



Republic  
of Palau

2025



Graduate School USA

EconMAP

# PALAU ECONOMIC REVIEW

Republic of Palau  
January 2026

# Abbreviations

## CURRENCY EQUIVALENTS

Currency unit: United States dollar (US\$)

## ABBREVIATIONS

ADB	—	Asian Development Bank	DB	—	Defined Benefit
ADSL	—	Asynchronous Digital Subscriber Line	DC	—	Defined Contribution
AIFFP	—	Australian Infrastructure Financing Facility of the Pacific	DER	—	Distributed Energy Rate
AIP	—	Annual Implementation Plan	DMU	—	Debt Management Unit
AML	—	Anti-Money Laundering	DRP	—	Disaster Resilience Program
ATO	—	Australian Tax Office	DSA	—	Debt Sustainability Analysis
BGRT	—	Business Gross Receipts Tax	EAG	—	Economic Advisory Group
BPT	—	Business Profits Tax	EconMAP	—	Economic Monitoring and Analysis Program
BSCC	—	Belau Submarine Cable Corporation	EFU	—	Economic and Fiscal Update
BOP	—	Balance of Payments	EPO	—	Electricity Power Operations
CARES	—	Coronavirus Aid, Relief, and Economic Security	FAS	—	Freely Associated States
CFT	—	Combatting the Financing of Terrorism	FCC	—	Federal Communications Commission
CNMI	—	Commonwealth of the Northern Marianas	FDI	—	Foreign Direct Investment
COFA	—	Compact of Free Association	FIC	—	Financial Institutions Commission
COTS	—	Commercial Off the Shelf	FMIS	—	Financial Management Information System
COVID-19	—	Coronavirus Disease 2019	FRDMA	—	Fiscal Responsibility and Debt Management Act
CPI	—	Consumer Price Index	FSM	—	Federated States of Micronesia
CPRO	—	Coronavirus Pandemic Relief Option	FTE	—	Full Time Equivalents
CRA-10	—	Compact Review Agreement - 2010	FY	—	Fiscal Year
CRA-23	—	Compact Review Agreement - 2023	GB	—	Giga Bytes
CSO	—	Community Service Obligations	GDP	—	Gross Domestic Product
CSPP	—	Civil Service Pension Plan	GFS	—	Government Finance Statistics
CTF	—	COFA Trust Fund	GNI	—	Gross National Income
			GRT	—	Gross Receipts Tax
			GSUSA	—	Graduate School USA
			ICT	—	Information and Communications Technology
			IHG	—	InterContinental Hotels Group
			IMF	—	International Monetary Fund
			IPP	—	Independent Power Producer
			JBIC	—	Japan Bank for International Cooperation
			JICA	—	Japan International Cooperation Agency

KASP	—	Koror Airai Sanitation Project	PSTS	—	Palau Sustainable Tourism Strategy
KYC	—	Know Your Customer	RAN	—	Radio Access Network
MCA	—	Multi-Criteria Assessment	RFP	—	Request for Proposals
MSME	—	Micro, Small and Medium Enterprises	RISES	—	Recovery through Improved Systems and Expenditure Support
MTDMS	—	Medium-Term Debt Management Strategy	RMI	—	Republic of the Marshall Islands
MTDS	—	Medium-Term Development Strategy	ROP	—	Republic of Palau
MW	—	Mega Watt	RPL	—	Republic of Palau Public Law
NADABAS	—	National Account Data Base System	RPPL	—	Republic of Palau Public Law
NDBP	—	National Development Bank of Palau	RTPF	—	Responsible Tourism Policy Framework
NGO	—	Non-Governmental Organization	RUS	—	Rural Utilities Service
NIIP	—	National Infrastructure Investment Plan	SEA-US	—	South East Asia United States
NMDP	—	National Master Development Plan	SFR	—	Strengthening Fiscal Resilience
OEK	—	Olbiil Era Kelulau	SME	—	Small and Medium-sized Enterprises
PC2	—	Palau Cable 2 (Submarine Fiber Optic Cable)	SOE	—	State-Owned Enterprise
PBL	—	Policy-Based Loan	SOFR	—	Secured Overnight Financing Rate
PDP	—	Palau Development Plan	SORS	—	Sustained Operations and Recovery Support (ADB policy-based loan)
PEFA	—	Public Expenditure and Financial Accountability	SP1, SP2	—	ADB Subprogram Loans 1 & 2 for Policy-Based Lending
PEWA	—	Palau Energy and Water Administration	RoPSSA	—	Republic of Palau Social Security Administration
PFM	—	Public Financial Management	TA	—	Technical Assistance
PFTAC	—	Pacific Financial Technical Assistance Center	USPS	—	United States Postal Service
PGST	—	Palau Goods and Services Tax	USTDA	—	United States Trade and Development Agency
PNCC	—	Palau National Communications Corporation	WSIP	—	Water Sector Improvement Program
PPA	—	Power Purchase Agreement	WWO	—	Water and Wastewater
PPEF	—	Pristine Palau Environmental Fee			
PPP	—	Private Public Partnership			
PPUC	—	Palau Public Utilities Corporation			
PSDI	—	Private Sector Development Initiative			

**NOTE:**

Each FAS government's fiscal year (FY) ends on September 30.



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## Disclaimer

The views and opinions in this Economic Review are those of the authors and represent an independent analysis of Palau's economic performance. They do not necessarily reflect the positions of the Government of Palau, Graduate School USA, the U.S. Department of the Interior, or any other organization or individual.

## Foreword

This is the seventh Economic Review prepared for the Republic of Palau (RoP). It aims to support Palau's implementation of the renewed economic assistance under the 2023 Amended Compact (CRA-23, agreed May 2023; enacted by U.S. Congress, March 2024) and to inform broader policy development and economic management. Prepared under contract with the U.S. Department of the Interior, Office of Insular Affairs, and administered by Graduate School USA's Pacific Islands Training Initiative, the Review assesses Palau's economic performance, policy environment, and provides a comprehensive data set.

The Review was authored by Mark Sturton for Graduate School USA and EconMAP (Economic Monitoring and Analysis Program). The statistical data sheet was compiled by Michael Barsabal with support from Glenn McKinlay. Additional contributions were provided by GSUSA team, Kevin O'Keefe, Emil Friberg and Jason Aubuchon. The authors thank Hon. Kaleb Udui, Director, Bureau of Budget and Planning, Ministry of Finance; Muriel Sinsak and Limei Tesei, Office of Planning and Statistics; and the many civil servants and business operators in Palau who assisted with the Review and its statistical content.

A digital copy of this review is available online at <http://www.econmap.org>.



## Key Features in the Review

### **Economic growth rebounded in FY24 and is expected to continue at a strong pace in FY25.**

After contraction during COVID, real GDP rose 11.9 percent in FY24 and is projected to have grown 7.3 percent in FY25 based on provisional data. The recovery reflects lower inflation, returning visitors, and new infrastructure projects; however, tourism remains weak relative to prior levels and the recovery has been slow compared to regional peers.

### **Employment has recovered and exceeded pre-pandemic levels, driven by tourism, construction, and retail.**

Employment fell by 1,693 jobs (about 15 percent) during COVID but increased by 2,305 jobs through FY24, surpassing FY19 levels. New positions arose in tourism, construction, and the opening of a major supermarket in Airai. Of the net increase, 2,024 positions were filled by foreign workers and 281 by Palauan workers, reflecting near-full employment among Palauans and private-sector reliance on offshore labor sources.

### **Inflation peaked in FY22–FY23, declined sharply in FY24, and again in FY2025.**

Imported price shocks and the introduction of the Palau Goods and Services Tax (PGST) contributed to average inflation of 13.2 percent in FY22 and 12.4 percent in FY23. Inflation fell to 3.7 percent in FY24 as one-time PGST effects dissipated, and global price impacts were minimal. Inflation was only 0.2 percent in FY25.

### **Tourism recovery has been slow and remains below pre-pandemic levels.**

Visitor arrivals rose from 35,052 in FY23 to 52,551 in FY24 and 65,558 in FY25, reaching 57 percent of FY18 arrivals. Recovery has been constrained by limited flight schedules from traditional markets and a strong US dollar; sustained improvement is expected only over the medium term.

### **Major tax reforms, enacted in FY23,**

**strengthened revenues.** The PGST and Business Profits Tax proposals were introduced after public consultation and an economic symposium in May 2021. PGST receipts exceeded expectations and helped restore fiscal balance. Tax effort for the taxes affected by the reforms rose from about 9 percent of GDP in FY22 to 16 percent by FY25. The PGST also contributed materially to the FY22–FY23 price level spike; of the 8.7 percent inflation between 2022-Q3 and 2023-Q1, an estimated 3.0 percentage points were due to tax changes, 4.6 percentage points to increased business margins, and 1.1 percentage points to normal price movements.

### **Fiscal balances deteriorated sharply during the pandemic but improved by FY24.**

The government required financing equivalent to roughly 29 percent of GDP during FY20–FY23. The deficit reached 13 percent of GDP in FY20 and the cumulative COVID-period deficit was about 29 percent of GDP (FY20–FY23). Tight controls reduced the deficit to 4.3 percent in FY22 and the deficit improved slightly to 2.3 percent in FY23. Under the CRA-23 and improved revenues, FY24 resulted in a surplus of \$10.8 million (3.4 percent of GDP).

### **FY25 produced a fiscal surplus though**

**smaller than FY24.** Revenues increased by \$13.9 million in FY25—taxes up \$10.2 million, including \$8.6 million from PGST—while expenditures rose by \$16.3 million. The result was a fiscal surplus of \$8.5 million (2.4 percent of GDP).

### **Public debt rose sharply during the pandemic and is now declining but remains high.**

Debt-to-GDP rose from 30 percent in FY18 to about 70 percent in FY21, peaked near 72 percent in FY23, and is estimated at 63 percent in FY24 and 54 percent in FY25. Debt service costs increased with higher global interest rates. The six-year CRA-23 fiscal consolidation grant (\$10 million annually) reduced debt service pressures but has not materially paid down principal beyond scheduled repayments and will end in FY30, creating a worrisome—self-imposed—fiscal adjustment. A debt reduction strategy is needed to return debt toward the 30 percent target set in the 2022 debt policy adopted to manage the quantity and quality of future borrowing.

**State-owned enterprises present fiscal and operational risks.** PPUC now achieves cost recovery for power with ADB support, but Water and Wastewater operations (WWO) operate below 50 percent of cost and requires ongoing subsidies for operations and debt service related to the Koror-Airai sanitation project; WWO's nonpayment for power creates an implicit subsidy. Palau National Communications Corporation (PNCC) has returned to cost recovery after losses during COVID. The Belau Submarine Cable Corporation (BSCC) is effectively insolvent without significant additional revenue or subsidy. OEK proposals requiring up-to-date audits before tariff changes may impede timely tariff adjustments and increase fiscal risk.

**Domestic financial intermediation remains limited despite high deposit levels and proposed lending mandates risk bank stability.** Commercial bank lending is low relative to deposits and constrained by weak borrower documentation, limited collateralization, lack of a credit bureau, and a statutory usury cap. Local US banks follow mainland practices that also inhibit local lending. A proposed Community Reinvestment Law would require banks to lend between 25 and 45 percent of deposits; this mandate risks financial integrity unless structural barriers to lending are first addressed.

**Palau has introduced fintech initiatives that require strengthened oversight.** Initiatives include draft legislation for a tokenized dollar (stable coin), a digital residency program with digital IDs, and plans for blockchain-based savings bonds. The stable coin trial occurred in 2023, and legislation has been transmitted to the OEK but not enacted. These innovations could aid resource mobilization but raise AML/CFT (Anti-Money Laundering/ Combatting the Financing of Terrorism) and regulatory capacity concerns that should be resolved before full implementation.

**Pension systems require prompt reform to prevent insolvency.** Republic of Palau Social Security (RoPSSA) is projected to be unable to meet obligations by FY34 without reform; a November 2021 workshop proposed a 2 percentage-point contribution increase, modest benefit adjustments, and indexation, and reforms were drafted and submitted to the OEK but not enacted. The Civil Service Pension Plan (CSPP) faces projected insolvency by FY29 without reform; a November 2022 proposal would convert CSPP to a defined-contribution scheme with measures to address legacy liabilities and a proposed 2 percent allocation of PGST revenues to fund remaining defined-benefit obligations. The United States committed \$26 million in FY25 conditional on implementation of actuarially sustainable CSPP reforms; actuarial updates are underway and a development symposium has been deferred pending completion of the updates. Stakeholders will be presented with a broad range of reform options and model-simulated results to support reform adoption.

**The second Compact Review Agreement (CRA-23) provides substantially increased multi-year support.** Major elements include:

1. Annual grants of \$20 million for education, health, climate adaptation, environmental protection, justice, and public safety, with a 2 percent annual upward adjustment.
2. \$5 million in annual infrastructure grants, plus a 2 percent adjustment.



3. \$5 million in annual infrastructure maintenance grants, plus a 2 percent adjustment.
4. Six annual grants of \$10 million, starting in FY24, for fiscal consolidation of debt incurred before April 1, 2023.
5. Two \$50 million tranches to be deposited in the Palau COFA Trust Fund in FY24 and FY25.

**Economic growth is expected to remain strong in FY26 as new hotels come online.**

GDP is projected to grow 8.2 percent in FY26 with visitor arrivals reaching about 85,000 and additional demand from a 10 percent civil-service pay increase and the final 75-cent private-sector minimum wage increase. Tourism-related activity, which accounts for about 20 percent of the economy, is projected to expand 28 percent and drive most of the FY26 growth. Average GDP growth for FY26–FY30 is projected at 4.1 percent as hotel construction and subsequent openings support activity.

**Fiscal prospects are favorable through FY26 but face a medium-term adjustment when consolidation grants end.** Tax revenues are projected to rise roughly 13 percent in FY26 while other revenues are growing modestly. With a 10 percent civil-service pay increase and limited non-wage spending growth, the fiscal surplus is projected to increase from 2.4 percent to 3.2 percent of GDP in FY26. However, the end of the fiscal consolidation grant in FY30 will weaken the fiscal position unless offsetting measures are adopted; the fiscal balance is projected to decline to about 1.9 percent of GDP without action.

# 1. Recent Economic Performance

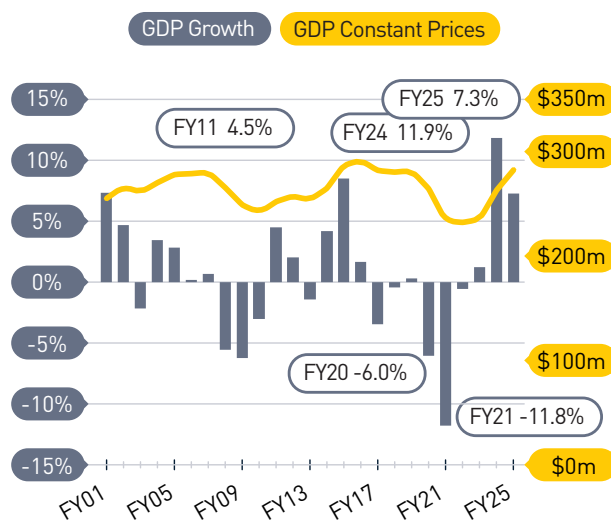
## Economic Performance

Palau's growth since FY00 has been modest and volatile. From FY00 to FY19 real GDP averaged 0.5 percent per year<sup>1</sup> (Figure 1), alternating between expansion driven by construction and tourism and sharp contractions. Four cycles are evident: (i) early expansion with the Compact Road and tourism growth; (ii) contraction during the Global Financial Crisis; (iii) a tourism boom driven by Chinese visitors; and (iv) contraction prior to the COVID shock.

<sup>1</sup> Trends estimated using log-linear regression.

**Figure 1: GDP level and growth (constant prices), FY19**

Palau's GDP fell sharply during COVID but recovery began in FY24.



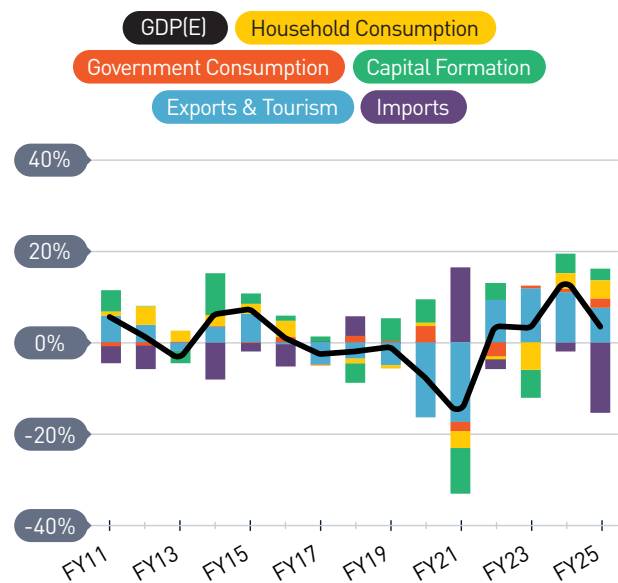
The pandemic caused a sharp GDP decline concentrated in FY20–FY21. GDP is estimated to have contracted 6.0 percent in FY20 and a further 11.8 percent in FY21, leaving FY21 about 17 percent below FY19. International travel stopped and tourism demand collapsed. Capital investment and government spending partially offset the shock in FY20, but by FY21 all demand components had contracted (Figure 2). The RoP's Cross Act and US CARES Act mitigation programs<sup>2</sup> supported household incomes and government expenditures, limiting the decline.

Recovery was slow and uneven through FY22–FY23. FY22 recorded negative growth of 0.5 percent amid global inflationary pressures and supply disruptions; visitor numbers remained low. By FY23 tourism improved but reached only about 35,000 arrivals, while inflation remained high at 12.4 percent due in part to international price pressures and the one-time impact of the introduction of the Palau Goods and Services Tax (PGST) in January FY23. Higher consumer prices and a contracting

<sup>2</sup> See earlier Economic Reviews for a detailed discussion of the impact of the CROSS and CARES programs on the Palau economy.

**Figure 2: GDP level and contributions to growth**

Tourism and investment are the primary growth drivers.



*The Palau economy is estimated to have grown 7.3 percent in FY25 as the recovery gained momentum.*

construction sector limited GDP growth to 1.2 percent in FY23.

**Economic activity strengthened in FY24–FY25 as tourism, construction, and domestic demand improved<sup>3</sup>.** Estimated GDP growth was 11.9 percent in FY24 and 7.3 percent in FY25. Visitor arrivals reached 66,000 by end-FY25, still below the pre-COVID level of 116,000 in FY18. Inflation moderated to 3.7 percent in FY24 and 0.2 percent in FY25 as global pressures eased and the one-time PGST impact dissipated. Public-sector wage increases and minimum-wage adjustments supported household consumption. New U.S. military spending, hotel construction, and an expansionary FY25 budget (including supplementals) contributed to higher government consumption and investment.

**The private sector contracted sharply during COVID but rebounded in FY24–FY25.** Private-sector activity declined fully 31 percent between FY19 and FY21 and remained depressed through FY22–FY23. As tourism and construction recovered, private activity rose by 19 percent in FY24 and 13 percent in FY25. Despite these gains, private-sector output in FY25 was only marginally above FY14 levels and remained well below pre-COVID peaks (Figure 3).

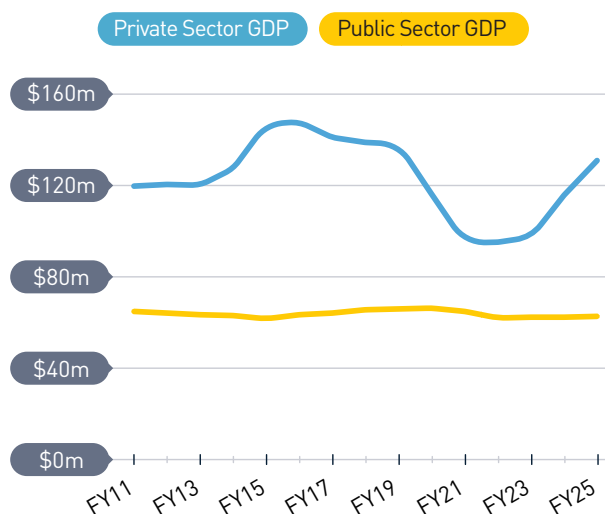
## Gross National Income per Capita

**The population of Palauans has been essentially static, while the foreign workforce has grown.** Palauan population rose only 0.1 percent since 1986 (accounting for external

<sup>3</sup> Data for FY25 has been estimated on provisional indicators for the period.

**Figure 3: Private and public GDP (constant prices), FY19**

Private-sector activity was volatile and bore the largest COVID shock.



migration), reaching about 12,436 in FY20. Foreign residents, largely employed in tourism, increased from 1,550 to 5,178 over this period.

**The World Bank has reclassified Palau as a high-income country.** Using national accounts, GNI per capita rose 4.7 percent annually over FY00–FY19, while the World Bank Atlas<sup>4</sup> method estimated a 1.9 percent annual increase. The Atlas method placed Palau in the high-income category before COVID, then in middle-income during the pandemic, which affected donor eligibility. As of July 1, 2025, Palau is again classified as high income and donor access will reflect that status.

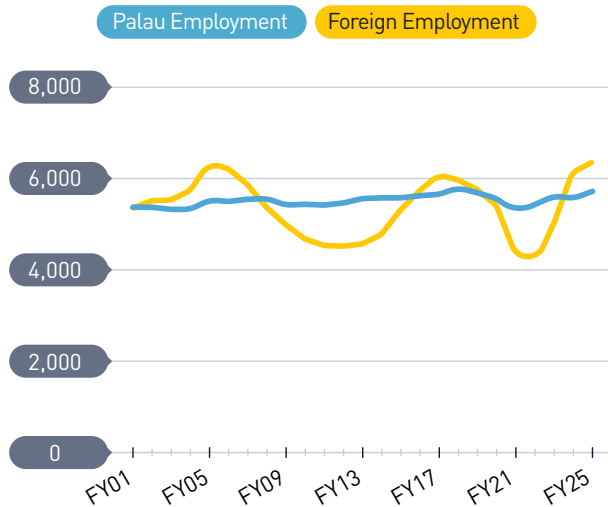
## Employment

**Job losses during the pandemic were substantial but smaller than early projections.** Between FY19 and FY21 the labor force lost 1,693 jobs (15 percent), versus earlier

<sup>4</sup> World Bank country income rankings are based on the Atlas method, which attempts to smooth exchange rate and inflation fluctuations and is not directly comparable to the Palau GNI per capita estimates, which are based on nominal GNI divided by the population.

