



Republic
of Palau

2022 ECONOMIC BRIEF

Republic of Palau



Palau Leadership Meeting | July 13, 2022

Presentation Outline

1. Economic Performance

- GDP, Employment & Wages, Prices, Tourism, and Fiscal Balance

2. Looking Forward

- GDP, Visitor Arrivals, External Debt, Fiscal Balance, Gov't Deposits

3. CROSS & CARES Act: Mitigation Success

- Does an efficiently targeted extension make sense?

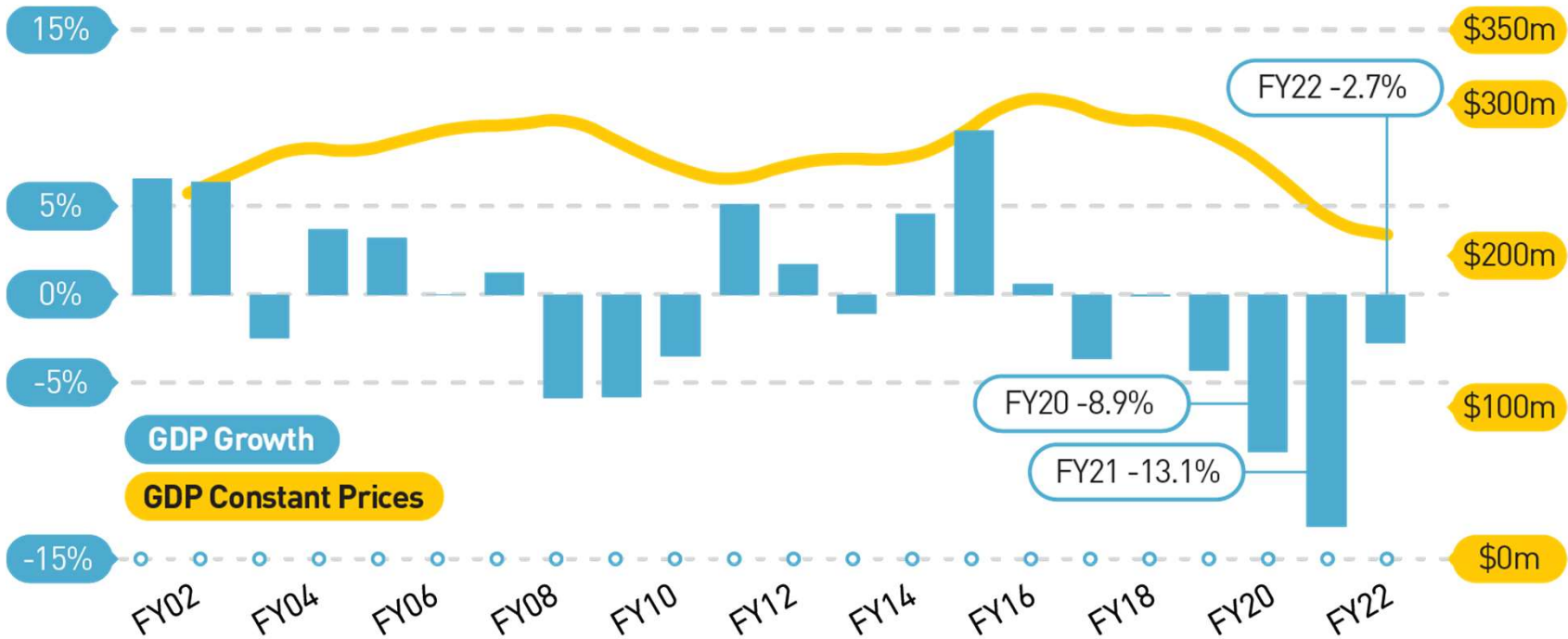
4. Policy Issues

- Tax reform implementation—benefits strongest when tourism recovers
- Fiscal Responsibility Act & Initial Economic and Fiscal Update
- Minimum wage cost and impacts
- Social Security Reform
- Civil Service Pension Plan



