

**Palau President Surangel S. Whipps, Jr.
Washington, DC Visit May 2-4, 2022**

Background

Palau is one of three Pacific island nations that has signed a Compact of Free Association with the U.S. (The other two nations are the Marshall Islands and Micronesia.)

The three Freely Associated States (FAS) span the Pacific from Hawaii to the Philippines and Indonesia and have a collective Exclusive Economic Zone (EEZ) larger than the 48 contiguous States. Palau, with an EEZ the size of Texas, is the closest to Asia.

Military commanders say that Palau is more strategically vital to the U.S. than it has ever been. The nation has just become the site of the Defense Department's new, over-the-horizon early-warning radar system. The military is planning to improve its main harbor and expand one of its runways and is considering building a new seaport and relocating its main airport.

The U.S. took the islands from Japan in World War II and convinced the U.N. to let it administer the islands as a territory to eventually be made independent. Later, not wanting to lose strategic control of the area, the U.S. extended Federal domestic programs and encouraged the new free association relationship.

Under Compacts, the islands let the U.S. control access to their waters and airspace (including shipping lanes China covets) and veto their interactions with other nations. The U.S. grants aid on a multi-year basis, provides Federal domestic programs, and free entry to their tiny populations. The Compacts with the other two freely associated states (FAS) expire in FY23; Palau's in FY24.

In 2019, the U.S. Indo-Pacific Commander testified that the FAS were being subjected to "the pernicious use of Beijing's economic leverage" in an attempt to distance them from the U.S. and Taiwan. For Palau, this has included China [abruptly cutting off](#) its Chinese tourism but offering to "fill every hotel room" and provide a 10,000-person call center if Palau's Taiwan policy were to change. A 2019 report for the Secretary of Defense advised that a failure of the U.S. to provide needed economic assistance "could come at the expense of the defense and foreign policy interests of the United States."

President Trump then met with the presidents of the FAS, followed by Secretary Pompeo going to the islands to announce talks to extend the Compacts. In 2020, however, State and Interior Department personnel who handled day-to-day relations proposed lesser aid to the FAS in Compact renegotiations, and the talks stalled.

President Whipps ran against the offer, defeating Palau's Vice President, who supported it, and candidates who, like some leaders of Palau's Congress, proposed advancing the island's relationship with China and accepting its offers.

The President has met with Secretaries Blinken, Austin, Haaland, CIA Director Burns, NSC Deputy Director Finer and Indo-Pacific Coordinator Campbell, and dozens of Members of Congress of both parties. In March, President Biden, responding to him, the Marshalls, and

Members of Congress of both parties, named a Special Presidential Envoy to revive the talks. The negotiations, however, are geared towards post-FY23 and post-FY24 needs.

Issues

- **Covid Revenue Loss Debt Relief** – With a private sector dependent on tourism and foreign fishing, Palau's economy has shrunk 28% due to the pandemic and China banning it at a tourism destination. Palau is the only U.S.- affiliated jurisdiction, however, to get loans instead of grants for Covid revenue losses.

President Whipps got the FY22 budget cut 10% and major tax, Social Security, and other self-help reforms, but Palau still faces an \$20 million deficit this year and a deficit in FY23.

The Asian Development Bank gave the other FAS grants because of lower pre-Covid incomes. It has loaned Palau \$60 million already and will loan another \$30 million for FYs 22 & 23. Palau needs \$90 million in COVID debt relief.

Palau borrowed as little as it could to prevent massive unemployment and a sharp reduction in disposable income. Economists consider such borrowing justifiable in a cyclical fiscal crisis, but the debt will have long-lasting negative impacts on the islands' economy and budget.

If no debt relief is provided, Palau's people will suffer from reduced government services and programs and its economy will suffer from that and a reduced ability to meet infrastructure needs.

- **Blue Prosperity Plan** - \$2.6 million of the deficit is due to Palau banning fishing in 80% of its waters. More fishing could generate more revenue, including from China, but The Nature Conservancy and the Biden Administration back a plan under which philanthropies would give Palau \$18.8 million over three years to not increase fishing and develop alternative marine resource alternatives. \$16 million is needed from the U.S. for the main harbor and aquaculture. The investments would generate the \$2.6 million a year after the third year.

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