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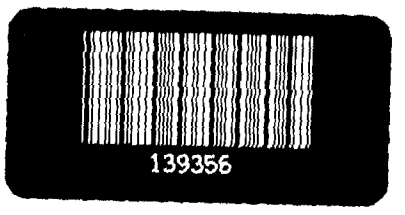
Report to Congressional Requesters

July 1989

U.S. TRUST TERRITORY

Issues Associated With Palau's Transition to Self-Government



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National Security and
International Affairs Division

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July 19, 1989

The Honorable Morris K. Udall
Chairman, Committee on Interior
and Insular Affairs
House of Representatives

The Honorable George Miller
Chairman, Subcommittee on Water, Power,
and Offshore Energy Resources
Committee on Interior and Insular Affairs
House of Representatives

The Honorable Ron de Lugo
Chairman, Subcommittee on Insular
and International Affairs
Committee on Interior and Insular Affairs
House of Representatives

This report summarizes our response to your request that we review U.S. agencies' oversight and assistance to the Republic of Palau and issues related to Palau's financial management, law enforcement, power plant, and referenda to approve a Compact of Free Association with the United States. The report includes recommendations to the Secretaries of the Interior and State, and the Attorney General to enhance Palau's financial management and law enforcement systems and provide greater assurance that compact funds will be used as intended.

A supplement to this report contains more detailed information on issues you asked us to address, including major contracts and agreements entered into by the government of Palau for infrastructure and services, law enforcement capabilities and U.S. law enforcement assistance, Palau's 1987 compact-related referenda, and potential problems regarding U.S. military use and operating rights in Palau following compact implementation.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to the Secretaries of the Interior, State, Defense, and Treasury; the Attorney General; the Director of the Federal Bureau of Investigation; the Administrator of the Drug Enforcement Administration; the government of Palau; and appropriate congressional committees. Copies will be sent to other interested parties upon request. Due to its length, we are limiting distribution of the supplement to appropriate congressional members, executive agencies, and the government of Palau, unless it is specifically requested by other interested parties.

This report was prepared under the direction of Nancy R. Kingsbury, Director, Foreign Economic Assistance Issues. Other major contributors are listed in appendix III.

Frank C. Conahan
Assistant Comptroller General

Executive Summary

Purpose

The Republic of Palau, an archipelago of more than 200 islands in the western Pacific Ocean, is the last remaining component of the U.N.-approved Trust Territory of the Pacific Islands, administered by the United States since 1947. The U. N. Security Council trusteeship agreement obligates the United States to promote Palau's development and eventual self-government. Consistent with this goal, the United States and the government of Palau signed a Compact of Free Association in 1986, which recognizes Palau as a self-governing entity but gives the United States full authority and responsibility for its defense for 50 years. Although a majority of Palau's voters supported the compact in six referenda, the compact has not been implemented because it has not received the constitutionally required 75-percent voter approval of U.S. nuclear transit rights included in the compact. Some Palauans have opposed the compact because they believed its funding provisions were inadequate or they were concerned about U.S. rights to use Palauan land for defense purposes.

At the request of the House Committee on Interior and Insular Affairs, GAO reviewed (1) Interior Department oversight of Palau, (2) Palau's financial condition and practices, (3) Palau's law enforcement system and U.S. law enforcement assistance, and (4) problems with Palau's 1987 compact-related referenda.

Background

Federal funds currently account for over 60 percent of the government of Palau's revenue. The compact will provide Palau with an estimated $478 million in economic assistance over 15 years. The United States expects that Palau will use these funds in accordance with agreed upon economic development plans and will eventually become financially self-sufficient.

The Department of the Interior has been responsible for oversight of Palau since 1951, and in 1979 it granted Palau greater autonomy, effective upon formation of a constitutional government, in anticipation of self-governing status under the compact. In 1981, Palau's constitution became effective and its first government took office. However, problems in obtaining 75-percent voter approval of the compact resulted in a prolonged transition period. During this transition, Palau has experienced financial problems; political unrest; and crimes, including politically motivated violence and illegal drug activity.

Events surrounding two compact-related referenda held in August 1987 aroused U.S. congressional concern. That year, Palau's President furloughed about two-thirds of the government workforce for 3 months due to financial problems, some Palauans filed and subsequently withdrew a lawsuit challenging the August 1987 compact-related referenda, and some Palauans alleged that violence and intimidation compromised the legitimacy of the compact referenda.

In August 1988, after the lawsuit was refiled, Palau's Supreme Court ruled that Palau had not ratified the compact in accordance with its constitution. That same month, Palau's President Lazarus Salii committed suicide. Palau has not scheduled another vote on the compact.

Results in Brief

Because of a 1979 policy decision to provide the government of Palau with greater autonomy, Interior did not closely monitor, advise, or prevent Palau from entering into some ill-advised contracts. Palau has not established sound procurement procedures requiring independent feasibility studies and competition; has not implemented its special prosecutor law; and has not established effective conflict-of-interest legislation. Palau's ability to successfully manage compact funds and achieve greater financial self-sufficiency is questionable unless, with increased U.S. advice and technical assistance, it acts to resolve these and other financial management problems.

In addition, as a result of Justice Department concerns over Federal Bureau of Investigation authority in Palau, the Bureau has not provided investigative assistance requested by Palau in 1987. This, combined with Palauan cultural constraints, the government's lack of experience and funding, and unfilled key law enforcement positions, continues to hinder Palau's overall law enforcement capability.

Principal Findings

Interior Oversight

Interior officials believe that Interior's decision in 1979 to recognize and delegate authority to Palau's constitutional government upon its establishment effectively reduced Interior's authority and responsibility for interceding in local decisions. This policy interpretation, in conjunction with Interior's declining presence in Micronesia, led Interior to exercise

limited oversight of Palau's financial situation and contract negotiations. Interior advised Palau to reduce expenditures and took action to assist Palau in resolving problems with 3 of the 18 major contracts and agreements GAO reviewed. However, Interior officials did not closely monitor Palau's actions regarding the remaining 15 contracts or provide Palau with timely advice to avoid or resolve problems.

Interior's technical assistance program, which provides grants to help Palau improve its government operations, has been slow in achieving benefits, partly due to weaknesses in Interior's management and Palau's slowness in implementing projects.

