

DEVELOPMENT COORDINATION

A. Major Development Partners: Strategic Foci and Key Activities

1. Palau comprises 340 islands with a population of about 18,400 (in 2018), almost 80% of whom live in Koror and Airai states. Like other small Pacific economies, Palau is dependent on overseas development assistance, which accounts for almost half of total government expenditures, or about 15% of GDP, from 2015 to 2019. Its major development partners are the Asian Development Bank (ADB); Australia; the European Union (EU); Japan; Taipei,China; the United Nations; and the United States (US). The partners provide aid through budget support and project or program operations. The International Monetary Fund (IMF) carries out economic surveillance, and the World Bank provides technical assistance (TA).

2. Palau depends heavily on tourism and services revenues, which account for almost 55% of annual GDP and employ three-quarters of the country's formal workforce. However, tourist arrivals are particularly volatile when natural disasters or external economic downturns occur. To prevent the transmission of the coronavirus disease (COVID-19), Palau, like other Pacific nations, has instituted a travel ban. With no tourist arrivals expected until at least 2022, Palau's economy is projected to contract by 9.5% in 2020 and 12.8% in 2021, compared with originally projected growth of 2.0% for 2020 and 2.6% for 2021. The resulting drastic decline in revenues and increase in health and social expenditures are projected to drive fiscal deficits to \$31.2 million (12.2% of GDP) in FY2020 and \$53.4 million (23.8% of GDP) in FY2021—the first fiscal deficits since FY2010. Estimates suggests that total tax revenue will decrease by \$11 million in FY2020 (4% of GDP) and \$19 million in FY2021 (7% of GDP). Increases in public expenditures—including higher spending on strengthening health systems and social assistance for individuals, households, and businesses affected by COVID-19—combined with a sharp decline in public revenue will widen the fiscal deficit. The public debt-to-GDP ratio will rise from 32.5% in FY2019 to 66.9% in FY2020 to help the government meet the estimated financing gap. Furthermore, the decline in tourism will result in increased unemployment and poverty, particularly among women, who were mostly employed in tourism and hospitality.

3. To cope with COVID-19, Palau prioritizes mobilization of additional concessional financing and grant funding from its development partners, including the governments of Japan, Taipei,China, and the US, for financing pandemic response measures.

4. Palau receives annual grants from the US for national development projects under the Compact of Free Association, which is a political, strategic, and economic treaty between the Republic of Palau and the US. The US provides support across sectors and subsectors, with the major focus on education, health, and infrastructure. Through the Compact, Palau expects to be able to access grants of up to \$40 million annually from 2015 to 2020.

5. Australia's bilateral aid program in Palau focuses on two strategic objectives: improving economic growth through upgraded telecommunications and internet coverage and achieving gender equality and enhancing women's empowerment. Australia's regional program includes projects to assist Palau in mitigating the impacts of severe climate, tidal, and oceanographic events.

6. The EU's strategic focus is on the energy sector and environmental issues, especially renewable energy. Japan's strategic focus is on energy, environment, education, and health. It supports the improvement of solid waste management and the establishment of a recycling system, as well as projects for natural resources management and sustainable development. Its support for coral reef research is an important contribution to monitoring the impacts of sewage outflow on the health of Palau's reefs. The Government of Japan, through the Japan International Cooperation Agency, also supports development of clean energy sources, and

improvements in medical and health services. Taipei, China focuses its development assistance on infrastructure, agriculture, and the environment. It supports small-scale rural water collection and transmission infrastructure as well as a cloud services project for the Ministry of Health. The United Nations Development Programme supports natural resources management and monitoring. The World Bank has no loan projects in Palau but is providing TA toward regulatory reform of the information and communication technology (ICT) industry.

7. ADB has been a key multilateral development partner in Palau. Since 2005, ADB has provided loans totalling \$84.8 million, a grant of \$0.2 million, and TA worth \$3.8 million for Palau in support of ICT, water supply and sanitation, health, and public sector management.

B. Institutional Arrangements and Processes for Development Coordination

8. Development assistance is coordinated through bilateral and multilateral consultations. Supported by the US Department of Interior, the Office of Budget and Grant Oversight under the Government of Palau undertakes donor-coordination activities aligned with Palau's national development priorities. The Minister of Finance is responsible for the programming of multilateral assistance and lending programs in Palau.

9. ADB consults with development partners when preparing the country operations business plan, and exchanges information on projects and TA provided to Palau through regular visits to the embassies in Koror, telephone conferences, and e-mails. For the proposed program, ADB participated in meetings with key project stakeholders and exchanged information with the IMF.

10. The steering committee to be established for the project provides a mechanism for improved coordination and consultation among stakeholders and provides a forum for the government to monitor and keep track of project activities and reforms at PPUC. ADB will be represented on the project steering committee, which also includes representatives of the executing agency (the Ministry of Finance) and implementing agencies (PPUC and the Palau Energy Administration), and senior government officials from other relevant departments and divisions.

C. Achievements and Issues

11. Consistent with the government's strategy, ADB assistance to Palau's energy sector focuses on energy reforms and renewable energy, which underpins the country's energy security and the sustainability of the sector. ADB support for the energy sector during 2020–2022 includes (i) power grid enhancement,¹ (ii) disaster-resilient clean energy financing,² and (iii) public–private partnership transaction advisory services for renewable energy.³ This lending program and ADB's overall energy sector strategy are also designed to support PPUC's sustainability and the government's target of 45% renewable generation by 2025.

12. Strengthening PPUC's corporate and financial management is the most critical prerequisite for energy and utilities' sustainability. Developing the capacity of PPUC will continue to be a priority for ADB and development partners.

D. Summary and Recommendations

13. By improving coordination through regular meetings and consultations with major development partners during the implementation of projects in Palau and during the

¹ ADB. Palau: Grid Upgrade for Renewable Integration Project. Manila. For processing.

² ADB. 2020. Project Concept Paper: Proposed Grant and Technical Assistance Grant to Palau for Disaster Resilient Clean Energy Financing. Manila.

³ ADB. Palau: Independent Power Producer Transaction Advisory Service. Unpublished.

preparation of subsequent interventions, ADB will ensure that it continues to make positive contributions to the sustainable development of the energy sector and other sectors. As Palau continues to receive technical and financial assistance from bilateral partners as well as from ADB to reform PPUC and promote renewables, the country can achieve its target of 45% renewable generation by 2025.

14. Because of COVID-19, Palau faces a future of uncertainties. Enhanced coordination and dialogue between key stakeholders will be critical. While ADB collaborates closely with the government and other stakeholders through in-country missions and remotely via electronic communication, it also must remain flexible and proactive in responding to emerging issues and challenges.