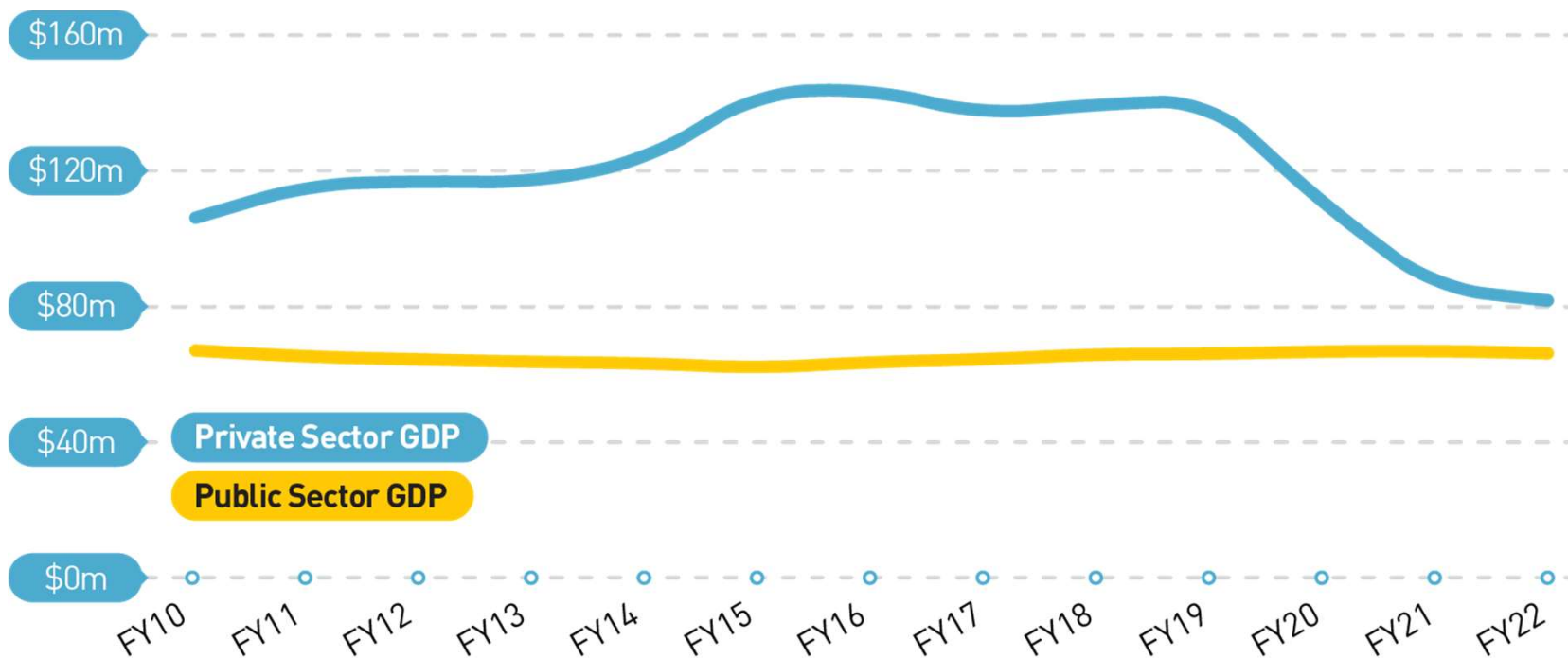
Real GDP Annual Growth

Palau economy fell by 9 percent in FY20, and further 13 percent in FY21



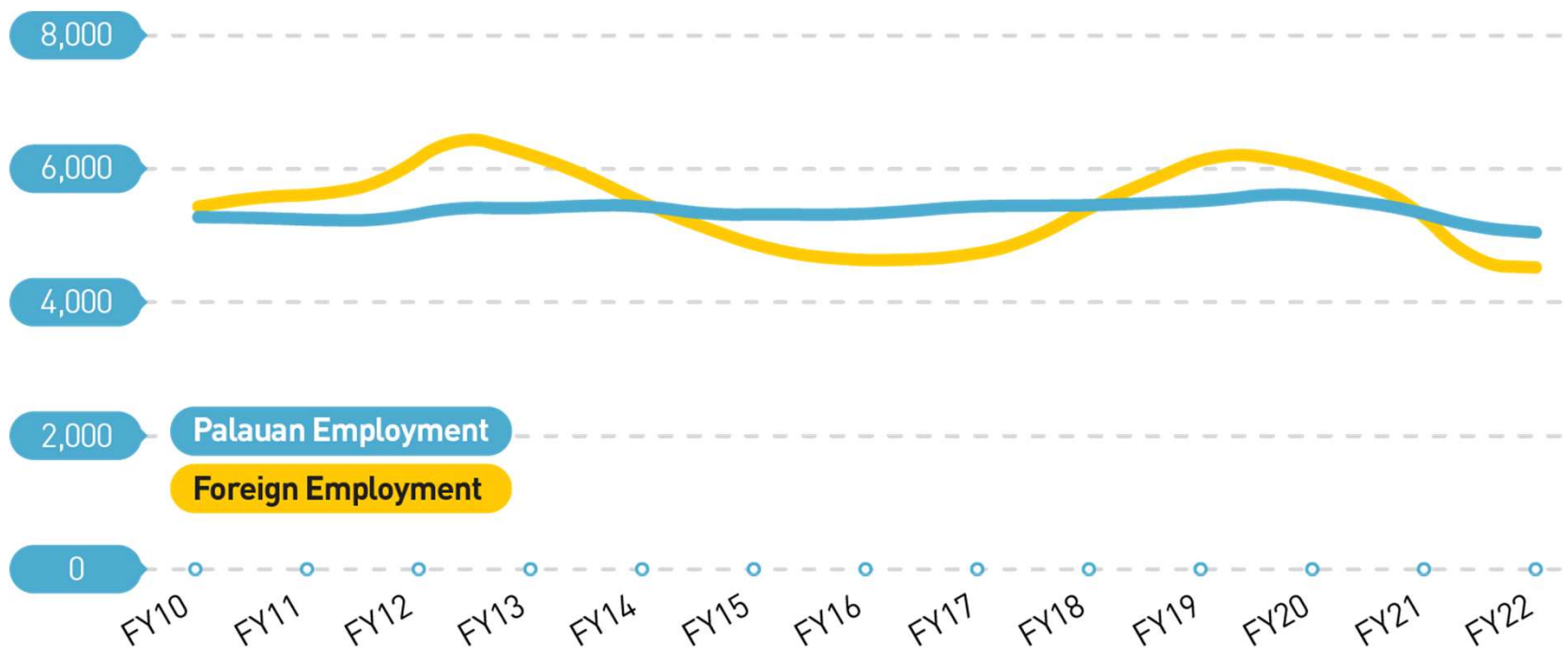
Private and Public Sector GDP

Private sector performance has been volatile and bore the brunt of COVID



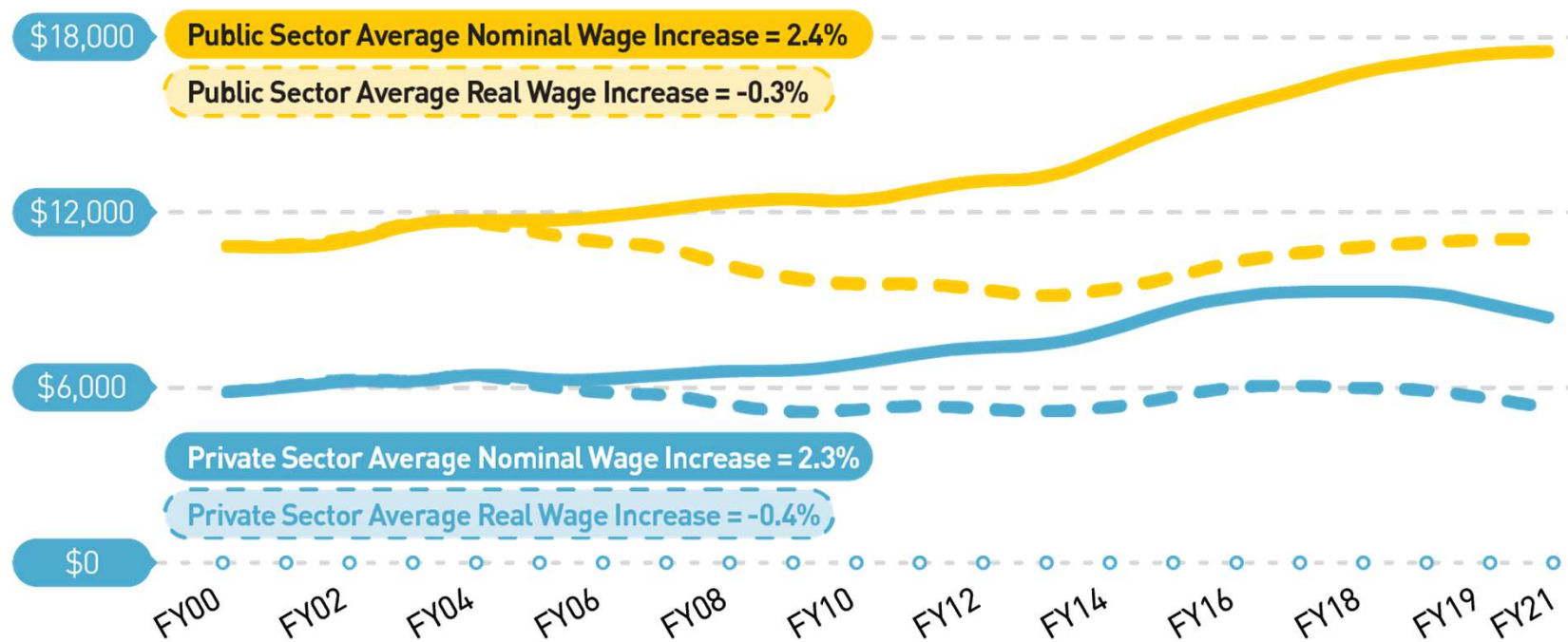
Employment by Palauan and Foreign Workers

Pre-Covid, labor volatility was limited to the foreign labor market



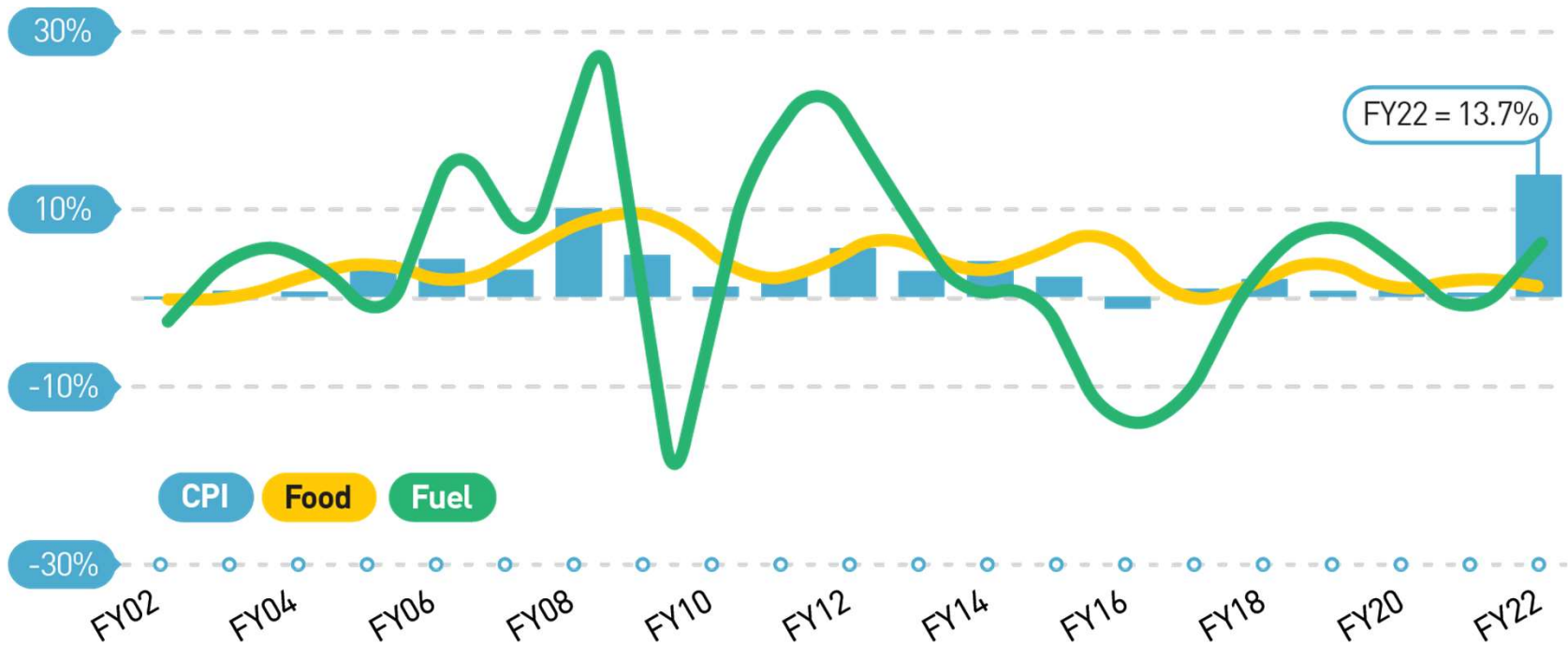
Nominal and Real Wages

Nominal wages increased; real wages have lagged; Public/Private differential unchanged.