Financial Management

Since 1981, Palau has experienced serious financial problems, including annual budget deficits; cash flow problems; accumulation of debt, including $44 million for a power plant; and widespread internal control weaknesses that create opportunities for inefficient and improper spending. Palau's failure to establish and follow sound acquisition procedures has resulted in several ill-advised contracts and agreements, some of which were entered into without required legislative approval or assured funding. For example, Palau incurred unnecessary costs by prematurely awarding a $32.5-million noncompetitive contract to construct a power plant to a firm that made questionable payments to Palauan officials involved in approving the project. In addition, Palau has not implemented its special prosecutor law, has experienced delays in hiring a public auditor, and lacks effective conflict-of-interest legislation.

Law Enforcement

Palau's public safety officers have improved their skill in routine law enforcement with the help of U.S. training and assistance coordinated by Interior but are not yet fully capable of independently investigating such complex crimes as political violence and drug trafficking. Because the Justice Department has not authorized it, the Federal Bureau of Investigation has not provided agents to assist Palau in investigating the 1987 murder of a compact opponent's father.

Compact Approval

Threats, property damage, and political pressure attended the Palau legislature's approval of compact-related legislation in 1987, and some Palau executive branch actions may have unfairly favored pro-compact interests. Moreover, pressure from compact supporters and violence, including the murder of a compact opponent's father, appear to have

been significant factors in the withdrawal of a 1987 lawsuit challenging the constitutionality of the compact approval process. Interior officials did not investigate these problems because they did not want to interfere with local politics and believed these were matters to be resolved through Palau's law enforcement system.

Recommendations

GAO recommends that the Secretary of the Interior (1) assist Palau in incorporating sound procedures in its procurement law and manual and in developing legislation to provide effective sanctions for conflicts of interest, (2) encourage Palau to implement its special prosecutor law, and (3) strengthen Interior's oversight of Palau's financial practices and improve the management of its technical assistance program.

GAO also recommends that the Attorney General authorize the Federal Bureau of Investigation to provide investigative assistance to Palau. GAO makes additional recommendations in chapters 3 and 5 (pp. 42-43, 65).

Agency Comments

As requested, GAO did not obtain comments on its report. However, GAO did seek the views of responsible agency officials during the course of our work and incorporated their views where appropriate.

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Abbreviations

DEA	Drug Enforcement Administration
FBI	Federal Bureau of Investigation
LNO	Liaison Officer
MSN	Micronesian Status Negotiations
OEK	Olbiil Era Kelulau
OMB	Office of Management and Budget
TIA	Territorial and International Affairs
TTPI	Trust Territory of the Pacific Islands

Introduction

The Republic of Palau is part of the Caroline Islands in the western Pacific Ocean. With a land mass of 170 square miles, Palau is an archipelago of more than 200 islands, only 9 of which are inhabited. (See fig. 1.1.) Palau has a population of about 14,000 people, about 68 percent of which live in the capital of Koror, an area of about 7.1 square miles.

Palauan society is shaped by traditional and modern values. The traditional system is hierarchical, and women play a major role by holding the power to select and remove traditional male chiefs. The matriarchal family is at the base of Palauan hierarchy; the family-defined clan and village are in the middle; and two high chiefs, known as the Ibedul and the Reklai, reign over the southwestern and northeastern parts of the archipelago, respectively. Palau's modern government is a constitutional democracy.

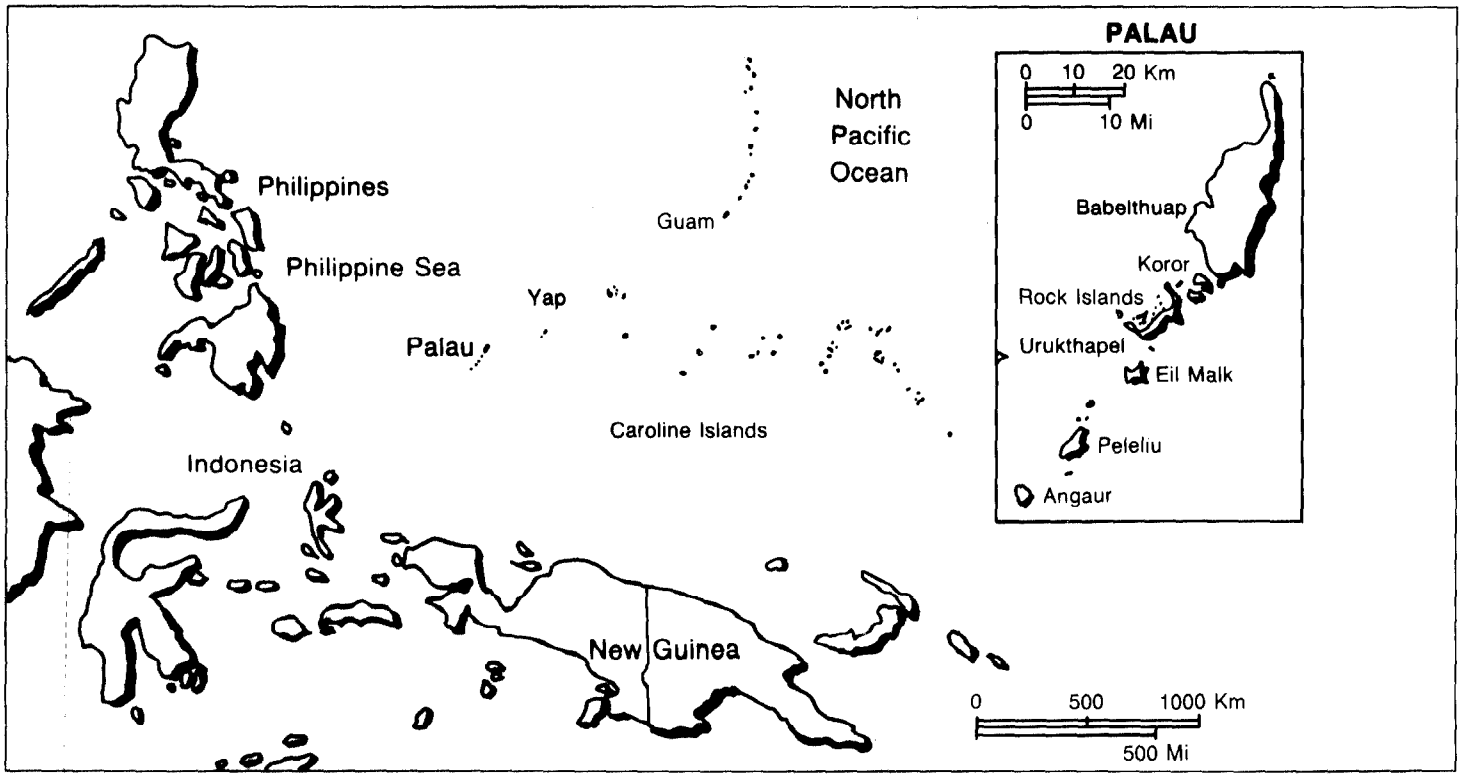
Palau's economy is characterized by a small production base and a weak production capacity, primarily due to limited national resources, the lack of skilled manpower, and the absence of production-based economic development strategies. The public sector accounts for a larger share of overall economic activity than most market economies. As of December 1987, the national government and 16 state governments employed 68 percent of Palauans who held regular jobs. Manufacturing is almost negligible, agriculture and fishing are primarily of a subsistence nature, and tourism is limited although it is a potential growth sector.

