

E. Country Chapter: Palau

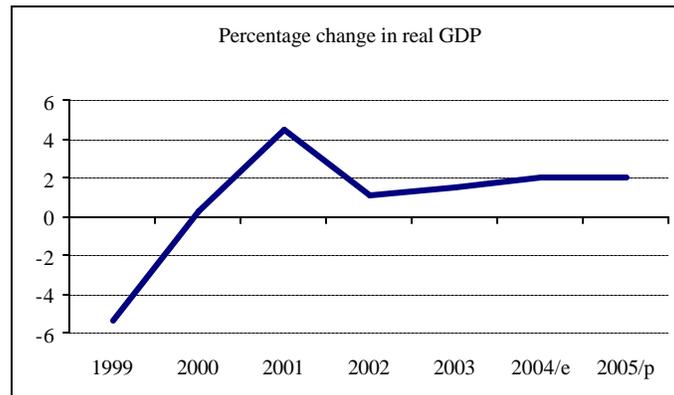
Table 20. Country Summary

Country	Republic of Palau
Prime Minister	President Tommy Esang REMENGESAU, Jr. (since January 19, 2001); the president is both the head of state and government.
Head of State	President Tommy Esang REMENGESAU, Jr. (since January 19, 2001)
Independence	October 1, 1994 (from the US-administered UN Trusteeship)
Government	Bicameral Parliament or Olbiil Era Kelulau (OEK) consists of the Senate (9 seats; members elected by popular vote on a population basis to serve four-year terms) and the House of Delegates (16 seats; members elected by popular vote to serve four-year terms).
Land area	458 sq km
Population	20,000 (2004 est.)
Cities	Capital: Koror; a new capital is being built about 20 km northeast of Koror.
Districts	16 states; Aimeliik, Airai, Angaur, Hatohobei, Kayangel, Koror, Melekeok, Ngaraard, Ngarchelong, Ngardmau, Ngatpang, Ngchesar, Ngeremlengui, Ngiwal, Peleliu, Sonsorol.
Languages	English and Palauan official in all states except Sonsoral (Sonsoralese and English are official), Tobi (Tobi and English are official), and Angaur (Angaur, Japanese, and English are official).
Natural Hazards	Typhoons (June to December)
Natural Resources	Forests, minerals (especially gold), marine products and deep-seabed minerals.
Major Products	The economy consists primarily of tourism, subsistence agriculture and fishing. Tuna is the main export.

1. Economic Overview

121. The republic of Palau has the highest income per capita (US\$7,500 in 2003) and the highest aid per capita (averaging US\$1,712 over 1999-2002) of the Pacific Island countries. Palau receives substantial assistance from the United States through the Compact of Free Association, with total direct payments of about US\$410 million over 1994-2009. In recent years, annual disbursements have averaged about 20 percent of GDP, to create a Compact Trust Fund to enable Palau to become self-sustainable, and to finance government operations.

122. Due to various external shocks that affected tourism (a principal source of income for Palau), economic growth averaged 1.3 percent in 2002-03, down from a strong growth of 4.5 percent in 2001 (see Figure 9). Forecast for real GDP growth in 2005 is slightly higher at 2 percent. The annual inflation rate has been subdued at below 1 percent for the years 2002-04, attributable to the use of the U.S. dollar as the domestic currency.

Figure 9. Growth in Palau's Real GDP during 1999-2005.

123. The budget deficit widened from 2 percent of GDP in 2003 to an estimated 12 percent of GDP in 2004. Public debt in 2004 is estimated to be 14 percent of GDP.

124. The external position has fluctuated extensively, with a widening of the current account deficit in 2002 following the aftermath of September 11, 2001. The current account deficit narrowed to 5 percent of GDP in 2003 as tourist activity picked up, but increased to 18 percent of GDP in 2004, reflecting the growth in imports.

125. Palau's economy is sustained mostly by tourism and external assistance, with the public sector accounting for nearly half of total employment. The tourism sector was adversely affected in 2002 by the sharp appreciation of the U.S. dollar against the Japanese yen early that year, limited air flights, and uncompetitive airfares. However, tourist earnings rebounded by 22 percent in 2003 and another 7 percent in 2004. Efforts have been made recently to introduce competition in air flights and to diversify the tourist base.