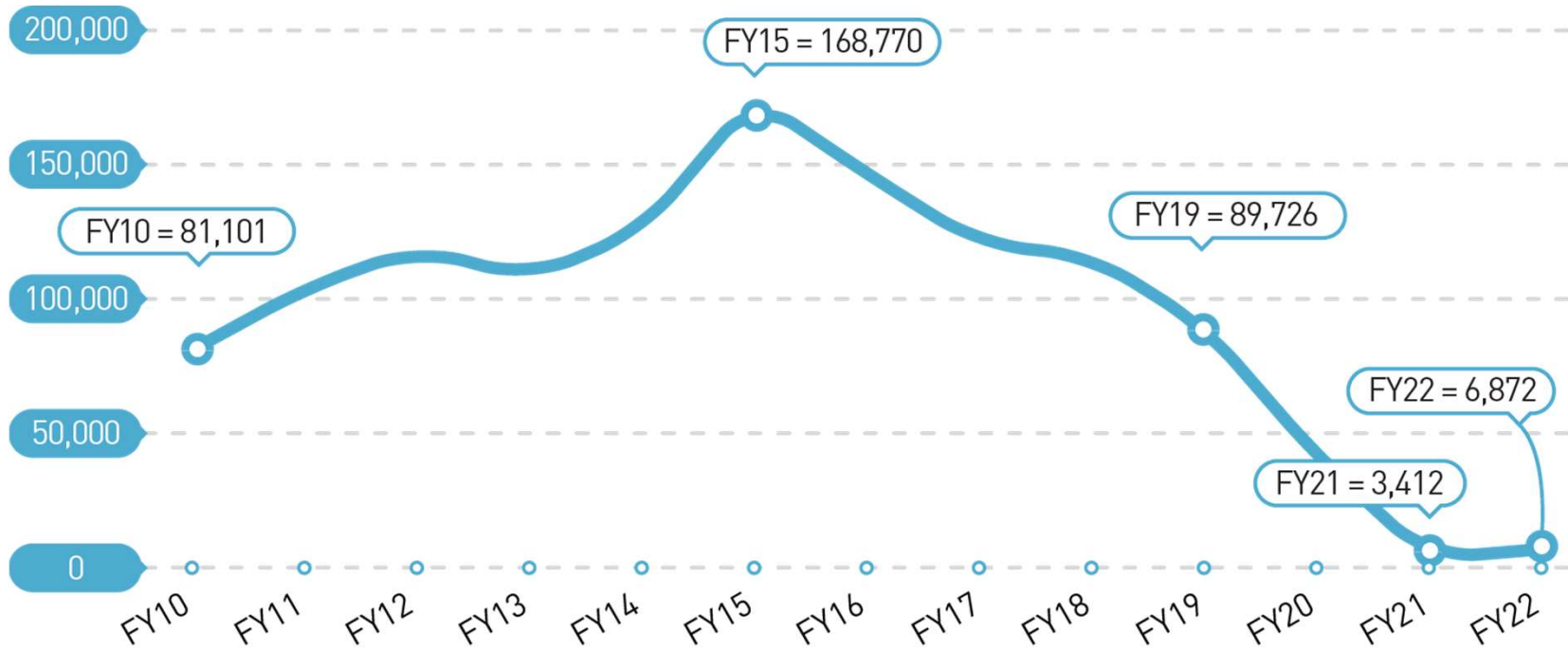
Consumer Price Index

Inflation is projected to reach ~14% in FY22 driven by fuel and food prices.



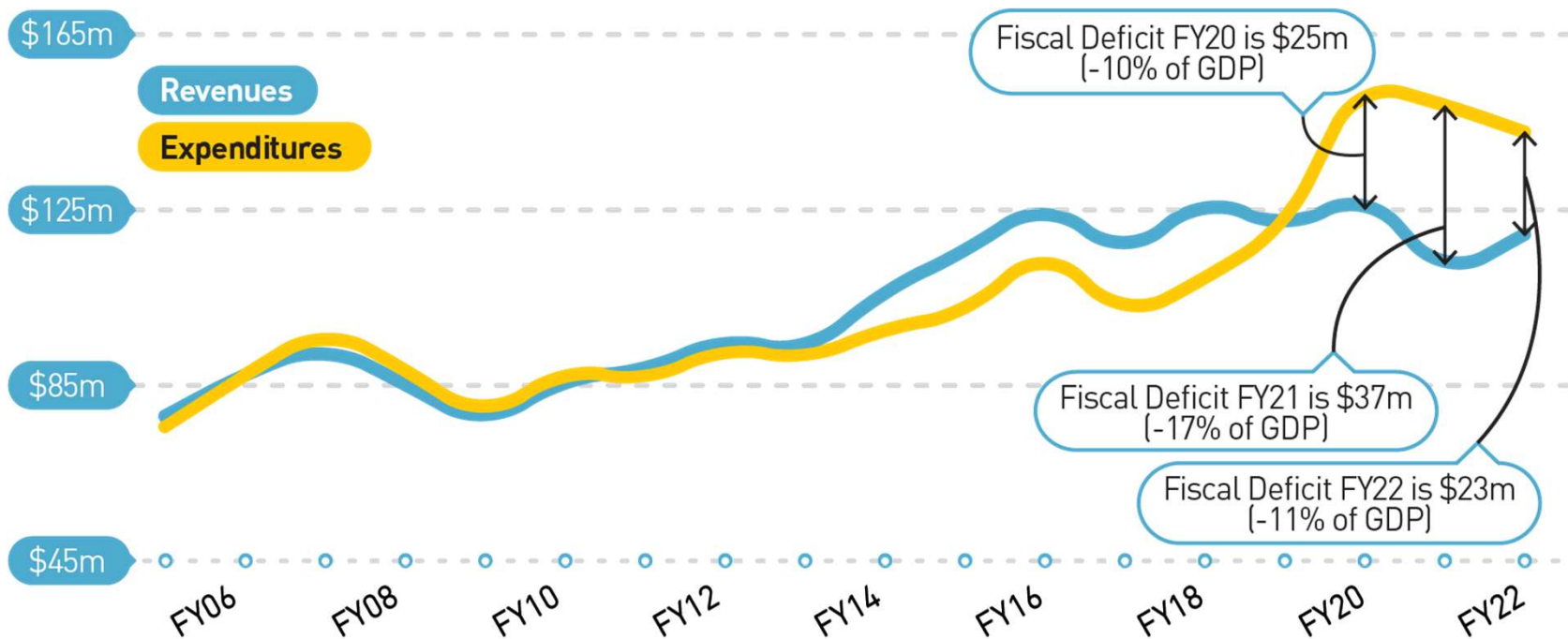
Visitor Arrivals

After peaking in FY15 visitor arrivals declined to near zero in FY21 and FY22 with impact of COVID.



Government Revenues and Expenditures

Palau generated large fiscal surpluses as tourism boomed; large fiscal deficits during COVID.