The Trust Territory of the Pacific Islands

The United States has administered the Trust Territory of the Pacific Islands (TTPI), which includes Palau, since 1947 under a U.N. Security Council approved trusteeship agreement. The TTPI, which covers some 3 million square miles of ocean and 2,000 islands, is commonly called Micronesia, or "tiny islands." The trusteeship agreement gives the United States administrative, legislative, and jurisdictional authority for the trust territory. U.S. trusteeship responsibilities include the promotion of political, economic, and social institutions needed by TTPI inhabitants for development and self-government.

The three other Micronesian governments that emerged from the TTPI have established permanent relationships with the United States. Pending its entry into a new political relationship, Palau is the only remaining jurisdiction within the TTPI.

Figure 1.1: Map of the Republic of Palau



Until 1951, the U.S. Navy was responsible for the TTPI. Jurisdiction was then transferred to the U.S. Department of the Interior. In 1962, the Kennedy administration called for accelerated development of political, economic, and social standards to ready the TTPI for a permanent association with the United States. Through a series of orders issued over the next few years, the Secretary of the Interior established a TTPI government in Micronesia with executive, legislative, and judicial branches.

Within this framework, the High Commissioner, a presidential appointee, was given executive and administrative authority over the TTPI government. The High Commissioner was responsible for discharging U.S. trusteeship obligations, under the direction of the Secretary of the Interior. Interior's Office of Territorial and International Affairs (TIA) provides the TTPI with policy direction, program coordination, and budgetary support.

In keeping with the transition toward self-government, the Secretary of the Interior issued Secretarial Order 3039 in April 1979 which provided

to the new local governments the maximum amount of self-government possible while still retaining the Secretary's responsibility under the trusteeship. Under the order, the High Commissioner retained (1) authority to suspend any laws enacted by the new governments that are inconsistent with trusteeship responsibilities, (2) responsibility for reviewing local governments' requests for U.S. funds, and (3) responsibility for auditing and monitoring financial activities of the new governments.

In January 1981, Palau installed its national government, which consists of an executive branch, a bicameral legislature known as the Olbiil Era Kelulau (OEK), and a judicial branch headed by the Palau Supreme Court. For fiscal years 1981-88, Palau received about $156 million from Interior and other federal agencies in direct assistance and capital improvements.

Effective July 10, 1987, Secretarial Order 3119 superseded Secretarial Order 3039. This order preserved Interior's delegation to Palau of self-government authority, abolished the office of the High Commissioner, and retained the Department of the Interior's general administrative authority under the trusteeship agreement.

Compact of Free Association

By 1969, a commission established by the Congress of Micronesia proposed "a self-governing Micronesia in free association with the United States." Over the next 10 years, four local governments emerged in Micronesia and began status negotiations with the United States.

Free association has no precise definition in international law but is recognized in U.N. resolutions as a fitting alternative to independent status for jurisdictions emerging from trusteeship status. In 1986, after several years of negotiations, Palauan and U.S. officials signed a Compact of Free Association. The compact recognizes that Palau is a self-governing state but gives full authority and responsibility for its defense to the United States for a period of 50 years. Under the compact, the United States may operate nuclear-capable or nuclear-propelled vessels and aircraft within Palau without either confirming or denying the presence or absence of such weapons. It may also designate defense sites and conduct activities and operations within Palau's lands, water, and airspace necessary for the exercise of its authority and responsibilities.

Also, in recognition that Palau is not ready to assume complete economic independence, the compact provides an estimated $478 million for continued U. S. economic assistance over a 15-year period. During the first year, the United States will provide an estimated $148 million, including one-time expenditures of at least $46 million for capital improvements[1] and $66 million for an investment fund that will be supplemented by $4 million in year 3. Approximately 80 percent of U.S. assistance to be provided to Palau under the compact is pledged with the full faith and credit of the United States. Should the United States fail in any year to provide the annual amount covered by the pledge, Palau would be able to seek relief in the U.S. Claims Court which is granted jurisdiction for such purpose. In fiscal year 1986, the U.S. Congress appropriated funds for Palau under the compact subject to its approval. These funds have not been spent because the compact has not taken effect. More information on compact funding and U.S funding during the trusteeship is included in chapter 4.

On November 14, 1986, the United States approved the compact, stipulating that Palau must approve it in accordance with its constitution[2]. Although a majority of voters has approved the compact in six referenda, the compact has not achieved the required 75-percent approval. Some Palauans have opposed the compact for a variety of reasons, such as concerns about the level of funding guaranteed by the compact, the compact's nuclear transit provisions, and U.S. rights to use Palauan land for defense purposes.

In 1987, events surrounding two compact-related referenda held in August aroused U.S. congressional concern. In July 1987, Palau's President Lazarus Salii furloughed about two-thirds of the executive branch workforce for 3 months due to financial problems. In August, 73 percent of Palau's voters approved a constitutional amendment that was intended to reduce the compact approval requirement from 75 percent to a simple majority. On August 21, 73 percent of Palauan voters approved the compact in a sixth referendum. A group of Palauan citizens filed and subsequently withdrew a lawsuit challenging the referenda, and political demonstrations and violence occurred.

