term sustainable development. In considering public sector reform issues in Palau, this roadmap firmly underlines the importance of distinguishing between the 'technical/rational' and the 'political' dimensions of the reform process.

i. Public Financial Management

2. The overall fiscal deficit is estimated to be 6.8% of GDP in FY2008, down from 25% of GDP at the beginning of the decade. There was a significant improvement in the accounts receivable/payable position to around 6.2% of GDP. The government wages and salaries bill as a proportion of GDP at 20% is still considered to be relatively high, but has fallen slightly over the decade.

3. An adjustment in the order of 20% of GDP is required to meet the target of 100% financing of current government expenditure. The 5 year targeted adjustment of 5% of GDP on government expenditure is achievable. The Government will need to: (i) review the current allocation at a broad level and determine how best to allocate a reduced budget across broad functional levels; and (ii) conduct a functional expenditure review to identify the extent to which activities can be modified or eliminated for each major functional expenditure category.

4. The Constitution prohibits the Government from accruing a deficit. However, the budget is reallocated during the year to reflect changing political demands without effective planning and budgeting controls on the process. The Office of Budget and Planning has been developing the main elements of suitable medium-term expenditure planning and monitoring framework necessary to plan expenditure, deliver MTDS priorities and to monitor government expenditure performance. Implementation and adherence to this framework will become increasingly important. Currently, the Office is hindered by a lack of appropriately experienced staff.

ii. Public Administration

5. The World Bank measure of government effectiveness ranks Palau behind a number of comparator countries and is ranked 8th out of 13 Pacific Developing Member Countries (PDMCs). The policy formulation capacity within ministries varies from very good in the education and health to relatively weak in others. Unless an 'executive committee' is formed, policy coordination is poor with legislation affecting these issues being passed without incorporating the whole of government in its preparation. Coordination and responsiveness is very poor between the National Government and the State Governments, where capacity is very limited. While good policies and regulations exist, their impact is being undermined by poor government effectiveness with regard to implementation and oversight.

6. Best practice in policy development, planning, budgeting and the execution of policies requires an integrated medium-term expenditure planning and monitoring framework, elements of this exist. Coordination processes have evolved over time including the Ministry Action Plans and their implementation frameworks.

7. The Government's planning and budgeting processes are intended to: (i) meet macro-fiscal discipline and stability and secure a platform for economic growth and development; and (ii) facilitate resource allocation to ensure government policies are effectively reflected in the structure of government spending. Notwithstanding, planning and budgeting tools are not implemented as budget approval is a Congressional responsibility and they lack the experience in overseeing medium-term expenditure frameworks and performance budgets. Some line Ministries also lack the experience to develop and implement multi-year expenditure and planning frameworks.

8. Palau's public administration is effected by capacity utilization rather than the capacity of its institutions and staff (although there are specific gaps in particular areas). This is influenced by domestic policies, institutional arrangements and traditional/informal decision-making processes. It results in plans which haven't been fully implemented and laws which aren't enforced, which underscores the importance of 'political' as well as the 'technical/rational' dimensions of capacity development in Palau. Prevailing incentives have not favored building up capacity (i.e., human and organizational capacity) but rather maximizing benefits associated with current grant aid financing arrangements.

9. These enabling constraints give rise to specific weaknesses including: (i) few institutional advocates for reform; (ii) an uncertain macroeconomic situation; (iii) politicization of public service processes; (iv) tensions between traditional and modern institutions (e.g., social obligations); (v) the absence of written traditional law and adjudication mechanisms; (vi) a lack of autonomy from political influence in recruitment and selection; (vii) limited ability to exercise policy influence and communicate these mandates; and (viii) decreasing budget for training, programs, services, technology, etc.

10. Human resource policies are, by and large, well articulated but implementation is clearly skewed by 'enabling environment' factors. Creating opportunities to better institutionalize the existing policies and refine them in some key areas need to be created if a serious change in 'outcomes oriented' human resource management is to become a reality.

iii. Governance

11. Palau's public sector performs well against other PDMCs on measures of voice and accountability, political stability, and the rule of law as measured by the World Bank Worldwide Governance Indicators.