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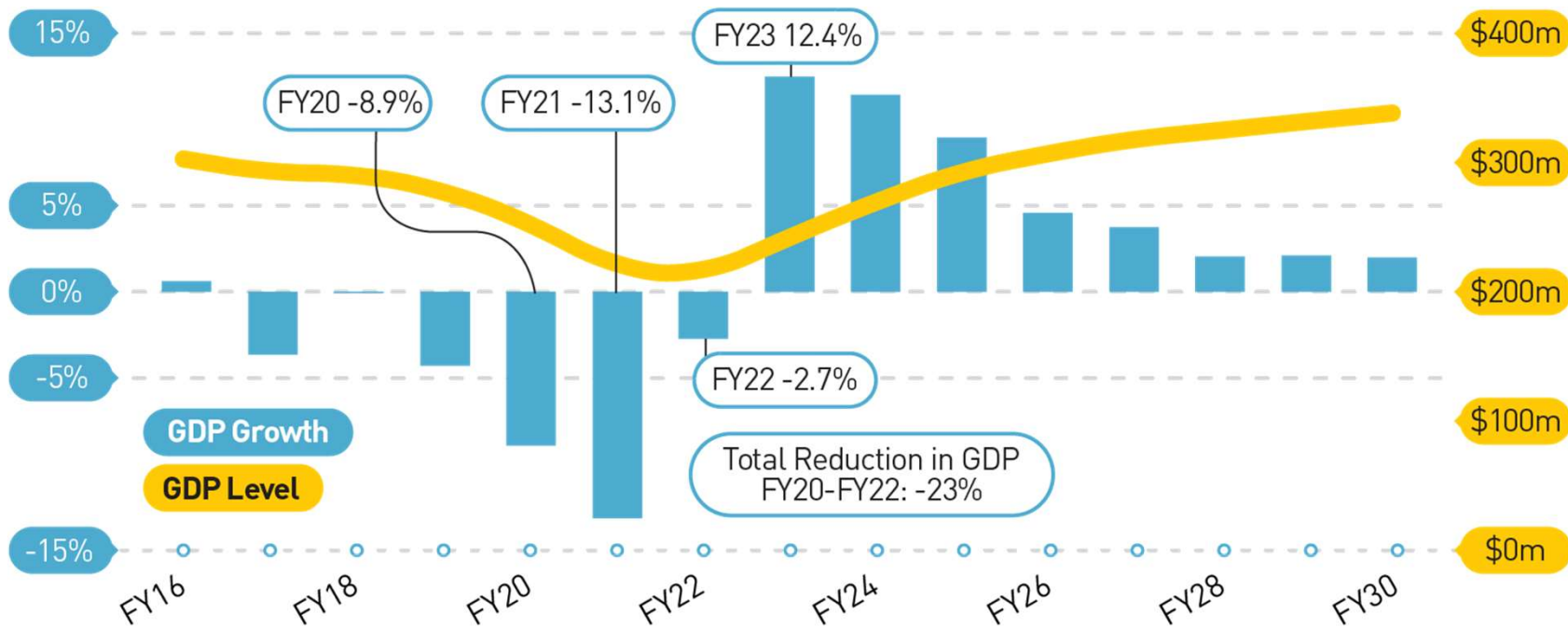
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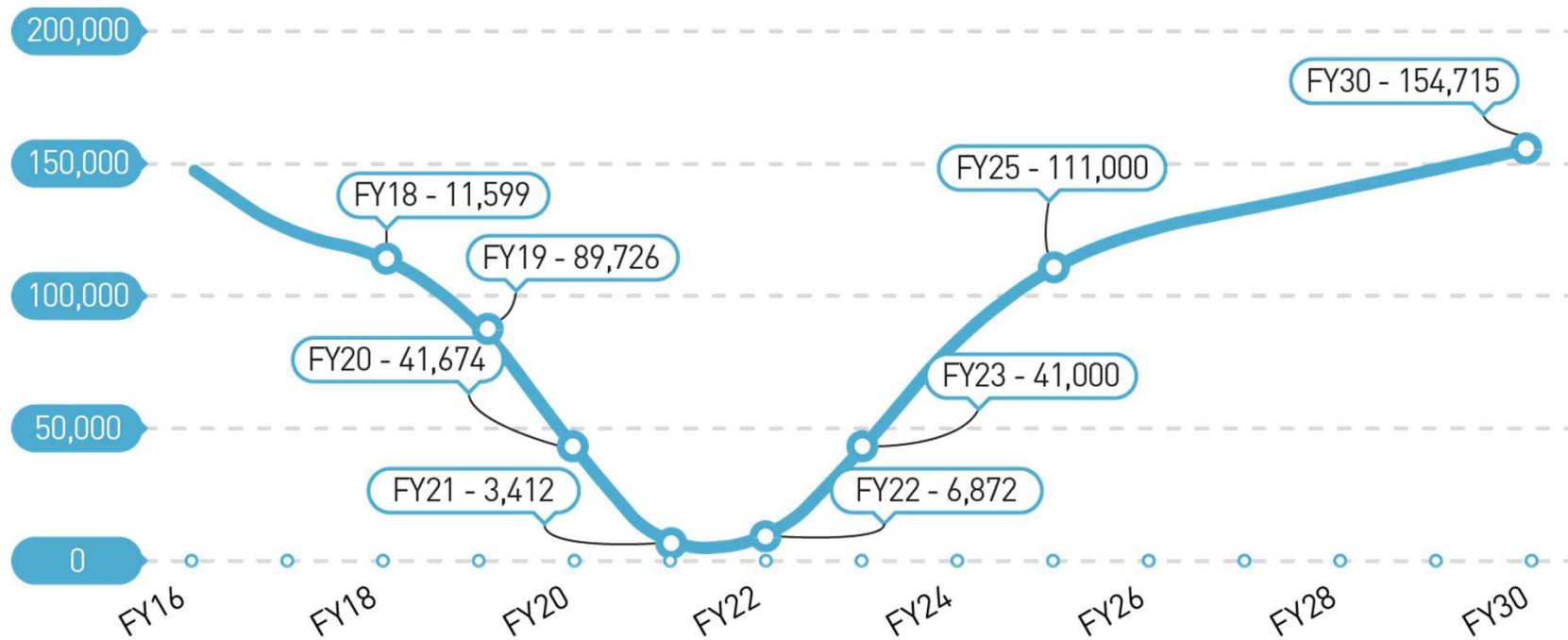
GDP Level and Growth: FY18-FY30

GDP is projected to contract further in FY22; recovery projected in FY23 and beyond.



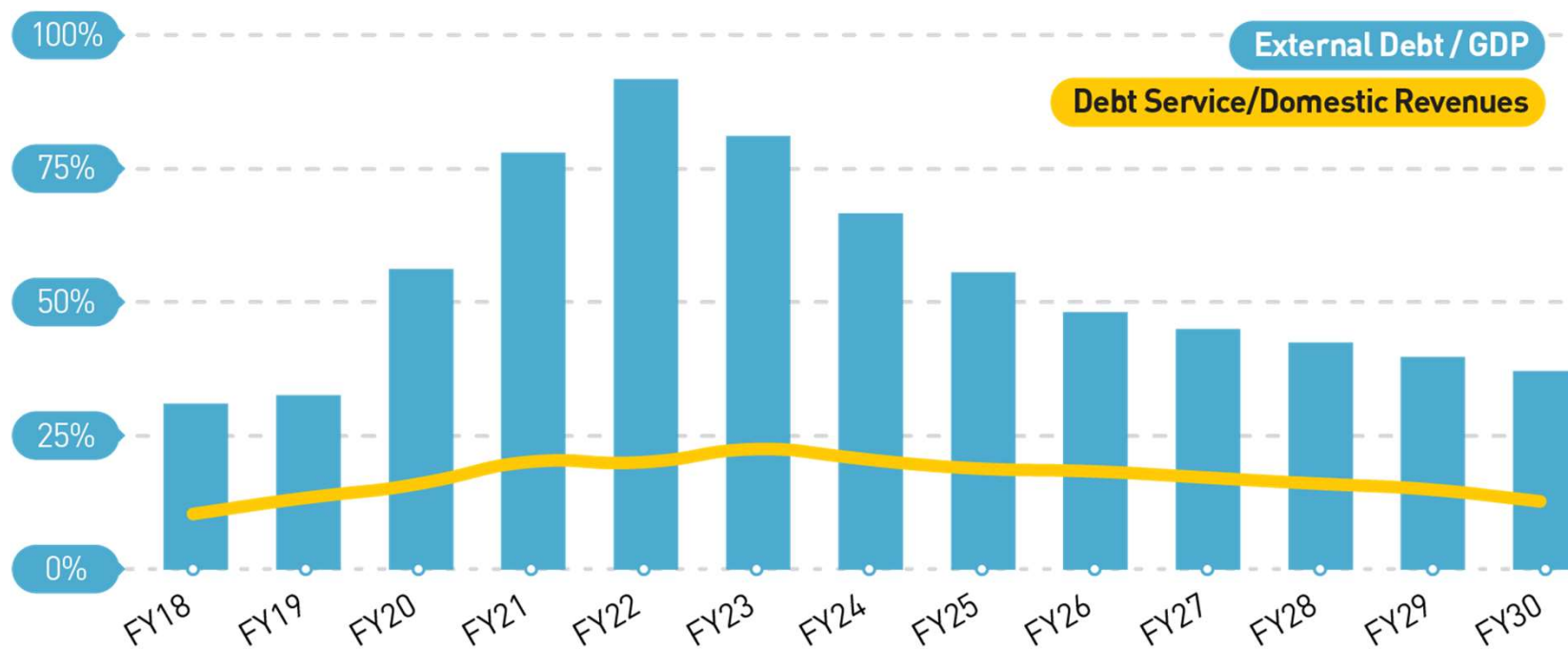
Visitor Arrival Projections: FY22-FY30

Tourism recovery is delayed until at least FY23; full recovery projected by FY25.