[1]The compact states that the United States will provide Palau with $36 million for capital improvements and that this amount will be partially adjusted for inflation since 1981, once the compact takes effect. We estimate that Palau will receive about $46 million, including the inflation adjustment, if the compact is implemented in 1989.

[2]Public Law 99-658.

On March 31, 1988, the lawsuit was refiled, and in August, Palau's Supreme Court ruled that Palau had not ratified the compact in accordance with its constitution. That same month, President Lazarus Salii committed suicide. Palau elected a new President in November 1988 and, as of June 1, 1989, had not scheduled another vote on the compact.

Pending U.S. Legislation

In November 1987, before the lawsuit challenging Palau's August 1987 compact referendum was reinstated, the President of the United States certified that Palau had approved the compact in accordance with its constitutional processes and requested the U.S. Congress to enact legislation authorizing its implementation. In response to the President's certification, the House Committee on Foreign Affairs and the Senate Committee on Energy and Natural Resources approved legislation to implement the compact. However, the House Committee on Interior and Insular Affairs, due to concerns about the legitimacy of Palau's compact approval process and other matters, did not support the legislation. Instead, Interior Committee members introduced a bill to address these concerns. For example, the bill would have required Palau to maintain an independent special prosecutor and public auditor for 15 years and would have provided additional funding. Although the House and Senate and the administration reached agreement during the last day of the 100th congressional session, Congress adjourned without voting on the compromise legislation.

In March 1989, Interior Committee members introduced House Joint Resolution 175, which was intended to reflect the compromise reached in late 1988. On June 27, 1989, the House approved the resolution. As of June 30, 1989, the Senate had not acted. The administration supported passage of House Joint Resolution 175 and has agreed to take administrative actions to address some House Committee on Interior and Insular Affairs concerns. For example, the State Department, in a March 1989 letter to congressional committee chairmen, stated it would take administrative action or seek appropriations of funds, totaling up to $9.3 million, for Palau. Also, on May 26, 1989, the governments of the United States and Palau signed a new subsidiary agreement to the compact that addresses needs for drug enforcement and treatment, fiscal procedures, a special prosecutor, a public auditor, and other matters.

Once the compact takes effect, the State Department will be responsible for U.S. relations with Palau and the Department of the Interior will serve as the channel for making compact payments and coordinating compact-related technical assistance.

Objectives, Scope, and Methodology

At the request of three members of the House Committee on Interior and Insular Affairs, we reviewed (1) Interior Department oversight of Palau's actions and use of funds since 1981, (2) Palau's financial condition and financial management practices, including efforts to acquire a new power plant, (3) Palau's law enforcement system and U.S. law enforcement authority and assistance, and (4) alleged problems associated with Palau's 1987 compact approval process, including allegations that legislators were pressured to approve compact-related referenda and plaintiffs in a lawsuit were intimidated. We also obtained and analyzed information on U.S. funding to Palau during the trusteeship and compared this assistance with proposed compact funding included in the compact approved by the U.S. Congress in 1986.

We conducted our review from November 1987 through December 1988. We reviewed files and interviewed officials at the Departments of the Interior, State, Defense, Commerce, and Justice; the Drug Enforcement Administration (DEA); the Federal Bureau of Investigation (FBI); and the U.S. Secret Service. We also met with former U.S. officials and with representatives of a private firm that has done business in Palau. At Interior, we reviewed correspondence and files related to these issues, documentation of U.S. funding to Palau, technical assistance to improve Palau's financial management and law enforcement systems, and prior audits conducted by Interior's Inspector General and Palau's auditors.

We conducted fieldwork in Hawaii, Guam, the Northern Marianas, and Palau from November 29 to December 18, 1987, and from October 24 to November 22, 1988. We interviewed officials from Interior, the TTPI government, the U.S. Navy, and U.S. law enforcement agencies, including the U.S. Attorney's Office. In Palau, we interviewed Palauan officials, legislators, Supreme Court Justices, state governors, auditors, representatives of private firms, and citizens. We reviewed Palau's constitution, national code, Supreme Court records, legislative records, and 1987-91 national development plan. Our examination of Palau's financial management was limited to reviewing prior audit reports, Palauan laws and regulations, contracts and related documents for major procurements, and selected financial transactions related to fiscal year 1987 compact education funds and other expenditures. We did not conduct a financial audit of U.S. funds provided to Palau, and therefore our report does not draw any conclusions about the extent to which federal grants may have been used for purposes other than those intended.

While reviewing matters related to Palau's power plant, we interviewed U.S. and Palauan officials and reviewed documentation on Palau's decisionmaking process and contracting procedures; U.S. agencies' roles in the project; and problems stemming from Palau's default on loans obtained to finance the power plant. We reviewed records maintained by a British firm responsible for liquidating the bankrupt company that built the plant, and we hired an engineering firm to develop an independent estimate of what the plant should have cost. We interviewed several Palauan and former U.S. officials who received payments from the British firm that built the plant. One Palauan businessman declined to meet with us, and an official of the Marshall Islands did not respond to our letter requesting details on the purpose of the payment he received.

During our work on local law enforcement matters, we reviewed Palauan criminal statistics and reports, criminal investigation files, and law enforcement training. Our examination of law enforcement activities was limited to (1) interviewing U.S. and Palauan officials about the extent and nature of illegal activities, such as drugs, counterfeiting, and arms trafficking, (2) identifying Palauan efforts to address these problems, and (3) reviewing procedures followed in major investigations by discussing them with Palauan and U.S. law enforcement officials and reviewing available documentation. We did not conduct any independent investigations of alleged criminal wrongdoing.

In accordance with the requesters' wishes, we did not obtain written comments on a draft of this report. However, the views of responsible agency officials were sought during the course of our work and are incorporated where appropriate. Our review was made in accordance with generally accepted government auditing standards.

U.S. Policy and Oversight

In 1979, when the Department of the Interior decided to delegate more authority to the Micronesian governments, the United States envisioned that the trusteeship would be terminated by 1981. However, problems in negotiating and obtaining Palauan voters' approval of the compact have led to a prolonged transition to full self-government. During this transition, Palau has experienced serious financial problems including budget deficits, ill-advised contracts, and internal control weaknesses which could adversely affect its economic development.

