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Palau Economic Advisory Group

General statement of objectives, principles and preliminary programs

This note sets out in general terms our view of some guiding principles for the economic and social development of the Republic of Palau in the context of free association with the United States, and summarizes recent positive developments in Palau-US economic relations.

1. Free association must be freely chosen and in the interest of all parties.

Palau at independence chose a Compact of Free Association with the United States, now up for renegotiation and renewal. It is axiomatic that such an agreement must be freely chosen and terminable by both parties. To be freely chosen, it must meet on mutually agreed terms the needs and requirements of both parties. The United States has primarily a strategic interest in the Pacific region, that it remain free and open and that it not become a region of military conflict. Peace and openness also are essential to Palau. But Palau's needs and requirements are primarily in the economic and social sphere, specifically in budget support, sustainable finance, the quest for long-term economic development. That requires as its foundation a just, flexible, workable relationship between the Palauan people and the United States, recognizing that the lives of the two societies are now deeply intertwined. The two interests are asymmetric but balanced; the vast security powers of the US find equivalence in economic prosperity for Palau. The Compact must recognize that the mutual goals of the two countries are to be achieved over an indefinite future. There is no natural end-point for either one.

Completion of negotiations for a renewal of the Compact of Free Association is a matter for the governments of Palau and the United States. It should result in a sufficient US financial commitment to resolve the present debt and budgetary issues, permitting Palau to focus on a program of reconstruction, development, diversification, and sustainability. The work of the Economic Advisory Group is concerned primarily with such a program, to be developed and implemented over time.

2. Toward sustainable economic development in Palau.

As a remote and very small country, Palau faces high transportation costs and large per capita fixed costs for basic infrastructure (airport, ports, communications, roads, energy, education, health care), as well as risks from natural disasters. Palau has come through a boom-and-bust cycle in the tourist economy; the attractions remain but the revenues have not recovered. In consequence, practically all Palauan infrastructure is outdated and in need of reconstruction



and replacement, which can only be financed on preferential terms. For this reason, Palau's graduation to high income country status, as decided by the World Bank, is inappropriate. Palau should be eligible for comprehensive assistance to support economic development and improve the quality of life.

Going forward, Palau needs to build a more diversified services-based economy while restoring tourism on a more sustainable, high-end basis with better revenue recovery. Comprehensive reconstruction of the core infrastructure is necessary, including the airport, port, hospital, schools, communications, energy, water and wastewater, the urban setting in Koror, soil reclamation, and environmental services, alongside provision for maintenance of new and old facilities. The energy system should be revamped to reduce dependence on diesel imports.

In addition to a renewed and improved tourist sector, an infrastructure development plan should aim to create the possibility in Palau for professional service hubs, corporate headquarters and branch offices, and for stable retirement communities to balance the ebb and flow of tourism. Thus a plan for capital improvements, financing and technical support should be provided for, including Palau as an eligible participant in programs of the DFC, Trade and Development Agency, the US Department of Agriculture and other entities such as the Department of Transportation as appropriate. In this connection, we note with pleasure the recent USDA award of \$34.9 million to Palau to install fiber-to-the-premises to residences and educational facilities.

During the visit of Finance Minister Kaleb Udoi to Washington October 17-20, 2022, several important meetings helped to clarify the path forward for US engagement through the U.S. Trade Development Agency (TDA) and the U.S International Development Finance Corporation (DFC), development agencies prepared to engage with Palau in a coordinated effort at reconstruction and development, especially with respect to core infrastructure. TDA is ready in principle to conduct on-site feasibility studies in several areas, including transportation, energy, agribusiness, communications and healthcare, preferably combining studies so as to produce an integrated investment program with effective coordination across sectors and projects. DFC is ready in principle to extend guarantees, loans and insurance for bankable projects involving private banks and private-sector partners, notably in energy, ICT, environmental projects and housing, in conjunction with the Japan Bank for International Cooperation (JBIC) and other partners, including TDA. Palau welcomes the initiatives of these agencies and the determination that it is eligible for partnership with them. The scene is therefore set for the development of a broad plan for new initiatives in line with Palauan priorities. Palau is ready to receive relevant delegation(s) to review conditions and work on specifics.

3. A viable relationship for all Palauans.

Palau as a former UN trust territory exists in complex relationship to US government laws and programs. In particular, over the last 75 years Palauans have enjoyed increasingly open and free access to the United States, and commonly leave the islands to study and work in the US, where incomes are multiples of what may be earned on Palau. As a result about half of all Palauans now live in the United States. The difficulty is that their integration into US society, including military service and veterans' benefits, Social Security, Medicare/Medicaid, and other programs creates a large barrier of inducement – an underpinning of economic life – which they would lose if they ever returned to live in Palau. Thus, while there is important remittance and return migration affirming ties of identity and enterprise, the possibility of returning and sustaining participation and contribution to the economic life and political economy of Palau is foreclosed for most Palauans living abroad. A revision of the Compact should take account of this development, and seek to make it possible for Palauans in the US to choose freely and fluidly whether to remain or to return – without loss of earned benefits or health insurance and care. It should also become possible for Palauans and



others to make gifts and bequests to public-purpose activities on the same basis as for charitable donations in the US. In this way the economic success of Palauans and their friends in the US private sector can help to support economic development in Palau. Specific ideas include:

A. A comprehensive infrastructure development plan, as highlighted above, is needed for the benefit of Palauans presently resident in Palau, but also to support private-sector investment, foreign investment, and the return of Palauans to Palau.

B. First-class communications for all Palauans and visitors. Of prime importance in creating a more stable and diverse economic base for Palau is electronic communications. Palau presently has a high-capacity undersea internet trunk line, but the local distribution infrastructure is outdated. Replacement with wired or wireless links covering the entire archipelago is indispensable to the development of a professional services, branch corporate, or retirement community economy – each of which would help provide a stabilizing anchor for the volatile tourist sector. The technology chosen should be designed to be robust to Palau’s climate challenges and to its terrain.

C. Extend Medicare, Medicaid and VA benefits to qualifying Palauan returnees from the US, and to qualified others who may choose to live there. Presently Palauans and others qualify for Medicare, Medicaid, and VA benefits only while resident in the United States. Extending this coverage to Palau itself would support health care in Palau and encourage a modest returnee retirement colony sector to develop, diversifying the economy.

D. Obtain charitable tax treatment for all public-purpose gifts and bequests to Palau. All US-based gifts and bequests to public-purpose entities in Palau, as designated by the Palauan government, should be treated as though they were to a 501(c)3 organization. Presently only the community college qualifies. Extending this tax treatment to health, other education, infrastructure, research facilities and to the government itself would encourage donations from expatriate Palauans, from wealthy US persons and from corporations, permitting the equivalent of a capital campaign for Palau.

This is a preliminary set of principles and programmatic proposals. The Economic Advisory Group takes a long-term view, and will work to extend, refine and develop these and related ideas in the months and years ahead.

Signed On Behalf of the Palau Economic Advisory Group

James K. GALBRAITH,
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