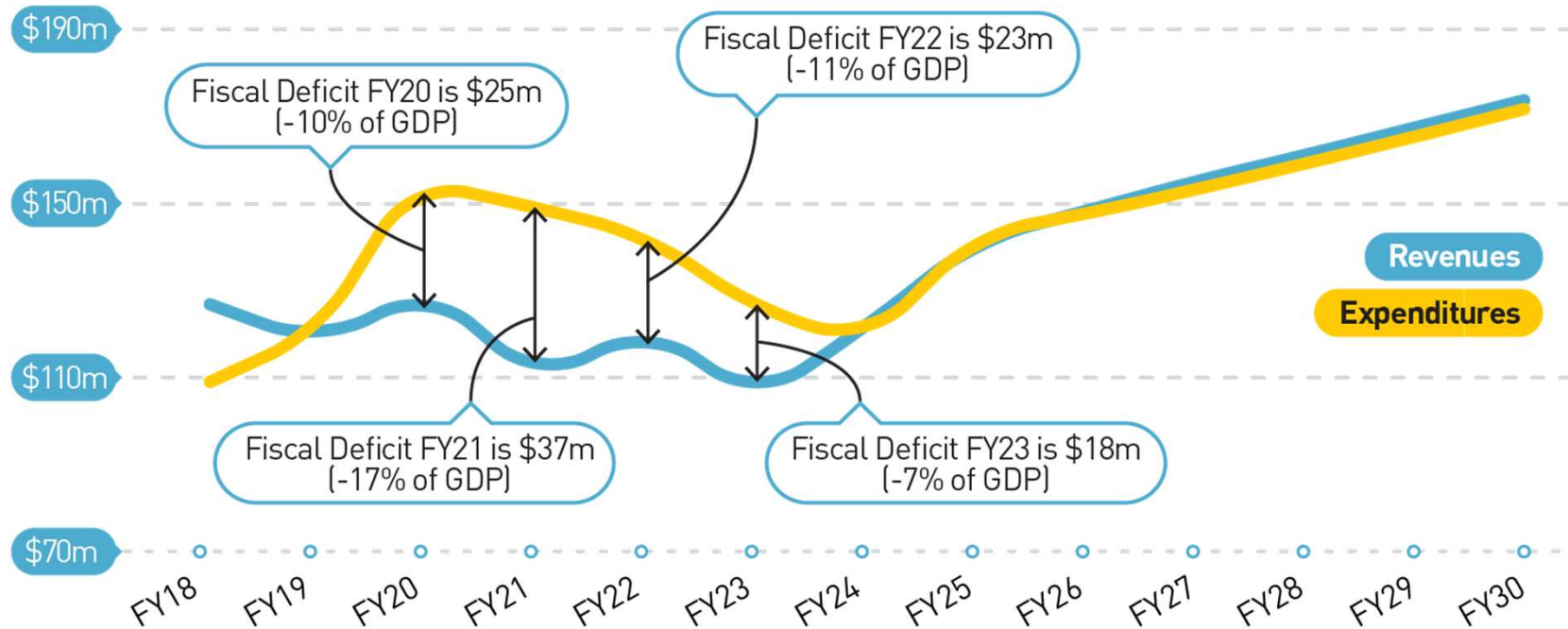
External Debt and Debt Service, % GDP

External debt rises to concerning heights due to COVID financing.



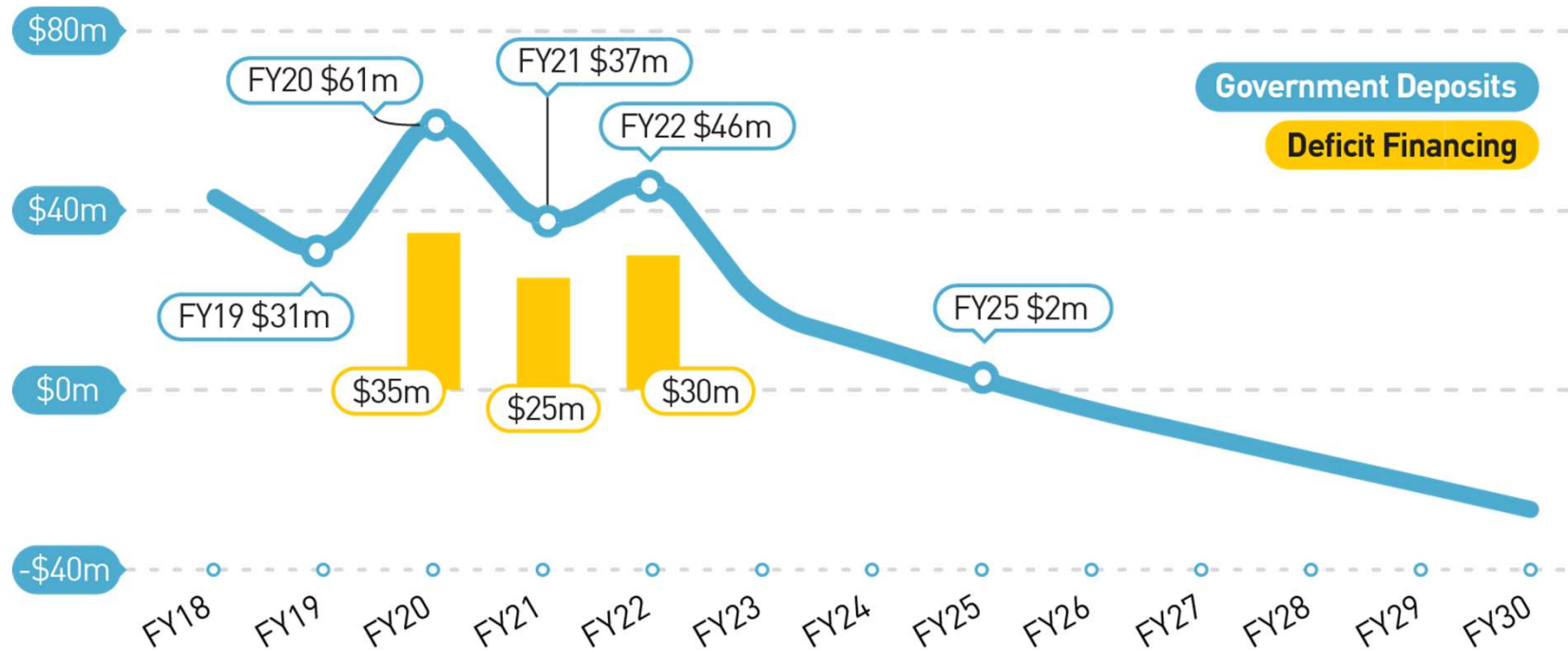
Government Revenue and Expenditure, FY19-FY30

Government runs large deficits from FY20 - FY23; balance restored in FY24 on current policies.



Government Deposits, FY19-FY30

Government deposits are projected to decline after FY22 and turn negative after FY25.