Interior's responsibilities for overseeing the government of Palau's activities were not clearly defined during this period. In 1979, the Secretary of the Interior issued Secretarial Order 3039 which delegated authority for most day-to-day government operations to the Micronesian governments but at the same time permitted the High Commissioner, under the general supervisory authority of the Secretary of the Interior, to exercise broad authority to take actions needed to carry out U.S. responsibilities under the 1947 trusteeship agreement. The trusteeship agreement obligates the United States to promote Palau's self-government and at the same time fulfill many other responsibilities such as promoting Palau's economic development.

In anticipation of compact implementation, Interior developed and implemented plans to phase out the TTPI government located in Saipan by reducing staff and in July 1987, pursuant to Secretarial Order 3119, abolished the High Commissioner's position and transferred trust territory oversight responsibilities to the Assistant Secretary for TIA. The order superseded Order 3039, but preserved the Secretary's right to exercise all authority necessary to carry out U.S. trusteeship obligations and responsibilities. Interior officials interpreted Secretarial Orders 3039 and 3119 to mean that Interior should not intercede in the government of Palau's financial decisions and contracting activities unless Palau's actions clearly conflicted with U.S. trusteeship responsibilities.

Our review focused on documenting Interior's actions since 1981, when Palau's constitution took effect and its first government took office. We found that Interior advised Palau to reduce expenditures in order to curb its budget deficit and took action to identify and assist Palau in resolving problems with 3 of 18 major contracts and agreements we reviewed. However, for the other 15 contracts and agreements, Interior officials, consistent with Interior's policy of delegating authority to Palau, did not monitor Palau's actions closely or provide Palauan officials with advice.

Interior's technical assistance program, which was established in 1982 to help the emerging governments of Micronesia enhance their operations and become more capable of self-government, has been slow to achieve benefits in Palau partly due to weaknesses in Interior's management and Palau's slowness in implementing projects.

Interior's Interpretation of Its Authority

Interior officials believe that the decision to recognize and delegate authority to Palau's constitutional government had the effect of significantly reducing Interior's authority and responsibility for reviewing and interceding in local decisions. This policy interpretation led Interior to exercise limited oversight of Palau's financial situation and contract negotiations.

Legislative Review and Veto Authority

Under Secretarial Order 3039, the TTPI High Commissioner retained explicit authority for certain functions, including reviewing legislation adopted by Micronesian governments and vetoing laws that conflicted with U.S. trusteeship responsibilities.[1] However, the incumbent High Commissioner during 1981-87 stated that she interpreted these powers as being rather narrow and therefore exercised veto authority only on a few occasions when she believed legislation clearly conflicted with trusteeship responsibilities. Her instructions were to delegate greater authority to the Micronesian governments and to develop plans to phase out the TTPI government.

When Secretarial Order 3039 took effect, Micronesian leaders believed that because it incorporated provisions requiring the High Commissioner to review local legislation, Interior had retained too much authority. In retrospect, however, some Palauans believe Interior should have exercised closer oversight and prevented Palau from proceeding with questionable projects.

In April 1983, Palau enacted legislation authorizing its President to award a noncompetitive contract to IPSECO International Power Systems, Ltd., to build a new power plant. The High Commissioner vetoed a portion of this law that would have permitted Palau to waive its sovereign immunity from suit, on the grounds that it raised questions about whether Interior grant funds could be subject to attachment in the event Palau defaulted on the loan. However, after consulting with Interior's

[1]This authority was transferred to Interior's Assistant Secretary for TIA by Secretarial Order 3119.

Assistant Secretary for TIA, the High Commissioner did not veto the legislation in its entirety, even though Interior's Inspector General and some Palauan officials had serious concerns about Palau's proposed waiver of competitive bidding requirements and lack of funds to pay for the plant.

We believe that Secretarial Order 3039 gave the High Commissioner authority to review and veto this legislation. The High Commissioner could have viewed Palau's lack of funds to pay for the project and waiver of Palau's competitive bidding requirement as conflicting with the U.S. trusteeship obligation to promote Palau's economic development. By suspending only a section of the legislation, Interior missed an opportunity to require Palau to use competitive bidding and prevent the $32.5-million project from going ahead prematurely. In addition to waiving its competitive bidding requirement, Palau, despite warnings from the Interior Inspector General and Palau state government officials in April 1983, did not engage an engineering firm prior to awarding the contract to (1) identify short-term and long-term requirements for electric power and fuel storage space and (2) prepare specifications and cost estimates for meeting identified needs.

As a result, Palau has incurred unnecessary costs. In June 1983, it completed arrangements to borrow $32.5 million to finance construction of the plant and a 6-million gallon fuel storage facility. An independent engineering firm that we hired concluded that Palau could have saved $4.3 million in construction funds for the plant by using competitive procurement. An additional $3.4 million could have been saved if the unused fuel storage facility had not been constructed. Palau defaulted on the loan in 1985 and now owes at least $44 million as a result of a lawsuit brought by banks that guaranteed the project. Additional information on this project and on the roles of U.S. officials is included in appendixes I and II.

Oversight of Palauan Contracts

Neither Secretarial Order 3039 nor 3119 address whether Interior or the High Commissioner are obligated to monitor Palau's negotiation of contracts and agreements and if necessary act to prevent Palau from (1) entering into agreements that might adversely affect Palau's financial situation or (2) signing contracts whose solicitation and negotiation did not follow sound procurement practices. Interior officials said that since Secretarial Orders 3039 and 3119 do not explicitly authorize Interior to intercede in negotiations for contracts and agreements conducted by the government of Palau, they believe Interior can offer advice but cannot

prevent Palau's executive branch from exercising its contracting authority. Officials stated that for the most part, they adhered to this policy even when they believed that agreements were not in Palau's best interest. Interior believes this policy is consistent with its philosophy that the Palau government became self-governing with regard to most matters in 1981, subject only to authority explicitly retained in Secretarial Orders 3039 and 3119.

The general supervisory authority formerly retained under Secretarial Order 3039 and currently effective under Order 3119 allows Interior to monitor Palau's efforts to negotiate contracts and agreements and to advise and assist Palau in addressing potential problems related to its economic development. Moreover, the orders state that Interior has the right to audit, and, after an audit, to require compliance with proper accounting principles and audit recommendations.