**Figure 4: Employment: Palauan and foreign workers**

The labor market has recovered COVID losses through rehiring foreign workers.



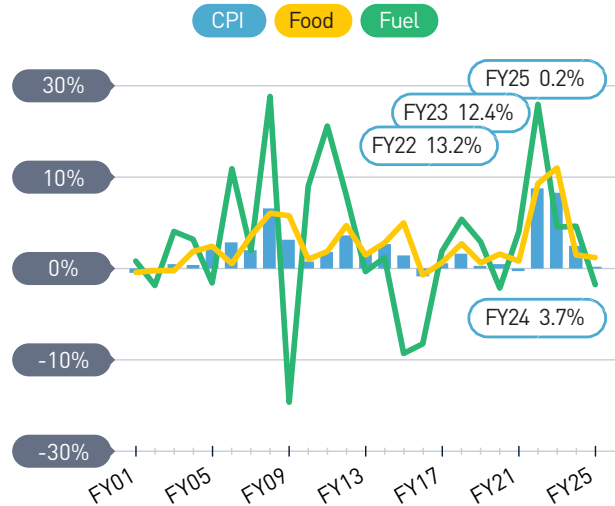
projections of up to 3,100 jobs. In FY19 employment comprised 5,675 Palauan workers and 5,765 foreign workers (Figure 4). Employers retained many workers on reduced hours, and government programs effectively mitigated the labor-market impact.

**Private-sector employment fell more sharply during COVID and recovered primarily through rehiring foreign workers.** Private-sector jobs declined by 1,550 (24 percent) between FY19 and FY21; full-time-equivalent losses were likely higher due to reduced hours. Between FY22 and FY25 total employment rose by 2,305 jobs (24 percent), largely in the private sector (45 percent increase), reflecting a 47 percent rise in foreign employment and a modest 5 percent rise in Palauan employment. Tourism-related hiring added 784 jobs, construction added 607, retail added 501 largely from

*With the 2025 recovery, Palau crosses the World Bank high-income threshold, affecting future grant eligibility.*

**Figure 5: Consumer Price Index and annual food & fuel price changes (%)**

Inflation peaked during FY22–FY23 (due to fuel, food, and PGST) and was near zero in FY25.



a large supermarket opening in Airai, and domestic home-help hiring added about 120 jobs following border reopening.

## Inflation

**Inflation rose sharply after FY21 due to global and domestic factors.** Trend inflation averaged 2.8 percent over FY00–FY21 but spiked to 13.2 percent in FY22 owing to global supply disruptions, expansionary fiscal measures, and energy and food price shocks from the Ukraine war (Figure 5).

**The PGST contributed to elevated inflation in FY23, with effects easing thereafter.** The PGST's introduction in FY23 coincided with a 12.4 percent inflation rate as businesses raised prices; removal of legacy taxes did not produce anticipated offsetting price reductions. Inflation fell to 3.7 percent in FY24 and to 0.2 percent in FY25 as the PGST effect and global pressures subsided.

**Decomposition of the 2020–2023 inflation surge shows multiple drivers.** Between 2020q1 and 2023q1 overall prices rose 27.5

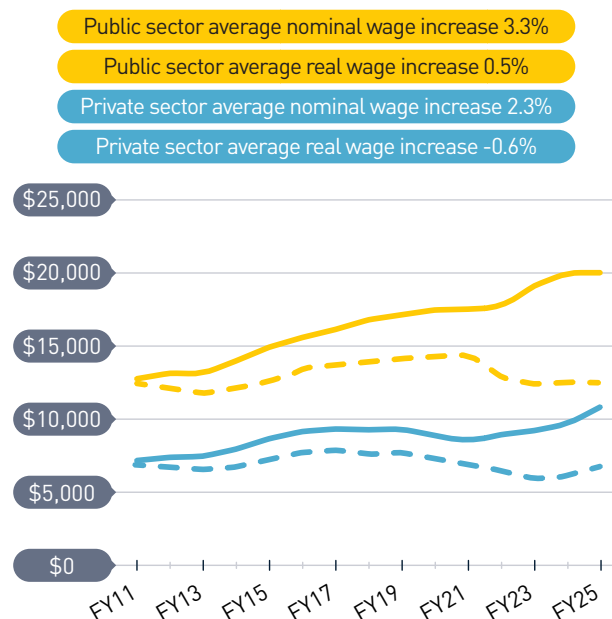
*Inflation moderated to 0.2 percent in FY25 as global price pressures and initial PGST impacts eased.*

percent: 17.6 percentage points from broad domestic and imported inflation (7.3 from food, 8.7 from fuel and electricity, remainder from other domestic factors) and 8.4 percentage points attributable to the PGST<sup>5</sup>. Of the PGST-related effect, 3.0 percentage points derived from discretionary tax-rate changes and 4.6 from higher business margins.

5 Of the total of 306 items priced in the CPI 276 are subjected to PGST. Of the 276 items 129 rose by exactly 10 percent (47 percent) and 179 (65 percent) rose by between 9.5 and 10.5 percent between January and February 2023 at the when PGST was implemented.

**Figure 6: Nominal and real wages by sector (private and public), FY10 prices**

Real wages rose during the tourism boom but fell after the post-COVID inflation spike.



## Wages

**Nominal wages rose modestly but failed to keep pace with inflation over the long term, eroding real wages.**

Between FY10 and FY25 nominal wages grew 2.3 percent annually in the private sector and 3.3 percent in the public sector (Figure 6). Real wages fell 0.6 percent in the private sector and rose 0.5 percent in the public sector over that period; in FY25 public-sector nominal wages were 86 percent higher than private-sector wages. Wages for Palauan workers were 67 percent higher than for non-Palauan workers, with most Palauans employed in the public sector and most non-Palauans in the private sector.

**Recent inflation produced significant real wage losses despite large nominal increases.**

Between FY20 and FY25 public-sector nominal wages rose 14.9 percent while inflation totaled 31.5 percent, producing a 12.6 percent real decline. Two rounds of increases of \$0.75 per hour in FY23 and FY24 partly offset this loss; the OEK approved an additional 10 percent increase effective FY26 which will reduce, but not fully eliminate, the FY20–FY25 real-wage shortfall (public-sector real wages remain about 3.9 percent below FY20 levels).

**Minimum-wage adjustments will raise private-sector wages over time, but effects will be gradual.**

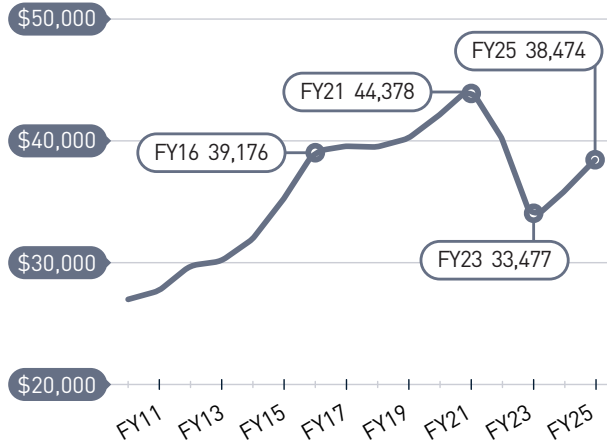
Private-sector nominal wages rose 21.5 percent between FY20 and FY25, but real wages fell 7.6 percent. The minimum wage increased by \$0.75 per hour at the start of FY25 and a further \$0.75 per hour at the start of FY26. The increase in FY26 implies an average private-sector wage rise of about 14 percent and would fully compensate wage earners for the recent increases in the cost of living. Because the new minimum applies primarily to new hires and contract renewals, full pass-through to all workers will take time.

## Household Incomes

**Mitigation programs limited income losses during COVID, but real incomes have not**

**Figure 7: Real household disposable income (FY15 prices)**

Household real disposable incomes rose to high levels during COVID but are currently still below their FY16 levels



recovered to pre-crisis levels. CARES Act support from the US and Palau’s One-Stop Shop Act raised real household disposable income by over 10 percent between FY19 and FY21<sup>6</sup>. This is evidence of just how insidious a (mostly) external price shock can be for any nation, but especially for a small, open economy such as Palau. (Figure 7). This is evidence of just how insidious a (mostly) external price shock can be for any nation, but especially for a small, open economy such as Palau.

**Household incomes began to recover in FY24–FY25 but remained below earlier levels.**

Economic recovery and back payments under the CARES Act improved incomes in FY24–FY25, but by FY25 real household disposable income remained below FY16 levels, leaving many households with ongoing difficulty meeting basic living costs.

<sup>6</sup> Estimates of household disposable incomes have been compiled from the national accounts based on incomes from production, primary incomes from interest and dividends, secondary incomes from pensions, social security less taxes plus transfers from government and remittances.

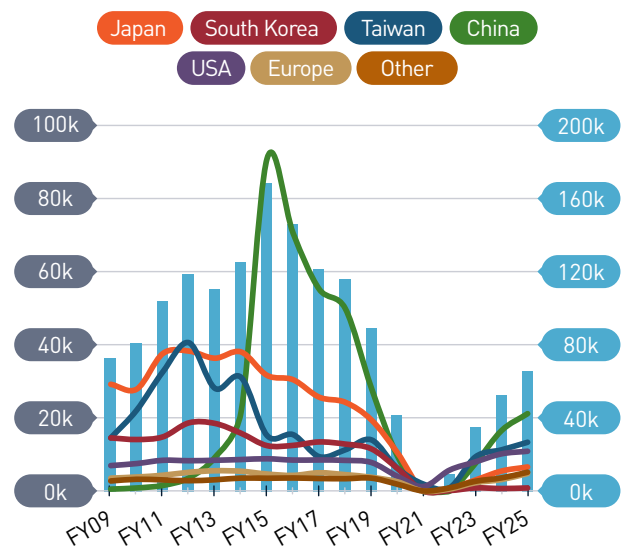
## 2. Tourism Developments and Policy

### Visitor Trends

Visitor arrivals increased rapidly in the early 2010s—driven primarily by growth in Chinese tourism—before declining through FY19 and collapsing during COVID. Arrivals increased from 80,897 in FY10 to 168,484 in FY15 (see Figure 8), largely due to Chinese visitors rising from near zero in FY10 to over 91,095 in FY15. Growth from China displaced visitors from traditional markets—Japan, Taiwan, and Korea—reducing their shares and concentrating auxiliary tourism services with dominant operators.

**Figure 8: Visitor arrivals: total and by nationality**

Visitor arrivals peaked in FY15, fell to zero in FY21, and are now recovering.



**Arrivals fell sharply in the late 2010s for several policy, operational, and environmental reasons.** Chinese arrivals declined from 91,095 to 28,368 through FY19. Contributing factors included: China’s enforcement requiring approved-destination status for travel agents (which Palau lacked), a presidential limit on charter flights (April 2015), a severe 2016 El Niño that reduced the jellyfish population in the Rock Islands, Delta Airline’s withdrawal of the Tokyo–Palau route in mid-2018, and financial/operational problems among charter operators. These factors together resulted in contracted demand and reduced effective capacity.

**COVID-19 caused a near-total collapse of tourism in early 2020; recovery began only in mid-2023.** FY20 was projected at 120,000 visitors based on early-year trends, but international arrivals fell to zero by March 2020; 41,674 visitors were recorded for the fiscal year beginning October 2019. Palau completed a comprehensive vaccination program and reopened borders in July 2021, but demand from key markets (notably Japan) remained weak. Flights from Taiwan charter services from Macau both resumed in mid-2023, combining with increased U.S. military personnel visits to produce 35,052 visitors in FY23.

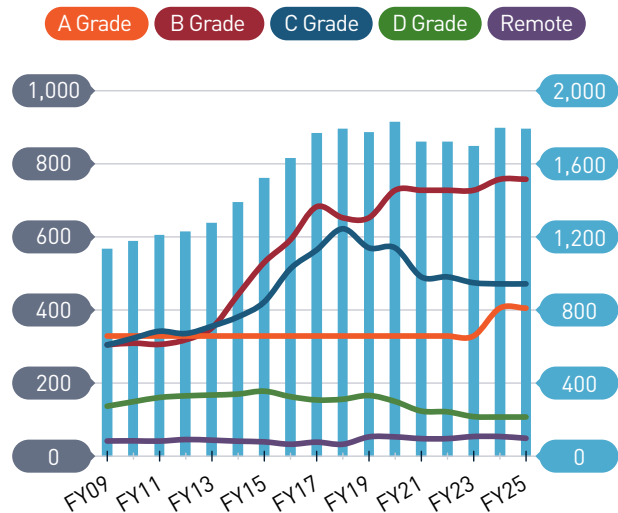
**Tourism has shown gradual recovery from FY23 through projected FY26 as new services resume.** Visitor numbers rose to 52,661 in FY24 and 65,558 in FY25, supported by scheduled flights from Hong Kong and a weekly Brisbane service by Qantas. United began twice-weekly Tokyo–Palau service in October 2025, and 85,408 visitors are projected for FY26.

## The Hotel Sector

**Hotel capacity expanded strongly before COVID and shows early signs of renewal in higher-grade development.** Room supply

**Figure 9: Hotel rooms available, by grade**

Hotel capacity expanded before COVID and will increase further with new developments.



grew from 1,291 rooms at the start of FY10 to 1,965 by end-FY18 (a 52 percent increase) with growth concentrated in mid-range (B and C) hotels<sup>7</sup> (see Figure 9). The FY15 visitor peak stimulated construction; many recently completed hotels opened with few guests after COVID. Several C-grade rooms went out of service for refurbishment and are expected to return as demand recovers.

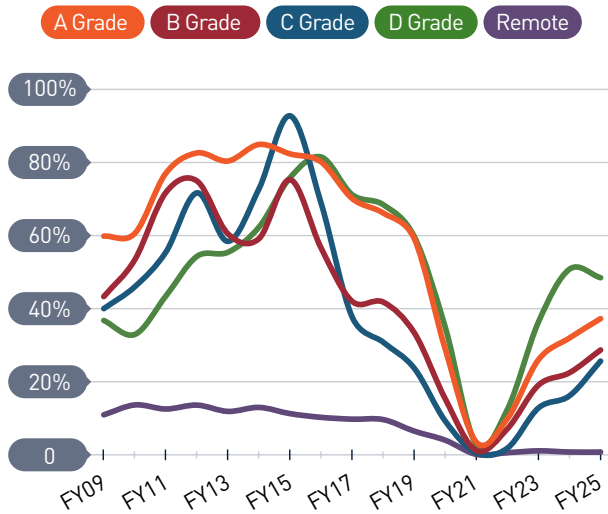
**Investment interest is concentrated in higher-grade properties despite current low occupancy.** A new A-grade hotel in Melekeok (initiated pre-COVID) is complete; IHG is developing a resort in Malakal (delayed by prefabrication issues); Marriott is building

<sup>7</sup> While no formal grading of tourism plant has been established in Palau, for the analysis presented in this review, hotels have been graded by EconMAP in consultation with industry representatives. Four grades have been given: A through D.

*Tourism recovery continued in FY25, but visitor arrivals (65,558) remain well below pre-COVID levels.*

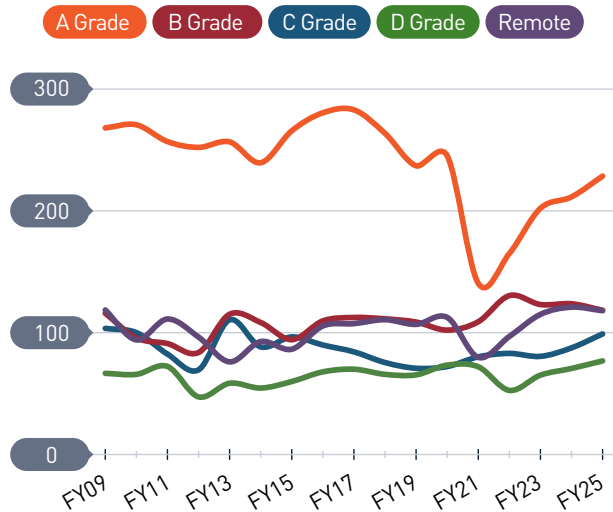
**Figure 10: Hotel occupancy rates, by grade**

Occupancy rates were high in the boom years, collapsed during COVID, and are recovering.



**Figure 11: Hotel room rates, by grade**

A-grade hotels command substantially higher room rates; rates fell in COVID and are recovering below prior highs.



in Meyuns; and there is interest in a Four Seasons resort, a high-end liveaboard operator, that plans 40 over-water bungalows.

**Occupancy and room rates remain below pre-pandemic levels and profitability thresholds.**

Average occupancy peaked near 65 percent in FY15 but fell to 27 percent in FY25 (see Figure 10). B and C hotels experienced the largest declines pre-COVID, while A and D groups declined less. Post-pandemic recovery saw relatively better performance in D-grade properties, likely reflecting charter activity. Figure 11 shows a large gap in hotel rates between A-grade and other groups; high-end hotels reduced rates during COVID and have not fully recovered, while other groups' nominal rates are largely unchanged but will have fallen in real terms.

*Hotel construction revived with branded projects by IHG, Four Seasons, and Marriott commencing.*

**has only partially recovered.** Direct tourism employment rose from 1,759 in FY10 to 2,296 in FY18 (annual growth 3.4 percent) while arrivals grew 4.6 percent annually, implying improved labor productivity. Employment fell from about 2,100 in FY19 to 994 in FY21. Operators largely retained reduced workforces to enable recovery; by FY24 direct employment rose to 1,632 (an increase of 638 jobs) but remained below the FY16 peak of 2,414. GSUSA estimates an additional 285 indirect tourism-related jobs in FY24<sup>8</sup> (see Figure 12).

## Economic Impact

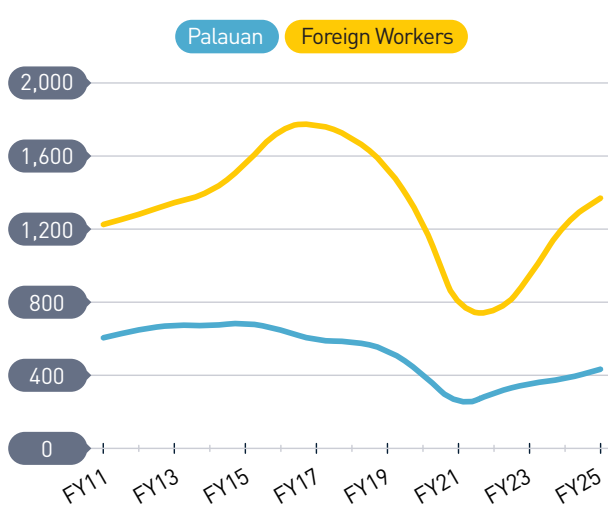
### Employment

**Tourism is a significant employer, but employment fell sharply with COVID and**

<sup>8</sup> GSUSA input-output analysis based on the estimation of a Social Accounting matrix for FY18 indicate an employment multiplier of 1.17. For each 100 jobs created directly by the industry an estimated further 17 jobs are created in other sectors of the economy.

**Figure 12: Tourism employment: Palauan and foreign workers**

Employment fell sharply during COVID and recovered to about 75 percent of FY16 levels.



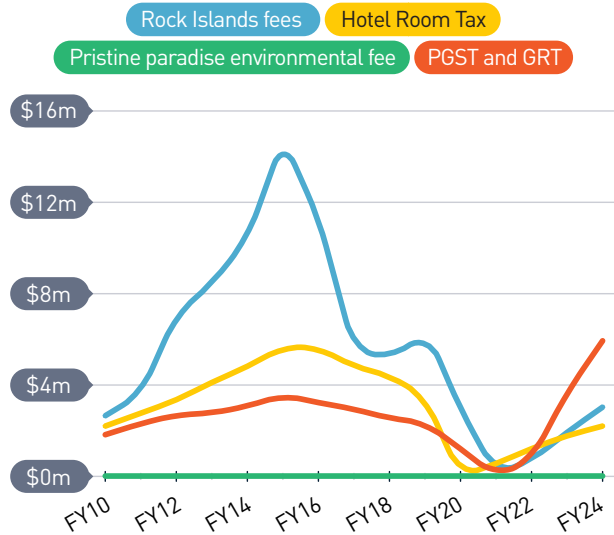
## Government Revenues

**Tourism generates significant but volatile tax revenues for national and state governments.**

Major sources include PGST, GRT, the Pristine Paradise Environmental Fee (PPEF), and the 10 percent hotel occupancy tax (see [Figure 13](#)). The PPEF is a per-visitor fee included in airline tickets, set at \$30 initially, raised to \$50 in FY13 and to \$100 in FY18 (included in airline tickets). Koror State raised per-person entry fees for the Rock Islands and Jellyfish Lake to \$50 and \$100 in FY12. As of yet there is no congestion pricing for tourism assets operated by Koror state (Jellyfish Lake and the Rock Islands). Tourism tax revenues averaged about 20 percent of national tax revenues through most of the 2010s and about 75 percent of Koror State revenues. COVID erased much of this tax base; revenue recovery has been aided by the broad-based PGST, which captures spending by non-residents. The reliance on tourism revenue—together with observed volatility—underscores the need to diversify the tax base and build fiscal buffers, such as a Cyclical Reserve Fund, to mitigate shocks.

**Figure 13: Government tourism revenue, by source**

Revenues collapsed in COVID; PPEF and PGST revenues have risen strongly during recovery.



## Tourism recovery and outlook

**Projections have repeatedly been revised downward because the sector's recovery has lagged regional peers.** Unlike Fiji, which benefited from market diversification, a regional carrier, and a favorable currency position, Palau depends on East Asian markets and regional carriers and has limited influence over air connectivity. A strong US dollar, until recently, also reduced competitiveness. Guam and CNMI have faced similarly slow recoveries, with arrivals around 50 percent of pre-COVID levels. These factors have required conservative projections.

**Investor interest continues, supporting a gradual medium-term recovery, but risks remain.** Major international hotel chains (Marriott, IHG, Four Seasons) are investing, and higher-grade and mid-range refurbishments are underway. New direct service to Australia marginally improved market diversification. A second weekly flight under consideration would be promising, indeed. Recovery hinges on establishing reliable, scheduled flights and competitive pricing.

### **EconMAP projects a slow recovery through the medium term with substantial uncertainty.**

Visitor arrivals are projected at 85,400 in FY26, 92,300 in FY27 (hotel occupancy about 42.0 percent), and 137,500 by FY30 (occupancy about 52.5 percent), still below the 60 percent occupancy, often considered a minimum return-on-investment benchmark, at least for A-grade hotels.