12. Palau has one National Government and 16 State Governments. This leads to significant inefficiencies in operations and management. States own the natural resources and most of the infrastructure. National Government is responsible for most of the government services provided to Palauans. The mismatch between responsibilities and ownership of resources leads to policy conflict and inaction while a broader consensus is obtained.

13. Palau has exemplary executive structures for the oversight of public employees and their performance. These also extend in many instances to the executive itself and to members of Congress. The Public Auditor is genuinely independent, audit findings taken seriously and the Auditor refers cases to a Special Prosecutor. The Special Prosecutor has powers to launch its own investigations. There is also an Ethics Commission made up of members of the public.

14. The Public Auditor and Special Prosecutor are adequately funded. The Ethics Commission is inadequately funded and has not sat for some time. There is a Public Servants

Grievance Committee but, in practice, complaints by the public or the public servant are usually raised by a member of Congress.

iv. Revenue Mobilization

15. To achieve its fiscal targets, Palau will need to increase its revenue by 5% of GDP over the next 5 years. IMF proposals for a simple value added (consumption) tax and an income tax, based on IMF technical assistance and as documented in the 1998 Tax Review Advisory Committee Report, were reflected in Bill No. 5-266 of July 1998. However, the Bill was not passed. The Bill is still highly relevant for Palau. While failure to move forward may be seen by outsiders as inertia or lack of capacity to advance a particular policy agenda, in fact, it may simply reflect the reality of the local political economy. This, clearly, has implications for the approach to be pursued by external actors, including ADB.

16. Implementing a new tax system will create greater efficiencies and appropriate incentives in generating government revenue. Additional support is also required to improve the efficiency and effectiveness of tax collection in Palau. The Pacific Financial Technical Assistance Centre (PFTAC) is assisting with this work. Moreover, implementing reforms for private sector development will result in increased investment and economic growth and increased revenue for the government. Key areas for these reforms are in: (i) foreign investment regulations; (ii) foreign labor regulations; and (iii) improving the security and access to land for investment.

17. Public enterprise reform is also expected to improve the revenue flow to government to meet its target and/or reduce the level of subsidy currently provided to Palauans by removing them and/or targeting them to the marginal poor. Expected benefits from enterprise reforms will come from: (i) improving efficiencies by contracting more maintenance functions such as roads and repairs and maintenance of government buildings; (ii) placing, on a commercial basis, the delivery of services such as electricity, water and sewerage; and (iii) improving the revenue from government corporations and profit-making enterprises including telecommunications and the airport.

B. Government's Sector Policy and Planning Framework

18. While the overall development strategy for Palau has been guided by the Palau 2020 national master development plan (1996-2020), public sector reform in Palau is guided by the Management Action Plan (MAP)¹ prepared during the first hundred days of President Remengesau's first term in office.² The two areas of focus for the MAP are management and maintenance. Its 11 goals and objectives encompass both public sector reform and policies for sustainable and environmentally sensitive economic growth. The public sector reform focus is on: (i) providing quality services at lower costs; (ii) ensuring accountability; (iii) streamlining the government structures and resource utilization; (iv) effectively managing its people; and (v) engaging community. Key policy objectives for public sector reform can be summarized as: (i) incorporating traditional values in decision-making; (ii) rightsizing the public sector, including shifting resources from the public to the private sector; (iii) improving human resource capability, including management training; and (iv) improving the work ethic and performance management.

¹ The MAP, March 2001, *President Remengesau, Vice President Pierantozzi Management Action Plan, Preserve the Best, Improve the Rest* was derived from previous planning documents prepared since independence including Palau 2020 national master development plan.

² President Remengesau 1 January 2001 to 1 January 2009.

