



Testimony
Before the Subcommittee on Indian,
Insular, and Alaska Native Affairs,
Committee on Natural Resources,
House of Representatives

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COMPACT OF FREE ASSOCIATION

Proposed U.S. Assistance to Palau for Fiscal Years 2016 to 2024

Statement of David B. Gootnick
Director, International Affairs and Trade

GAO Highlights

Highlights of [GAO-16-788T](#), a testimony before the Subcommittee on Indian, Insular, and Alaska Native Affairs, Committee on Natural Resources, House of Representatives

Why GAO Did This Study

The U.S. Compact of Free Association with the Republic of Palau entered into force in 1994. In September 2010, the United States and Palau signed an agreement that would, among other things, provide assistance to Palau and modify its trust fund. Currently there are two bills pending before Congress to implement the 2010 agreement.

The U.S.–Palau compact provided for several types of assistance aimed at promoting Palau’s self-sufficiency and economic advancement. The compact provided 15 years of direct assistance to the Palau government; contributions to a trust fund meant to provide Palau \$15 million each year in fiscal years 2010 through 2044; construction of a road system; and federal services such as postal, weather, and aviation. U.S. agencies also provided discretionary federal programs related to health, education, and infrastructure.

This testimony examines the potential effects of proposed legislation on (1) U.S. assistance outlined in the 2010 agreement and (2) the sustainability of a trust fund established for Palau under the U.S.–Palau compact. For this statement, GAO reviewed H.R. 4531, summarized previous reports and testimonies issued in 2008 through 2016, and incorporated updated information from Palau and the Department of the Interior to update prior projections regarding the Palau trust fund. GAO is not making any new recommendations in this testimony.

View [GAO-16-788T](#). For more information, contact David Gootnick at (202) 512-3149 or gootnickd@gao.gov.

July 6, 2016

COMPACT OF FREE ASSOCIATION

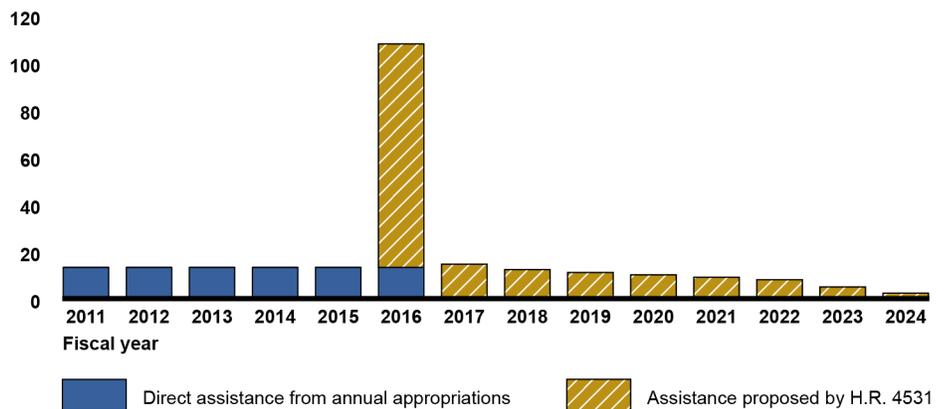
Proposed U.S. Assistance to Palau for Fiscal Years 2016 to 2024

What GAO Found

If enacted, House Bill 4531 (H.R. 4531) would provide funding for, and make modifications to, the September 2010 agreement between the governments of the United States and Palau regarding their Compact of Free Association (the 2010 agreement). Congress has not, to date, approved legislation to implement the 2010 agreement, which scheduled approximately \$216 million in U.S. assistance for fiscal years 2011 through 2024. Since 2011, the United States has provided \$79 million in economic assistance to Palau through annual appropriations. However, this amount was less than anticipated under the agreement. If H.R. 4531 were enacted, Palau would receive approximately \$30 million more in U.S. assistance through fiscal year 2024 than it would receive under the 2010 agreement. H.R. 4531 would also reschedule U.S. assistance, increasing the amount to be provided in fiscal year 2016 but reducing amounts in subsequent years. Finally, H.R. 4531 proposes that the United States pay for Palau’s future audits of compact assistance required by the 2010 agreement, and certain specified commitments in the 2010 agreement would be backed by the full faith and credit of the U.S. government.

U.S. Assistance to Palau Provided from Annual Appropriations and Proposed in H.R. 4531

Dollars (in millions)



Source: GAO analysis of House Bill 4531 (H.R. 4531), 114th Cong. (2016) (as introduced in the House) and Department of the Interior documents. | GAO-16-788T

The provisions of H.R. 4531 would improve the long-term prospects of Palau’s trust fund. GAO estimates that, including inflation adjustments, H.R. 4531 would provide approximately \$32.85 million in contributions to the Palau trust fund from 2016 to 2023. If the trust fund contributions and withdrawal schedule proposed under H.R. 4531 are enacted, GAO estimates that the changes would improve the fund’s prospects for sustaining payments beyond fiscal year 2044. Without the changes proposed by H.R. 4531, the trust fund would be sustained through fiscal year 2044 if it maintains its historical rate of return, but the account balance would be significantly lower.

Chairman Young, Ranking Member Ruiz, and Members of the Subcommittee:

Thank you for this opportunity to discuss proposed legislation¹ to modify and approve the September 2010 agreement between the governments of the United States and the Republic of Palau (2010 agreement).² In recent years, we have provided analyses of several aspects of compact implementation, including previous testimony on the 2010 agreement.³ My statement today will examine the potential effects of House Bill 4531 (H.R. 4531) on (1) U.S. assistance outlined in the 2010 agreement and (2) the sustainability of a trust fund established for Palau under the U.S.–Palau compact (compact trust fund).

To examine the proposed legislation’s potential effects on U.S. assistance outlined in the 2010 agreement, we reviewed the proposed legislation as well as Senate Bill 2610 (S. 2610).⁴ We also analyzed U.S. economic assistance to Palau in fiscal years 2011 through 2016 and updated our projections for Palau’s compact trust fund based on the prior body of work we have conducted on this issue between 2008 and 2016. Detailed information on the scope and methodology for our prior work summarized

¹H.R. 4531, 114th Cong. (as introduced in the House on February 10, 2016).

²*The Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review* (Sept. 3, 2010).

³See GAO, *Compacts of Free Association: Issues Associated with Implementation in Palau, Micronesia, and the Marshall Islands*, [GAO-16-550T](#) (Washington, D.C.: Apr. 5, 2016); *Compact of Free Association: Proposed U.S. Assistance to Palau through Fiscal Year 2024*, [GAO-12-798T](#) (Washington, D.C.: Sept. 10, 2012); *Compact of Free Association: Proposed U.S. Assistance to Palau for Fiscal Years 2011-2024*, [GAO-12-249T](#) (Washington, D.C.: Nov. 30, 2011); and *Compact of Free Association: Proposed U.S. Assistance to Palau and Its Likely Impact*, [GAO-11-559T](#) (Washington, D.C.: June 16, 2011).

⁴S. 2610, 114th Cong. (as introduced in the Senate) also proposes legislation to implement the 2010 agreement. If enacted, S. 2610 would approve, provide funding for, and make modifications to the September 2010 agreement between the governments of the United States and Palau regarding their compact. S. 2610 would not greatly alter the total U.S. assistance to Palau for fiscal years 2011 through 2024 specified in the 2010 agreement. However, S. 2610 would make changes to the provision of assistance outlined in the agreement in line with the reduction in U.S. assistance in fiscal years 2011 through 2016 from that planned in the 2010 agreement. We have previously testified on the provisions of the Senate legislation. See [GAO-16-550T](#).

in this testimony can be found in the reports cited.⁵ We shared the analysis included in this statement with officials at the Department of the Interior. Interior provided no views on the information we shared.