## **Tourism Planning and Policy**

### **Palau initiated a tourism policy and planning framework to address uncontrolled tourism development.**

During the boom years the sector lacked an overall vision—no agreed limits on size, location, market focus, or carrying capacity (environmental and social). In the absence of policy-focused regulation or quality standards, market forces largely determined investments and outcomes. In 2015 Palau requested Asian Development Bank (ADB) support to rationalize the industry; ADB's report endorsed attracting high-value visitors and called for a comprehensive tourism strategy and master plan.

### **Palau adopted the Responsible Tourism Policy Framework (RTPF) in 2017.**

Funded by a U.S. Department of the Interior grant, the RTPF (2017–2021)<sup>9</sup> responded to visitor influx and emerging overtourism by promoting community-led tourism, local entrepreneurship, environmental protection, and high-value rather than high-volume markets. The RTPF set important principles but remained largely aspirational and lacked detailed sector analysis, a comprehensive planning framework, and clearly defined activities, outputs, or actionable steps.

### **The Government of Palau developed a new planning framework supported by the Private Sector Development Initiative.**

In 2023, the government began preparing the Palau Sustainable Tourism Strategy (PSTS),

<sup>9</sup> Bureau of Tourism Ministry of Natural Resources, Environment and Tourism, Republic of Palau, Palau Responsible Tourism Policy Framework, Palau, 2016

*Palau adopted a Sustainable Tourism Strategy in 2025 focused on destination management.*

2025–2028<sup>10</sup>. The PSTS was developed in 2024 through research and consultations with national and state governments, the private sector, NGOs, and local communities, and was finalized in early 2025. The PSTS introduction states:

*The [P]STS steers tourism development in Palau toward a long-term shared vision for the sector. It does so by following a strategic framework of guiding principles, goals, objectives, priorities, and activities from 2025 to 2028. A four-year strategy is conducive to a tourism sector emerging from a disruptive decade and within the context of pandemic recovery conditions still unfolding...*

**The PSTS centers on destination management as the core approach.** The strategy defines sustainable tourism in economic, environmental, and social terms and emphasizes collaborative destination management among all stakeholders, shifting focus from tourists and businesses to destinations' places and people.

*The description of 'responsible and sustainable destination management' by the World Tourism Organization reflects this: "[It] should entail a process that effectively and harmoniously addresses the interactions between the visitors, the industry that serves them, the community that hosts them and the environment in a broad sense (natural and cultural resources)...Destination management takes a strategic approach to link-up the sometimes very isolated and occasionally diverging elements for the better planning*

<sup>10</sup> See Palau Sustainable Tourism Strategy, prepared with assistance from the Private Sector Development Initiative—PSDI, a regional technical assistance facility cofinanced by ADB, the Government of Australia, and the Government of New Zealand.



*and management of the destination; calling for a coalition of many organizations and interests working towards a common goal.*<sup>11</sup>

**The PSTS structure combines state and national analyses.** It begins with state-based destination analyses and one-page state profiles developed with each state administration and stakeholders, followed by a national tourism situation analysis that assesses tourism demand and supply. Each analysis covers:

1. Demand
2. Supply: accommodation, products and visitor services.
3. Air services and infrastructure.
4. Infrastructure
5. Labor supply
6. Environment for private sector investment in tourism
7. Environmental, cultural and social considerations, and
8. Tourism governance and stakeholder collaboration.

**The PSTS presents objectives, priorities, and activities for 2025–2028.** The final chapter—the core of the strategy—defines four major objectives:

1. destination management structures and systems,
2. tourism supply, products, people, access and infrastructure,
3. supporting conditions for sustainable tourism sector development, and
4. destination marketing and distribution.

11 World Tourism Organization. 2019. UNWTO Guidelines for Institutional Strengthening of Destination Management Organizations (DMOs) – Preparing DMOs for New Challenges. Madrid: UNWTO. p. 10.

These four objectives are then subdivided into:

- 14 outcome-level objectives to be pursued through the strategy. These support the strategy’s defined goals, uphold its guiding principles, and ultimately contribute to the long-term vision for tourism in Palau.
- 65 strategic priorities to be progressed over the next four years to achieve each of the objectives, each with suggested activities.

**The PSTS provides a comprehensive program but does not resolve all big-picture issues.**

Compared with the RTPF, the PSTS includes a detailed supply-and-demand analysis and a comprehensive set of objectives and activities. It does not, however, determine site- or national-level carrying capacities (for example, Jellyfish Lake) nor does it specify the sustainable long-term visitor volume range. The strategy does identify activities to address those issues, including:

*Activity 9B. Define and manage carrying capacity volumes and visitor flow solutions for tourism attractions in environmentally and culturally sensitive locations.*

*Activity 9E. Determine optimal carrying capacity volumes for the country as a whole, accounting for the available supply of public infrastructure and services and food supply.*

**Adoption and implementation of the PSTS require increased capacity and resources.** The PSTS offers an opportunity to move away from the previous ad hoc, market-driven approach, but its scope is ambitious relative to current agency capacity. Achieving PSTS objectives will require a significant increase in resources; without adoption and implementation of a framework such as the PSTS, Palau remains at risk of unsustainable growth with adverse environmental and social consequences.

### 3. Fiscal Performance and Reform

#### Fiscal Outcomes

##### The Historical and COVID Era

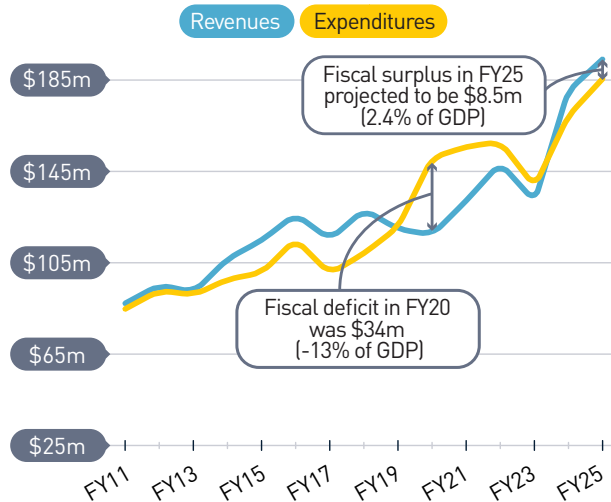
**Palau maintained prudent fiscal policy and ran surpluses during the tourism boom years.**

After post-Global Financial Crisis deficits, the fiscal position improved between FY10 and FY13, reaching fiscal balance (see Figure 14). Economic recovery in FY14 and the tourism boom through FY18 produced annual surpluses averaging 4.6 percent of GDP. Government deposits peaked at \$43 million by end-FY18, \$34 million higher than five years earlier. In FY19 visitor arrivals fell to FY10 levels, tightening the fiscal position; the government recorded a small deficit of 0.4 percent of GDP and cash deposits declined to \$31 million. Nonetheless, prudence during the boom years created a buffer that proved beneficial during the COVID shock.

**Total financing needs of 29 percent of GDP were required to finance deficits during FY20–FY23.** Palau’s fiscal position deteriorated rapidly with COVID. The deficit rose from 0.4 percent of GDP in FY19 to \$33.7 million (13.0 percent of GDP) in FY20. Higher grants reduced the FY21 deficit to \$23.5 million (9.9 percent of GDP). In FY22 further grant increases narrowed the deficit to \$10.5 million (4.3 percent of GDP). In FY23 tax reforms raised tax revenue by \$17 million (40 percent over FY22), but expenditure growth—driven by a 75¢ pay award, higher goods and services spending, and increased grants and subsidies—limited fiscal improvement; thus, in FY23 the deficit

**Figure 14: Government revenues and expenditures**

Palau ran large surpluses during the tourism boom, deficits during COVID, and returned to surplus thereafter.



narrowed to \$6.3 million (2.3 percent of GDP). Total financing needs over the COVID period amounted to \$74 million (29 percent of GDP).

**Available financing enabled government to maintain operations through FY23.** Palau secured ADB loan support through the Disaster Resilience Program (DRP), the COVID Pandemic Relief Option (CPRO), and the RISES program, totaling \$90 million. Combined with tourism-era reserves, available funds exceeded the \$74 million financing need and preserved financial stability. Tax reform further reduced total financing reliance.

##### Recovery, and Impact of Compact Review Agreement and Tax Reform, FY24

**Revenues rose sharply in FY24, driven by Compact grants and tax reform.** Total revenues increased 35 percent (\$47 million). With a full year under the new tax regime, tax revenues (net of refunds<sup>12</sup>) increased

<sup>12</sup> Palauans earning less than \$15,000 are eligible for a full refund of all wage taxes paid, while those earning between \$15,000 and \$30,000 are eligible for flat refund of \$480.



\$10 million (16 percent) over FY23. The 2023 Amended Compact Review Agreement (CRA-23), agreed in May 2023 and funded in March 2024, provided new resources: \$20 million operational support, \$5 million infrastructure grants, \$5 million infrastructure maintenance, \$10 million for fiscal consolidation, and continued access to the COFA Trust Fund (CTF) with a \$15 million drawdown or 4 percent threshold, whichever is the greater<sup>13</sup>. Palau drew the \$20 million operational grant but did not utilize the infrastructure grant due to planning and timing constraints. Policy was adopted to withdraw the full entitled CTF draw (\$15 million) to avoid future withdrawal restrictions; no formal framework exists specifying whether these funds are to be saved or used for consumption or investment.

**An overall surplus of \$10.8 million (3.4 percent of GDP) was recorded in FY24.**

Expenditure increases included a second 75¢ hourly civil service pay rise and mid-year supplemental appropriations. Transfers to other government layers rose \$9.9 million (47 percent), including increased block grants to states (from \$9.6 million to \$14.1 million), subsidies, and transfers to Social Security (SS, \$1.8 million) and the Civil Service Pension Plan (CSPP, \$3.0 million). Transfers to PPUC supported operations and KASP loan repayments. Although \$5 million of Compact capital funds was available, Palau did not draw these due to capacity constraints. After accounting for additional revenues and expenditures, FY24 achieved a \$10.8 million surplus (3.4 percent of GDP).

<sup>13</sup> The new CRA-23 budget streams are discussed in greater detail in chapter 9.

*After pandemic deficits, the fiscal position improved markedly in FY24 as recovery, tax reform, and CRA-23 took effect.*

## The FY25 Outturn

**Revenues continued to grow in FY25, though less dramatically than in FY24.** Preliminary FY25 data indicate revenues rose \$13.9 million (7.7 percent). The tourism sector expanded 25 percent and GDP grew 7.3 percent. Tax collections rose \$10.2 million (15 percent)<sup>14</sup>, largely from PGST growth of \$8.6 million (33 percent). Compact grants were received as scheduled, but infrastructure grant draws remained constrained by limited project capacity. A large back payment for COVID-era CARES Act humanitarian payouts was offset by other Federal grants; overall grants fell \$1.2 million (1.3 percent). Total revenues are projected to be up 7.7 percent (\$13.9 million).

**Expenditure growth outpaced revenues, reducing the surplus to \$8.5 million (2.4 percent of GDP).** Payroll costs rose 3.1 percent due to step increments without a wage increase. Goods and services grew an estimated 6.5 percent after year-end adjustments. Interest, subsidies, and transfers to agencies and states increased by \$2.6 million. Social benefits rose substantially due to CARES Act unemployment back payments funded by U.S. Federal grants. Infrastructure spending increased \$4.7 million. Overall expenditures rose \$19.6 million (9.3 percent), yielding a reduced surplus of \$8.5 million (2.4 percent of GDP).

## Cash Management

**The national government holds a significant pool of unreserved cash reserves.** Reserves peaked at \$42.9 million in FY18, fell to \$31 million in FY19, and provided a buffer during COVID. Palau borrowed \$90 million during FY20–FY23 while accumulating a \$74 million deficit. In FY24 Palau borrowed an additional \$12.5 million in budgetary support (including \$5 million earmarked for Koror State). The government ran a combined FY24–FY25

<sup>14</sup> The FY25 figures are based on downloads from the Tyler FMIS in mid-November and will be subject to revision.

surplus of \$19 million. After accounting for debt repayment (net of Compact fiscal consolidation grant) and funds reserved for specific purposes, Palau retains a substantial cash position though true uncommitted balances require further reconciliation through Palau's audit process.

**Maintaining large unreserved balances entails opportunity cost and should be optimized.** While restoring fiscal buffers after the pandemic was prudent, continued accumulation of unreserved funds now carries opportunity cost. Available objectives for these funds include full funding of cyclical and climate resilience reserve funds and reduction of high-cost market debt. Prioritizing these uses would rebuild buffers consistent with existing mandates and reduce debt service costs.

### *The Impact of the FY26 Budget*

**FY26 projections are favorable if visitor numbers at end-FY25 are sustained.** The FY26 budget passed on December 4, 2025, after a 65-day continuing resolution; projections assume continuation of new routes—United direct service to Japan (from October 2025), six-month charter flights from Hong Kong (from July 2025), and higher utilization of Qantas Brisbane flights—bringing projected visitor arrivals to 85,400, slightly below FY19 levels. With first use of the Compact infrastructure grant, GDP is projected to grow 8.2 percent, attaining a level of 4.6 percent above the FY16 peak.

**Revenues are expected to remain buoyant in FY26, driven by broad-based tax growth.** Tax revenues are projected to rise 11 percent, with wages tax, BPT, PGST, tourism-related taxes, the Pristine Paradise Environmental Fee, and hotel occupancy tax all expected to increase. Major grant activity includes a \$5 million use of the Compact infrastructure grant. CARES Act residual funds have been fully drawn, so overall grant revenues are projected to be largely unchanged.

### **The FY26 budget introduces new initiatives and expenditure items:**

1. A national government wage increase of 10 percent and corresponding increases in block grants to states to maintain alignment with national wages.
2. Creation of several offices proposed in the President's original budget were not approved: Cybersecurity Office, Office of Compact Management, National Planning Office, and Financial and Economic Intelligence unit.
3. Establishment of an embassy in Australia.
4. The national government's share of Sub Program 2 of the ADB policy-based loan<sup>15,16</sup> (\$7.5 million) was not allocated for retirement of high-interest debt.

**The FY26 budget is modestly larger than FY25 after adjustments.** On a comparative basis FY26 is \$3.4 million (2.7 percent) larger than FY25. The wage increase raises the wage bill by \$5.8 million and is assumed to include annual wage drift (scheduled wage step increases). Previous subsidies for water and power lifelines continue, but the untargeted \$0.10 per unit subsidy for the first 500 household units has been terminated. After adjustments, non-payroll expense before debt service is estimated to fall \$2.3 million (1.8 percent) from FY25.

**If recovery continues and expenditures are controlled, the FY26 fiscal position should remain favorable.** GSUSA modeling estimates a likely surplus of \$12.9 million (3.2 percent of GDP) based on continued recovery and buoyant revenues. This projection excludes any mid-year supplemental appropriations; additional supplements would, of course, reduce the projected surplus.

15 *Strengthening Fiscal Resilience for Sustainable Development Program*, June 2024, ADB, Manila,

16 Of the total loan of \$12.5 million, \$5 million is earmarked for Koror State with the remainder for the National government.



## Fiscal Responsibility and the RISES Program

Palau adopted a **Fiscal Responsibility Framework supported by ADB technical assistance and the RISES Program**<sup>17</sup>. Under late-2018 ADB technical assistance, a fiscal strategy recommended adoption of a fiscal responsibility framework<sup>18</sup>. Subsequently, the RISES Program (Recovery through Improved Systems and Expenditure Support)<sup>19</sup> supported COVID budgetary needs and included these elements:

1. Policy and legislative framework for public financial management:
  - i. Fiscal Responsibility Law
2. Public sector reforms:
  - ii. Tax reform
  - iii. Development of a fiscal strategy and preparation of the FY22 Economic and Fiscal Update
  - iv. National infrastructure plan
  - v. External debt management law and policy statement
  - vi. Social Security reform
3. Private sector reforms:
  - vii. Public-private partnership framework
  - viii. Arbitration law
  - ix. Corporations law and registry

Details of the RISES program loan are discussed in subsequent sections.

<sup>17</sup> *Recovery through Improved Systems and Expenditure Support Program*, a Policy Based Loan, ADB, Manila, May 2022

<sup>18</sup> *Toward a Medium-Term Fiscal Strategy for Sustainable Economic Development*, ADB TA-8581 REG: Strengthening Public Sector Management in the North Pacific, November 2018.

<sup>19</sup> *Recovery through Improved Systems and Expenditure Support Program*, a Policy Based Loan, ADB, Manila, May 2022.

## The Fiscal Responsibility Law

Palau enacted the Fiscal Responsibility and Debt Management Act in November 2021. FRDMA (RPPL No. 11-13) defines fiscal responsibility principles consistent with international practice and tailored to Palau's context:

- A. The government shall pursue its policy objectives in accordance with the following principles of responsible fiscal management:
  1. Manage **operating expenditures** over the medium term within operating revenues and in relation to the growth rate of the economy.
  2. Manage net **capital and financial assets** to achieve rising real national net worth over time.
  3. Manage **debt** prudently.
  4. Manage the revenue regime to best fit the structure of the economy, ensuring equitable allocation of tax burdens and predictability over time.
  5. Manage **reserves and insurance coverage** to offset cyclical volatility, natural disasters, and the impact of climate change.
  6. Manage the non-primary government public sector prudently, ensuring that **State-Owned Enterprises (SOEs) and Public Financial Institutions** deliver services effectively and sustainably.
  7. Manage **fiscal risks** and contingent liabilities prudently.
- B. Notwithstanding subsection A, the government may depart from these principles of fiscal responsibility, provided that:
  1. The departure is temporary.

2. The President states the reason for the departure.
3. The President specifies the period required to return to adherence to the principles.
4. If circumstances arise during the fiscal year that force a departure from these principles, they must be disclosed timely in accordance with the FRDMA.

*Palau partially adheres to fiscal-responsibility principles but should avoid drawing down buffers before conditions are met.*

## Adherence to the Principles of Fiscal Responsibility

Palau has restored adherence to the first four fiscal responsibility principles, but gaps remain in reserve buffer management, SOE sustainability, and governance related to fiscal risks. **Box 1** below provides an assessment of the adherence to the principles. While adherence to principles 1–4 was interrupted during COVID, it has been restored with economic recovery, CRA-23, and tax reform. Fiscal balance has returned and general government net financial worth is back to pre-COVID levels with CTF capital inflows. The Debt-to-GDP ratio has begun declining with economic recovery. The modernized tax regime meets the fourth principle’s objectives.

**However, rules and transparency for fiscal buffers need strengthening.** FRDMA requires cyclical and climate resilience reserves. Although contributions have been made, transparency and consistent reporting on reserve levels are lacking. Prior budgets, including FY26, have drawn on the Cyclical Reserve when statutory triggers (a 5 percent reduction in local revenues or a declared national emergency) were not met. As it turns out, the use of that reserve as a budgetary source was unnecessary as cash reserves not dedicated to the Cyclical Reserve were available. Regulations must specify cash-flow thresholds before transfers to the cyclical reserve and define a target for the

climate resilience reserve. Clear procedures would reduce fiscal vulnerability and ensure CRA-23 compliance.<sup>20</sup>

**SOE pricing and pension systems are not financially sustainable.** PPUC’s water and wastewater operations lack full-cost recovery. BSCC’s wholesale internet provision through two international fiber systems is not generating sufficient cash flow to service debt. CSPP and Social Security trust fund investments are projected to be unsustainable, with potential collapse in the 2030s without major reform. These fiscal risk issues require substantial commitment; SOE and pension reforms are addressed in a later chapter.

**The absence of a confirmed Minister of Finance poses fiscal risk.** The former Minister was re-nominated but not confirmed after multiple attempts; the President has assumed the duties. This interim arrangement is not clearly sub-optimal and risks orderly financial management and policy continuity.

**FRDMA requires a sequence of public documents to enhance transparency, but implementation is incomplete.** The Act mandates:

1. Preparation and publication of a Fiscal Strategy for the President’s four-year term,
2. Annual Economic and Fiscal Update with Minister attestation to FRDMA adherence,
3. A Budget Statement, and
4. A Mid-Year Fiscal and Economic Update.

<sup>20</sup> Adherence to Palau’s own FRDMA principles is a requirement under Article 4 of CRA-23.



Principle	Compliance
Manage <b>operating expenditures</b> over the medium-term within operating revenues and in relation to the rate of growth of the economy	<b>In compliance.</b> With recovery in the post COVID economy operating balance has been restored
Manage <b>net capital and financial assets</b> , including the COFA Trust Fund, to achieve rising real national net worth over time	<b>In compliance.</b> With additional contributions to the COFA fund, net public sector financial wealth has been restored to pre-COVID levels.
Manage <b>debt prudently</b>	<b>In compliance.</b> Debt/GDP rose rapidly during COVID, peaked in FY23 at 72% of GDP and fell to 54% in FY25.
Manage the <b>revenue regime</b> to best fit the structure of the economy, to provide for an equitable allocation of tax burdens, and to allow for predictability over time	<b>In compliance.</b> The tax reform has successfully implemented an efficient, equitable and predictable tax regime.
Manage <b>reserves and insurance coverage</b> to offset cyclical volatility, the costs of natural disasters, and the impact of climate change	<b>Not in compliance.</b> The Cyclical Reserve has been used to fund budgets when the conditions of withdrawal have not been met. Regulations are needed to define cash flow operational needs and target level of the climate resilience reserve.
Manage the <b>non-primary public sector prudently</b> , including ensuring State Owned Enterprises and Public Financial Institutions are managed to deliver services on an effective and financially sustainable basis	<b>Not in compliance.</b> SOEs are not operating on a commercial basis and PFIs have not been reformed and are at risk of collapse
Manage <b>fiscal risks</b> and contingent liabilities prudently	Deemed in compliance. Formal analysis to be undertaken on all fiscal risks

**Key required documents remain outstanding.**

A Fiscal Strategy for the current Presidential term has not been released (a draft exists). During 2021–2024 a Fiscal Strategy was transmitted to the OEK and Economic and Fiscal Updates were prepared for FY23–FY24, but no Budget Statement or Mid-Year Update

was produced. In the current cycle the updated Fiscal Strategy and required Economic and Fiscal Update were not released; Budget Statement and Mid-Year Update were also absent for FY25. Passage of the FY26 budget presents an opportunity to restore adherence to FRDMA reporting requirements.