19. With a new administration in 2009, the role of the MAP as a policy tool for government is unclear. However, the MTDS, adopted by the new administration contains sector plans which incorporate many of the actions identified in the MAP.

C. Government's Institutional Arrangements and Capacity in the Sector

20. The President, Ministers (who are political appointments), the President's Office and the Bureau of Public Service Systems within the Ministry of Finance have overall responsibility for performance and delivery of public sector functions. Ministry budgets are prepared taking into consideration the State of the Republic Address, Presidential Directives and the MAP. These directives and frameworks are not, however, robustly linked the NMDP. There are effective strategic and management plans in some Ministries but performance in terms of policies and activities is not consistently or effectively monitored and linked back to expenditure allocations. There are performance reports but the performance indicators are inadequate and links to the budget are ineffective. Tight budgets, with a priority to more tangible outcomes, inexperienced management, traditional power structures, competing alliances and limited accountability result in the public sector reform agenda being secondary to the immediate priorities of public sector management.

21. Notwithstanding these contextual pressures there is increasing demand for a more effective Government. The MTDS provides the framework for policy coherence and the associated sector plans detail the policies for adoption and implementation. These are not a fiscal burden on the Government and require commitment, monitoring and performance reporting to ensure the sector policies are implemented.

D. ADB Sector Experience

22. ADB has significant experience in public sector reform activities, specializing in public financial management, budgeting and planning, procurement and financial sector reforms throughout the Pacific. More recently, ADB has been involved in human resource improvements and governance interventions. In identifying capacity development as a theme for all reforms in the Pacific, ADB has restructured its design and implementation approaches to institutionalize its experiences in public sector reform activities. The approach to public sector reform in a more holistic manner in the Palau CPS recognizes these lessons.

E. Role of Other Development Partners in the Sector

23. All development partners are in some way or another engaged in public sector reform through their official development assistance programs. Whether it is improving human resource capacity or strengthening institutions and systems for the delivery of service obligations, donor partners are working towards a more self sufficient and sustainable economy. To date, this assistance has been directed by the government in an ad-hoc manner based on the immediacy of the government needs and the expertise of the particular development partner.

24. JICA has an extensive volunteer program providing technical expertise and personnel substitution in a range of government Ministries including Health, Education and Resources and Development. PFTAC provides capacity development of both personnel and systems in statistics, banking, tax and financial administration. Australia provides assistance, predominantly, in coastal surveillance and through its international scholarship program. Through the many US sector programs, expertise is provided to build and maintain technical systems and, through this, train key personnel.

25. To a large extent the extensive capacity/human resource development in these programs is directed by development partners and, less so, through a planned and directed public sector reform program. With the implementation of the MTDS, development partners and the government will be able to direct development assistance to those areas identified as priorities for Palau.

F. Intended Sector Outcomes and Key Outputs Supported by ADB

26. The CPS *Objective 1, Improve public sector effectiveness to achieve the medium-term fiscal strategy* underpins Palau's public reform agenda by supporting the government achieve its fiscal expenditure and revenue targets and working towards greater productivity and accountability of Government. In achieving this objective, the public sector will develop the policy direction and fiscal space necessary to deliver the key actions of the MTDS.

27. To deliver CPS Objective 1, ADB interventions will initially focus on the functional realignment of the public sector through the conduct of a functional review and support to the implementation of its findings. Allied to this, the CPS will strengthen human resource and performance management to improve the productivity in the public sector. Building the capacity for budgeting and financial management will assist in appropriate resource allocations to achieve their fiscal target and create the financial space to deliver the MTDS goals. Private sector development initiatives will include public enterprise reform and the enabling environment for private sector development, furthering the productivity of the public sector.

G. Links to CPS outcomes and other sectors

28. The efficacy of CPS strategic objectives to: (i) facilitate private sector development; (ii) deliver safe water and sanitation services; and (iii) manage the threat of climate change hinge on the commitment to, and implementation of, Palau's public sector reform agenda. The policy and legislative reforms required for private sector growth; enterprise reforms needed to create an effective water supply and sanitation utility; and the whole of government approach necessary for managing the impacts of climate change require an agreed vision and joint action by the Congress and the public sector. These requirements are detailed in the MTDS and its supporting sector plans upon which the CPS is derived.