We conducted the work on which this statement is based in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

U.S. relations with Palau and other Freely Associated States of the Pacific began when American forces liberated the islands near the end of World War II. In 1947, the United Nations assigned the United States administering authority over the Trust Territory of the Pacific Islands, which included what are now Palau, the Federated States of Micronesia, and the Republic of the Marshall Islands. U.S. Compacts of Free Association with the Federated States of Micronesia and the Republic of the Marshall Islands entered into force in 1986. The U.S. and Palau governments concluded their Compact of Free Association in 1986, and it entered into force on October 1, 1994. The Department of the Interior's (Interior) Office of Insular Affairs (OIA) has primary responsibility for monitoring and coordinating all U.S. assistance to the Freely Associated States, and the Department of State is responsible for government-to-government relations. The United States has responsibility for the defense of the Freely Associated States and has exclusive military use rights in these countries. According to the Department of Defense, the compacts have enabled it to maintain critical access in the Asia-Pacific region.⁶ In 2014, Palau had a population of approximately 17,708 and a

⁵See [GAO-16-550T](#); [GAO-12-798T](#); [GAO-12-249T](#); [GAO-11-559T](#); GAO, *Compact of Free Association: U.S. Assistance to Palau, Accountability Over Assistance Provided, and Palau's Prospects For Economic Self-Sufficiency*, [GAO-08-858T](#) (Washington, D.C. June 12, 2008); and GAO, *Compact of Free Association: Palau's Use of and Accountability for U.S. Assistance and Prospects for Economic Self Sufficiency*, [GAO-08-732](#) (Washington, D.C. June 10, 2008).

⁶Vikram J. Singh, Deputy Assistant Secretary of Defense for South and Southeast Asia, Office of the Secretary of Defense for Policy, testimony before the Senate Committee on Energy and Natural Resources, July 11, 2013.

per capita gross domestic product (GDP) of \$14,066. From 2004 to 2014, Palau's per capita GDP, adjusted for inflation, grew by 8 percent.⁷

The Palau compact provided for several types of assistance aimed at promoting Palau's economic advancement and eventual self-sufficiency. In addition to establishing Palauan sovereignty and U.S.–Palau security and defense arrangements, the compact provided economic assistance to Palau. This assistance comprised, among other things, direct economic assistance to the Palau government for 15 years; the establishment of a trust fund intended to provide Palau \$15 million annually from 2010 through 2044; investments in infrastructure, including a major road, known as the compact road; provision of federal services, such as postal, weather, and aviation; and other discretionary programs. The compact also established a basis for U.S. agencies to provide discretionary federal programs related to health, education, and infrastructure. (See app. I for a table summarizing the key provisions of the Palau compact.) In fiscal years 1995 through 2009, the United States provided about \$574 million in compact assistance to Palau, including \$70 million to establish Palau's compact trust fund and \$149 million for road construction. In addition, U.S. agencies—Interior, the Department of Education, and the Department of Health and Human Services, among others—provided assistance to Palau through discretionary federal programs as authorized by U.S. legislation and with appropriations from Congress.

On September 3, 2010, the governments of the United States and Palau reached an agreement to extend U.S. assistance to Palau totaling

⁷Graduate School USA, Pacific Islands Training Initiative, *Republic of Palau Fiscal Year 2014 Economic Review* (August 2015). Historically, Palau's private sector has relied heavily on foreign workers, mostly from the Philippines. For example, we reported in 2008 that since 1994, foreign workers, as registered with Palau's Social Security Office, had grown to account for half of Palau's total labor force. Because many of these foreign workers send wage income back to their home nations, in 2005 the annual net outflow of remittances from Palau equaled an estimated 5.5 percent of its GDP. See [GAO-08-732](#).

approximately \$216 million in fiscal years 2011 through 2024.⁸ The planned assistance included providing direct economic assistance to Palau, providing infrastructure project grants and contributions to an infrastructure maintenance fund, establishing a fiscal consolidation fund, and making changes to the compact trust fund.⁹ The 2010 agreement included the following:

- **Direct economic assistance.** The 2010 agreement would provide direct economic assistance—budgetary support for Palau government operations and specific needs such as administration of justice and public safety, health, and education—of \$13 million in 2011, declining to \$2 million by 2023. The 2010 agreement also calls for the U.S. and Palau governments to establish a five-member Advisory Group to provide annual recommendations and timelines for economic, financial, and management reforms. The Advisory Group must report on Palau’s progress in implementing these or other reforms, prior to annual U.S.–Palau economic consultations.¹⁰ These consultations are to review Palau’s progress in achieving reforms¹¹ such as improving fiscal management, reducing the public sector workforce and salaries, reducing government subsidization of utilities, and implementing tax reform. If the U.S. government determines that Palau has not

⁸Unless otherwise noted, all years cited in this report are fiscal (Oct. 1–Sept. 30) and all dollar amounts are nominal (i.e., unadjusted for inflation). Interior reports that the 2010 agreement provides \$229 million to Palau for fiscal years 2010 through 2024. The agreement, signed on September 3, 2010, acknowledged that the United States provided \$13.25 million in economic assistance to Palau in fiscal year 2010. Actual economic assistance provided by the United States to Palau was \$13.147 million in fiscal year 2010. We are reporting the assistance cited in the 2010 agreement for fiscal years 2011 through 2024.

⁹[GAO-12-798T](#).

¹⁰The 2010 agreement requires that Palau undertake economic, legislative, financial, and management reforms giving due consideration to those identified by the International Monetary Fund; the Asian Development Bank; and other creditable institutions, organizations, or professional firms.

¹¹The compact requires that the United States and Palau consult annually regarding Palau’s economic activities and progress in the previous year, as described in a report that Palau must submit each year. In 2008, we reported that Palau had met reporting conditions associated with direct assistance but that, contrary to compact requirements, the bilateral economic consultations had not occurred on an annual basis; and had been informal and resulted in no written records. See [GAO-08-732](#).

made significant progress in implementing meaningful reforms, direct assistance payments may be delayed until the U.S. government determines that Palau has made sufficient progress.

- **Infrastructure projects.** Under the 2010 agreement, the U.S. government would provide U.S. infrastructure project grants to Palau for mutually agreed infrastructure projects—\$8 million in 2011 through 2013, \$6 million in 2014, and \$5 million in both 2015 and 2016. The 2010 agreement requires Palau to provide a detailed project budget and certified scope of work for any projects receiving these funds.
- **Infrastructure maintenance fund.** The 2010 agreement stipulates that the United States make contributions to a fund to be used for maintenance of U.S.-financed major capital improvement projects, including the Compact Road and Airai International Airport. From 2011 through 2024, the U.S. government would contribute \$2 million annually, and the Palau government would contribute \$600,000 annually to the fund.¹²
- **Fiscal consolidation fund.** The 2010 agreement states that the United States will provide a grant of \$5 million in both 2011 and 2012 to help the Palau government reduce its debts. Unless agreed to in writing by the U.S. government, these grants cannot be used to pay any entity owned or controlled by a member of the government or his or her family, or any entity from which a member of the government derives income. U.S. creditors must receive priority, and the government of Palau must report quarterly on the use of the grants until they are expended.
- **Trust fund contributions.** The 2010 agreement provides for the United States to contribute \$30.25 million to the fund from 2013 through 2023. In addition, the government of Palau would reduce its previously scheduled withdrawals from the fund by \$89 million.¹³ From 2024 through 2044, Palau can withdraw up to \$15

¹²Under the compact, Palau owes the United States a total of \$3 million. Under the 2010 agreement, Palau would deposit \$3 million in the infrastructure maintenance fund but not expend it. Any future income derived from the \$3 million must be used exclusively for the maintenance of the Compact Road.

