

DEVELOPMENT COORDINATION

A. Major Development Partners: Strategic Foci and Key Activities

1. Palau comprises 340 islands with a population of about 18,200 (in 2022), almost 80% of whom live in Koror and Airai states. Like other small Pacific economies, Palau is dependent on overseas development assistance, which accounted for almost half of total government expenditures or about 15% of gross domestic product (GDP) from 2015 to 2019. Palau's major development partners are the Asian Development Bank (ADB); Australia; the European Union; Japan; Taipei,China; the United Nations; and the United States (US). They 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, with annual receipts averaging the equivalent of 45.9% of GDP during fiscal year (FY) 2010–FY2019. The sector employs about three-quarters of the formal workforce. However, tourist arrivals are particularly volatile when disasters, external economic downturns, or health emergencies occur. To prevent the transmission of the coronavirus disease (COVID-19), Palau, like other Pacific nations, closed its borders for travel in March 2020. With no tourist arrivals during the second half of the fiscal year, the economy contracted by 9.7% in FY2020. A further 17.1% contraction was recorded in FY2021 as tourism continued to struggle despite gradual steps toward reopening the economy.¹ The COVID-19 driven drastic decline in revenues and increase in health and social expenditures drove fiscal deficits to \$28.2 million (10.9% of GDP) in FY2020 and \$42.2 million (19.5%) in FY2021—the first fiscal deficits since FY2010. The deficit is projected to narrow slightly to \$30.6 million (12.6% of GDP) in FY2022. Estimates suggest that total tax revenue declined by \$7.2 million in FY2020 (1.5% of GDP) and by \$17.1 million in FY2021 (4.3% of GDP). Increases in public expenditures—including to strengthen health systems and social assistance for individuals, households, and businesses affected by COVID-19—combined with a sharp decline in public revenue to drive large fiscal deficits over the near term. The public debt–GDP ratio rose from 38.6% of GDP in FY2019 to 62.1% in FY2020 and further to 85.7% in FY2021—before peaking at a projected 90.3% in FY2022—to help the government bridge the estimated financing gap. 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 mobilizing additional concessional financing and grant funding from its development partners, including Japan; Taipei,China; and the US, to finance pandemic response measures.

4. Palau receives annual grants from the US for national development projects under the Compact of Free Association, a political, strategic, and economic treaty between the two countries. The US provides support across sectors and subsectors, focusing on education, health, and infrastructure. With the renewal of the economic provisions of the Compact under the Compact Review Agreement approved in 2018, Palau expects to be able to access grants totaling \$123.9 million from 2018 to 2024.

5. Australia's bilateral aid program in Palau has three strategic objectives: (i) improving economic growth through upgraded telecommunications and internet coverage, (ii) achieving

¹ Steps include a safe travel bubble arrangement with Taipei,China, which commenced in April 2021, followed by broader reopening to vaccinated travellers in July and August. Despite originally estimated arrivals of 24,000 tourists during FY2022, total arrivals in the first half of the fiscal year were less than 4,000 and resulted in tax revenue reduction and slow economic recovery.

gender equality and enhancing women's empowerment, and (iii) developing renewable energy. Australia's regional program includes projects to help Palau mitigate the impacts of severe climate, tidal, and oceanographic events.

6. The European Union's strategic focus is on energy and the environment, especially renewable energy. Japan's strategic focus is on energy, the environment, education, health, and water supply. Japan supports the improvement of solid waste management and the establishment of a recycling system, as well as projects for natural resource management and sustainable development. Japan's 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, supports the development of clean energy sources, technical assistance to reduce physical and commercial losses from public water supply systems, and improvements in medical and health services. Taipei, China focuses its development assistance on infrastructure, agriculture, and the environment, and supports small-scale rural water collection and transmission infrastructure as well as a cloud service project for the Ministry of Health. The United Nations Development Programme supports natural resource management and monitoring. The World Bank has no loan projects in Palau but is providing TA for regulatory reform of the information and communication technology industry.

7. ADB has been a key multilateral development partner in Palau. Since 2005, ADB has provided loans totaling \$84.8 million, a grant of \$0.2 million, and TA worth \$3.8 million for information and communication technology, 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 government's Office of Budget and Grant Oversight coordinates donor activities aligned with national development priorities. The minister of finance is responsible for programming multilateral assistance and lending programs.

9. ADB consults with development partners when preparing its 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-mail. For the proposed program, ADB participated in meetings with key project stakeholders and exchanged information with the IMF.

10. The Ministry of Finance established the project steering committee to improve coordination and consultation among stakeholders and provide a forum for the government to monitor and keep track of project activities and reforms at Palau Public Utilities Corporation (PPUC). ADB is represented on the committee, which includes representatives of the executing agency (Ministry of Finance), implementing agencies (PPUC and the Palau Energy Administration), and senior government officials from other departments and divisions.

C. Achievements and Issues

11. Consistent with the government's strategy, ADB assistance to the energy sector focuses on reforms and renewable energy, which underpins energy security and the sector's sustainability. ADB support for the energy sector during 2020–2022 includes (i) power grid

enhancement,² (ii) disaster-resilient clean energy financing,³ and (iii) public–private partnership transaction advisory services for renewable energy.⁴ The lending program and ADB’s overall energy sector strategy are designed to support PPUC’s sustainability and help the government reach its target of 45% renewable generation by 2025. ADB is helping PPUC upgrade the Koror sewer system through the Koror–Airai Sanitation Project.⁵

12. Strengthening PPUC’s corporate and financial management is critical to deliver reliable and sustainable electricity, water supply, and sewerage services. 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 project implementation and the preparation of subsequent interventions, ADB will ensure that it continues to make positive and coordinated contributions to the development of Palau. 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 and enjoy improved water supply and sanitation services.

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 must remain flexible and proactive in responding to emerging issues and challenges.

² ADB. *Palau: Grid Upgrade for Renewable Integration Project*. Manila. (For processing)

³ ADB. 2020. *Project Concept Paper: Proposed Grant and Technical Assistance Grant to Palau for Disaster Resilient Clean Energy Financing*. Manila.

⁴ ADB. *Palau: Independent Power Producer Transaction Advisory Service*. Unpublished.

⁵ ADB. 2013. *Report and Recommendations of the President: Koror-Airai Sanitation Project*. Manila