## Tax Reform

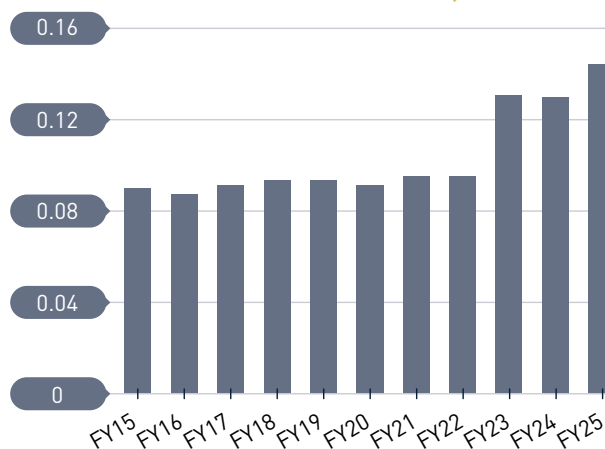
**Palau enacted comprehensive tax reform in September 2021 after multi-year modernization efforts.** As part of the RISES program, Palau prioritized tax reform. An earlier Palau Goods and Services Tax (PGST) bill, first proposed in 2018, was revised to include a Business Profits Tax (BPT) and reintroduced in January 2021. The bill underwent extensive hearings and town halls, and an economic symposium supported by the Chamber of Commerce was held in May 2021 before the law passed in September 2021. The main features of the law are:

1. A 10 percent Palau **Goods and Services Tax (PGST)**.
2. **Excise taxes** replace the former import duties.
3. A 12 percent **Business Profits Tax (BPT)**.
4. Medium-sized businesses remain under the Business Gross Receipts Tax (BGRT), while small businesses pay an annual fee.
5. Rates for the **wages and salaries tax** were revised with those earning between \$0-\$8,000 taxed at 8 percent, between \$8,000-\$40,000 at 10 percent, and for those above at 12 percent. For Palauans a full refund for those earning less \$15,000 is issued after the end of the calendar year, and a refund of \$480 is issued to those earning between \$15,000-\$30,000.
6. The **hotel-room occupancy tax** was reduced to 10 percent.
7. Introduction of a nominal **carbon tax**.

**Implementation was rapid and included capacity building, IT extensions, and public outreach.** The reform launched on January 1, 2023. Implementation activities included administration training, extension of existing IT systems, public outreach, and a major

**Figure 15: Tax reform impact on revenues**

Tax collections rose with tax reform and consolidated further in FY25.



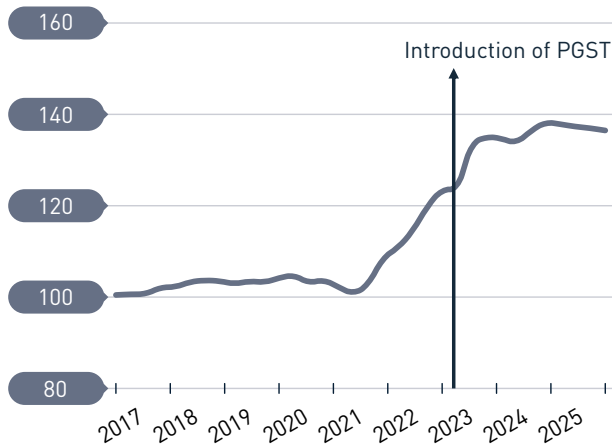
symposium. Donor support came from the IMF, Pacific Financial Technical Assistance Centre (PFTAC), and the Australian Tax Office (ATO). ATO support was remarkably responsive to late-stage implementation issues as they arose. After an initial adjustment period, the new system is well established.

**The reforms produced a large increase in tax revenue relative to GDP.** Legacy taxes (gross receipts, general import, and wages taxes) were stable at an average tax-to-GDP ratio of 9.2 percent in FY15-FY22 (see [Figure 15](#)). Following implementation in FY23, the ratio rose to about 13.0 percent despite that year covering only three quarters under the new system. Collections remained similar in FY24 and increased to 16 percent of GDP in FY25. Offsetting measures—reductions in the wages tax, refunds for Palauans, and targeted support for low-income households—reduce the net fiscal effect relative to the headline tax figures.

*The introduction of tax reform and the Palau Goods and Services Tax is a milestone in Palau's economic development.*

**Figure 16: PGST introduction impact on CPI**

CPI rose sharply after PGST introduction, contributing to elevated price levels.



*Tax reform implementation succeeded but coincided with a price uptick linked to higher business margins.*

funds were earmarked for an RFP and selection of a Commercial Off-the-Shelf (COTS) system to enable enhanced reporting, monitoring, and risk analysis. Additional funds will be required to procure the system and cover ongoing maintenance.

**A principal downside was a larger-than-expected one-time increase in consumer prices coincident with global inflation.**

Although some pass-through was expected, price rises exceeded the net tax change (10 percent PGST offsetting repeal of 4 percent BGRT and 3 percent general import tax).

Figure 16 shows the CPI during the inflationary period; CPI rose 8.4 percent between 2023-Q1 and 2023-Q2 when the reforms took effect.

A price survey found many items increased by roughly 10 percent, suggesting vendors added the full PGST without adjusting for repealed legacy taxes. GSUSA estimates indicate profit margins rose by 4.8 percent of GDP. Subsequent data show more modest inflation—2.1 percent between 2023-Q1 and 2025-Q3—suggesting some absorption of the initial shock and that the sharp price increase was largely one-time.

**Current policy emphasizes consolidation and improving tax administration and compliance through a modern risk-based IT system.**

Since reform introduction, administration and compliance have tightened, which likely contributed to higher collections in FY25. Given stakeholder reactions during reform, the government's priority is to secure the gains before further tax changes. FY25 supplemental

## 4. External Debt

### Recent Trends in External Debt

**Palau incurred substantial external borrowing to finance their COVID response.** Palau took on multiple ADB loans: (i) \$15 million under the Disaster Resilience Program, (ii) \$20 million under the COVID Pandemic Relief Option, and (iii) a \$55 million policy-based loan under RISES (two subprograms of \$25 million and \$30 million). Conditions for Subprogram 1 (SP1) were met by early 2021 and for Subprogram 2 (SP2) by end-FY22, resulting in \$90 million of total COVID-related debt.

**Additional concessional policy-based financing was arranged in 2023 despite fiscal improvement.** In 2023 Palau arranged a further ADB policy-based loan under the Strengthening Fiscal Resilience for Sustainable Development Program, comprising two \$12.5 million subprograms. With CRA-23 financing and tax reform improving the FY24 outlook, the additional funds were no longer required for COVID relief, but the government proceeded with SP1 because of its favorable terms (40-year term, 10-year grace, 1% interest). SP1 funds were received in 2024-Q3; SP2 is under development on similar terms but with more stringent conditions. The government intends to use the concessional proceeds of

the program loan SP2 component for debt consolidation and repayment of higher-cost COVID-era borrowing.

**Palau also incurred non-COVID external borrowing totaling over \$60.8 million.**

These obligations include a \$15 million Taiwan Housing Development loan (FY20); \$5 million from Taiwan for Women and Youth Entrepreneurs and MSME relending (FY21); an ADB policy-based loan of \$10 million for PPUC in FY22–FY23; \$15.8 million from Australia and JBIC for a second internet fiber project (FY23); and a \$15 million Saudi Arabia loan for NDBP land subdivision and housing, recently approved by OEK.

**The external debt-to-GDP ratio rose sharply, peaking in FY23 before declining with the economic recovery.** External debt increased from 30% of GDP in FY19 to 52% in FY20, then to 70% in FY21, and reached 72% in FY23 (see [Figure 17](#)). Much of the rise reflected GDP contraction. As the economy recovered in FY24–FY25, the ratio fell to 54% in FY25<sup>21</sup>. Given persistent output gaps and a favorable medium-term outlook, the debt-to-GDP ratio is expected to decline further if no large new borrowing occurs.

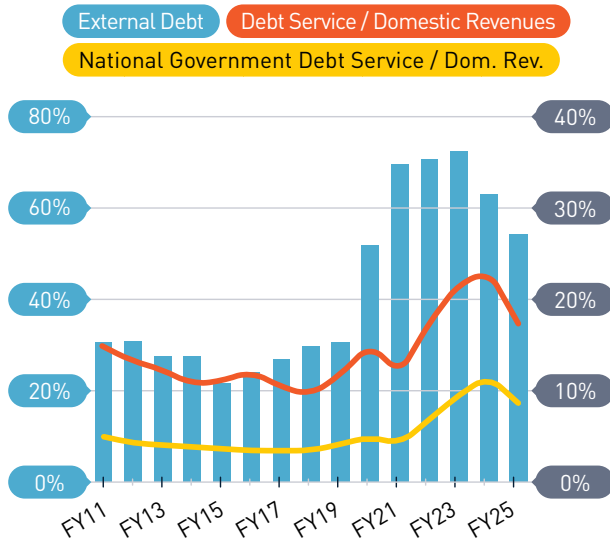
**External debt service has risen significantly, lagging the debt-to-GDP increase.** Measured as a percentage of national government domestic revenues, debt service followed a similar but lagged trend to the debt-to-GDP ratio: it was 12 percent of domestic revenues before the crisis in FY19 (including State-Owned Enterprise (SOE) debt service) and rose

21 Earlier estimates of the debt to GDP ratio have been revised downwards due to the delay in processing SP2 of the ADB *Strengthening Fiscal Resilience for Sustainable Development PBL and Saudi loan*.

*External debt rose to 72 percent of GDP in FY23 and moderated to 52 percent by FY25 as the economy recovered.*

**Figure 17: External debt and debt service (% of GDP)**

External debt increased significantly to finance COVID responses.



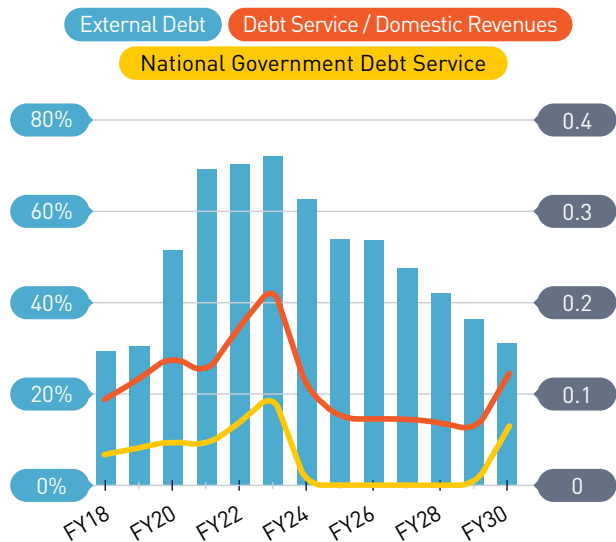
to 22 percent in FY24. Excluding SOE on-lent debt service, national government debt service was projected to peak at 11 percent of general fund revenues in FY24.

## The Compact Fiscal Consolidation Grant

**The Compact fiscal consolidation grant eased post-COVID fiscal stress but creates a fiscal adjustment in FY30.** The CRA-23 fiscal consolidation grant—\$10 million annually for six years through FY29—was earmarked for ADB loan debt service and provided material relief after COVID. During the grant period, debt service obligations on eligible ADB loans closely matched the roughly \$60 million available; the grant expanded fiscal space but did not finance principal repayments beyond normal debt service. As [Figure 18](#) shows, overall effective debt service fell to 11 percent of national government revenues in FY24 and national government debt service was effectively eliminated that year. Debt service is projected to spike in FY30, requiring an

**Figure 18: Fiscal consolidation grant impact on debt service**

National government debt-service obligations fell effectively to zero in FY24 but create a fiscal adjustment in FY30.



additional \$9.4 million (about 1.9 percent of GDP) in resources.

## Debt Sustainability

**Rising global interest rates increased debt service but projected costs fall as rates normalize.** Nearly half (48%) of Palau’s external debt is concessional (1–2% interest), providing a buffer against market-rate increases. Market-rate loans currently reference SOFR plus 1% and carry interest in excess of 5%. Total interest rose from \$2.5 million in FY19 to \$7.1 million (18.1% of domestic revenues) in FY25. With continued revenue growth and easing global rates, interest costs are projected to fall to \$4.1 million (12.3% of domestic revenues) by FY30.

**IMF assesses Palau’s sovereign risk as moderate, but a formal debt management strategy is required.** The 2023 IMF Article IV consultation judged sovereign stress risk as moderate and debt sustainability likely with

high probability<sup>22</sup>. A subsequent Article IV has been completed but not published<sup>23</sup>; the debt profile remains materially unchanged. Given likely pressure to incur new borrowing amid recovery, Palau needs a Medium-Term Debt Management Strategy (MTDMS) to preserve downward debt momentum while allowing limited new borrowing within sustainable limits. Suitable targets need to be set with a path and timeline to achieve them.

## Institutional Arrangements for Debt Management

**The Fiscal Responsibility and Debt Management Act (FRDMA) established institutional arrangements, including a Debt Management Unit.** The FRDMA requires creation of a Debt Management Unit (DMU) with duties as set out below:

1. Provide **technical discussion** on every proposed borrowing and proposed issuance of a sovereign guarantee, in particular, assessment of the various risks involved, terms and conditions of borrowing, and debt-servicing strategy;
2. Assist the Minister to develop and maintain a **debt management policy** for consideration by the President;
3. Develop and utilize a **project appraisal and approval framework** for the assessment of loan financed project and activity proposals and to provide subsequent advice to the Minister;
4. Undertake a periodic **Debt Sustainability Analysis** to support the debt management component of the annual economic and fiscal update; and
5. Undertake an annual **risk assessment** on the loan portfolio in its entirety and render its opinion or advice thereon to the Minister.

**A Debt Management Policy and prescribed debt limits establish the framework for a Medium-Term Debt Management Strategy (MTDMS).** A Debt Management Policy, drafted with PFTAC support and signed into law on April 4, 2022, adopts IMF and World Bank best practices, emphasizes transparency and accountability, and formalizes the DMU's functions. The Policy requires preparation of a MTDMS and sets debt anchors and limits, including a debt-to-GDP cap of 30% and a debt-service cap of 15% of domestic revenues. The Policy outlines the steps for the MTDMS:

1. Identify the **objectives** for public debt management and scope of the MTDMS;
2. Identify the current **debt management strategy** and analyze the cost and risk of the existing debt;
3. Identify and analyze potential funding sources, including their cost and **risk** characteristics;
4. Identify **baseline projections** and risks in key policy areas—fiscal, monetary, external, and market; and
5. Review key **longer-term structural** factors;
6. Assess and rank **alternative strategies** on the basis of the cost-risk trade-off.

**The DMU has been established and a modern debt recording system is being implemented,**

*Palau's external debt is not currently high-risk, but climate or other shocks could raise stress; a debt-reduction strategy is advisable.*

<sup>22</sup> International Monetary Fund, *Staff Report for the 2023 Article IV Consultation*, Washington D.C., November 13, 2023.

<sup>23</sup> International Monetary Fund, *IMF Staff Completes 2025 Article IV Mission to Palau*, Washington D.C., November 19, 2025.

**but capacity gaps remain.** The DMU now exists within the Ministry of Finance and Palau is implementing the Meridian/Commonwealth Secretariat debt recording and management system to improve debt recording, reporting, and DSA inputs. However, the DMU currently relies on staff seconded from other Ministry units; recruiting dedicated personnel should be prioritized.

**Palau should develop a MTDMS to restore compliance with the Debt Management Policy anchors.**

Current indicators exceed policy limits (debt-to-GDP at 54% and debt service at 17% of domestic revenues in FY25). With institutional arrangements in place, the government should finalize the MTDMS to define targets, timelines, and measures to return debt indicators to the policy anchors while accommodating limited, prudent new borrowing.

## 5. Public Financial Management

### Public Expenditure and Financial Accountability

**The PEFA framework is the standard tool for assessing public financial management.**

The Public Expenditure and Financial Accountability (PEFA) framework, developed by the World Bank and international donors, provides an objective benchmark to evaluate and improve public financial management (PFM). It comprises seven major areas and 31 individual topics:

1. Budget reliability
2. Transparency of public finances
3. Management of assets and liabilities
4. Policy-based fiscal strategy and budgeting
5. Predictability and control in budget execution
6. Accounting and reporting
7. External scrutiny and audit

**Palau completed an Agile PEFA assessment in late 2022 following an earlier self-assessment.**

In March 2013 Palau conducted a PEFA self-assessment with PFTAC support, intending a formal external evaluation after addressing major weaknesses. A scheduled external assessment was delayed (programmed for 2019) and postponed by COVID. A reduced but comprehensive “agile

*Palau completed a PEFA assessment and adopted a PFM reform roadmap but needs basic skills development to advance implementation.*

PEFA<sup>24</sup> was completed in late 2022. The report provides detailed analysis of individual PFM elements but does not offer an overall PFM rating. It identified stronger performance in transparency (item 2), asset management (item 3), and policy-based fiscal strategy (item 4). Budget reliability (item 1) scored relatively low except for contingency reserves, predictability and control in budget execution (item 5) showed mixed results, and accounting and reporting (item 6) scored poorly due to delayed audits.

**Palau requested PFTAC assistance to develop a PFM roadmap, which the government approved in November 2023<sup>25</sup>.** The roadmap prioritizes and sequences reforms appropriate to Palau's staffing and resource constraints rather than addressing all PEFA elements simultaneously. Current priority areas include:

- Macroeconomic and fiscal forecasting
- Planning and budgeting
- Financial reporting
- Public investment management
- Internal audit
- Procurement
- Asset management
- SOE oversight

24 PFTAC, *Public Expenditure and Financial Accountability (PEFA) Performance assessment report, 2022*, Suva.

25 PFTAC, *Republic of Palau Public Financial Management Reform Roadmap and Action Plan*, November 2023, Palau

- Fiscal risk management
- Strengthening transparency
- Debt management
- Budget execution
- Strengthening PFM in state governments

**Palau implemented several PFM reforms during the COVID period that created momentum for the PEFA and roadmap.** These reforms included elements of the ADB RISES program: the Fiscal Responsibility and Debt Management Act (FRDMA), the Fiscal Strategy and Economic and Fiscal Update, tax reform, the national infrastructure plan, reforms to RoPSSA and CSPP social security and pension schemes, and adoption of a modern Financial Management Information System (FMIS). The timing of the Agile PEFA and the roadmap followed these reforms and provided a foundation to sustain progress.

## Green PFM

**IMF and PFTAC supported development of a Green PFM framework for Palau in April 2025.**

A joint mission assisted Palau in integrating climate considerations into PFM using the IMF's Green Public Financial Management Framework<sup>26</sup>. The report notes climate impacts that pose macro-critical risks and the fiscal demands of Palau's mitigation and adaptation targets, including a renewables target of 45% and a 35% energy-efficiency improvement by 2025. The report's introduction states that:

*Palau is experiencing climate change effects which are impacting on the environment and the economy, and the policy responses are placing new demands on its fiscal policy. Rising temperatures, increasing sea levels, ocean acidification, and intensified rainfall*

26 IMF, PFTAC; "Mainstreaming Climate Change into Public Financial and Investment Management; Ozlem Aydin, Kris Kauffmann, Murray Petrie, and Paul Seeds, Palau, April 2025.



*events threaten biodiversity, fisheries, and tourism, posing macro-critical risks. Without adaptation, sea-level rise could cost Palau up to 4% of GDP annually by 2040. Palau also has ambitious mitigation targets including increasing the share of renewables to 45% energy generation and improving energy efficiency by 35% by 2025. Effective adaptation and mitigation require integrating climate change considerations into development planning, prioritizing key areas, and ensuring efficient resource allocation in the context of the budget.*

**Palau has existing Green PFM elements but needs further integration and capacity building.** The report notes the Climate Resilience Reserve Fund under the FRDMA, the Palau Development Plan 2023–26, and the Office of Climate Change (established 2015) as existing entry points. It recommends using the Fiscal Strategy as a principal entry point to align climate goals with the Palau Development Plan and to manage fiscal risks from climate events. The report also recommends developing a comprehensive Disaster Risk Financing Strategy and integrating these measures into the annual economic and fiscal update.

**The Green PFM proposal identifies practical entry points in budgeting and infrastructure planning.** It recommends tagging budget items that affect climate goals, preparing a green budget statement, and including a budget book detailing agency goals and spending. The proposal advises a short-term strategy at the start of the annual budget process to integrate Green PFM into public investment planning.

**Capacity constraints limit Palau’s ability to implement Green PFM fully, so efforts should prioritize feasible actions.** The proposal recommends focusing on priority areas aligned with national objectives and strengthening human capacity. Given current constraints and the ongoing PFM roadmap, Palau should first consolidate basic PFM competencies before scaling Green PFM measures.

## The Palau Development Plan: 2023–2026

**The PDP 2023–2026 sets five development pillars and a national/community geographic focus.** Earlier plans, including the Palau 2020 National Master Development Plan (NMDP) and the 2009–2014 Medium-Term Development Strategy (MTDS), followed traditional growth-focused models. The four-year Palau Development Plan (PDP) 2023–2026 defines five pillars—social, culture, environment, economic, and governance—with a vision to substantially enhance quality of life for current and future generations. The plan integrates these pillars across two geographies: national and community (urban, rural, outer islands).

1. Improve the quality of social support
2. Nourish Palauan culture and identity
3. Maintain the environment and counter climate change
4. Restore economic growth
5. Strengthen governance in support of growth

**The PDP is organized by 16 sector chapters aligned with government agencies and includes monitoring matrices.** Each sector chapter sets goals, assesses status and trends, outlines strategy, and lists priorities, programs, and projects. A monitoring matrix at each chapter’s end tracks performance, outcomes, outputs, and provides a budget for sector activities. The PDP was well suitable to CRA-23 requirements: for the use of Compact funds, and as a framework for the bilateral economic consultations with the US.

**The PDP applies a Multi-Criteria Analysis (MCA) for capital and recurrent priority selection.** The plan describes a five-step Capex selection process from the National Infrastructure Investment Plan (NIIP):

1. Compile a list of proposed capital expenditures (NIIP)

*A Macroeconomic Committee was established to strengthen economic management.*

2. Assess each proposal's readiness for appraisal
3. Approve the Multi-Criteria Analysis (MCA) criteria
4. Use the MCA to score proposals ready for appraisal and prioritize them
5. Seek funding

**The MCA weights the five pillars equally.**

Projects are scored (-1 to 3) against the pillars with economic projects receiving an additional simple cost-benefit analysis. A similar process is used to prioritize new recurrent initiatives. This approach has the potential to prioritize non-economic factors over economic factors and limits rigorous assessment of financial or economic returns.