¹³Under the 2010 agreement, Palau would withdraw \$5 million annually through 2013 and gradually increase its maximum withdrawal from \$5.25 million in 2014 to \$13 million in 2023.

million annually, as originally scheduled.¹⁴ Moneys from the trust fund account cannot be spent on state block grants, operations of the office of the President of Palau, the Olibiil Era Kelulau (Palau national congress), or the Palau judiciary. Palau must use \$15 million of the combined total of the trust fund disbursements and direct economic assistance exclusively for education, health, and the administration of justice and public safety.

H.R. 4531 Would Reschedule and Increase Assistance to Palau and Modify the 2010 Agreement

If enacted, H.R. 4531 would appropriate funding for, and make modifications to, the September 2010 agreement between the governments of the United States and Palau regarding their compact. H.R. 4531 would increase the total U.S. assistance to Palau through fiscal year 2024 by approximately \$30 million over the 2010 agreement. Compared to the 2010 agreement, H.R. 4531 would also reschedule U.S. assistance, increasing the amount to be provided in fiscal year 2016, equaling the amount of assistance in fiscal year 2017, and reducing the amounts of assistance in subsequent years. Finally, H.R. 4531 would make changes to some provisions of the 2010 agreement. These changes include providing for the United States to pay for future audits of assistance required by the agreement and applying a U.S. pledge, contained in the compact, of the full faith and credit of the United States for the full payment of specified commitments in the 2010 agreement.

H.R. 4531 Would Increase and Reschedule Assistance Outlined in the 2010 Agreement

With the assistance that H.R. 4531 proposes for fiscal years 2016 through 2024, the total amount of assistance received by Palau in fiscal years 2011 through 2024 would be approximately \$30 million more than the amount outlined in the 2010 agreement. The total assistance that H.R. 4531 proposes, combined with appropriations that Interior has provided for fiscal years 2011 through 2016, is approximately \$246 million. The assistance outlined in the 2010 agreement totals \$216 million. Under S. 2610, the total assistance to Palau for this time period would approximately equal the amount specified in the 2010 agreement. The direct economic assistance proposed by H.R. 4531 is \$17 million more than the direct economic assistance that would be provided by S. 2610.¹⁵

¹⁴The Palau compact detailed an annual distribution goal of \$15 million from fiscal years 2024 through 2044 from the trust fund.

¹⁵See app. II for details on the schedule of U.S. assistance to Palau in S. 2610

We also estimate that inflation adjustments included in H.R. 4531 would total \$13 million over fiscal years 2016 through 2024.¹⁶

H.R. 4531 would also reschedule the assistance outlined in the 2010 agreement. Under the 2010 agreement, the \$216 million in total assistance was to decline steadily, from \$28 million in fiscal year 2011 to \$2 million in fiscal year 2024. H.R. 4531 would provide approximately \$95 million in assistance in fiscal year 2016,¹⁷ decline to approximately \$15 million in fiscal year 2017, and continue to decline through 2024 to \$2 million.¹⁸ Figure 1 shows the annual assistance to Palau scheduled in the 2010 agreement and the annual assistance scheduled in H.R. 4531.¹⁹

¹⁶To calculate the inflation adjustments included in H.R. 4531, we used the price index from the Bureau of Economic Analysis to calculate inflation adjustments to U.S. contributions in fiscal year 2016. We used the gross domestic product price index projection from the Congressional Budget Office to calculate future inflation adjustments to U.S. contributions for fiscal years 2017 through 2024. See: Congressional Budget Office, Budget and Economic Outlook: 2016 to 2026 (January 2016).

¹⁷This amount does not include the \$13.147 million already provided by Interior in fiscal year 2016.

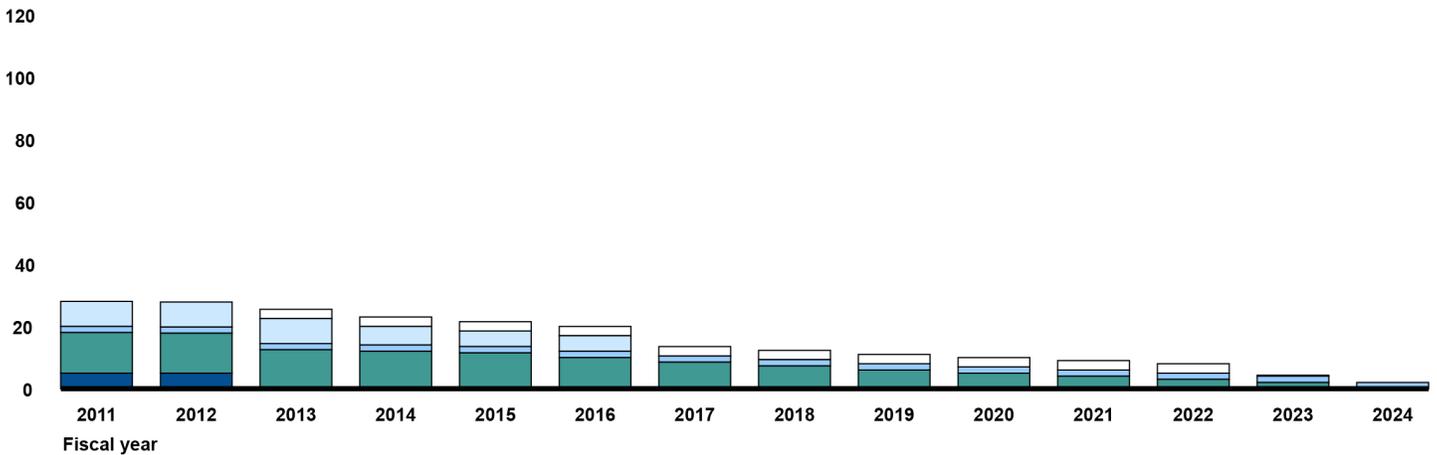
¹⁸This amount includes inflation adjustments for assistance provided in fiscal years 2016 through 2024.

¹⁹ The assistance schedule that S. 2610 proposes also differs somewhat from the schedule H.R. 4531 proposes. H.R. 4531 proposes providing all \$40 million in U.S. infrastructure project grants in fiscal year 2016; S.2610 proposes providing \$8 million in infrastructure project grants for each fiscal year from 2017 through 2019 and then in declining annual amounts through fiscal year 2022. In addition, H.R. 4531 proposes providing \$10 million in U.S. contributions to Palau's fiscal consolidation fund in fiscal year 2016; S. 2610 proposes providing \$5 million in fiscal year 2017 and the remaining \$5 million in fiscal year 2018.