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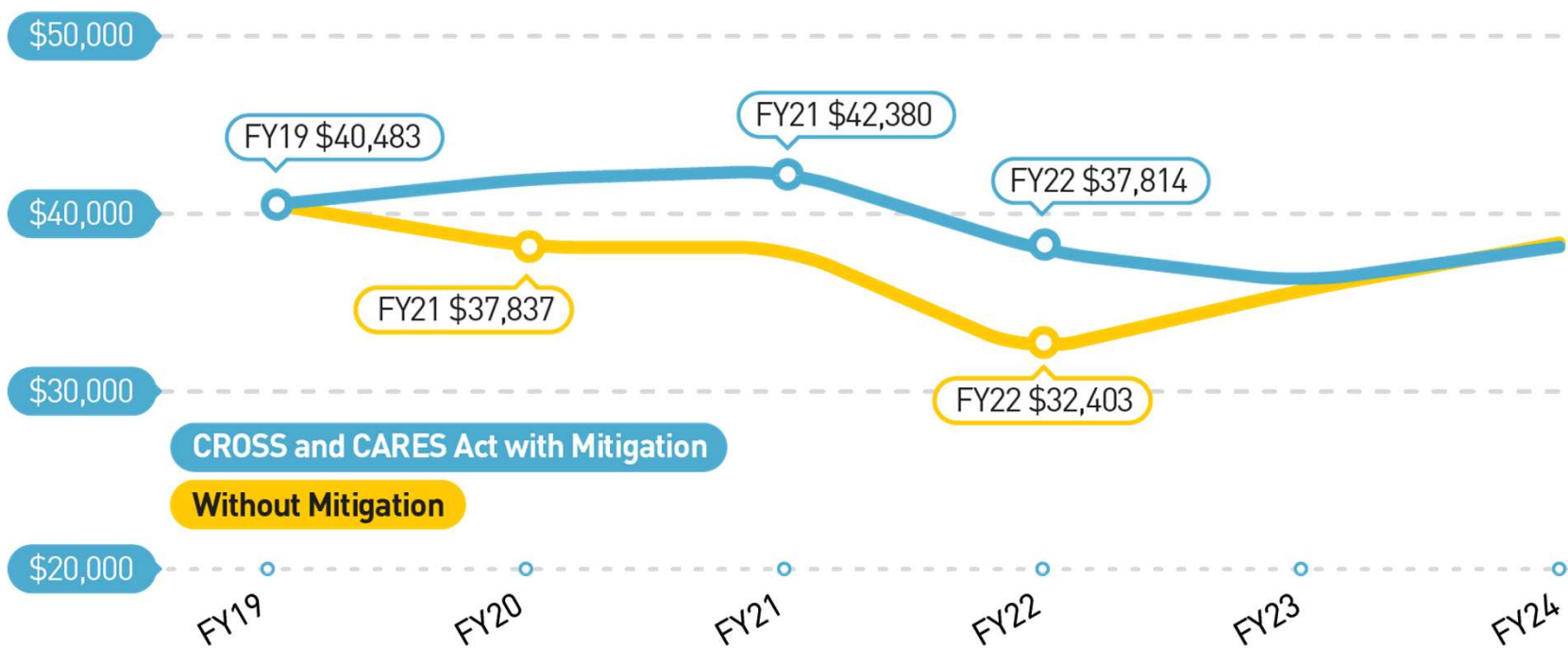
Mitigation Programs Successful

- Mitigation programs have had a **large beneficial impact** on household incomes
 - Household incomes declined 11% from FY2019 – FY2022
 - Without mitigation the decline would have been nearly double at 19%



Mitigation Impact on Households

Household incomes fell 11% from FY19 - FY22 with mitigation (19% without mitigation).



CROSS extension?

Data-Driven Targeting Example...

EXAMPLE	BGR 2019 Q End March 30	BGR 2022 Q End March 30	% of pre-COVID gross \$	Total Employees 2019 March	Total Employees 2022 March	# of Employees on CROSS	\$ of Recovery per CROSS Covered Employee
Business A	200,000	30,000	15%	30	10	15	\$ 11,333
Business B	50,000	21,000	42%	10	3	3	\$ 9,667
Business C	300,000	249,000	83%	45	20	20	\$ 2,550



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Tax Reform: Fit for Purpose and Timing

- Tax reform in Palau is coming soon... and Palau's economy is **ideally suited** to the PGST.
- Tourism sector **recovery** is needed for the new tax system to have the strongest impact...
- ... the new tax regime will ensure tourists **contribute more**... allowing Palauans to pay less at any given level of tax effort



Palau's New Fiscal Regime

- Statutory Action: **Fiscal Responsibility and Debt Management Act**, leading to:
 - Fiscal Strategy
 - Model-driven forecasts to budget “envelope”
 - Economic and Fiscal Update
 - ...
- FY24 **budget cycle** will follow the designed timing



Economic and Fiscal Update

PRINCIPLES	STATUS	RETURN TO ADHERENCE
1 Manage operating expenditures over the medium-term	Not in adherence	[est. FY24/FY25]
2 Manage net capital and financial assets	Not in adherence	[est. FY24/FY25]
3 Manage debt prudently	Not in adherence	[est. FYFY25/26]
4 Manage the revenue regime	Approaching adherence	End of CY22
5 Manage reserves and insurance coverage	Approaching adherence Minister of Finance to establish reserve funds	End of FY22
6 Manage the non-primary government public sector prudently	Not in adherence	[est. 3-5 years]
7 Manage fiscal risks and contingent liabilities prudently	Deemed in adherence	Done



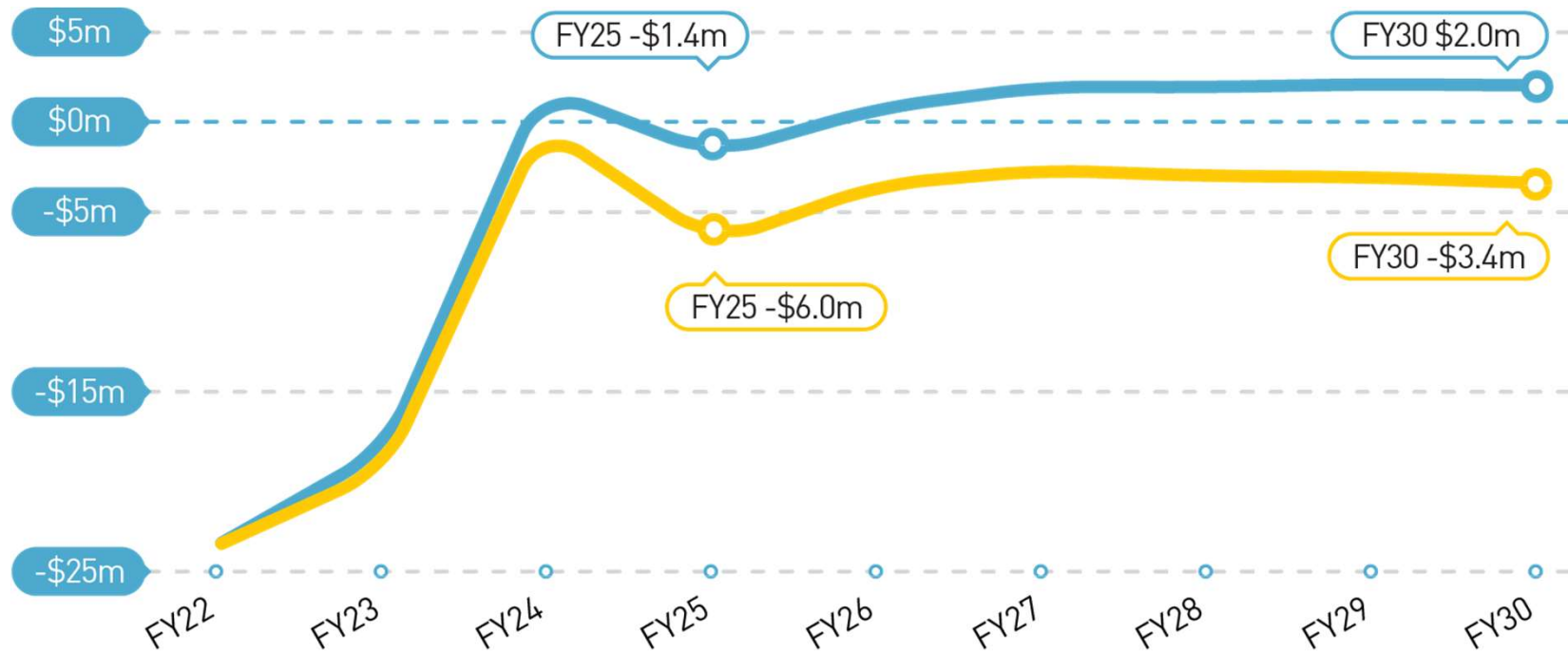
Minimum Wage Increase

- Modeling we show is based on **two increases** of \$0.75 each from a base of \$3.50 to a new level of \$5.00... modeling results follow...