H. Monitoring Mechanisms

29. In accordance with best practice approaches for fragile states such as Palau, the ADB will monitor public sector reform performance through the Monitoring and Evaluation Unit established to assist in the implementation and management of the MTDS. This will be supplemented by the CPS results framework and include specific indicators to measure performance against the CPS sub objectives. These indicators are being developed in cooperation with the government Palau.

Public Sector Reform Results Framework

National Medium Term Development Strategy		Asian Development Bank Strategic Agenda Inclusive Growth				
MTDS Actions ^a	Key constraints	Strategy Outcome ^b	Outcome Indicators	ADB Assistance Program	Ongoing Program Performance ^c	Risks Mitigation
<p>MTDS Actions Undertake reforms to ensure a cost conscious and highly productive government</p>	<p>Economic dependence on public sector employment as an economic driver.</p> <p>Reluctance to pay for the services provided by Government</p> <p>Agreement to reallocate staffing resources from other Ministries.</p> <p>Community expectations take precedence over work responsibilities.</p> <p>Positions of cultural authority have precedence over employers authority. Political and community expectation of a public sector to create employment.</p>	<p>CPS Objective 1: Improve public sector effectiveness to achieve the medium-term fiscal strategy</p> <ul style="list-style-type: none"> • Build capacity for financial, budgeting • Strengthen performance and human resource management • Support realignment of public sector functions 	<ul style="list-style-type: none"> • PI-12^a Multiyear Perspective in fiscal planning, expenditure policy and Budgeting (Score B) • PI-24 Quality and timeliness of in-year budgets (Score B) • 60% of Ministries deliver against 80% of annual performance targets. • End-of-year Staff numbers match initial budget allocation (including contracted staff). • Public sector functional review measures adopted. • Planned changes resourced effectively 	<p>Ongoing RETA 6414, Managing for Development Results in the Pacific</p> <p>TA 4929-PAL, Facility for Economic and Infrastructure Management</p> <p>TA 7970-PAL Sustainable Health Sector Financing</p> <p>RETA 6333 Statistical Capacity Building in the Asia Pacific Region</p> <p>Proposed Public Sector Reform Facility Cluster Phase 1 & 2</p>	<ul style="list-style-type: none"> • Economic & social planning & policy decisions informed by statistical information • Improved economic and infrastructure management • Enhanced government policy and legislation to achieve sustainable health care financing • Long term statistical capacity building program developed • Reform legislation discussed at public fora • Fiscal strategy implemented 	<p>Risks</p> <ol style="list-style-type: none"> 1. Civil society rejects rightsizing government at the risk of losing public sector jobs. 2. Insufficient OEK support for substantial reorganization. 3. OEK Members do not support strengthening the policy advisory capacity of the OEK. <p>Mitigation</p> <ol style="list-style-type: none"> 1. Public awareness program of government policy and opportunity costs. 2. Support Congress policy advice and analysis. 3. Broad public sector & civil society participation in TA design processes

^a The MTDS strategic priorities are: **A. Preserving key values** (the environment, cultural values, political stability, public security and civil order, relationships with development partners); **B. Achieving consensus for change** (the benefits of the MTDS, attitudes to the role and functions of Government); and **C. Addressing binding constraints on development** (change people's expectation of subsidies, explore and reduce conflicts of interest). These are addressed in the CPS approach and methodology, while the strategy directly aligns to the key actions over the next 5 years.

^b The program will contribute significantly to the CPS objective. Direct attribution of the CPS is identified in the necessary conditions underneath the CPS objective statement.

^c PI is the Public Financial Management, Performance Measurement Framework, detailing internationally accepted financial management indicators, public expenditure and financial accountability (June 2005).