Figure 1: U.S. Assistance to Palau for Fiscal Years 2011–2024 as Scheduled in the 2010 Agreement and in House Bill 4531 (H.R. 4531)

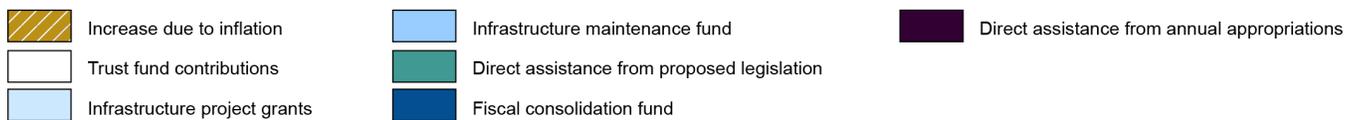
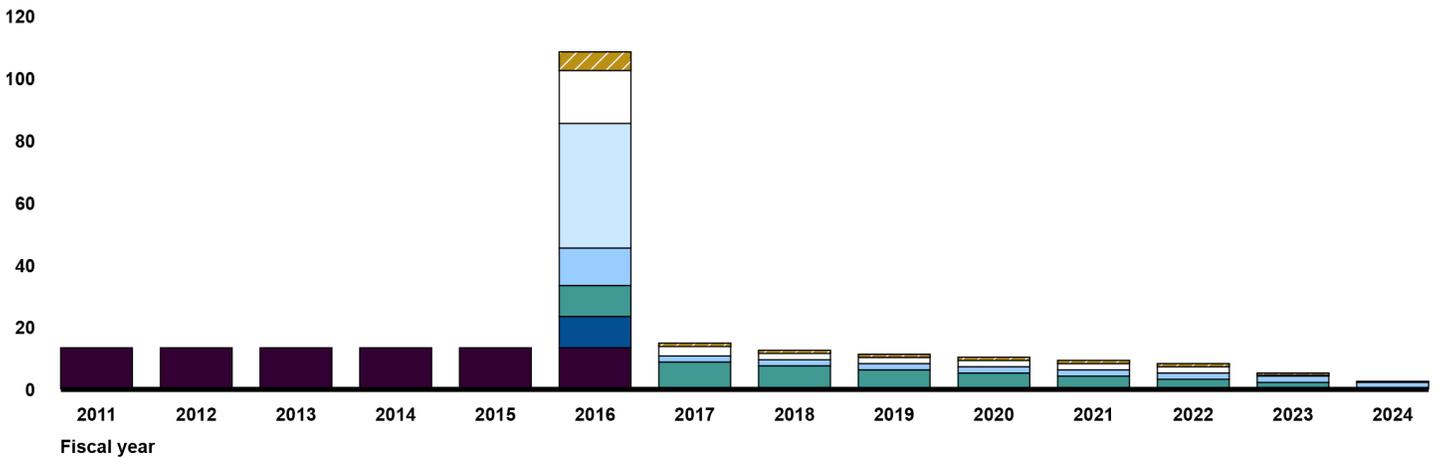
As outlined in the 2010 agreement

Dollars (in millions)



As outlined in H.R. 4531

Dollars (in millions)



Source: GAO analysis of the agreement between the Government of the United States of America and the Government of the Republic of Palau following the Compact of Free Association Section 432 review, House Bill 4531 (H.R. 4531), 114th Congress (2016) (as introduced in the House) and Department of the Interior documents. | GAO-16-788T

Legend: H.R. 4531 = House Bill 4531

Notes: Years are fiscal (Oct. 1–Sept. 30). Dollar amounts in top graph are nominal (i.e., unadjusted for inflation). Dollar amounts in bottom graph assume enactment of the provisions of H.R. 4531, including the bill's inflation adjustments to U.S. contributions. Compact federal services and discretionary federal programs are not included in this analysis.

H.R. 4531 Places Conditions on Palau's Trust Fund Withdrawals and Includes Some Provisions Not in the 2010 Agreement

If enacted, H.R. 4531 would place a condition on withdrawals from the compact trust fund, in addition to other changes. H.R. 4531 proposes that if Palau were to withdraw more than \$5 million from the compact trust fund in fiscal year 2015, additional assistance would be withheld until Palau reimbursed the trust fund for the amounts that exceed the \$5 million.²⁰ However, H.R. 4531 also includes a provision that would allow funds provided for the fiscal consolidation fund to be used to replenish the trust fund if an arrangement had been made between Palau and the United States.²¹

In contrast to the 2010 agreement, H.R. 4531 also would

- apply the full faith and credit provision of the compact to the amounts included in the 2010 agreement and modified by H.R. 4531;²²
- require Interior to provide funds to Palau for required audits of compact assistance;²³ and

²⁰This was also a condition of the fiscal year 2015 appropriation of assistance to Palau. In the 2010 agreement, Palau agreed to a maximum withdrawal of \$5 million annually in fiscal years 2011 through 2013, with the maximum subsequently increasing in increments through fiscal year 2023 to \$13 million. Under the 2010 agreement, Palau agreed to withdraw up to \$6.75 million in fiscal year 2016 and \$8 million in 2017. Palau did not commit to a withdrawal schedule beyond 2023 in the 2010 agreement. However, the compact details an annual distribution goal of \$15 million for 2024 through 2044 from the trust fund.

²¹S. 2610 also places conditions on withdrawals that differ from the commitment made by Palau in the 2010 agreement for fiscal years 2016 and 2017. Under the provisions of S. 2610, if Palau withdraws more than \$5 million from the trust fund in fiscal year 2016 or more than \$8 million in fiscal year 2017, additional assistance would be withheld until Palau reimbursed the trust fund for the amounts that exceed the \$5 million for fiscal year 2016 or the \$8 million for fiscal year 2017.

²²The compact provision that H.R. 4531 would apply to certain commitments in the bill establishes that, except as otherwise provided, approval of the compact shall constitute a pledge of the full faith and credit of the United States for the full payment of assistance covered by the pledge. The obligation of the United States to provide the assistance is enforceable in the U.S. Claims Court or its successor court. S. 2610 does not contain this provision.

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- authorize annual appropriations to Interior of \$1.5 million in fiscal years 2016 through 2024 to subsidize U.S. postal services. Under H.R. 4531, these funds may be available to the U.S. Postal Service on the condition that domestic postage could be used for mail to Palau, the Federated States of Micronesia, and the Republic of the Marshall Islands.²⁴