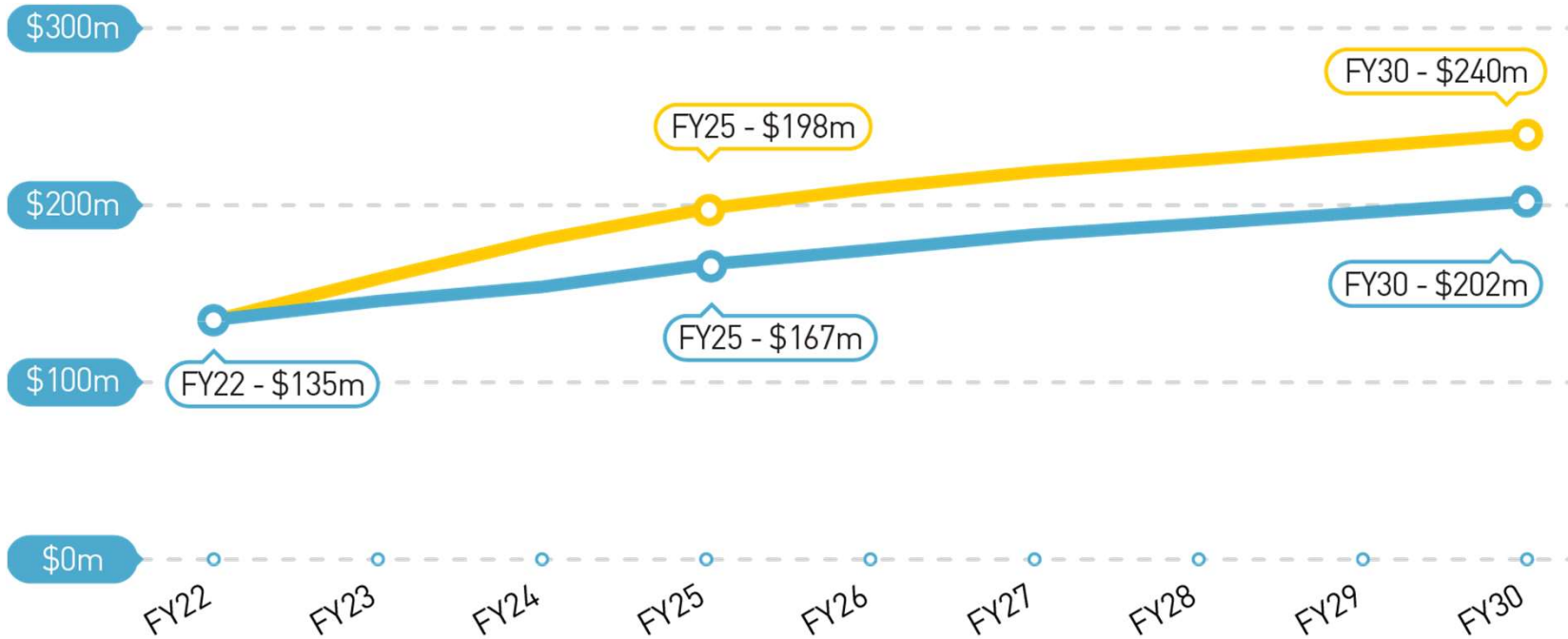
Minimum Wage Impact on Fiscal Deficit, FY23-FY30

Accumulated additional funds required to pay for minimum wage increase by FY30 is \$32 million.



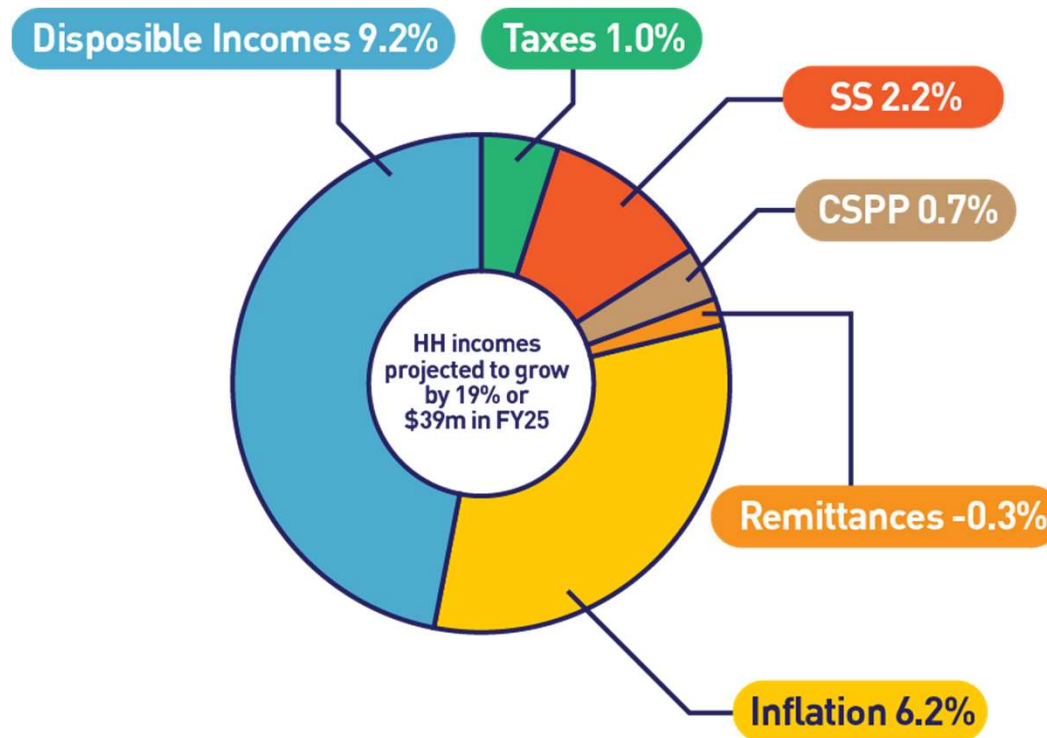
Minimum Wage Impact on Wage Bill, FY22-FY30

Total wage bill increase with minimum wage increases is 19% higher.



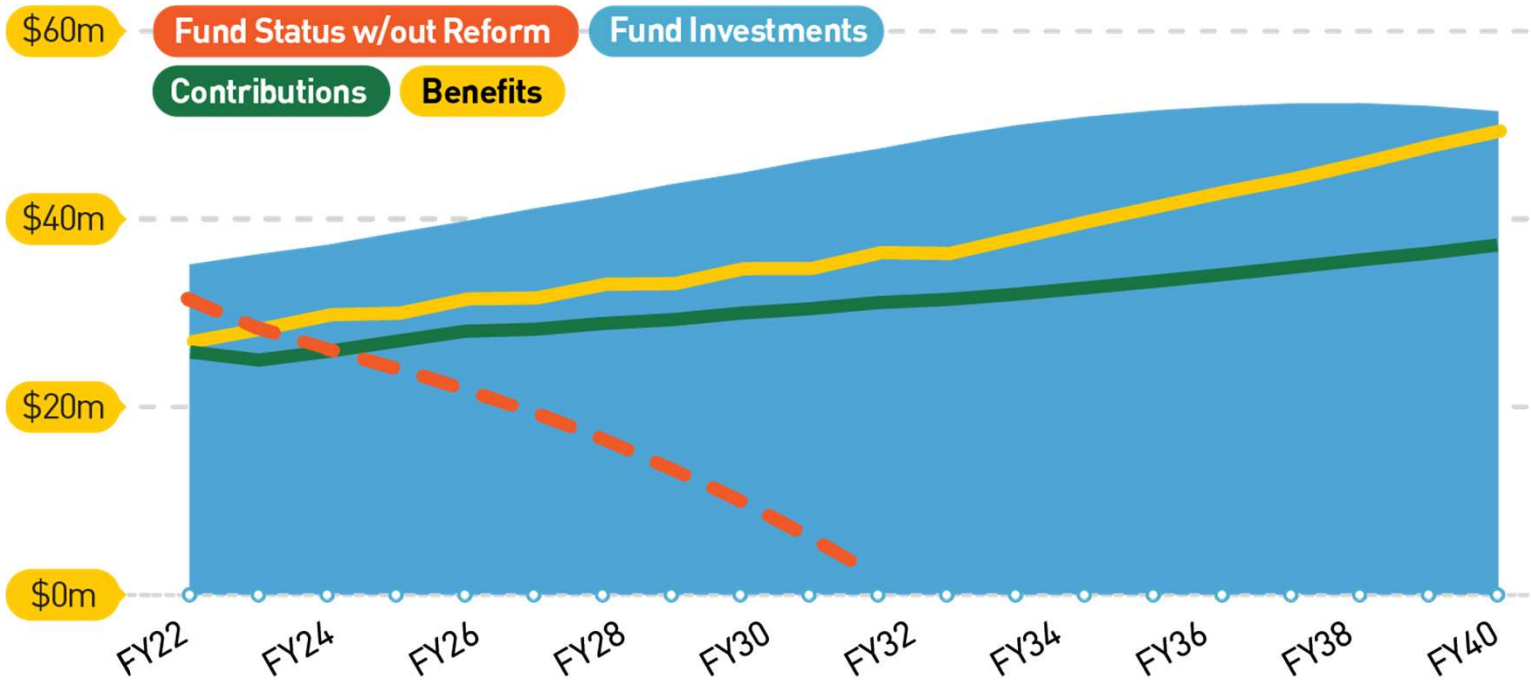
Minimum Wage Increase Benefits, FY30

Incomes rise by 19%, but disposable income only rises by 9.2%.