**A major omission is the lack of a macroeconomic framework to assess fiscal feasibility.** The PDP's financing chapter lists funding sources but the Plan does not contain a macroeconomic chapter which evaluates overall financial viability or fiscal implications. Palau has traditionally funded capital projects through external grants and loans, but its reclassification to high-income status increases the need for domestic resource mobilization. Yet, the PDP does not provide adequate strategies to raise domestic savings or align fiscal policy with plan obligations.

**A critical review of the PDP is warranted before any follow-on plan is prepared.** The PDP expires in 2026 and a review should assess the plan's approach, structure, methodology, implementation success, and alignment of annual budgets with PDP priorities. Any follow-on plan should build on strengths of the PDP but must address macroeconomic and financing implications and

integrate with existing infrastructure plans; an outline for a successor plan should only be developed after a review is conducted.

## Accounting, Audits and Financial Management Information Systems (FMIS)

**Palau successfully implemented a new FMIS (Tyler-Munis) in mid-2020, though implementation faced delays.** The Tyler-Munis system, funded by CRA-10, meets U.S. government accounting standards and federal program requirements. Deployment was completed in mid-2020, with data migration and COVID-related delays; finance staff now use its reporting tools effectively.

**Significant audit delays remain a priority issue, with audits currently more than two years behind Compact requirements.** The FY20 audit was completed in April 2023, FY21 in November 2024, and FY22 in October 2025 (28 months late). COVID-related travel restrictions and the departure of Deloitte created a backlog; replacement external auditors Ernst & Young (E&Y) and limited trained staff contributed to delays. The Office of Insular Affairs is prioritizing backlog clearance, and Palau plans to achieve compliance with Compact single audit requirements through timeline issuance of its FY2026 audit by mid-2027.

**The FMIS does not fully integrate with IMF GFS reporting or with performance budgeting.** Although the chart of accounts was adjusted and broadly mapped to GFS categories, the standard account codes lack the detail to generate high-quality GFS reports without additional data extraction, correspondence tables, and transaction coding. A further issues has arisen with the reduction in the detail provided in the annual audits, which no longer provide a classification of expense by account codes or economic classification. This inhibits analysis of fiscal trends and fiscal balance<sup>27</sup>.

<sup>27</sup> This issue is explored further in the final chapter of this Review on statistics

The system also lacks integration of output/performance budgeting, limiting its utility for modern fiscal management.

## The Macroeconomic Committee

Palau has initiated formation of a **Macroeconomic Committee but has not yet formalized its mandate.** In March 2025 PFTAC proposed establishing a committee; an initial meeting discussed functions and objectives. Proposed functions included:

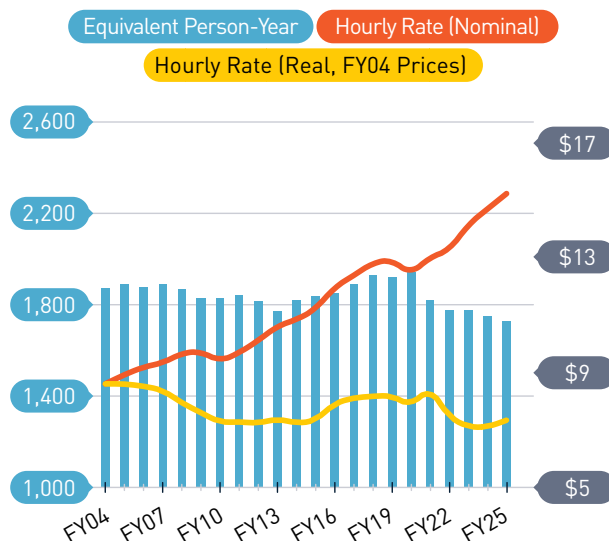
1. Review current economic trends and produce medium-term projections of key macro variables.
2. Estimate the revenue ceiling and fiscal envelope for the government budget, consistent with FRDMA fiscal responsibility principles.
3. Draft the annual Economic & Fiscal Update (EFU) and Half-Yearly EFU.
4. Support development of macroeconomic and fiscal policies.
5. Have the Minister of Finance or a representative chair the Committee.
6. Prepare briefs on meetings for the Minister and presentations to the President and OEK.

A second meeting in June 2025 broadened participation but the Committee still needs formal establishment and defined scope. Participants included:

- Bureau of Tax and Revenue,
- Bureau of Budget and Planning,
- Bureau of National Treasury,
- Office of Planning and Statistics,
- Debt Management Unit, and
- The Graduate School USA.

**Figure 19: Government payroll: FTEs and hourly wages**

Government payroll (full-time equivalents) have trended downwards.



**Further formalization is required to operationalize the Committee and deliver regular outputs.** The June meeting was exploratory; participants discussed economic and fiscal developments but did not produce a draft assessment or formal conclusions.

## Public Sector Payroll

**Palau has maintained control over civil service size and payroll costs, with mixed real-wage outcomes.** Between FY04 and FY19 FTEs were largely stable while hourly pay (including benefits) rose from \$8.47 to \$12.84 (average annual growth 2.7% percent), see [Figure 19](#). Adjusted for inflation, real wages declined by about 0.5% annually. The 2008–09 global financial crisis led to reductions in employment and wage rates, including cuts to hours and overtime.

**Recent wage adjustments and FTE declines have affected real compensation and staffing levels.** FTEs fell 10.9% between FY20 and FY25, partly due to out-migration of Palauans during

COVID and labor recruitment pressures from the U.S. Hourly wages rose 21.7% after two 75¢ increases in FY23 and FY24, but inflation rose 31.5%, producing a 7.5% real wage decline. A subsequent 10% pay increase in FY26 should restore purchasing power lost since FY20.

**The IMF provided TA on wage bill analysis to improve workforce planning and compensation policy.** In November 2023 and May 2024 the IMF delivered technical assistance and a wage-bill analytical tool that decomposes drivers of the wage bill—remuneration rates, workforce numbers, age cohorts, functional composition, and turnover. Preliminary analysis identified wage compression as a retention and recruitment issue and highlighted the potential role of foreign recruitment to address labor shortages. The tool offers functions that require further government follow-up to realize full benefits.

## 6. State-Owned Enterprise Reform

### The SOE Sector

**Palau's SOE sector is small but presents material fiscal risks.** Compared with other Micronesian economies, Palau's SOE sector is relatively small. The four principal SOEs are the Palau National Communications Corporation (PNCC), the Palau Public Utilities Corporation (PPUC), the National Development Bank of Palau (NDBP), and the Belau Submarine Cable Company (BSCC). Airport operations and the Post Office are government departments; the port is owned by Koror State and operated by a private company under a 25-year concession. Airport terminal operations and upgrades have been restructured under a joint venture involving the government, JICA, and a private Japanese firm.

**Weak governance and management practices have left SOEs underperforming and financially exposed.** A 2017 assessment<sup>28</sup> identified the absence of a commercial legal framework, frequent politically appointed board members lacking sector experience, noncommercial pricing set for “affordability,” deferred maintenance, and resulting higher long-term capital costs and service disruptions.

**Palau has not yet established a rules-based commercial framework or effective SOE oversight.** A 2014 presidential SOE policy

28 Private Sector Assessment (PSA) of Palau: *Policies for Sustainable Growth Revisited: A Private Sector Assessment for Palau*, the Pacific Private Sector Initiative, Sydney, Australia, 2017.

*The SOE sector underperformed; power tariffs approaching full-cost recovery should improve sustainability, but water and wastewater operate well below cost.*

set principles for commercial operation, Community Service Obligations (CSO), qualified directors, business plans, and performance monitoring, but little progress has been made to establish the necessary legal and institutional arrangements. Establishing and operationalizing an SOE monitoring unit would provide timely performance information to policymakers and support evidence-based decisions. Replacing political influence with a rules-based governance system remains a key reform priority but requires a conducive political and institutional environment.

## Reforms in the utilities sector

### Power Generation and Distribution

#### **PPUC has adopted a reform package to restore financial viability and governance.**

PPUC is responsible for power generation, distribution, water, and wastewater services. Prior to reforms it operated below cost recovery and had deferred maintenance; by 2020 it was reported insolvent. The ADB supported the *Palau Public Utilities Corporation Reform Program*, a policy-based loan<sup>29</sup>. Subprogram 1 (\$5 million) targeted (i) tariff reform with cost recovery and targeted subsidies, (ii) financial management, (iii) corporate governance, and (iv) market access for private participation in renewables.

29 Palau Public Utilities Corporation Reform Program (Subprograms 1 and 2), Completion Report, ADB, Manila, April 2023.

**Regulatory approval of a cost-recovery tariff improved PPUC's power operating results.** Despite initial delays in Subprogram 1 implementation, PEWA approved tariff petition procedures and a full cost-recovery methodology. PPUC's petition was adopted and, since FY23, Electricity Power Operations show positive operating income consistent with cost recovery, though implicit subsidies for WWO power use remain problematic<sup>30</sup>.

**Palau's first solar PPP is operational but constrained by grid integration and storage gaps.** A PPA with Solar Pacific financed by the Australian Infrastructure Financing Facility for the Pacific (AIFFP) (\$22 million: \$18 million loan, \$4 million grant) aimed to replace 20% of power demand. Solar generation met expectations, but grid integration issues and lack of battery storage limited utilization and caused curtailment. Australia pledged A\$15 million to support a battery energy storage system for the 15 MW solar farm.

**Legislative constraints on tariff adjustments expose PPUC to significant financial risk.** A new tariff structure replaced the Automatic Fuel Price Adjustment Clause in September 2024 and included a monthly service charge, commercial cost recovery, energy charge, Distributed Energy Rate (DER), IPP energy costs, and other components. However, the OEK's FY25 supplemental budget prohibited automatic tariff changes until PPUC audits are current. With audits only up to FY22 and backlog clearance expected by mid-2027, PPUC cannot petition for tariff adjustments in the near term and faces exposure to fuel-price volatility and potential large financing requirements or subsidies.

**The residential electricity subsidy is being refocused to target low-income households.** A universal subsidy introduced in FY22 was

30 By law PPUC is not permitted to cross subsidize water and wastewater operations. However, failure of WWO to pay for power incurs an implicit annual subsidy of \$3.25 million (FY22 audit). Total accumulated accounts payable in the FY22 PPUC audit indicates an accumulated cross subsidy of \$15.5 million.

narrowed in FY23–FY25 to 10¢/kWh for the first 500 units, but it still benefited higher income households. The FY26 budget veto eliminated the broad subsidy while preserving a targeted Lifeline Subsidy Program for low-income households, a development that should improve targeting of fiscal support.

## Water and Wastewater Services

**Water and wastewater services continue to operate at large losses and below cost recovery.** The ADB-funded Water Sector Improvement Program (WSIP, \$15 million) sought a legal framework, independent water corporation, full cost recovery, and public consultation. Instead, water services merged into PPUC, reducing operational independence. Water and Wastewater Operations (WVO) has failed to pay Electric Power Operations (EPO) for power, effectively creating cross-subsidies. Tariff increases under WSIP were insufficient and PPUC continues to record substantial operating losses.

**Subprogram 2 of the PPUC PBL targeted full cost recovery for WVO and governance reforms.** Extended in mid-2022 with an additional \$5 million, Subprogram 2 focused on WVO cost recovery with targeted subsidies, improved financial management, corporate governance aligned with the SOE policy, and PPP procedures to support transparent PPAs.

**Recent tariff petitions aim to improve WVO's finances but face political resistance.** Based on unaudited FY figures, WVO reported \$5.4 million revenue against \$11.4 million expenses. PEWA approved staged tariff increases; in February 2025 PPUC petitioned to raise water/wastewater tariffs from \$6.75 to \$8.37 per 1,000 gallons (24%), which PEWA approved. The OEK challenged the increase and enacted a tariff freeze via the FY25 supplemental, preventing tariff adjustments and deepening WVO's fiscal strain. The law requires modification to permit the tariff flexibility necessary for financial sustainability.

**Residential water subsidies are inefficient and insufficiently targeted.** The FY24 budget allocated free the first 2,500 gallons for all residential consumers with \$1.0 million in FY24 and \$1.2 million in FY25–FY26. This universal approach subsidizes all households rather than targeting low-income households and creates inefficiency.

**Additional funding is required to complete the Koror–Airai Sanitation Project (KASP).** KASP initially allocated \$28 million for infrastructure upgrades but remains incomplete after delays and contractual issues; an additional \$5 million is needed to finish the project.

## ICT Reforms

**The submarine fiber cable projects have materially improved internet connectivity.** BSCC, established in 2017 with ADB support, connected Palau to the SEA-US cable, reducing ICT costs and improving access. The SEA-US link transformed Palau's ICT landscape after years of high costs.

**A moratorium on new competition in the ICT market has been extended to June 2028.** Telecom reform legislation (2017) removed incumbent monopolies, created the Bureau of Communications, and allowed market entry after a moratorium. The moratorium, initially through June 2025, was extended for three more years.

**Palau is implementing a second fiber spur (PC2) to provide redundancy and resilience.** PC2 involves a 110-km spur to the Echo subsea cable system; construction of the spur

*ICT services improved; RUS financing for fiber-to-the-home and mobile modernization will deliver a modern IT infrastructure.*

*Two fiber connections provide redundancy, but high debt-service burdens threaten BSCC's solvency.*

is complete but splicing to the main cable awaits regulatory approvals in Singapore and the FCC. Connection is anticipated in January 2026 and commissioning by October 2026. PC2 funding includes loans and grants from Japan, Australia, the U.S. Compact, and other sources; estimated total cost is \$29.9 million with \$15.8 million already expended.

**BSCC's current finances are near breakeven but PC2 debt service will create insolvency risks.** FY24 operating income was \$0.74 million with a net deficit of \$0.1 million after non-operating expenses. Once PC2 debt service (over \$3 million annually) begins, projected annual deficits approach \$2.25 million at current revenue levels. BSCC is legally required to operate at full economic cost, implying significant price increases for retail ISPs or the need for interim financing support. Consideration of a temporary subsidy or donor support—similar to the RMI approach—may be warranted given the strategic and redundancy rationale for PC2.

**A successful RUS ReConnect grant will extend fiber to homes and premises.** PNCC secured a \$34.9 million RUS ReConnect grant to replace copper with fiber-to-the-home/premises. An RFP has been issued; contractor selection is expected by end-February 2026. Implementation is planned over three years with completion by end-2029.

**Mobile network modernization and 5G rollout are underway with Open RAN adoption.**

A USTDA<sup>31</sup> grant (\$870,000) and additional funding are supporting PNCC's mobile network

upgrade and 5G readiness. An RFP issued in July 2024 selected Nokia for the 4G/5G core; RAN procurement faced vendor issues but selection is now expected. Core construction begins early 2026 with 14-month completion for the core and 10–12 months for the RAN. Funding sources include unused COVID tracing funds, U.S. Coronavirus Capital Projects Fund, and an Australian grant.

**High retail internet prices remain a core policy challenge despite improved infrastructure.** Internet prices fell after the first fiber project but remain high (about \$120/month for a 20/1 Mbps ADSL connection). Data use growth has been modest (from 5 GB in early 2020 to 7 GB five years later). The RUS grant condition requires affordable household pricing; international benchmarks suggest a 25 Mbps basic service should cost roughly 2% of GNI per capita (\$25/month for Palau). Achieving this price will be difficult for PNCC without substantial adjustments to tariffs, cost structures, or subsidies.

**Regulatory treatment of satellite broadband (Starlink) raises competition concerns.** Starlink offers competitive satellite broadband at lower prices in other Pacific jurisdictions. Palau's regulator has banned Starlink, a decision seen as anti-competitive. While Starlink would likely have limited impact on PNCC's residential base, it could affect commercial revenues and provide valuable redundancy, especially in remote areas. The ban may be justifiable temporarily during RUS and mobile modernization works, but the moratorium should be lifted for distant islands immediately and for all of Palau after project completion to allow competition.

31 US Trade and Development Agency, *Palau Partner on Mobile Network Modernization* <https://www.ustda.gov/ustda-palau-partner-on-mobile-network-modernization/>, June 21, 2023.

## 7. The Financial Sector

### Banking

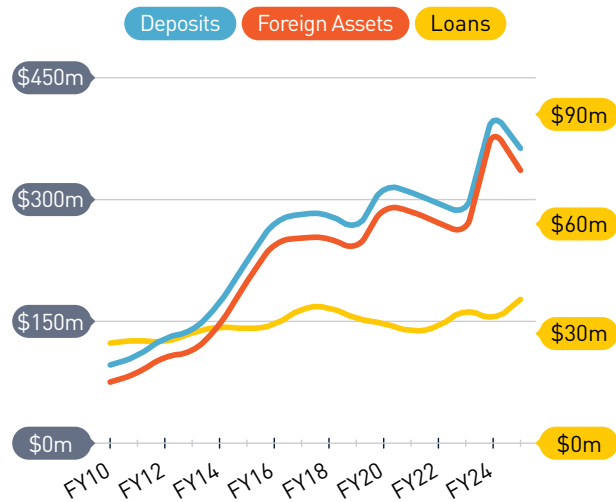
**Deposits in Palau expanded during the tourism boom and saw an exceptional spike in FY24.** The deposit base grew rapidly from FY10 to FY16 due to economic expansion, FDI, and land-lease purchases (see [Figure 20](#)). After peaking in FY15 the deposit base stagnated and contracted by FY19 as the economy weakened. Deposits rose again at the onset of COVID reflecting unspent COVID-related borrowing, then contracted in FY21–FY23 as national and state government deposits were drawn down. In FY24 private-sector deposits spiked after a regional entity parked over \$100 million in Palau<sup>32</sup>; partial runoff occurred in FY25 as some funds were shifted offshore. Over time the large FY24 inflow is expected to dissipate and deposit growth to revert to prior trends.

**Household deposits rose during the 2010s and at the pandemic onset but have since plateaued.** Household deposits grew on average about 9 percent per annum between FY10 and FY21 (see [Figure 21](#)), supported by the tourism boom and pandemic-related savings accumulation. From the FY21 peak through FY25 household deposits leveled off as CARES Act stimulus ended and high inflation and falling real incomes offset the nascent recovery in FY24.

<sup>32</sup> The exact origin of the funds is not currently known and FIC is investigating. If the funds represent local deposits of a non-resident they should be classified as foreign liabilities. This would reduce the level of deposits and net foreign assets.

**Figure 20: Commercial bank deposits, lending, and net foreign assets**

Commercial bank lending remains weak; banks hold substantial offshore investments.

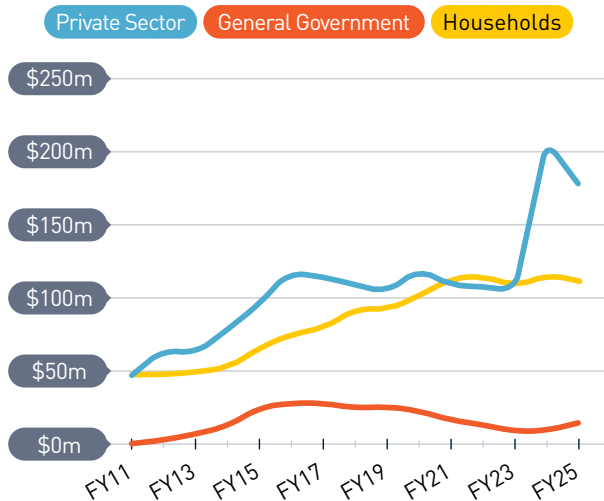


**Government cash reserves increased early in the pandemic and have recently been restored following a period of heavy spending.** Government deposits rose in FY20 as unspent borrowing accumulated, were drawn down in FY21–FY22 to fund deficits and increased again in FY23 following additional budgetary borrowing. In FY24–FY25 the fiscal position turned to surplus following tax reform and CRA-23, and cash reserves grew—although much of the increase was invested short-term in Time Certificates of Deposit (TCDs) and is not fully reflected in government deposit balances.

**Koror State built reserves pre-COVID, which were largely depleted and are now being rebuilt.** Koror State had nearly \$26 million in reserves pre-COVID, which fell to \$9 million by end-FY24 after Rock-Island fee revenues collapsed. Koror requested a \$10 million loan from the national government; in FY25 it received a \$5 million tranche on-lent from national proceeds of the ADB Strengthening Fiscal Resilience policy-based loan, with a second tranche conditional on Sub Program 2 effectivity. Koror’s deposits rose to \$14 million by end-FY25 as tourism recovered.

**Figure 21: Commercial bank deposits, by institution**

Commercial deposit growth has been weak, with an unexplained spike in FY24.



**Private sector credit remained weak despite a large deposit base reflected in growing excess liquidity in foreign assets.** Private lending peaked at \$36.5 million in FY17 (about 12.9 percent of deposits), fell before and during COVID, and recovered to \$39.3 million by FY25. However, deposit growth outpaced lending and the loans-to-deposits ratio fell to 10.8 percent, contributing to an accumulation of foreign assets of \$336 million in FY25.

**Several structural factors constrain commercial lending in Palau.** Low domestic lending reflects high perceived risk and a shortage of bankable projects. Principal constraints include:

*Commercial lending is among the lowest in the region, but introduction of a Community Reinvestment Act is a blunt tool of policy while other reform options exist.*

1. Businesses' limited capacity to produce credible business plans and audited financial statements,
2. Lack of usable collateral and restrictions on using land as security or obtaining title insurance,
3. A usury law capping lending rates at 4 percentage points above the US prime rate (currently translating to an 11.0 percent cap), which limits pricing flexibility relative to typical Small and Medium-sized Enterprises (SME) lending rates in comparable markets<sup>33</sup>,
4. Absence of a credit bureau, and
5. Practices of foreign US banks that require offshore loan approvals and standards unsuited to the local environment.

**Tax reform may improve credit assessment if banks can access tax-filed financials.** New tax rules require businesses to prepare financial statements for tax filings, which could support loan underwriting. NDBP has proposed legal changes to permit banks, with client consent, to access tax records for credit assessment.

**A proposed Community Reinvestment Act (CRA) would mandate local lending targets but raises feasibility concerns.** Draft bill RPL 12-33, tabled in the OEK, would require banks to lend 45 percent of deposits locally (subject to a floor of 25 percent set by FIC). However, the CRA does not require banks to make loans that are inconsistent with safe and sound operations. Qualifying instruments include loans to individuals and businesses and purchases of securities issued by the Republic, financial institutions, or local businesses. The Financial Institutions Commission (FIC) would calculate each bank's CRA using a 12-month moving average of deposits; enforcement provisions include a 30-day period to make any shortfall good, a 10 percent fine on persistent

<sup>33</sup> <https://www.bankrate.com/loans/small-business/sba-loan-rates/>

shortfalls, and compelled institutional deposits at NDBP for noncompliance.