Proposed Legislation Would Improve Long-Term Prospects for Palau's Trust Fund

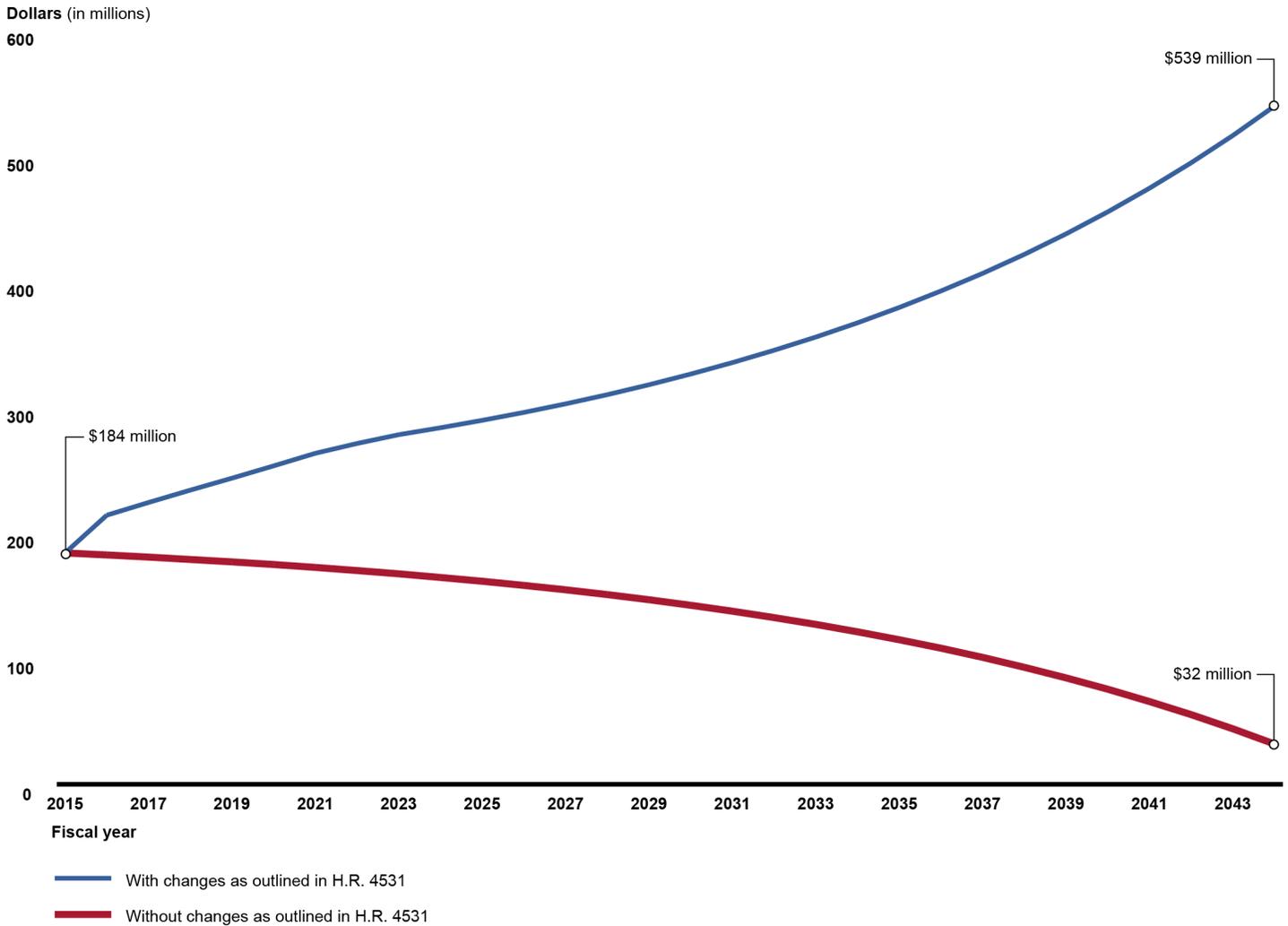
The contributions to, and conditions on withdrawals from, Palau's compact trust fund that H.R. 4531 outlines would improve the fund's prospects for sustaining payments beyond fiscal year 2044. At the end of fiscal year 2015, the trust fund had a balance of nearly \$184 million. With or without the contributions and conditions that H.R. 4531 would provide, the trust fund would be sustained through fiscal year 2044 if it maintains the 7.6 percent net compounded annual rate of return it earned from its inception through fiscal year 2015. However, given this historical rate of return, the account balance at the end of fiscal year 2044 would be dramatically lower without the contributions and conditions outlined in H.R. 4531 than it would be with them—about \$32 million versus about \$539 million (\$18 million vs. \$302 million in 2015 inflation-adjusted dollars).²⁵ Figure 2 compares the fund balance, at the historical rate of return, with and without the changes outlined in H.R. 4531.

²³Under the 2010 agreement, the government of Palau is to bear the cost of these audits. In 2012, we reported that, according to an Interior official, these audits cost approximately \$500,000 annually (see [GAO-12-798T](#)). S. 2610 does not contain this provision. We have not included an estimate of the total costs of these audits in our calculation of the differences between H.R. 4531 and the 2010 agreement.

²⁴This authorization of appropriations would also extend to the subsidization of postal services by the U.S. Postal Service to the Republic of the Marshall Islands and the Federated States of Micronesia. S. 2610 does not condition the transfer of funds to the U.S. Postal Service on the continuing use of domestic postage.

²⁵We used the price index from the Bureau of Economic Analysis to calculate inflation adjustments to U.S. contributions in fiscal year 2016. We used the gross domestic product price index projection from the Congressional Budget Office to calculate future inflation adjustments to U.S. contributions for fiscal years 2017 through 2024. See Congressional Budget Office, *Budget and Economic Outlook: 2016 to 2026* (January 2016). For fiscal years 2027 through 2044, we assumed that the price deflators would remain unchanged from 2026.

Figure 2: Projected Palau Trust Fund Balance at Historical Rate of Return in Fiscal Years 2015–2044, with and without Changes Outlined in H.R. 4531



Source: GAO analysis of Palau trust fund data and House Bill 4531 (H.R. 4531), 114th Congress (2016) (as introduced in the House). | GAO-16-788T

Notes: Years shown are fiscal (Oct. 1–Sept. 30). The trust fund balances shown are nominal (i.e., unadjusted for inflation). The historical net rate of return is 7.6 percent. The analysis shown is based on the trust fund's balance as of September 30, 2015, and assumes enactment of the provisions of H.R. 4531, including the bill's inflation adjustment to trust fund contributions. Withdrawal from the trust fund in 2016 is assumed to be \$5 million, based on conditions in the fiscal year 2016 appropriation.

In addition, with the changes in H.R. 4531, Palau's trust fund would be able to sustain scheduled payments through 2044 given varying rates of return in fiscal years 2015 through 2044.

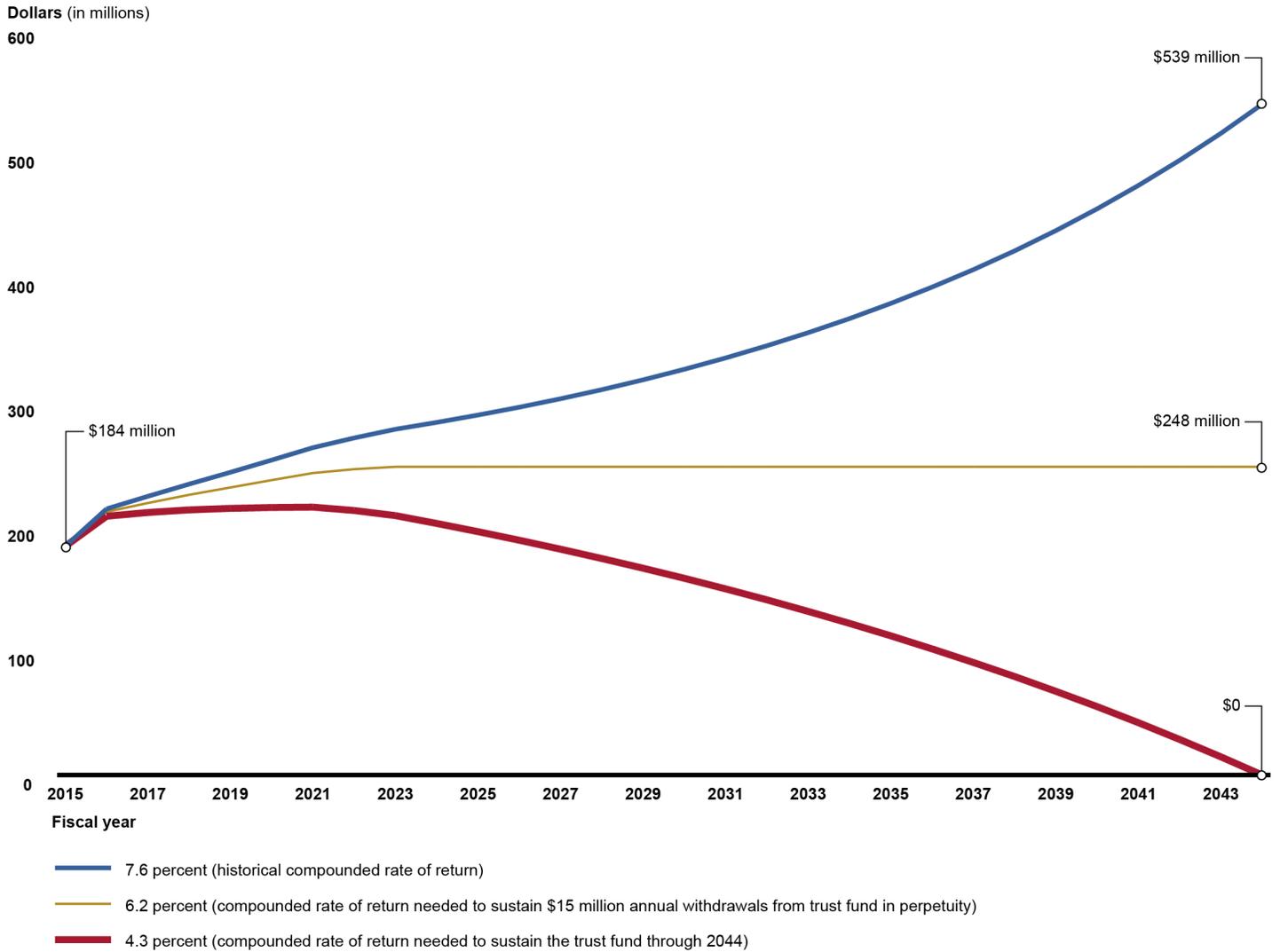
- With its historical 7.6 percent net annual compounded return, Palau's trust fund would sustain its annual withdrawal schedule, would continue to grow beyond 2044, and would have a balance of \$539 million at the end of fiscal year 2044.²⁶ (The 2044 balance would be \$302 million in 2015 inflation-adjusted dollars.)
- With at least a 6.2 percent net annual compounded rate of return, Palau's trust fund would sustain its annual withdrawal schedule and would have a balance of \$248 million or more at the end of fiscal year 2044. (The 2044 balance would be \$139 million in 2015 inflation-adjusted dollars.)
- With a 4.3 percent net annual compounded return, Palau's trust fund would sustain its annual withdrawal schedule through 2044 and would have a balance of \$0 at the end of fiscal year 2044.²⁷