We reviewed 18 contracts and agreements[2] and found 3 for which Interior monitored the government of Palau's activities and took actions, such as (1) advising Palau about potential problems, (2) initiating audits or investigations, or (3) notifying other U.S. agencies, such as the Justice Department, about Palau's actions and potential problems. For example, TTPI officials advised Palauan officials not to open bids for a 22-mile road in Babelthuap and cautioned that Palau was opening itself up for liability problems by advertising a project when there was no funding available. The United States, under the compact and a related subsidiary agreement, plans to build a road in the same area once the compact takes effect. After Palau awarded the contract despite Interior's advice to the contrary, Interior (1) hired an engineering consultant to review the competitive bidding process and (2) requested Interior's Inspector General to review the contract. As discussed in chapter 3, Interior's consultant and its Inspector General found problems with the bid process. In September 1988, after President Salii's death, Palauan officials terminated the road contract on the basis of the contractor's breach of certain contract provisions.

Also, after learning that Palau issued bonds totalling $398 million in August 1986, Interior cautioned Palau's President and notified other U.S. agencies, including the Justice Department, about concerns related to the bond issue. For example, Interior's Assistant Secretary for TIA urged Palau's President to make arrangements for an analysis of the

[2]Appendixes I and II address the IPSECO power plant contract. The supplement to the report contains information on 17 contracts and agreements.

economic viability of projects to be financed by the bonds and how they are to provide the financial return necessary to repay principal and interest on the bonds.

For the other 15 contracts and agreements we reviewed, Interior—consistent with its philosophy on delegating authority—did not closely monitor Palau's actions nor provide Palauan officials with advice. Some of these contracts were awarded without competition and may have violated Palauan laws.

For example, on November 12, 1986, the Palau National Communications Corporation entered into a noncompetitive joint venture agreement with Orion Telecommunications, Ltd., to install a cellular phone system in Palau. Although Secretarial Order 3039 explicitly states that Interior has authority for the operation and maintenance of telecommunications within the trust territory, Interior officials did not monitor Palau's involvement with the firm, did not advise Palau on the benefits of obtaining competition, and were not aware that Palau National Communications Corporation board members believed that Palau's Office of the President pressured them to approve the agreement.

In 1986 and 1987, Palau executive branch officials, without obtaining legislative approval, entered into three noncompetitive agreements involving plans to construct a new international airport. One contract, which may have obligated Palau to pay $1.2 million to a Japanese firm, did not include a certification of funds availability as required by Palauan law. Interior did not have much information on these contracts and we found no evidence that Interior officials were aware that these contracts may have violated Palauan law.

In November 1986, Palau entered into two 5-year noncompetitive contracts with two oil companies in which the firms each agreed to supply Palau with an annual minimum of 750,000 gallons of oil and provide Palau with $1 million each as security deposits to be repaid through fuel surcharges. Palauan officials agreed that the security deposits were actually loans. Interior had no information on these contracts and was not aware that they may have violated provisions of Palauan law requiring competitive bidding, prior certification of funds availability, and legislative notification of executive branch loan negotiations.

Additional details on these and other contracts, including Interior's role, are included in the supplement to this report.

Lack of Full-Time Interior Representative

The Chairman and other members of the House Committee on Interior and Insular Affairs repeatedly have questioned whether Interior's presence in Palau is sufficient to ensure that the United States has adequate knowledge of developments and is fulfilling trusteeship responsibilities. Interior officials believe their presence has been adequate, given Interior's reduced responsibilities since 1981. However, Interior's limited knowledge and oversight of major projects may be partially attributable to its declining presence in Micronesia since 1981.

After Interior delegated authority to the Micronesian governments in anticipation of terminating the trusteeship, the TTPI government in Saipan stopped administering most programs and became responsible for phasing out the TTPI bureaucracy and overseeing the Micronesian governments' activities and use of U.S. funds in accordance with Secretarial Order 3039. The number of TTPI government employees decreased from 740 in 1978 to 155 by 1985. In July 1987, the High Commissioner's position was abolished and these responsibilities were transferred to Interior's Assistant Secretary for TIA in anticipation of compact implementation. Interior still has a small Office of Transition in Saipan with several employees.

According to TTPI officials, full-time Interior or TTPI representation in Palau ended in 1981, when Palau installed its constitutional government. Since then, Interior has monitored events in Palau by sending TTPI staff or Interior staff assigned to Guam or Washington to Palau, typically for 1 to 2 weeks at a time.

In September 1987, after Palau's former President furloughed over 900 government workers and political violence occurred, the Chairman and other members of the House Committee on Interior and Insular Affairs asked Interior to appoint a representative in Palau. Instead, Interior began sending TTPI or Interior staff to Palau on a rotational basis. In February 1988, the Secretary of the Interior informed congressional committees that Interior planned to post a full-time representative in Palau within the next few weeks. However, the position was not filled until November 1988.

Oversight of U.S. Funds

Over 60 percent of Palau's revenue for government operations comes from the U.S. government. Between fiscal years 1981 and 1988, Palau received about $90 million in grants from Interior and about $36 million in grants from other federal agencies. In addition, the United States has financed construction of about $29 million in capital improvements. (See

ch. 4 for a detailed discussion of federal assistance, including Palauan and U.S. officials' views on its adequacy.)

Since about 1981, Interior has allowed Palau to determine how it will spend its annual grant from the United States for general government operating expenses. According to Interior officials, Palau must submit a budget each year to the United States, but Interior does not closely review or question Palau's planned allocation of funds. Interior officials believe this approach is consistent with its policy of promoting greater autonomy and self-government. U.S. funds for government operating expenses are deposited in Palau's general fund and are commingled with local revenues, thus losing their identity.

Our limited review of Palauan expenditures disclosed certain items that may be considered questionable in view of Palau's financial crisis. For example, in 1986 and 1987 Palau spent over $70,000 renovating a leased residence for its former President. We obtained documentation that raises questions about who owns the house and whether government expenditures for rent and renovations were proper. (See supplement.) Also, documentation was not available to show how some compact education and referenda funds were spent during the summer of 1987 when over 900 of the more than 1,300 government employees were on furlough. For example, we found no documentation supporting the payment of $10,000 to the chairman of the furloughed workers committee (see ch. 6). Also, the Senate president, who received compact education funds totaling $17,000, stated that these funds were used for barbecues and other activities to promote compact support. Interior officials had no information on either the renovations to the house or the use of compact education and referenda funds during fiscal year 1987.