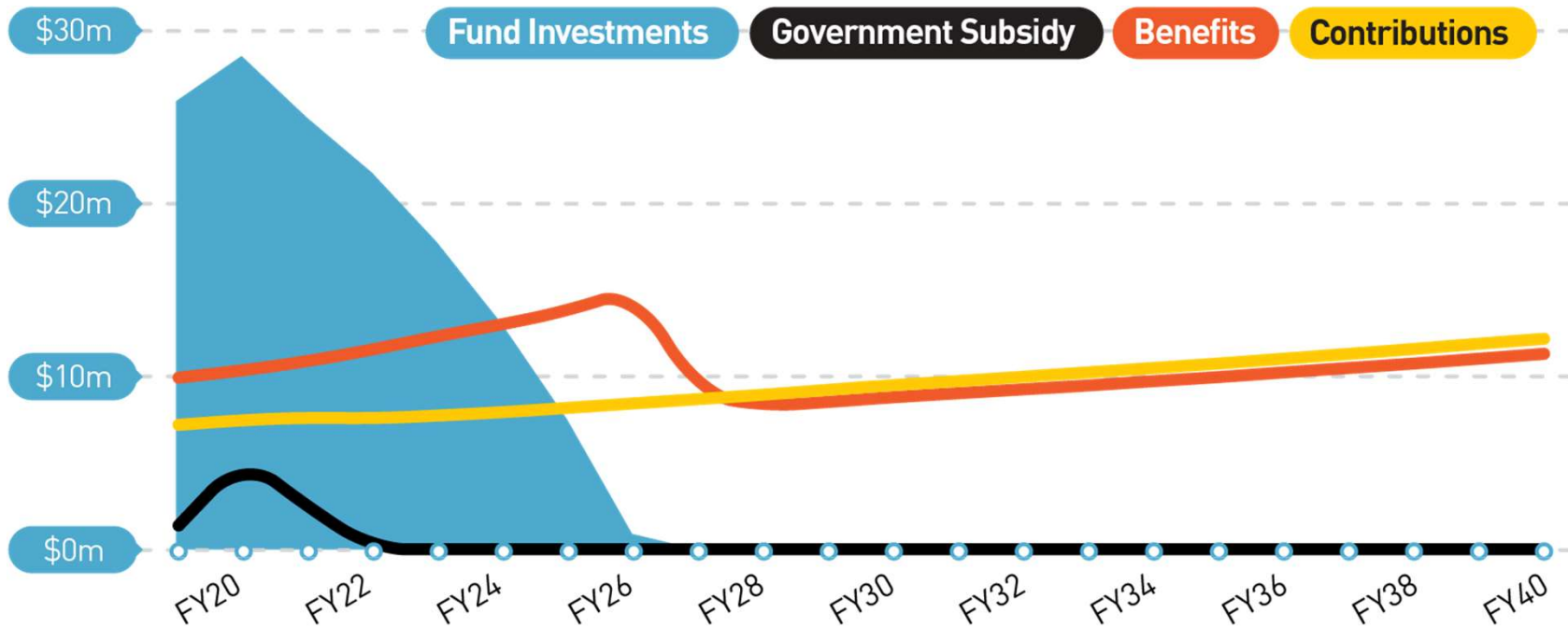
Social Security Fund Outlook

SS is projected to achieve sustainability based on reform implementation.



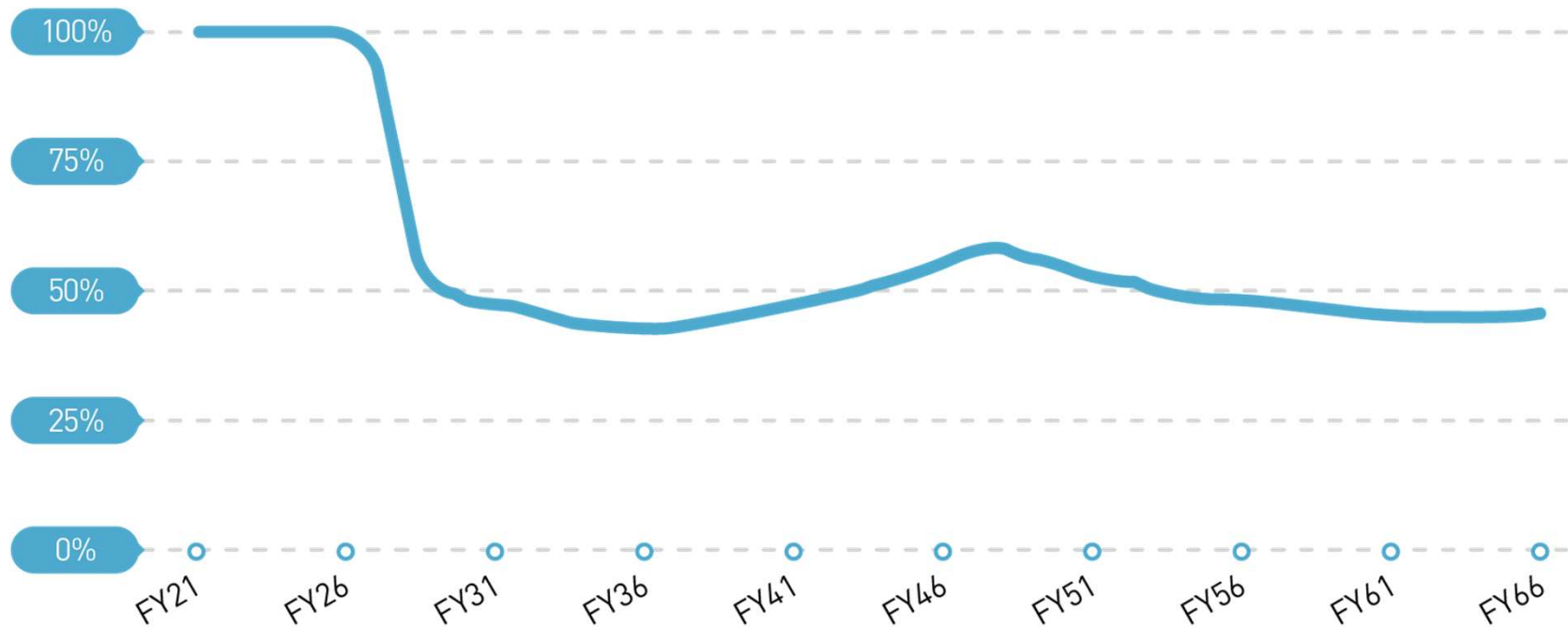
Civil Service Pension Plan Outlook

Collapse of the CSPP Fund threatens retirees with a 50% cut in benefits.



Payout Percentage of Benefit

If CSPP Fund collapses... payouts will be cut in half and decline to as low as 42%.





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QUESTIONS?



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Palau's Income Status

- Palau's Gross National Income per capita is **projected to decline** from \$16,745 in FY2019 to \$13,870 in FY2021 and \$13,973 in FY2022.
 - Decline from a peak in FY2019 by 17%
- The World Bank's high-income group has a **lower threshold** of \$12,696.
 - Palau was categorized as "high-income" among developing countries
 - This may change to Palau's near-term benefit