Figure 3 shows the projected trust fund balances with these varying assumed rates of return.

²⁶At its inception, the trust fund's distribution goals were based on the assumption that the fund would have an annual rate of return of 12.5 percent.

²⁷If the fund earns a 4.3 percent net annual compounded return but does not receive the contributions outlined in H.R. 4531, the fund will be depleted before the end of fiscal year 2033 rather than sustained through fiscal year 2044.

Figure 3: Projected Palau Trust Fund Balances in Fiscal Years 2015–2044 under the Contribution Schedule Outlined in H.R. 4531, with Varying Assumed Rates of Return



Source: GAO analysis of Palau trust fund data and House Bill 4531 (H.R. 4531), 114th Congress (2016) (as introduced in the House). | GAO-16-788T

Notes: Years shown are fiscal (Oct. 1–Sept. 30). The trust fund balances shown are nominal (i.e., unadjusted for inflation). The analysis shown is based on the trust fund’s balance as of September 30, 2015, and assumes enactment of the provisions of H.R. 4531, including the bill’s inflation adjustment to trust fund contributions. Withdrawal from the trust fund in 2016 is assumed to be \$5 million, based on conditions in the fiscal year 2016 appropriation. The compounded rates of return are net of fees.

Chairman Young, Ranking Member Ruiz, and Members of the Subcommittee, this concludes my statement. I would be pleased to respond to any questions you may have.

GAO Contact and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact David Gootnick, Director, International Affairs and Trade at (202) 512-3149 or gootnickd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made key contributions to this testimony are Emil Friberg (Assistant Director), Ming Chen, Martin De Alteriis, Brian Hackney, Andrew Kurtzman, Reid Lowe, Grace Lui, Ian P. Moloney, Mary Moutsos, Michael Simon, and Ozzy Trevino.

Appendix I: Key Provisions of the U.S.–Palau Compact of Free Association and Subsidiary Agreements

Key provisions of the U.S.–Palau compact and its subsidiary agreements address the sovereignty of Palau, types and amounts of U.S. assistance, security and defense authorities, and periodic reviews of compact terms. Table 1 summarizes these key provisions and subsidiary agreements.

Table 1: Key Provisions of U.S.–Palau Compact of Free Association and Subsidiary Agreements

Compact section	Description of key provisions
Title one: Government Relations	<p><i>Sovereignty</i></p> <p>Established Palau as a self-governing nation with the capacity to conduct its own foreign affairs.</p> <p><i>Immigration privileges</i></p> <p>Provided Palauan citizens with certain immigration privileges, such as the rights to work and live in the United States indefinitely and to enter the United States without a visa or passport. This privilege remains in effect as long as the compact agreement is not amended by mutual agreement or mutually or unilaterally terminated.</p>
Title two: Economic Relations	<p><i>Compact direct assistance</i></p> <p>Established 15-year term of budgetary support for Palau, beginning on compact's effective date. This support included direct assistance for current account operations and maintenance and for specific needs such as energy production, capital improvement projects, health, and education.</p> <p><i>Trust fund</i></p> <p>Required the United States to contribute to a trust fund for Palau.</p> <p><i>Compact Road</i></p> <p>Required the United States to construct a road system (the Compact Road).^a</p> <p><i>Compact federal services</i></p> <p>Required the United States to make available certain federal services and related programs to Palau, such as postal, weather, and aviation. The compact subsidiary agreement implementing such services was in force until Oct. 1, 2009.^b</p> <p><i>Accountability for compact funds</i></p> <p>Required Palau to report on its use of compact funds and required U.S. government, in consultation with Palau, to implement procedures for periodic audit of all grants and other assistance.</p>

**Appendix I: Key Provisions of the U.S.–Palau
Compact of Free Association and Subsidiary
Agreements**

Compact section	Description of key provisions
Title three: Security and Defense Relations	<p><i>U.S. authority for security and defense matters</i></p> <p>Established that the United States has full authority and responsibility for security and defense matters in, or relating to, Palau; would take action to meet the danger of an attack on Palau; and may conduct activities on land and water and in airspace as necessary.</p> <p><i>Strategic denial</i></p> <p>Foreclosed Palau to the military of any nation except the United States, unless they are invited by the United States and under the control of the U.S. armed forces.</p> <p><i>U.S. defense sites and operating rights</i></p> <p>Established that the United States may establish land and sea defense sites in Palau and has certain military operating rights. The subsidiary agreement implementing this provision provides the United States exclusive use of certain land adjoining the airport and certain submerged land in Malakal Harbor and remains in effect through 2044.</p> <p><i>Service in the armed forces</i></p> <p>Established eligibility of Palau citizens to serve in the U.S. armed forces. The provisions on U.S. authority for security and defense matters, U.S. defense sites and operating rights, and service in the armed forces remain in effect unless the compact is terminated by mutual agreement or, if the compact is unilaterally terminated, until October 1, 2044, and thereafter as mutually agreed. The strategic denial provision remains in effect through 2044 and thereafter until terminated or otherwise amended by mutual consent.</p>
Title four: General Provisions	<p>Established general provisions regarding approval and effective date of the compact, conference and dispute resolution procedures, and compact termination procedures. Required reviews of its terms on the 15th, 30th, and 40th anniversaries of the compact's entry into force—that is, in 2009, 2024, and 2034, respectively.</p>

Source: GAO analysis of the Compact of Free Association between the Government of the United States and the Government of the Republic of Palau. | GAO-16-788T

Notes: The compact's subsidiary agreements relate to specific titles of the compact; in many cases, they contain implementing details of compact provisions. Years cited are fiscal (Oct. 1–Sept. 30).

^aThe compact called for the United States to build the Compact Road according to mutually agreed specifications before Oct. 1, 2000. The road was completed and turned over to Palau on Oct. 1, 2007. See [GAO-08-732](#), app. V, for more information.

^bFederal Programs and Services Agreement Concluded Pursuant to Article II of Title Two and Section 232 of the Compact of Free Association, which took effect in 1995, established the legal status of programs and related services, federal agencies, U.S. contractors, and personnel of U.S. agencies implementing both compact federal services and discretionary federal programs in Palau. Under this agreement, the United States Postal Service (USPS) conveys mail between the United States and Palau and offers other services such as Priority Mail®, Collect on Delivery, and USPS Domestic Money Orders. Palau maintains its own postal service for internal mail delivery. Under this agreement, the National Weather Service reimburses Palau for the cost of operating its weather station in Palau, which performs upper air observations twice daily and as requested for the purpose of Palau's airport operations and the tracking of cyclones that may impact other U.S. territories such as Guam; and the Federal Aviation Administration provides aviation services to Palau, including en-route air traffic control from the mainland United States, flight inspection of airport navigation aids, and technical assistance and training.