To its credit, Interior has cautioned Palau repeatedly about the need to either reduce government expenditures or increase local revenues to balance its budget. Moreover, Interior placed Palau on a monthly drawdown system to preclude overspending early in the fiscal year. Despite these actions and warnings, Palau continued to outspend its resources.

Although Interior was aware that Palau was experiencing cash flow problems in fiscal year 1987, it did not send anyone to Palau to independently evaluate whether Palau would run out of funds or to identify potential cost savings measures. Had Interior monitored Palau's finances more closely, it would have been in a better position to advise the U.S. Congress whether a furlough could have been prevented through cost

savings measures and/or about the amount of additional funds needed to avoid a furlough. After being criticized by the Chairman, House Subcommittee on Insular and International Affairs, for problems associated with Palau's 1987 furlough and compact referenda, Interior sent someone to Palau in 1988 to evaluate the government's financial situation.

Since 1984, Interior has engaged a certified public accounting firm to annually review Palau's financial statements and internal controls. Interior's Office of the Inspector General also has audit responsibility in Palau, but it suspended coverage of Palau in mid-1986 because of security concerns, limited travel funds, and Palau's inaction to implement outstanding audit recommendations. In mid-1988, the Inspector General resumed work in Palau.

Technical Assistance Grants

In 1983, we reported[3] that Palau and other Micronesian governments lacked sufficient management and technical expertise to efficiently plan, implement, and monitor public sector programs and services without technical assistance from the United States. Our current review disclosed that these problems persist in Palau.

Interior's technical assistance program, which began in 1982, is intended to improve territorial government operations. As of December 1988, Interior had provided Palau with 32 technical assistance grants totaling $1.66 million for purposes such as acquiring a financial management system, hiring a national planner, and contracting for an electric rate study. Technical assistance grants for law enforcement are included in this total. (See ch. 5.) In addition, Interior granted almost $1 million to the TTPI government or federal agencies for projects which directly benefited Palau. Palau will be eligible to continue receiving grants when the compact is implemented.

Stronger Grant Management Needed

Although Interior has recently improved its grant management process, including changes to its filing system and establishing stricter grant requirements, it has not established a formal system for monitoring the status of grants or evaluating their benefits. Interior is aware of these weaknesses but has been slow to make improvements.

For example, Interior required final narrative reports for most of the 24 grant agreements we reviewed as well as interim reports for about half

[3]The Challenge of Enhancing Micronesian Self-Sufficiency (ID-83-1) Jan. 25, 1983.

the agreements. Palau had submitted none of the final narrative reports required and many interim reports were missing. In September 1988, Interior sent Palau a request for missing reports and requested the status of grants dating back to 1984. However, this had not been a routine practice.

Furthermore, Interior did not routinely monitor grants to ensure that funds were administered in accordance with Office of Management and Budget (OMB) Circular A-102. This circular required that all procurements, regardless of dollar value, were to be conducted in a manner that provides open and free competition[4] .

For example, in June 1986, Palau received a grant to prepare a communications action plan. The grant agreement stated that Palau would comply with OMB Circular A-102, but Palau's President signed a contract with one firm to conduct the study without obtaining competition. Interior did not monitor this grant and therefore was not aware that Palau may have violated the grant agreement requirement that it comply with OMB Circular A-102. Palau was permitted to draw down and spend $45,000 under the grant, but a September 1988 Interior report listed the project's status as unknown and indicated that the required narrative reports had not been submitted.

In February 1987, Interior provided Palau with a $50,000 grant to hire a qualified individual or firm to review procurement procedures and laws and develop a comprehensive procurement manual. Interior required Palau to ensure that it would comply with the requirements of OMB Circular A-102. In August 1987, Palau's President awarded a noncompetitive $35,000 contract[5] to a former Interior employee who had resigned as director of Interior's technical assistance program in April 1987. In May 1987, Interior's Deputy Agency Ethics Official informed this former employee that it was acceptable for him to work for Palau on technical assistance projects as long as he had not worked on such projects in a personal and substantial way during his last year of service.

[4]This circular was superseded in March 1988 and no longer contains the open and free competition requirement. The requirement was included in a common rule on Uniform Administrative Requirements For Grants and Cooperative Agreements to States and Local Governments. This rule has been adopted by many federal agencies, including the Department of the Interior.

[5]As of November 1988, Palau had not obligated or spent the remaining $15,000 of Interior's $50,000 grant to develop a procurement manual.

Interior officials were aware of Palau's plans to award the contract to the former Interior employee but did not advise Palau to seek competition. Although this former official's conduct does not appear to violate U.S. laws that impose post-employment restrictions on former U.S. government employees, Interior should have required the contract to be awarded competitively in view of Palau's agreement to follow OMB Circular A-102 requirements for competition. At Palau's request, Interior's Inspector General officials reviewed the draft manual developed under this grant and identified weaknesses. As of November 1988, Palauan officials had not taken action to ensure that these problems would be addressed.

Interior's annual reviews of internal controls have identified weaknesses in grant management since 1983. In 1987, the Inspector General reported that a "formal system to control projects had not been established and information on the progress, results and financial status of projects was generally not available." A consultant who reviewed the program in 1988 found these problems and others, such as the program's lack of a full-time director and Interior's failure to clearly define the responsibilities of its field representative in Guam. The consultant recommended a number of staffing and operational changes.

Benefits Are Slow to Be Achieved

Interior has not always responded to Palau's needs in a timely manner, and in some cases Palau has been slow in implementing technical assistance grants provided by Interior. For example, Interior did not award a grant to develop a procurement and property manual until February 1987, although Interior's Inspector General identified serious weaknesses in Palau's procurement and property management in 1984. As of November 1988, the manual was still in draft and Interior had not followed up on the cause of the delay. Interior also was slow in awarding a grant to provide the training Palau needed to better use a computerized financial management system installed in 1983.

Palau, however, has been slow to implement some technical assistance projects approved by Interior. For example, in one case, Palau put no one in charge of a June 1986 grant to develop an administrative manual and, as a result, lost track of it. As of November 1988, Palau had drawn down $15,000 but had initiated no work on the project. Interior officials were not aware of this situation.