**Local capacity to absorb a mandated CRA is limited and could create market distortions.**

With an 11 percent loans-to-deposits ratio, a 45 percent CRA would require additional lending equivalent to roughly \$123 million. Under local conditions there are few local businesses that could absorb this level of credit in a safe and sound way. Further, there is no development of a local financial securities market to absorb the liquidity. The likely outcome would be the need for the government to issue local bonds, NDBP guaranteed securities or deposits at higher interest rates. The RMI experience—where a 70 percent local-lending requirement exists but is not enforced—illustrates enforcement challenges when the commercial banking sector has not been de-risked.

**Policy alternatives that strengthen the lending environment are preferable to coercive lending mandates.**

A fixed lending quota risks inefficient resource allocation and could undermine financial stability and correspondent banking relationships. Priority reforms include revising the usury law, establishing a credit bureau, strengthening land-collateral frameworks, and developing a domestic securities market (government or NDBP-issued) to mobilize excess liquidity. These measures should precede consideration of mandatory lending quotas.

## National Development Bank of Palau

### *The Role of the NDBP*

**NDBP is a significant, government-owned development institution with a substantial lending portfolio.** Established in 1982 and wholly government-owned, NDBP has a larger relative role in Palau’s financial system than peer institutions in many Pacific islands; its loan portfolio is comparable in size to

*The Development Bank is central to housing finance, while business lending remains weak.*

commercial banks’. Six board members are presidential appointees with OEK advice and consent; the seventh board member serves as CEO, appointed by the Board. Current strategic emphasis is on:

1. Financial market diversification — addressing gaps in product range and weak commercial bank lending performance,
2. Development — supporting SME incubation and growth,
  1. Industrial policy — promoting diversification into non-traditional sectors.

### *Core Operations*

**NDBP’s portfolio is dominated by housing loans while commercial lending remains limited.** Unaudited FY24 data show total loans of \$36.3 million: \$27.4 million (76 percent) for homeownership, \$6.3 million (17 percent) for commercial lending, \$0.9 million for agriculture, \$0.4 million for fisheries, and \$1.3 million for home solar. Housing loans rose from \$12.2 million in FY18 to \$27.4 million by FY24, driven largely by home equity products. Commercial lending peaked at \$11.0 million in FY22 but declined thereafter. Despite acute housing needs, NDBP’s commercial finance role remains limited and declining.

**NDBP’s balance sheet and recent governance reforms have strengthened its financial position.** Approximately 13 percent of assets are cash or equivalents; lending represents about 81 percent (\$35.8 million) of assets. Under new management since August 2023, NDBP implemented risk-management



reforms, established a risk oversight committee, and restructured the loan book. Non-performing loans fell from nearly 19 percent in FY23 to about 0.5 percent in FY25. NDBP's liabilities-to-assets ratio averaged 26 percent over the last three years. The Bank has borrowed modestly from RoPSSA (\$0.6 million), on-lent Taiwan-guaranteed loans for agribusiness (\$3.3 million) and for Women and Youth Entrepreneurs/MSMEs (\$4.5 million), and participated in the ADB solar project (\$2.5 million).

### **New Initiatives**

**NDBP is leading a state-partnered housing project financed by a \$15 million Saudi loan approved by the OEK.** The proposed project would use state-provided land and NDBP financing, with sales or rentals repaying the loan. The Saudi loan carries a 2.5 percent charge, a five-year grace period, and a 15-year repayment period; it is denominated in Saudi Riyals, which introduces potential exchange-rate risk despite the Riyal's longstanding peg to the US dollar. Some concerns exist regarding specific Islamic-banking requirements.

**NDBP has applied for a banking license but has not completed the licensing process.** Both FIC and NDBP favor regulation under the Financial Institutions Commission. NDBP applied for a banking license in March 2024; Palau's licensing process requires (i) assessment of board competence and (ii) confirmation that procedures meet regulatory standards. The Bank did not submit required documentation to complete stage one within the six-month approval window and has not refiled.

**Deposit-taking would expand funding options but poses maturity- and mandate-related risks.** A banking license would enable deposit mobilization and potential lending expansion, but NDBP's asset profile is long-term (68 percent of loans exceed three years) while deposits are typically short-term. Accepting deposits could require structural changes

(e.g., attracting long-term institutional funds) and may pressure NDBP to adopt more commercial risk profiles that could conflict with its development mandate. Any move to deposit-taking should preserve the Bank's development objectives.

## **Financial sector digital innovations**

**Palau has initiated several fintech initiatives to diversify the economy.** Recent projects include (i) a Tokenized Dollar, (ii) the Digital Residency Program, and (iii) blockchain-based Savings Bonds.

### **Tokenized Dollar**

**The Ministry of Finance piloted a US-dollar-backed stablecoin in 2023 and is proposing a Ministry-issued tokenized dollar.** The 2023 pilot, developed with Ripple on the XRP Ledger, tested a stable coin with 168 government employees over three months; user feedback was positive. The pilot's stated objective was<sup>34</sup>:

*To promote the use of a Stable Coin at a national level and make it a convenient and cost-effective way of payment, giving people innovative and secure ways to access and transact with their money without physically going to a bank, handling fiat cash, or paying higher fees associated with credit cards and other electronic payment systems.*

**Concerns about legal compliance stalled further development and prompted a legislative replacement proposal in 2025.** OEK reviews in 2025 raised audit and authorization issues. In July 2025 a bill was tabled to replace the stable coin with a tokenized dollar issued and backed one-to-one by Ministry-held US dollar reserves; the Ministry would maintain infrastructure, handle redemptions, act as an exchange, and may contract private partners for system functions.

<sup>34</sup> Ministry of Finance Republic of Palau, *Stablecoin Program: Phase 1 Report*, Melekeok, Palau, December 2023.

*New fintech initiatives, including a tokenized dollar and digital residency, raise supervisory concerns and require stronger regulatory capacity.*

**Material operational, regulatory, and market barriers remain and no legislation has been enacted.** No Palau commercial bank or US-based correspondent has agreed to accept stable coin transactions or serve as an exchange. The Ministry lacks in-house capacity to develop and operate the required IT and financial infrastructure, and FIC lacks adequate expertise and resources to regulate Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) and Know Your Customer (KYC) compliance for such a product. IMF consultations have suggested simpler digital-wallet or payment solutions may better fit Palau's needs. To date no legislative action has been taken.

### Digital Residence

**Palau implemented a Digital Residency Program in November 2021<sup>35</sup> that issues a digital identity but does not confer legal residency.** Modeled on Estonia's program, Palau's digital residency permits up to 180 days' physical residence in Palau yet is not accepted by local banks as proof of identity nor usable to obtain a local driver's license.

**The Ministry of Finance administers the program and fees support operations.** The Digital Residency Office validates KYC information (with Cryptic Labs), issues ID cards, and manages subscriptions (\$50 application fee; \$100 annual fee; 5- and 10-

35 Olbiil Era Kelulau, *RPPL No. 11-14: to provide for Digital Residency, to appoint a service provider to administer the Digital Residency Program*, Melekeok, Palau, November 2021.

year options available). Regulations now permit digital residents to lease Postal Service mailboxes (subject to postmaster general and USPS approval); a virtual phone-number service is under consideration.

**The program has generated significant revenue but shows weak renewal rates and regulatory concerns.** Reported figures indicate roughly 23,000 digital residents and fee revenue rising from \$0.1 million in 2022 to \$2.7 million in FY25, yielding nearly \$7.3 million cumulatively; only 2,045 renewals suggest limited ongoing utility. Concerns include potential circumvention of US rules via mail forwarding using a US ZIP code and a name-change provision that could obscure beneficial ownership. During the 2023 IMF Article IV consultations the IMF Board advised caution and the need to strengthen regulatory and AML/CFT frameworks, concluding<sup>36</sup>:

*Noting the benefits to financial inclusion, Directors called for a cautious approach to Fintech initiatives. They underscored the need to first close existing gaps in the regulatory and governance frameworks, and strengthen the country's AML/CFT framework, before exposing the financial system to new risks.*

### Savings Bonds

**The Ministry of Finance is developing a blockchain-based digital savings bond platform to broaden domestic financing options.** In partnership with Soramitsu, the system uses Hyperledger Iroha and a mobile app to enable small-denomination savings bonds held in digital wallets. Specific terms, interest rates, and issuance procedures remain under development; proceeds are expected to provide additional resources for NDBP.

36 International Monetary Fund, *IMF Executive Board Concludes 2023 Article IV Consultation with Palau: Press Release No. 23/467*, Washington D.C., December 21, 2023.



## Social Security Sustainability

**Actuarial assessments show RoPSSA is financially weak and requires reforms to avoid trust fund depletion.** An FY18 assessment<sup>37</sup> reported a funded ratio of 35.4 percent and stable medium-term cash flow. A subsequent FY20 assessment<sup>38</sup> reduced the funded ratio to 20.3 percent and projected fund collapse by FY42, primarily due to lower assumed investment returns (accounting for 9 percentage points of the deterioration), increased longevity (3 points), and other factors (3 points).

**Unfunded supplemental benefits accelerate insolvency risks, moving projected collapse to FY35.** Three \$50 monthly supplements granted in 2014, 2017, and 2020 were only partially funded; the 2017 supplement accompanied a contribution-rate increase from 6 to 7 percent, while the other supplements required annual treasury appropriations. Including these supplements reduced the FY20 funded ratio to 17.5 percent and moved projected collapse to FY35; **Figure 22** shows pensioners would receive about \$0.74 per dollar in FY35. The government would face a financing gap of approximately \$13 million (2.1 percent of projected GDP or 7.6 percent of domestic revenues).

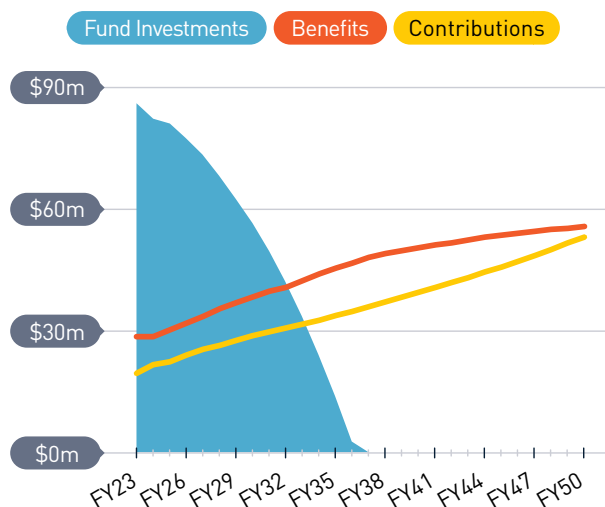
**A participatory reform process developed consensus reform options, but legislative action is pending.** Under the ADB RISES program, a pension working group and a national consultative process in November 2021 produced consensus recommendations: increase contributions from 7 to 9 percent, raise retirement age to 65, grant full benefits after 35 years of service, index benefits to inflation but below average-wage growth, and operate the system without subsidies.

37 Wilshire Associates, Inc., *Republic of Palau Social Security Administration Actuarial Valuation as of October 1, 2018*, Santa Monica, CA 90401, September 2020

38 Callund Consulting Ltd, *Actuarial Study and Assessment of the Republic of Palau Social Security Administration as of October 2020*, Berkshire, UK, February 2021.

**Figure 22: Social Security — no reform (projected)**

Without Social Security reform, pensioners would receive about \$0.74 per dollar in FY33.



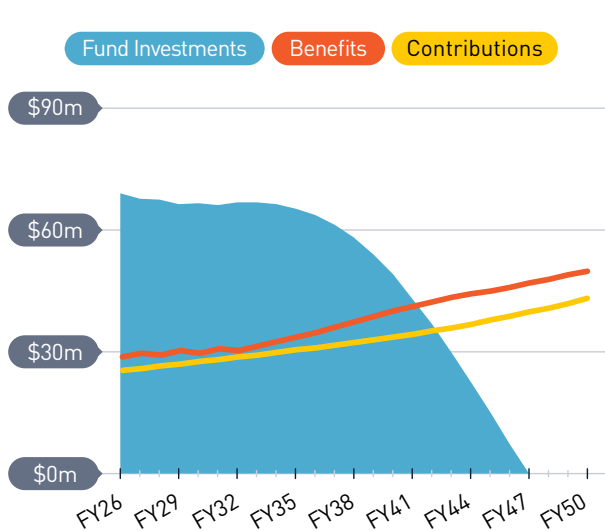
These recommendations were drafted into a presidential bill and reviewed by the IMF but remain unacted upon by the OEK.

**IMF recommends prompt enactment of the social security reform bill to restore sustainability.** Stakeholder consultations indicated willingness—particularly among younger cohorts—to accept higher contributions to preserve the system. IMF Article IV consultations in 2023 reiterated the need for prompt legislative action. **Figure 23** shows that the proposed reforms would materially improve RoPSSA's long-term stability, though further adjustments may be required depending on investment returns and demographics.

*An actuarial review shows Social Security faces solvency risks; proposed reforms could restore long-term sustainability.*

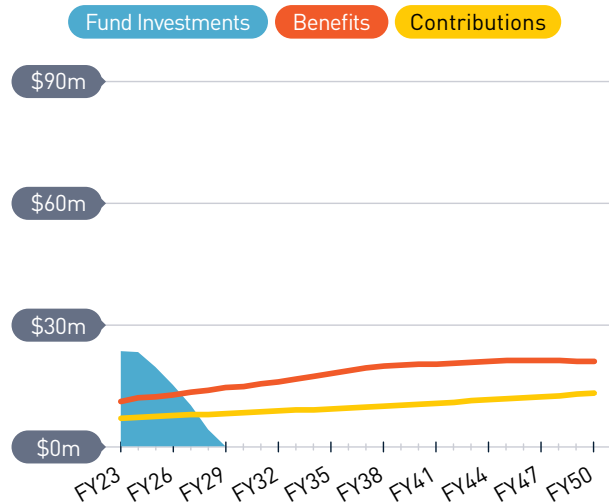
**Figure 23: Social Security — with reform (projected)**

With reforms, Social Security remains stable for around 15 years but may require further action thereafter.



**Figure 24: CSPP — no reform (projected)**

Without CSPP reform, civil servants' benefits would fall to roughly \$0.57 per dollar by FY27.



## Civil Service Pension Plan

**Actuarial analyses indicate the Civil Service Pension Plan is at high risk of near-term insolvency without reform or fiscal support.**

The 2019 Milliman report<sup>39</sup> found a 16 percent assets-to-liabilities ratio and projected collapse between 2023 and 2025, driven by legacy benefit accruals for pre-contribution service. The December 2023 Callund assessment<sup>40</sup> confirmed the trajectory and projected collapse by FY26 absent reform or cash injections (see [Figure 24](#)); it estimated pensioners would receive about \$0.57 per dollar of earned benefits and reported accrued liabilities of \$232.9 million versus assets of \$23.5 million (10 percent funding). The OEK provided \$13.2 million over FY19–FY25 to mitigate short-term pressures but not to reverse long-term insolvency.

**A reform task force and participatory process endorsed termination of the DB scheme in favor of a DC scheme for new accruals.**

Following ADB technical assistance, the task force recommended closing the existing Defined Benefit (DB) scheme and redirecting future contributions to a Defined Contribution (DC) scheme. Existing pensioners would continue to receive benefits; employees with accrued rights would receive either a cash payout or modified benefits.

**A November 2022 workshop produced a consensus reform package with phased transition and revenue measures.** The reform package adopted the following provisions:

1. Normal retirement age set at 63 years.

*CSPP faces imminent strain; reforms propose closing the Defined Benefit scheme and adopting a Defined Contribution model.*

39 Milliman, *Republic of Palau Civil Service Pension Plan Strategic Review*, Singapore, June 2019.

40 Callund Consulting Ltd, *Republic of Palau Civil Service Pension Plan Draft Actuarial Valuation Report as at October 1, 2022*, Berkshire, U.K. December 2023.

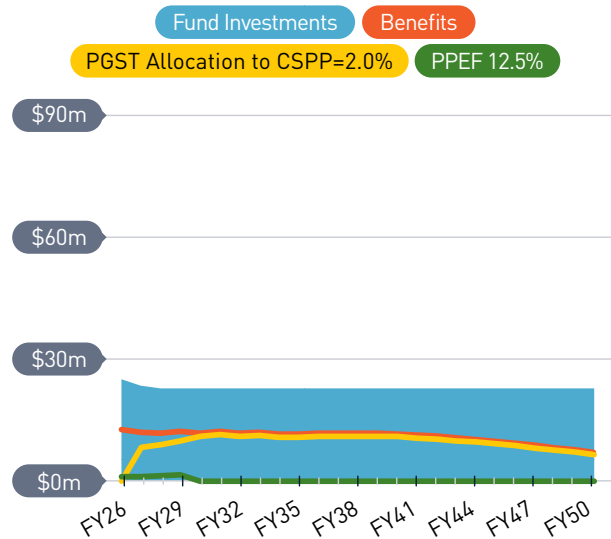
2. Unvested civil servants with less than five years' service to receive a cash payout equal to contributions (no earnings), affecting 1,044 members.
3. Vested civil servants with five to 15 years' service retain existing pension rights, with pensions based on the average of their three highest salary years at reform, affecting 1,229 members.
4. Vested civil servants with 15+ years' service have the crediting rate reduced from 2.0 to 1.5 percent, based on the average of their three highest salary years, affecting 883 members.
5. Current retirees are exempt from reforms.
6. New DC scheme: 6 percent employee contribution and 3 percent employer contribution; the 3 percent difference from the old scheme supports the legacy DB obligations.
7. Two percent of PGST collections allocated to fund the legacy DB scheme (actually 20 percent of revenues based on the 10 percent PGST).

**US grant funding has catalyzed reform momentum contingent on enactment of actuarially sustainable reforms.** In 2025 the US agreed to provide \$26 million to support CSPP, conditional on passage of actuarially sustainable reforms and timely use of funds; these funds were received and held in escrow by CSPP pending reform enactment. An intended November 2025 development symposium was deferred to allow updated actuarial assessments and model revisions; ADB has now

*With US support—a \$26 million pension grant—a development symposium is planned for early 2026 to advance reforms.*

**Figure 25: CSPP reform: DB closure, contributions, and benefits**

CSPP benefit payments gradually decline over the long term, funded by PGST and PPEF.



approved funding to update actuarial evaluations and simulation models. The symposium will convene after the actuarial assessments have been completed and models re-estimated.

**Financing the DB closure will require multiple revenue streams and a long transition period.**

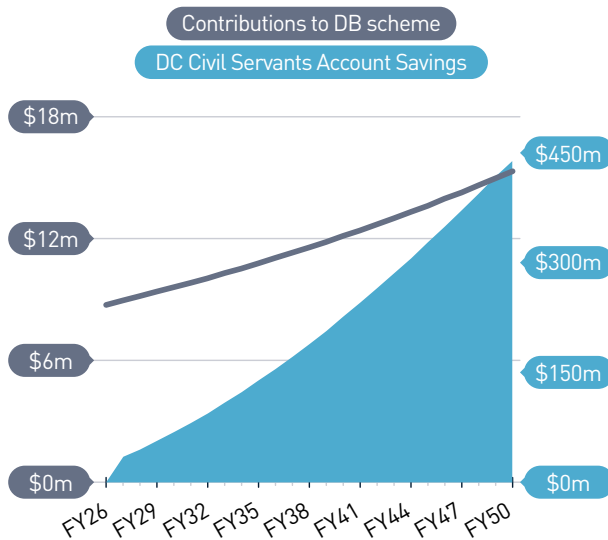
Figure 25 simulates DB closure: benefits are expected to remain relatively stable until FY37 and decline thereafter. Proposed financing sources include (i) a 2 percent PGST allocation, (ii) a 12.5 percent allocation from PPEF, and (iii) a \$26 million US contribution<sup>41</sup>. Simulations assume that once PGST contributions exceed benefit needs, PPEF allocations would cease and PGST allocations would adjust to match net requirements (less investment earnings)<sup>42</sup>.

41 The original grant of \$20 million has been increased to \$26 million, which fuller covers buyout of civil servants with less than 15 years of service and contributed to their DC accounts

42 The simulation includes the reforms proposed during the CSPP workshop but excludes the 3 percent employer transfer. All civil servants with less than 15 years of service are transitioned to the new DC. For civil servants with < 5 years of service they will be credited with their contributions, but for those with >=5 years and <15 years they will be credited with employee and employer contributions.

**Figure 26: Projected civil servant assets under a defined contribution scheme**

Projected future CSPP contributions will allow household savings to accumulate significantly.



**Under the reform package, CSPP net worth improves as legacy liabilities decline and DC savings accumulate.** All future contributions would flow to the DC scheme, gradually increasing household savings and plan investments (see [Figure 26](#)). Under the existing, unreformed DB scheme, investments remain small and unfunded liabilities remain large.

## 8. Private Sector Development

### The World Bank's B-Ready Survey

**The World Bank has replaced Doing Business with the B-Ready survey, but Palau, FSM and the Marshall Islands are not yet included.**

The former Doing Business Report provided a widely used metric for assessing the business environment, including in the North Pacific, but was discontinued in 2021 after irregularities. The World Bank launched B-Ready as a replacement, structured around three pillars and ten topics, and introduced it gradually<sup>43</sup>. Phase 1 (2024) covered 50 countries and Phase 2 (2025) covered 101 countries; Palau, the FSM and the Marshall Islands were not included. The final phase will extend coverage to 164 countries by the end of 2026 and will include the North Pacific nations.

**Palau's last Doing Business ranking (2020) indicates room for improvement.** In 2020 Palau ranked 145 of 190 countries, placing it in the bottom third of respondents and below most South Pacific nations. Palau scored poorly in areas including starting a business, construction permits, electricity access, investor protection, trading across borders, and bankruptcy resolution. The 2020 ranking remains a useful, though dated, indicator of constraints on the business climate.

<sup>43</sup> World Bank. 2025. "Business Ready 2025." World Bank, Washington, DC.

## Land Tenure

**Land ownership and tenure restrictions constrain private sector development in Palau.** Land is restricted to Palauan citizens and is held by individuals, clans, and the government. Foreign-owned financial institutions cannot take ownership of land or leases on default, creating uncertainty for mortgage collateral. Although law may allow interim foreign ownership provided land ultimately returns to a Palauan, ambiguity and risk have discouraged foreign banks from accepting land as collateral. The National Development Bank of Palau remains the primary institution able to issue mortgages on land or leases.