Appendix II: U.S. Assistance to Palau as Outlined in the 2010 Agreement and as Proposed in H.R. 4531 and S. 2610

In September 2010, the U.S. and Palau governments reached an agreement to extend approximately \$216 million of U.S. assistance to Palau in fiscal years 2011 through 2024 (the 2010 agreement).¹ Table 2 shows the assistance schedule outlined in the agreement, which, to date, has not been approved.

Table 2: Proposed U.S. Assistance to Palau for Fiscal Years 2011–2024 as Outlined in the 2010 U.S.–Palau Agreement

Dollars (in millions)

Types of assistance	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total
Trust fund contributions	\$0	\$0	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$3.00	\$0.25	\$0	\$30.25
Infrastructure maintenance fund	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	\$28.00
Infrastructure project grants	8.00	8.00	8.00	6.00	5.00	5.00	0	0	0	0	0	0	0	0	\$40.00
Fiscal consolidation fund	5.00	5.00	0	0	0	0	0	0	0	0	0	0	0	0	\$10.00
Direct economic assistance	13.00	12.75	12.50	12.00	11.50	10.00	8.50	7.25	6.00	5.00	4.00	3.00	2.00	0	\$107.50
Total	\$28.00	\$27.75	\$25.50	\$23.00	\$21.50	\$20.00	\$13.50	\$12.25	\$11.00	\$10.00	\$9.00	\$8.00	\$4.25	\$2.00	\$215.75

Source: GAO analysis of The Agreement between the Government of the United States of America and the Government of the Republic of Palau Following the Compact of Free Association Section 432 Review (Sept. 3, 2010). | GAO-16-788T

Note: Years shown are fiscal (Oct. 1–Sept. 30), and dollar amounts are nominal (i.e., unadjusted for inflation).

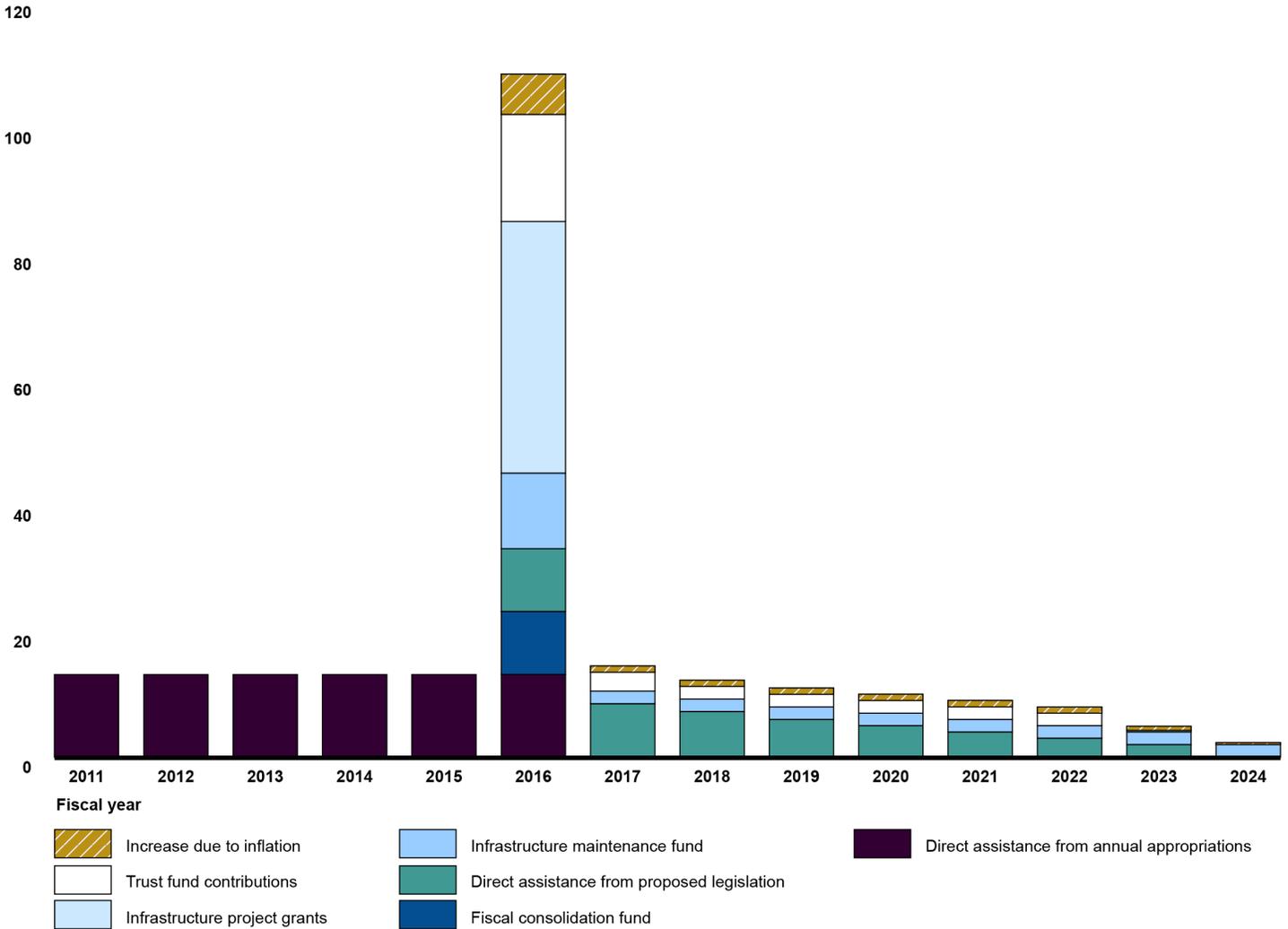
House Bill 4531 (H.R. 4531) would modify the schedule outlined in the 2010 agreement, increasing the amounts of U.S. assistance to Palau in fiscal years 2016 through 2024. Figure 4 and table 3 show the assistance

¹Unless otherwise noted, all dollar amounts are nominal (i.e., unadjusted for inflation). Interior reports that the 2010 agreement provides \$229 million to Palau for fiscal years 2010 through 2024. The agreement, signed on September 3, 2010, acknowledged that the United States provided \$13.25 million in economic assistance to Palau in fiscal year 2010. Actual economic assistance provided by the United States to Palau was \$13.147 million in fiscal year 2010. We are reporting the assistance cited in the 2010 agreement for fiscal years 2011 through 2024.

that the U.S. government provided in fiscal years 2011 to 2016 and that H.R. 4531 proposes for fiscal years 2016 through 2024.