2. Outlook

126. In the near-term, economic growth will be sustained, but medium-term prospects face fiscal uncertainties, particularly with the scheduled sharp reduction in grant assistance from the United States after 2009, which would significantly affect government expenditure, domestic consumption, and economic activity. The recovery of tourism and continuing large other donor-financed infrastructure projects should support growth.

127. To limit the potential risks faced by the economy, prudent management of the Compact Trust Fund, as well as public sector reform to limit unproductive public expenditure, including restraint on public sector wages and overall size of public sector in the economy while strengthening the tax revenue, are needed. Other steps include improving the business environment for private sector-led growth and foreign investment attraction, which is vital for economic self-reliance and for absorbing workers from the public sector.

3. Key Issues Shaping the World Bank's Involvement

128. Palau became a Bank member in 1997. Since that time, the Bank's assistance has been limited to the provision of technical assistance in a limited range of areas, principally oil and gas and natural resource management. Palau is an IBRD-eligible country.

129. The Bank's approach in Palau is shaped by an awareness of three major factors. First, Palau has access to large-scale grant resources from other development partners (mainly the Japan, Taiwan Province of China, and the United States). Second, Palau has high per capita GDP relative to other Pacific countries. And third, Palau has the potential to achieve more robust economic growth outcomes given its growing tourism industry—but will need to undertake a strong reform program to achieve such outcomes, particularly to address its fiscal challenges and to enhance the private sector enabling environment. The government has indicated its preparedness to start down this path, and the Bank will seek to support such efforts. In this context, the role of the Bank over 2005-08 will be to focus on the provision of targeted policy advice and analytical support in a few key areas to leverage donor resources and build local capacity. The Bank has held initial consultations with the Palau Government on areas of possible support and expects an agreement on these to be concluded in the near future.

4. Donor Coordination

130. Table 21 describes the nature of the assistance provided by Palau's other development partners.

Table 21. Activities of Other Development Partners

<i>Development partner</i>	<i>Primary activities</i>
ADB	Palau became a member of the ADB on December 31, 2003. ADB's program is currently under development.
Australia	AusAID provided approximately A\$200,000 in bilateral aid in the period 2003-04. This was focused on education, training and community development initiatives mediated through a small grants program.
European Union	Under the 9 th EDF, Palau received an allocation of Euro 2 million the majority of which is to be applied to the energy sector. The principal objectives of the program are to improve the overall efficiency of the energy sector; to increase the production through renewable energy sources; and, to reduce local pollution and environmental risks associated with current energy generation practices.
Japan	JICA supports Palau through a Technical Assistance program staffed by volunteers. In FY03 (April 1, 2003 – March 31, 2004) volunteers were involved in program areas that include: education and human resource development (focusing on primary and pre-school education, vocational training and education for the disabled) Japan has also provided some major infrastructure grants to Palau.
New Zealand	Support to Palau is included within NZAID's program to Micronesia with an allocation of NZ\$835,000 in 2003-04. The focus is on education and with limited grant funds for self-standing community development initiatives.
United States	<p>In 1994, the Republic of Palau Compact of Free Association with the United States of America became law. Under the compact, Palau receives U.S. grant assistance for a period of 15 years in return for furnishing the United States with military facilities.</p> <p>The status of free association recognizes Palau as a sovereign state with the capacity to conduct foreign affairs consistent with the terms of the Compact. The Compact places full responsibility for Palau's defense with the United States. The Compact also provides grant funds and Federal program assistance, principally through the Department of the Interior's Office of Insular Affairs (OIA).</p> <p>In FY04, Palau received US\$14.07 million, and under appropriations endorsed by the U.S. Congress, can expect to receive a total of US\$77.16 million over the period FY04-09. Use of the compact funds is determined through consultations between the OIA and government representatives, however OIA encourages use of the funds in six main areas: health, education public infrastructure, capacity building, private sector development and the environment. Of these, health, education and public infrastructure represent the most significant programs.</p> <p>In addition to the funds received under the compact of free association, Palau is also eligible for federal programs in sectors including health and education.</p>
Others	The following UN agencies have activities: UNEP, ITC, WHO, FAO, UNFPA, UNICEF, UNDP