**Weak land-use planning compounds the tenure constraint, particularly for tourism.** Lease terms of up to 99 years reduce some concerns, but the absence of effective land-use planning remains a significant weakness for a tourism-based economy where coordinated land policy is essential to achieving high-value outcomes.

## The Regulatory Environment

**Recent corporate and secured-transactions reforms modernize Palau’s legal infrastructure for business.** The OEK passed a reformed Companies Act, and an electronic Corporations Registry became active. Palau’s legal framework—shaped by the constitution, customary law, and U.S. common law—lacked a Uniform Commercial Code equivalent. An ADB Private Sector Assessment found the previous Companies Act to be outdated and the company registry to be poorly functioning. Under the ADB RISES program and with PSDI support, the new Companies Bill (passed September 2021) established an electronic framework with key features including:

1. A standardized set of forms for online corporate filing to streamline incorporation.

2. Compliance with global AML/CFT obligations.
3. An online public registry providing current corporate information.
4. Stronger provisions for foreign corporations doing business in Palau.
5. A new classification framework for nonprofits: (i) charitable organizations for public good, (ii) religious organizations, and (iii) member-benefit entities such as chambers of commerce.

**New registries for corporations and secured transactions went live in January 2025.** The Corporations Registry provides a digital portal for real-time searches and filings, public disclosure of directors and shareholders, a mandatory resident director requirement, and remote registration. The Secured Transactions Registry—enabled by the 2012 Secure Transactions law but activated in 2025—records security interests in movable property and offers a searchable database of notices. Together, these registries should improve transparency and support commercial lending, though their full effects will take time.

**The recently completed centralized “one-stop shop” will reduce regulatory complexity.** Consolidating permits, licenses, and approvals into a single administrative office (the former finance buildings in Koror has been repurposed for this) and integrating the online registries will simplify business registration and approvals. Palau currently lacks a bankruptcy statute, leaving debtors and creditors without an efficient system for discharge of debts and complicating proof-of-debt processes.

*New online Secure Transactions and Corporations registries will improve the environment for commercial lending and private sector development.*

**Arbitration reforms provide an international dispute-resolution mechanism.** Palau acceded to the New York Convention and enacted an International Arbitration Law in April 2021, enabling commercial arbitration and defining its interaction with the court system. PSDI-supported stakeholder sessions accompanied these reforms.

## Foreign Direct Investment

**Palau's foreign investment framework remains restrictive and dated.** The Foreign Investment Act, amended in March 2016 to address "front" businesses, expanded board powers but has not reduced the prevalence of front companies or attracted higher-quality FDI. The stricter approach has not improved investment outcomes and may hinder the adoption of more modern, efficient regulations. A balanced, better-monitored framework with limited discretionary decision-making on a timely basis would likely be more effective.

## Private Public Partnerships (PPP)

**Palau needs to pursue alternative infrastructure financing as a high-income country.** Historically dependent on government funding, bilateral aid, and multilateral loans, Palau now needs new financing and operational models for infrastructure and utilities. With PSDI support and as part of the RISES program, Palau developed a PPP policy statement that the president adopted.

**A PPP unit within the Ministry of Finance will coordinate project development and oversight.** The unit has been established but is not yet operational. Its responsibilities will include developing a PPP framework, aligning projects with the Fiscal Responsibility Framework and the debt management unit, screening projects through a ministerial PPP project committee, overseeing feasibility assessments, and forwarding approved projects to the president and OEK for final approval. The unit will also monitor project delivery to ensure compliance with agreed terms.

# 9. Compact Renewal

## Background

**The second Compact Review (CRA-23) was agreed in May 2023 and enacted by the US Congress in March 2024.** The original Compact between the US and Palau was signed in January 1986 and ratified by Palauan referendum in 1993; it took effect in 1995 for a 15-year period. The Compact provided annual economic assistance grants and established the COFA Trust Fund (CTF). The original agreement required reviews in the 15th, 30th, and 40th years. The first review (CRA-10) completed in September 2010 extended economic assistance through FY24 and added funds to the CTF, but Congress approved CRA-10 only in 2018. CRA-23, completed in May 2023, established a 20-year extension covering FY24–FY43 and was signed into U.S. law in March 2024<sup>44</sup>.

## Compact Review Agreement 2023

**CRA-23 sets out key objectives, conditionalities, and processes for annual review and oversight.** The agreement highlights Palau's adoption of the Fiscal Responsibility and Debt Management Act, COVID-19 impacts, climate change and sea-level rise risks, and the need for long-term development planning to support stability and self-reliance.

<sup>44</sup> CRA-23 was advanced one year earlier from 2025 to 2024; this aligned the Compacts of Palau, the FSM and Marshall Islands.

Key features of CRA-23 include:

### *Annual Economic Assistance*

- **Annual operating grants:** \$20 million per year for education, health, climate adaptation, environment, justice administration, public safety, and audit-related expenses; a 2 percent annual adjustor replaces GDP deflator-based indexation.
- **Infrastructure grants:** \$5 million per year (2 percent adjustor) allocated project-by-project from the National Infrastructure Plan.
- **Infrastructure maintenance grants:** \$5 million per year (2 percent adjustor) for projects originally constructed by the US or Taiwan, subject to mutual agreement.
- **Post-FY43 consideration:** A clause allows consideration of continued annual assistance after FY43 limited to the \$20 million operational grant, \$5 million infrastructure, and \$5 million infrastructure maintenance (all inclusive of 19 annual 2 percent adjustments). The wording has been modified from prior periods such that the amount of support going forward after FY43 is specified; however, mutual agreement between the two nations is still required.

### *Fiscal Consolidation*

- **Targeted grants for pre-existing debt:** Six annual grants of \$10 million (no adjustor), starting in FY24, to consolidate debt incurred before April 1, 2023; funds may repay ADB obligations without need for further US approval or other creditors subject to US approval.

*The 2023 Amended Compact introduces significant new initiatives and grant streams.*

### *The Cofa Trust Fund*

- **Capital injections:** Two tranches of \$50 million each to the COFA Trust Fund; after the second tranche the Fund stood at \$438 million as of September 2025.
- **Withdrawal rules:** Withdrawals permitted at 4 percent of the fund value (based on a 3-year moving average) or \$15 million, whichever is greater, are restricted to education, health, climate adaptation, environment, justice, and public safety.
- **Extraordinary withdrawals:** Up to \$5 million annually allowed under extraordinary circumstances between FY24 and FY26, with similar provisions potentially extending beyond FY26.

### *Fiscal Management*

- **Ongoing reforms:** Palau must continue fiscal reforms and consider recommendations from the IMF, ADB, PFTAC, and the US, and adhere to its own Fiscal Responsibility and Debt Management Act (as it existed at the time of CRA-23 enactment).

### *Federal Programs and Services*

- **Access maintained:** The US will continue providing access to federal programs and services as agreed in the original Compact and additional programs made available during CRA-10.

## Economic Advisory Group

- **Continued oversight:** The Economic Advisory Group (EAG), established under CRA-10, will continue under CRA-23 to advise on economic, fiscal, and financial management. The EAG must meet twice yearly and submit an annual report by May 1. The EAG held its first meeting in Palau in August 2022 and met subsequently in August 2023, and in Palau in September 2024 and 2025; three economic reports have been issued with the 2026 report<sup>45</sup> pending.

## Annual Economic Consultations

- **Scheduled bilateral reviews:** CRA-23 mandates annual bilateral meetings before August 30 each year to review the bilateral economic relationship, Palau's economic situation, US fund use and audits, PDP implementation, and reports from the EAG, IMF, ADB, and PFTAC. Bilateral meetings resumed in June 2023 and June 2024 in Palau and again in July 2025 in Washington, D.C., marking the first meetings under CRA-23.

## Annual Implementation Plan

- **Submission requirement:** Palau must submit an annual implementation plan (AIP) each July before issuance of direct economic assistance grants, specifying purposes for operating grants, COFA withdrawals, and infrastructure maintenance in alignment with the Palau Development Plan (PDP) 2023–2026. The US may recommend modifications within 30 days and may decline funds if Palau is noncompliant. The PDP expires at end-2026 and

must be updated, or perhaps formally extended, to meet CRA-23 conditions..

- **Initial AIPs and process formation:** Palau prepared its first AIPs for FY24 and FY25, though submission was delayed to July/August 2024 due to the absence of established formats. In line with the Fiscal Procedures Agreement, the first two AIPs were presented during the mid-2024 bilaterals. By the FY26 AIP cycle the CRA-23 process and formats were established and approvals proceeded smoothly.
- **Performance reporting:** CRA-23 does not require Palau to submit an annual performance report on direct economic assistance, unlike FSM and RMI. While this reduces administrative burden, Palau may benefit from instituting its own annual performance review of Compact-funded allocations consistent with public financial management (PFM) reforms.

## Issues relating to CRA-23

**CRA-23 provides significant support but raises fiscal policy and implementation challenges that require clear government decisions.** The agreement will aid Palau's recovery from COVID-related shocks and high debt, but its structure presents key trade-offs and risks.

### *Perpetual CoFA Fund or Source of Revenue for Government Operations*

**CRA-23 requires Palau to reconsider the COFA Fund's long-term role.** Palau's Fiscal Strategy (2022) adopted a goal to build a perpetual fund to replace annual drawdowns of \$15 million in real terms. CRA-23's provision allowing the US to consider continued assistance after FY43 introduces an alternative path, potentially reducing the imperative to reach a sufficiently

<sup>45</sup> Palau Economic Advisory Group, Annual Reports, see <https://pitiviti.org/palau-eag>

large perpetual-fund corpus. Replacing 43.702 million annually after FY24 with high conviction of perpetual funding would require a fund in excess of \$1.5 billion using GSUSA stochastic modeling.

**Policy choices and fiscal implications are consequential.** Palau must decide whether to prioritize building a perpetual fund for intergenerational equity, rely on possible post-FY43 assistance, or limit COFA withdrawals to capital investments that preserve or increase net national worth. CRA-23's withdrawal rules and sector restrictions imply acceptance of capital drawdowns for current (operational) needs, which conflicts with the FRDMA principle to increase net national worth over time.

**Palau lacks a formal policy for investing COFA withdrawals and accumulated cash reserves.**

. During the first three years of CRA-23 Palau drew the full permitted COFA amount and has accumulated cash reserves earning money-market rates below returns in the COFA Fund. Palau should develop a fiscal rule and investment policy that govern use, investment, and retention of sovereign resources to avoid inefficient cash accumulation and to preserve real value. At a minimum, Palau should consider creating a sub-account for a portion of its cash reserves to be invested in parallel with its COFA trust fund investments.

### *Inflation Adjustment*

**The fixed 2 percent annual adjustor exposes Palau to real-term declines in Compact assistance during periods of higher inflation.**

The 2 percent adjustor is lower than historical average CPI growth (near 3 percent before recent global spikes), implying a projected gradual erosion in the real value of grants of roughly 1 percent annually in normal times and greater losses during inflationary spikes. Palau should plan for this decline and consider compensatory fiscal measures or contingency buffers.

### *Infrastructure*

**CRA-23's limited infrastructure allocation constrains capital investment priorities.**

Infrastructure funding under CRA-23 totals \$5 million annually (16.7 percent of the \$30 million package), below the 25 percent allocation in FSM and RMI. CRA-23 also restricts COFA fund use for infrastructure and appears to exclude infrastructure and maintenance grants from post-FY43 assistance consideration. Given the EAG's emphasis on infrastructure renewal<sup>46</sup>, Palau will need to mobilize alternative financing—domestic resources, bilateral and multilateral donors, PPPs, and other sources—to address aging capital stock and meet development objectives.

### *The Fiscal Consolidation Grant*

**The fiscal consolidation grant eased short-term fiscal pressure but created a future fiscal adjustment when it expires.**

The six annual \$10 million consolidation grants have provided fiscal space during recovery but were used largely to meet debt-service obligations rather than reduce principal. When the grants end in FY30, Palau will face an adjustment roughly equivalent to the \$10 million grant and will need to absorb full debt-service costs, requiring a significant fiscal adjustment to maintain fiscal sustainability.

<sup>46</sup> Palau Economic Advisory Group, *First Annual Report of the Palau Economic Advisory Group*, April 2023, See <https://pitiviti.org/palau-eag>

## 10. The economic and fiscal outlook

### Assumptions informing the outlook

Projections assume a gradual recovery without a rapid return to pre-pandemic occupancy levels<sup>47</sup>. Earlier GSUSA forecasts expected a swifter recovery by mid-2022 and alignment with South Pacific patterns, but slower tourism recovery from East Asia prompted successive downward revisions. Current projections therefore adopt a conservative baseline reflecting gradual tourism recovery and existing flight schedules.

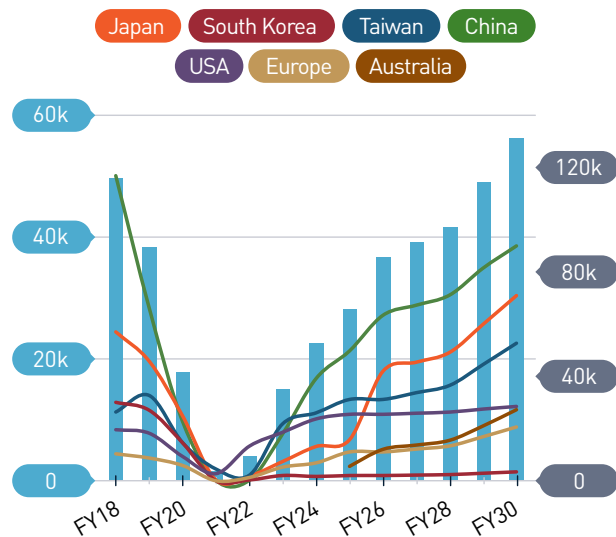
**Tourism projections for FY26 reflect current routes and modest capacity gains.** Chapter 2 estimates about 85,408 visitors in FY26 (see Figure 27), based on the new twice-weekly Japan route and the weekly Qantas Brisbane service. First-quarter FY26 arrivals rose over 40 percent versus Q1 FY25, implying a possible annual total above 90,000. New hotel capacity (IHG, Marriott, Four Seasons) is expected to come online after FY26; by FY30, hotel occupancy is assumed to reach about 50 percent and arrivals 131,000, aligning with 2010s averages and serving as a baseline scenario.

**Construction demand is projected to increase but will be phased and discounted.** The forecast accounts for on-budget CRA-23 capital projects and Taiwanese grants; off-budget donor projects (RUS, U.S., Japan,

<sup>47</sup> The projections of the economy for the FY26-FY30 period are derived from an economic model, MTEF-mod, developed by the Graduate School USA. The projections form the basis for discussion and analysis of the economic outlook.

**Figure 27: Visitor arrival projections, FY18-FY30**

Tourism recovery is projected to continue expanding through FY30.



ADB); U.S.-funded projects (Meyuns hospital relocation, Malakal port redevelopment); private hotel investment; and general investment. Projections apply phased, lagged implementation and a conservative reduction from planned investment to conservatively estimate likely outturns.

### The fiscal baseline uses FY26 appropriations and historical expenditure growth patterns.

Projections incorporate the FY26 civil-service 10 percent wage increase, assume a constant civil-service headcount, and apply historical nominal wage growth (3 percent, FY00-FY19) thereafter. Other recurrent costs are held constant in real terms. Recent minimum wage increases (75¢ per hour in FY25-FY26) are included. Under these assumptions, while consistent with historical performance, the government expenditure-to-GDP ratio declines over time.

**Major reforms and debt paydown are not assumed in the baseline.** The projections treat CRA-23 consolidation funds as financing normal debt service rather than reducing principal and do not assume implementation of RoPSSA, CSPP, or other pending reforms.

## Outlook for the Economy

**Economic growth is strong in FY26 and strengthens in the late 2020s as new hotels open.** Under baseline assumptions GDP grows 8.2 percent in FY26, driven by tourism recovery (85,408 visitors), the 10 percent civil-service pay increase, and the final 75¢ minimum wage rise (see [Figure 28](#)). Tourism-related activity expands about 28 percent and, given tourism’s ~20 percent share of GDP, contributes roughly 5.5 percentage points to growth. PGST gains add about 1.2 percentage points.

**Growth moderates in FY27–FY28 and accelerates as new accommodation becomes operational in FY29–FY30.** Hotel construction drives near-term activity; once new hotels open, GDP growth increases further. Average growth for FY26–FY30 is projected at 4.1 percent, indicating a return toward normal output and stronger activity from under-construction hotel projects.

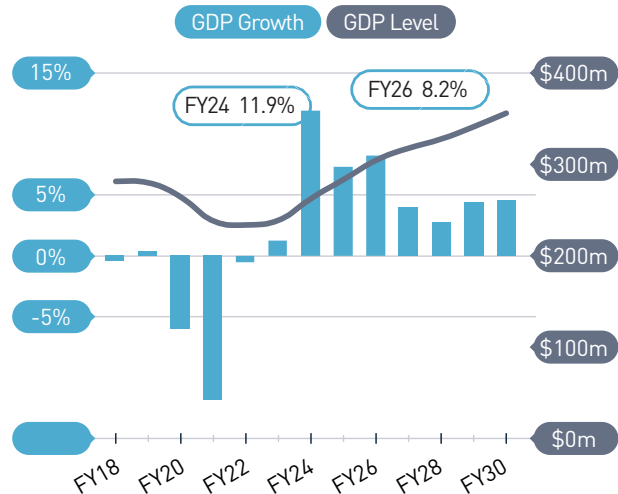
## Employment

**Employment recovered to pre-pandemic levels by FY25, and future growth will depend on foreign labor.** Palauan employment is near full employment, with additional demand met primarily by foreign workers. Because many Palauans work in the public sector, pandemic impacts on that group were limited. Sustained tourism and construction expansion in the late 2020s will drive demand for foreign labor unless policies attract returning Palauans. Overall employment is projected to grow about 2.2 percent per annum from FY25 to FY30 (see [Figure 29](#)).

*The economic outlook for FY26 is favorable, driven by tourism growth, hotel construction, and large grant-funded projects through FY30.*

**Figure 28: GDP level and growth, FY18–FY30**

GDP is projected to grow strongly in FY25 and strengthen in the late 2020s as new hotels open.

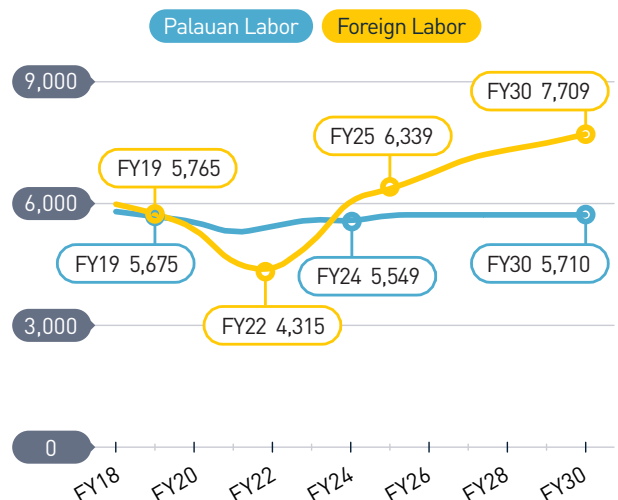


## Fiscal Impact

Revenue growth remains strong in the near term, moderating thereafter but staying positive through the end of the decade. After

**Figure 29: Employment of Palauans and foreign workers, FY18–FY30**

Palauan employment is near full employment; demand for foreign labor will increase with economic expansion.



robust tax revenue growth in FY24, increases slow in FY25 and FY26 but remain favorable; total revenues are projected to rise about 5 percent in FY26 and average 3.9 percent per annum thereafter. PGST is expected to grow 13 percent in FY26 due to tourism and wage increases; hotel room and departure taxes (PPEF) rise as well. Grants decline slightly in composition; U.S. CARES Act payments ended in FY25, while Palau is expected to fully utilize the CRA-23 Compact infrastructure grant. Other revenue sources remain stable.

**The fiscal position is forecast to record a surplus of 3.2 percent of GDP in FY26.**

Payroll costs increase in FY26 from the 10 percent pay rise, then revert to ~3 percent annual growth. Goods and services spending increases modestly and then remains constant in real terms, adjusted by the GDP deflator. Interest payments remain broadly stable. Without reforms, transfers to RoPSSA (\$2.0 million) and CSPP (\$3.2 million) continue, with additional household and utility subsidies totaling about \$2.2 million. State block grants remain above \$14.8 million and grow with the deflator. These assumptions yield a FY26

*Fiscal outcomes should remain favorable if expenditures are contained in real terms and fiscal buffers are rebuilt.*

surplus of \$12.9 million (3.2 percent of GDP) (see [Figure 30](#)).

**Surpluses persist to FY29 but fall in FY30 when the fiscal consolidation grant ends.**

Revenues and prudent real-term expenditure management support surpluses through FY29 (projected 3.5 percent of GDP). When the \$10 million annual fiscal consolidation grant ceases in FY30, the fiscal position weakens to a surplus of 1.9 percent of GDP.

**Cash Reserve Levels**

**Government deposits rose during the pandemic despite fiscal deficits, and reserves are projected to continue increasing.**

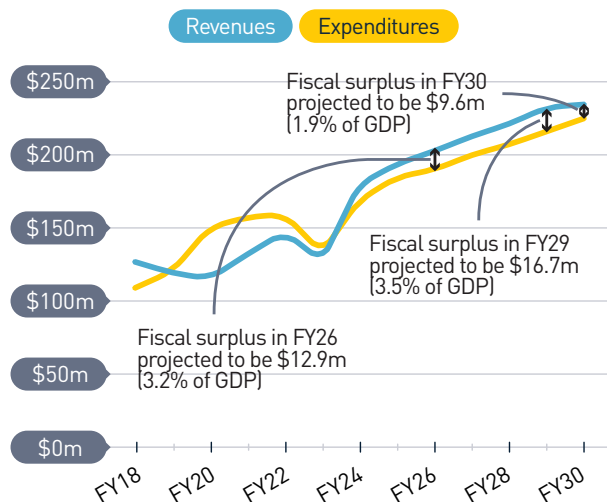
Deposits reflect “below-the-line” transactions (new borrowing, debt service). During COVID the government borrowed \$90 million from the ADB while accumulated fiscal deficits totaled \$74 million, enabling reserve accumulation. In FY24 the government borrowed another \$12.5 million (ADB SORS program), on-lent \$5 million to Koror State, and ran a \$10 million surplus; FY25 added an \$8.5 million surplus. These transactions markedly increased deposits (see [Figure 31](#)).<sup>48</sup>

**Baseline projections show continued reserve growth through FY30 despite the end of consolidation grants.**

Ongoing fiscal surpluses sustain rising deposits, indicating available fiscal space to pursue reforms (SS, CSPP) and debt reduction if the government so chooses.