Figure 4: U.S. Assistance to Palau through Discretionary Appropriations in Fiscal Years 2011–2016 and as Proposed in House Bill 4531 for Fiscal Years 2016–2024

Dollars (in millions)



Source: GAO analysis of House Bill 4531 (H.R. 4531), 114th Cong. (2016) (as introduced in the House of Representatives) and Department of the Interior documents. | GAO-16-788T

**Appendix II: U.S. Assistance to Palau as
Outlined in the 2010 Agreement and as
Proposed in H.R. 4531 and S. 2610**

Table 3: U.S. Assistance to Palau through Discretionary Appropriations in Fiscal Years 2011–2016 and as Proposed in House Bill 4531 for Fiscal Years 2016–2024

Dollars (in millions)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total	Increase due to inflation
Direct assistance from annual appropriations	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	0	0	0	0	0	0	0	0	\$78.88	
Trust fund contributions	0	0	0	0	0	17.00	3.00	2.00	2.00	2.00	2.00	2.00	0.25	0	\$30.25	\$2.59
Infrastructure maintenance fund	0	0	0	0	0	12.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	\$28.00	\$2.80
Infrastructure project grants	0	0	0	0	0	40.00	0	0	0	0	0	0	0	0	\$40.00	\$2.68
Fiscal consolidation fund	0	0	0	0	0	10.00	0	0	0	0	0	0	0	0	\$10.00	\$0.67
Direct economic assistance	0	0	0	0	0	10.00	8.50	7.25	6.00	5.00	4.00	3.00	2.00	0	\$45.75	\$4.50
Total	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	\$102.15	\$13.50	\$11.25	\$10.00	\$9.00	\$8.00	\$7.00	\$4.25	\$2.00	\$232.88	
Increase due to inflation	0	0	0	0	0	5.96	1.06	1.03	1.05	1.06	1.05	1.01	0.67	0.34	\$13.24	
Total with inflation	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	\$108.10	\$14.56	\$12.28	\$11.05	\$10.06	\$9.05	\$8.01	\$4.92	\$2.34	\$246.12	

Source: GAO analysis of House of Representatives Bill 4531 and Department of the Interior budget justifications and performance information. | GAO-16-788T

Note: Years shown are fiscal (Oct. 1–Sept. 30).

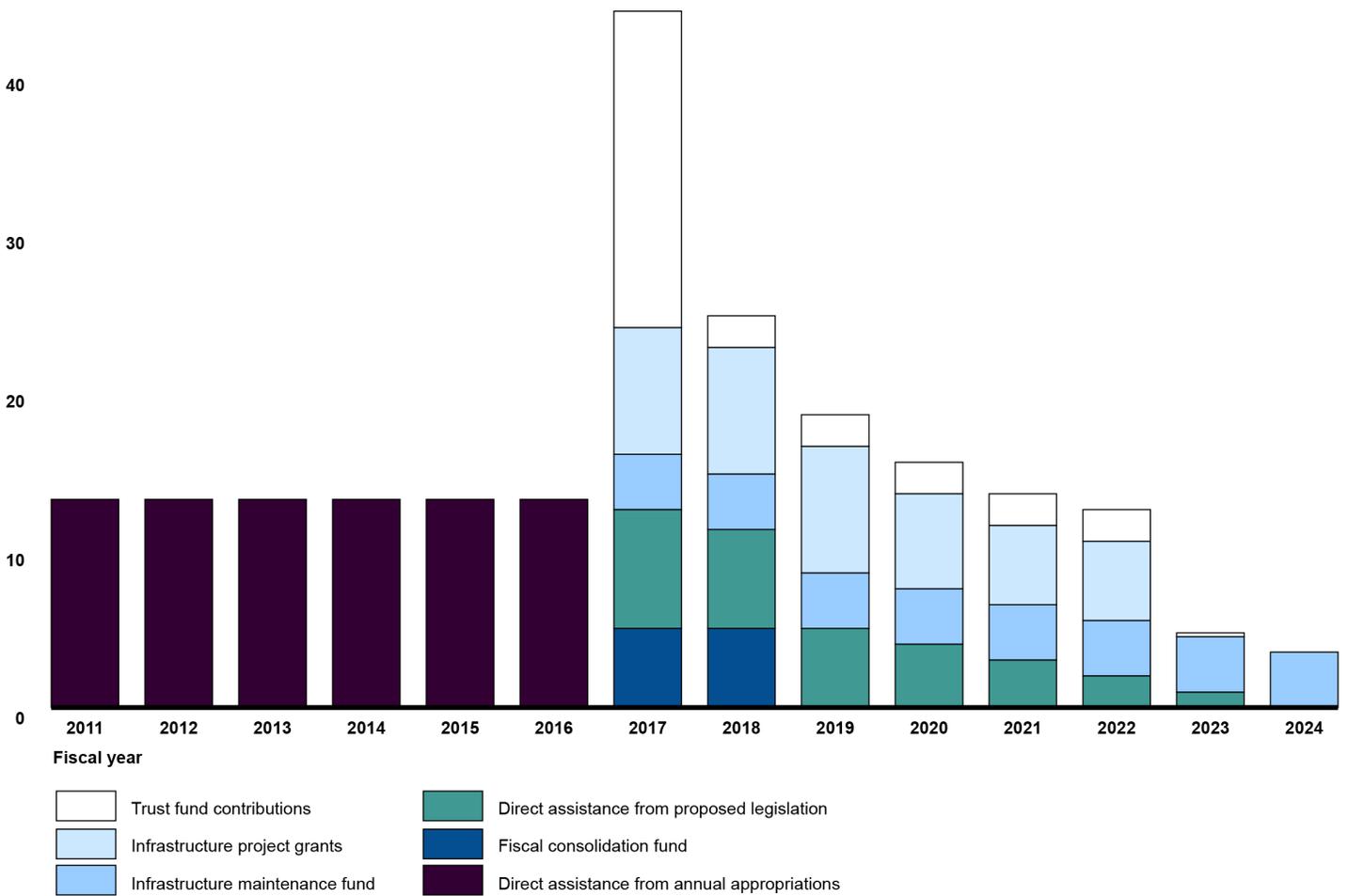
Senate Bill 2610 (S. 2610) would also modify the schedule of U.S. assistance to Palau but would keep the level of funding approximately equal to that provided in the 2010 agreement.² Figure 5 and table 4 show the assistance that the U.S. government provided to Palau in fiscal years 2011 to 2016 and that S. 2610 proposes for fiscal years 2016 through 2024.

²See [GAO-16-550T](#) for more information about S. 2610.

Appendix II: U.S. Assistance to Palau as Outlined in the 2010 Agreement and as Proposed in H.R. 4531 and S. 2610

Figure 5: U.S. Assistance to Palau through Discretionary Appropriations in Fiscal Years 2011–2016, and as Proposed in Senate Bill 2610 for Fiscal Years 2017–2024

Dollars (in millions)
50



Source: GAO analysis of Senate Bill 2610 (S.2610) (as introduced in the Senate) and Department of the Interior documents. | GAO-16-788T

**Appendix II: U.S. Assistance to Palau as
Outlined in the 2010 Agreement and as
Proposed in H.R. 4531 and S. 2610**

Table 4: U.S. Assistance to Palau through Discretionary Appropriations in Fiscal Years 2011–2016 and as Proposed in Senate Bill 2610 for Fiscal Years 2017–2024

Dollars (in millions)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Total
Direct assistance from annual appropriations	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$78.88
Trust fund contributions	0	0	0	0	0	0	20.00	2.00	2.00	2.00	2.00	2.00	0.25	0	\$30.25
Infrastructure maintenance fund	0	0	0	0	0	0	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	\$28.00
Infrastructure project grants	0	0	0	0	0	0	8.00	8.00	8.00	6.00	5.00	5.00	0	0	\$40.00
Fiscal consolidation fund	0	0	0	0	0	0	5.00	5.00	0	0	0	0	0	0	\$10.00
Direct economic assistance	0	0	0	0	0	0	7.50	6.25	5.00	4.00	3.00	2.00	.97	0	\$28.72
Total	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	\$13.15	\$44.00	\$24.75	\$18.50	\$15.50	\$13.50	\$12.50	\$4.72	\$3.50	\$215.85

Source: GAO analysis of Senate Bill 2610 and Department of the Interior budget justifications and performance information. | GAO-16-788T

Note: Years shown are fiscal (Oct. 1–Sept. 30) and dollar amounts are nominal (i.e., unadjusted for inflation).

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