**Figure 30: Government revenues and expenditures, FY18–FY30**

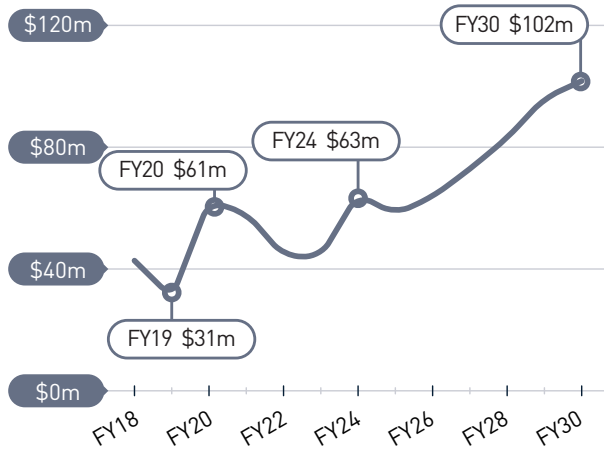
The government is projected to record rising surpluses after the recovery.



<sup>48</sup> The data Figure 31 reflects deposits in the local banking system and does not include TCDs invested off-shore

**Figure 31: Government deposits, FY18–FY30**

Government deposits rose during the pandemic and are projected to continue rising with ongoing surpluses.



## External debt

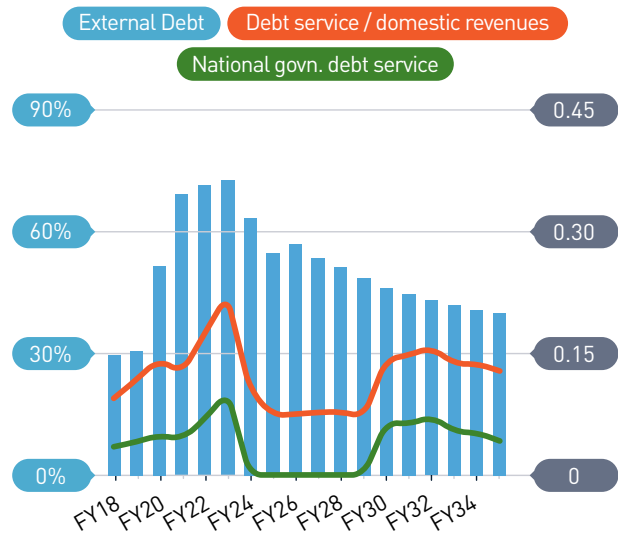
**CRA-23 consolidation funds have financed debt service rather than reducing principal, leaving debt ratios largely unchanged in the short term.** Baseline projections follow the FY24–FY26 approach of using CRA-23 funds to meet debt service, without reducing principal balances. The baseline also assumes new borrowing equal to 4 percent of GDP annually (about \$15 million in FY26). Under these assumptions the debt-to-GDP ratio declines gradually from 73 percent in FY23 to about 40 percent by FY35 (see [Figure 32](#)) but stays above the government’s 30 percent target.

**Palau faces a \$10 million fiscal adjustment in FY30 when consolidation funds expire.** CRA-23 temporarily reduced national government debt-service costs from its own resources, but because principal was not amortized, debt-service obligations will rise sharply in FY30 after the consolidation grant ends.

**A deliberate debt reduction strategy is advisable despite current concessional debt conditions.** Debt service rose after COVID-era borrowing and higher global rates; while concessional terms limit immediate stress risk, future shocks (climate events,

**Figure 32: External debt (% GDP) and debt service (% government revenues), FY18–FY35**

External debt rose to high levels due to COVID financing and is not projected to return to the 30% GDP target.



pandemics, geopolitical disruptions) could raise debt-stress risks. Palau should consider using fiscal space and reserves to more expeditiously achieve the 30 percent debt target, thereby increasing net national worth and strengthening resilience.

*Prudent fiscal policy will create space for CSPP and Social Security reforms and implementation of a debt-management strategy.*

## 11. Statistical Developments

**Palau’s administrative statistical systems now provide a broadly sound basis for fiscal and economic monitoring.** After a period of weak macroeconomic data, the authorities compile a comprehensive set of statistics, including GDP by production and expenditure (current and constant prices), employment, wages, CPI, banking, balance of payments (BoP), and government finance statistics (GFS). Initial fiscal estimates are typically available by end-March, with final estimates following annual audits by end-June; however, the audit process is currently three years behind schedule, delaying final releases and there can be significant differences between early and audit outcomes.

**Reduction in information provided in the audits has reduced the ability to prepare meaningful GFS statistics and estimates of the fiscal balance.** With the changeover of auditors, information on expenses classified by account or economic classification essential for GFS compilation is no longer provided. It is understood the auditors are prepared to rectify this situation provided a change is made to the contract with the government. It is highly recommended that this change is made so a full analysis of the fiscal position and surplus/deficit can be made.

**Deployment of NADABAS has strengthened data integration and integrity across series.** National Account Data Base System (NADABAS) is used to compile national accounts, GFS, external sector, BoP, and monetary statistics, reducing

spreadsheet-linkage errors and allowing concurrent multi-user work across datasets<sup>49</sup>

**Tax reform (PGST) will materially improve statistical coverage and timeliness.** Monthly PGST returns will provide a consistent, high-frequency data source to construct GDP production series. The FY23–FY25 GDP estimates remain based on gross-receipts coefficients derived from historical corporate returns, but a major 2026 initiative will derive GDP production directly from PGST data and revise back series from FY23 onward. Where firms lack product-level intermediate consumption detail, value-added coefficients will still be applied. Annual business profits tax data will further inform intermediates, inventories, and investment and may eliminate the need for a separate business survey. A remaining deficiency is the absence of a producer price index to support constant-price estimation. With the updated national accounts, Palau aims to phase in regular quarterly estimates as statistical capacity allows.

**The IMF Data Adequacy Assessment identifies strengths and weaknesses, scoring most series in the “B” range.** The Article IV-mission assessment rated national accounts average “B,” citing timeliness weaknesses; many series are available within six months, but some key data have caused delays in publication. Prices scored “B” (limited to CPI). GFS received a “B” but requires improved external-debt reporting and inclusion of extra-budgetary units in general government. Palau is investing in external-debt management software to address the debt series. External debt and monetary statistics were graded “C,” reflecting BoP errors and omissions, weak FDI data, incomplete monetary coverage (exclusion of NDBP), and inadequate financial soundness indicators.

**Priority actions are clear: complete overdue audits, implement PGST-based national accounts, expand BoP and FDI coverage, and**

<sup>49</sup> See <https://sites.google.com/nadabas.net/nadabas/overview>

**build producer-price and monetary coverage.**

Addressing audit delays and implementing planned IT and tax-data reforms will materially improve timeliness, accuracy, and policy relevance of Palau's statistics.

## Palau summary economic indicators, FY24-FY30

	FY24	FY25	FY26	FY27	FY28	FY29	FY30
<b>Per Capita Income measures</b>							
GDP current prices, \$ million	321.0	353.0	392.2	416.2	437.8	469.3	505.0
<b>Population</b>	17,637	17,648	17,659	17,669	17,680	17,691	17,702
GDP per capita \$	18,202	20,002	22,209	23,554	24,765	26,525	28,531
<b>GNI per capita \$</b>	18,253	20,337	22,469	23,778	24,937	26,543	28,364
GNDI per capita \$	22,998	23,609	25,143	26,457	27,640	29,324	31,197
<b>National accounts</b>							
<b>GDP, at constant FY2019 prices, \$ million (ave. GDP(P) and GDP(E))</b>	<b>263.4</b>	<b>282.6</b>	<b>301.9</b>	<b>312.8</b>	<b>321.8</b>	<b>338.8</b>	<b>358.0</b>
<b>GDP, % growth</b>	<b>11.9%</b>	<b>7.3%</b>	<b>6.8%</b>	<b>3.6%</b>	<b>2.9%</b>	<b>5.3%</b>	<b>5.7%</b>
<b>GDP by Production, at constant 2019 prices, \$ million</b>	<b>263.4</b>	<b>282.6</b>	<b>301.9</b>	<b>312.8</b>	<b>321.8</b>	<b>338.8</b>	<b>358.0</b>
Agriculture and fisheries	8.1	8.1	8.1	8.1	8.1	8.1	8.1
Manufacturing, utilities, construction	27.2	29.5	28.6	31.3	32.2	30.6	30.1
Wholesale and retail trade	32.5	35.8	36.6	37.1	37.5	38.2	38.9
Accommodation, restaurants and transport	39.4	47.7	59.5	63.5	67.9	79.0	90.5
Public admin, Health and education	62.4	62.6	63.0	63.0	63.1	63.2	63.3
Other services	65.5	69.8	74.3	76.5	78.4	82.6	87.1
Taxes less subsidies on products	28.2	29.0	31.9	33.3	34.6	37.2	40.0
<b>GDP by Expenditure, at constant 2019 prices, \$ million</b>	<b>270.5</b>	<b>279.6</b>	<b>296.5</b>	<b>308.1</b>	<b>315.7</b>	<b>330.0</b>	<b>346.3</b>
Final consumption expenditure, government	96.4	101.8	101.8	103.3	104.3	106.0	107.9
Final consumption expenditure, households	184.0	194.9	201.6	206.2	210.6	216.6	223.4
Gross capital formation	88.4	97.6	90.0	103.0	106.7	96.0	91.4
<b>Gross domestic expenditure</b>	<b>368.8</b>	<b>394.3</b>	<b>393.4</b>	<b>412.5</b>	<b>421.6</b>	<b>418.6</b>	<b>422.7</b>
Exports	89.9	110.1	137.5	146.9	157.1	183.4	210.6
Less Imports	183.3	224.9	234.3	251.3	263.0	272.0	287.0
<b>Prices (annual percent change)</b>							
<b>Consumer price index</b>	3.7%	0.2%	1.3%	2.8%	2.2%	2.2%	2.2%
Average wage	1.6%	4.0%	7.8%	2.3%	2.5%	2.4%	2.4%
Export price Index	3.6%	1.9%	2.8%	2.7%	2.4%	2.3%	2.3%
Import price Index	2.7%	-2.3%	-0.4%	2.7%	1.9%	1.7%	1.8%
Terms of trade	0.8%	4.3%	3.2%	0.0%	0.4%	0.6%	0.6%
<b>Employment and Wages</b>							
<b>Number of employees</b>	<b>11,678</b>	<b>12,049</b>	<b>12,275</b>	<b>12,625</b>	<b>12,813</b>	<b>13,037</b>	<b>13,366</b>
% change	9.8%	3.2%	1.9%	2.8%	1.5%	1.8%	2.5%
Private sector	6,847	7,283	7,493	7,836	8,019	8,222	8,524
% change	16.1%	6.4%	2.9%	4.6%	2.3%	2.5%	3.7%
Public sector	3,883	3,889	3,901	3,909	3,915	3,931	3,951
% change	-0.7%	0.2%	0.3%	0.2%	0.2%	0.4%	0.5%
Other	948	876	882	881	879	884	891
Palau citizens	5,549	5,516	5,612	5,697	5,791	5,893	6,047
Foreign workers	6,129	6,533	6,664	6,928	7,022	7,144	7,319
<b>Average annual wage</b>	<b>15,198</b>	<b>15,800</b>	<b>17,038</b>	<b>17,431</b>	<b>17,868</b>	<b>18,305</b>	<b>18,736</b>
% change	1.6%	4.0%	7.8%	2.3%	2.5%	2.4%	2.4%
Private sector	11,269	12,112	12,753	13,113	13,442	13,689	13,968
% change	5.1%	7.5%	5.3%	2.8%	2.5%	1.8%	2.0%
Public sector	23,423	23,859	26,396	27,164	27,962	28,867	29,793
% change	4.7%	1.9%	10.6%	2.9%	2.9%	3.2%	3.2%
<b>Average annual real wage (FY21 prices)</b>	<b>11,499</b>	<b>11,930</b>	<b>12,694</b>	<b>12,638</b>	<b>12,674</b>	<b>12,703</b>	<b>12,720</b>
% change	-2.0%	3.7%	6.4%	-0.4%	0.3%	0.2%	0.1%



# Palau summary economic indicators, FY24–FY30 cont'd

	FY24	FY25	FY26	FY27	FY28	FY29	FY30
<b>Tourism</b>							
<b>Total Tourism receipts, \$ million</b>	<b>76.4</b>	<b>100.0</b>	<b>132.7</b>	<b>146.4</b>	<b>161.4</b>	<b>195.5</b>	<b>232.2</b>
<b>Tourist nights</b>	<b>305,120</b>	<b>386,994</b>	<b>494,491</b>	<b>532,798</b>	<b>574,073</b>	<b>680,721</b>	<b>789,525</b>
Receipts per visitor, \$	1,453	1,525	1,553	1,587	1,620	1,650	1,689
Receipts per visitor night, \$	250	258	268	275	281	287	294
<b>Average length of stay, nights</b>	<b>5.8</b>	<b>5.9</b>	<b>5.8</b>	<b>5.8</b>	<b>5.8</b>	<b>5.7</b>	<b>5.7</b>
<b>Tourism arrivals</b>	<b>52,551</b>	<b>65,558</b>	<b>85,408</b>	<b>92,258</b>	<b>99,602</b>	<b>118,476</b>	<b>137,490</b>
Japan	5,603	6,702	17,922	19,719	21,681	26,816	32,196
South Korea	710	863	863	950	1,044	1,291	1,550
Taiwan	11,161	13,367	13,367	14,707	16,171	20,001	24,013
China	16,766	21,286	27,136	29,139	31,146	35,925	39,875
USA	10,142	10,893	10,893	11,111	11,333	11,869	12,346
Europe	2,958	4,750	4,750	5,321	5,957	7,650	9,492
Australia	0	2,420	5,200	6,034	6,995	9,646	12,742
Other	5,211	5,277	5,277	5,277	5,277	5,277	5,277
Hotel occupancy rate	22.8%	26.8%	39.0%	42.0%	45.2%	48.7%	52.5%
<b>Number of Hotel rooms, yearly average</b>	<b>1,734</b>	<b>1,831</b>	<b>1,831</b>	<b>1,831</b>	<b>2,015</b>	<b>2,169</b>	<b>2,219</b>
<b>Government Finance Statistics, (\$ million)</b>							
<b>Revenue</b>	179.9	193.8	201.3	206.1	214.7	227.0	230.5
Tax revenue	69.8	80.0	88.8	94.8	100.5	110.7	121.8
Grants	95.1	93.9	93.4	91.6	94.1	96.0	87.8
Other revenue	14.9	19.9	19.0	19.7	20.0	20.4	20.9
<b>Expense</b>	-145.8	-157.3	-164.9	-168.1	-174.2	-182.2	-191.1
Compensation of employees	-51.7	-54.8	-60.6	-62.4	-64.3	-66.2	-68.2
Use of goods and services	-43.0	-45.8	-46.7	-49.2	-51.3	-54.2	-57.4
Other expense	-51.1	-56.8	-57.6	-56.5	-58.6	-61.8	-65.4
<b>Net Worth and its Changes</b>	-34.1	-36.4	-36.4	-38.0	-40.5	-44.9	-39.4
Nonfinancial assets	-23.3	-28.0	-24.6	-25.1	-25.6	-26.2	-26.7
Financial assets	-19.4	5.4	-32.7	-0.3	-2.1	-6.1	-0.1
Financial liabilities	8.6	-13.9	20.9	-12.5	-12.7	-12.6	-12.6
<b>Overall fiscal balance</b>	<b>10.8</b>	<b>8.5</b>	<b>11.8</b>	<b>12.9</b>	<b>14.9</b>	<b>18.7</b>	<b>12.7</b>
(In percent of GDP)							
<b>Revenue</b>	56.0%	54.9%	51.3%	49.5%	49.0%	48.4%	45.6%
Taxes	21.8%	22.7%	22.7%	22.8%	23.0%	23.6%	24.1%
Domestic revenues	29.6%	26.6%	23.8%	22.0%	21.5%	20.5%	17.4%
Grants	4.6%	5.6%	4.9%	4.7%	4.6%	4.3%	4.1%
<b>Expense</b>	-45.4%	-44.6%	-42.0%	-40.4%	-39.8%	-38.8%	-37.8%
Compensation of employees	-16.1%	-15.5%	-15.4%	-15.0%	-14.7%	-14.1%	-13.5%
Use of goods and services	-13.4%	-13.0%	-11.9%	-11.8%	-11.7%	-11.6%	-11.4%
<b>Non Financial Assets</b>	-7.3%	-7.9%	-6.3%	-6.0%	-5.9%	-5.6%	-5.3%
<b>Overall fiscal balance</b>	<b>3.4%</b>	<b>2.4%</b>	<b>3.0%</b>	<b>3.1%</b>	<b>3.4%</b>	<b>4.0%</b>	<b>2.5%</b>

	FY24	FY25	FY26	FY27	FY28	FY29	FY30
<b>Balance of Payments</b>							
<b>Current account balance</b>	-53.4	-90.4	-81.4	-94.6	-100.0	-81.8	-70.4
<b>Goods and services balance</b>	-137.9	-154.1	-133.2	-145.9	-150.9	-131.3	-117.6
<b>Goods balance</b>	-162.1	-202.9	-213.3	-235.2	-251.7	-264.4	-284.2
Exports of goods f.o.b.	4.6	4.7	5.1	5.6	5.9	6.7	7.5
Imports of goods f.o.b.	166.7	207.6	218.5	240.8	257.6	271.1	291.6
<b>Services balance</b>	24.2	48.8	80.1	89.3	100.8	133.1	166.5
Exports of services	91.6	115.2	149.4	164.0	179.8	215.3	253.5
of which Travel	76.4	100.0	132.7	146.4	161.4	195.5	232.2
Imports of services	67.4	66.4	69.2	74.7	78.9	82.1	86.9
<b>Primary income balance</b>	0.9	5.9	4.6	4.0	3.0	0.3	-3.0
Inflows	28.0	34.4	35.6	36.6	37.6	38.7	39.9
Outflows	27.1	28.5	31.1	32.6	34.5	38.4	42.8
<b>Secondary income balance</b>	83.7	57.7	47.2	47.3	47.8	49.2	50.2
Inflows	107.3	82.9	74.2	76.4	78.5	81.8	85.2
of which: Grants on budget	92.3	66.9	55.8	57.1	58.2	59.2	60.3
Outflows	23.6	25.2	26.9	29.1	30.7	32.6	35.1
<b>Capital account balance</b>	5.3	54.7	15.0	10.3	10.5	10.7	10.9
<b>Net lending/borrowing (Current+Capital)</b>	-48.0	-35.7	-66.3	-84.4	-89.5	-71.0	-59.5
<b>Financial account balance</b>	126.9	18.2	-46.8	-36.0	-40.7	-28.9	-32.0
Direct investment (net lending(+)=assets-liabilities)	-40.6	-27.0	-36.2	-47.6	-53.4	-46.7	-44.8
Portfolio investment (net lending(+)=assets-liabilities)	44.4	40.3	-13.1	-15.8	-17.5	-18.3	-19.7
Other investment (net lending(+)=assets-liabilities)	123.1	4.9	2.5	27.5	30.2	36.0	32.5
Assets (net acquisition)	124.9	-5.3	22.5	14.1	16.5	22.5	19.0
Liabilities (net incurrence)	1.8	-10.2	20.0	-13.4	-13.6	-13.5	-13.5
Of which: Public sector loans	1.8	-10.2	20.0	-13.4	-13.6	-13.5	-13.5
<b>Errors and omissions</b>	174.9	54.0	19.5	48.4	48.8	42.1	27.5
<b>External Debt, \$ million</b>							
<b>Gross External Debt, total</b>	201.9	191.7	211.7	198.3	184.7	171.2	157.6
National Government	189.0	179.6	200.5	188.0	175.2	162.6	150.0
Public Enterprises	14.6	13.8	12.9	12.1	11.2	10.3	9.3
<b>Gross External debt as % of GDP</b>	62.9%	54.3%	54.0%	47.6%	42.2%	36.5%	31.2%
Debt Service	19.0	17.3	19.6	18.4	18.4	17.9	17.6
<b>Debt service as % of national government revenues</b>	10.6%	8.9%	9.7%	9.0%	8.5%	7.9%	7.6%
<b>Cofa Trust Fund</b>	372.3	437.9	454.2	469.4	484.2	499.6	515.3
<b>Depository Corporations Survey (\$ million)</b>							
<b>Net foreign assets</b>	376.8	371.6	394.1	408.2	424.7	447.3	466.3
<b>Domestic claims</b>	-29.7	-12.7	-17.4	-17.6	-20.1	-26.0	-25.2
Net claims on national government	-62.7	-48.2	-56.4	-58.7	-62.9	-70.7	-72.3
Claims on other sectors	33.0	35.5	39.0	41.1	42.8	44.7	47.1
Private non-financial corporations	2.6	2.9	3.2	3.4	3.6	3.8	4.1
Individuals	30.4	32.6	35.8	37.7	39.2	40.9	42.9
<b>Broad money liabilities</b>	336.7	350.1	367.3	380.5	393.8	410.7	430.5
Demand deposits	199.6	209.4	220.0	226.7	232.7	240.7	249.6
Other deposits	137.2	140.7	147.3	153.8	161.1	170.0	180.9
<b>Capital and other accounts</b>	10.3	8.7	9.4	10.1	10.8	10.5	10.6
Loans to deposit ratio, %	9.8%	10.1%	10.6%	10.8%	10.9%	10.9%	10.9%





# PALAU ECONOMIC REVIEW 2025

Republic of Palau  
January 2026

The Palau Economic Review is produced annually to provide an independent assessment of the Republic of Palau's economic performance and policy environment, along with independently verified economic statistics. It has been developed, in part, to assist the governments of the Republic of Palau and the United States fulfill their respective reporting requirements under Palau's Compact of Free Association with the United States.

The Review has been prepared by the Economic Monitoring and Analysis Program (EconMAP) of the Graduate School USA, with funding support from the U.S. Department of the Interior's Office of Insular Affairs. Visit [www.econmap.org](http://www.econmap.org) for statistical datasets, past publications, and additional information.



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