Palauan officials stated that technical assistance grants have been beneficial and acknowledged a need to improve compliance with grant

requirements. Three officials suggested that compliance problems may be due partially to the lack of a central coordinator within their government.

In some instances, expected grant benefits were not achieved because the Palauan government did not implement project recommendations. For example, Palau has not implemented recommendations generated by a 1986 study of Palau's electric rates for several reasons, including politicians' concerns over how their constituents would respond to an increase in rates.

Conclusions

Interior has exercised limited oversight of Palau's financial situation and major contracts due to its anticipation that the compact would be implemented and its interpretation that Secretarial Orders 3039 and 3119 significantly limited its authority and responsibility for reviewing and questioning Palau's decisions. Interior's declining presence in Micronesia and its lack of a permanent representative in Palau with clearly defined oversight responsibilities also may have contributed to its limited awareness of problems. In our opinion, Interior could have taken additional steps to prevent or address Palau's ongoing financial problems, consistent with its authority under Secretarial Orders 3039 and 3119.

Interior's technical assistance program has been adversely affected by delays in implementing projects, inadequate grant monitoring, insufficient follow-up on project results, and Palau's lack of a grant coordinator. Because Palau will continue to be eligible for this program following compact implementation and the program could be a useful tool for readying Palau for self-government, it is particularly important that Interior address problems that have limited this program's effectiveness.

Recommendations

We recommend that the Secretary of the Interior require the Assistant Secretary for TIA to

- assign the field representative in Palau responsibility for (1) monitoring Palau's financial situation and obtaining information on progress in competing and negotiating major contracts and agreements and (2) identifying situations in which Interior may need to advise Palau or take other actions concerning projects or agreements that appear questionable;

- establish procedures for ensuring that technical assistance grants are routinely monitored and periodically evaluated; and
- request the President of Palau to establish a central point of contact responsible for implementing technical assistance grants on a timely basis and ensuring that project managers comply with grant requirements.

Problems Affecting Financial Management and Economic Development

Since 1981, when Palau assumed authority for most day-to-day government operations, the government of Palau has experienced serious financial problems, including a history of budget deficits, cash flow problems leading to reduced workweeks and a furlough, and widespread internal control weaknesses that have created opportunities for inefficient spending and corruption. In addition, Palau's executive branch, state governments, and government-owned corporations have entered into some ill-advised contracts and agreements that do not comply with sound procurement principles, may violate Palauan law, and may adversely affect Palau's ability to achieve its economic development goals.

U.S. financial assistance to Palau under the compact is intended to stimulate economic development and assist Palau in achieving financial self-sufficiency. Palau's ability to successfully manage compact funds and achieve these goals is questionable unless, with U.S. advice and technical assistance, it acts to address weaknesses in its financial management and acquisition practices.

Budget Deficits Began in 1982

Since 1982, Palau's obligations have consistently exceeded revenues received from the United States and from local taxes. The government has financed shortfalls by repeated short term borrowing, and by the end of fiscal year 1988, it owed about $7 million on various bank notes, two oil company loans, and miscellaneous accounts payable. In addition, Palau owes at least $44 million on two loans obtained to build a power plant.

In at least two instances, Palau's cashflow problems resulted in demonstrations and civil unrest by government workers, who held 68 percent of all jobs in Palau in 1987. In 1982, government employees went on strike to protest low government wages and, after burning the President's office, were awarded a pay raise which put an additional strain on Palau's budget. In 1987, President Salii furloughed over 900 of more than 1,300 executive branch employees from July through September 1987, resulting in a 3-month demonstration.

Although some Palauans fault the Department of the Interior for failing to provide Palau with sufficient resources to meet payroll and other essential operating expenses, they also acknowledge that Palau has not adequately controlled expenditures and has mismanaged funds. Also, Palau's auditors have noted that Palau lacks adequate local tax and utility revenue assessment and collection systems and have recommended

that billing and collection procedures be established to enhance local revenue collections.

Internal Control Weaknesses

Our review, as well as audits conducted by Interior's Inspector General and Palau's auditors, identified internal control weaknesses in areas such as procurement, property management, government housing, federal grant monitoring and administration, revenue and receivable collections, cash management, and outstanding encumbrances. These weaknesses have permitted situations of noncompliance with federal grant terms and have created opportunities for inefficient and improper spending of federal and local funds. As of November 1988, Palau had made limited progress in implementing 198 audit recommendations, some of which have remained open since 1984.

Procurement Laws and Regulations Inadequate

Section 402, title 40, of the Palau National Code requires formal competitive bidding for procurements of construction, repair, or rebuilding projects; goods, commodities, and materials; and related services over $5,000. However, the Palau Supreme Court has ruled that the law does not require competition for service contracts. As a result, Palau has awarded some large multi-year management contracts without competition. We found that a 5-year contract for the management of Palau's power plant and a 2-year contract for management of its new Civil Service Pension Plan had been awarded noncompetitively. Detailed information on the power plant management contract is included in the supplement to this report.

Several Palauan officials, including the Attorney General and the Senate legal counsel, believe that major service contracts should be subject to some form of competition and that section 402 probably should be changed to require competition for these types of contracts. We agree that requiring competition for large service contracts could help to ensure that the government of Palau obtains the most cost effective services.

Palau's progress in developing a comprehensive procurement manual has been extremely slow. Interior's Inspector General identified serious weaknesses in Palau's procurement and property management systems in October 1984; however, Palau did not act to address this problem until February 1987, when Interior provided Palau with a $50,000 technical assistance grant to develop a procurement manual. As discussed

earlier, Palau awarded a contract in August 1987 to a former Interior employee to develop the manual.

During our November 1988 visit, we found that the draft manual developed under this grant contains deficiencies that need to be addressed before it is finalized. For example, Interior Inspector General officials in Guam told us that the draft appears to be taken almost verbatim from the American Bar Association Model Procurement Code and does not include detailed regulations and desk procedures tailored to Palau's needs. Also, Palau's Attorney General stated that the draft manual conflicts with Palau's procurement law and should be made consistent with existing law, since new legislation will require significant time to develop. In June 1989, Palau's Vice President informed us that the manual will be completed by October 1989.

Controls Over Property

The only property requirements we identified are contained in Executive Order 9, which provides a brief statement of duties for the chief of property and supply. These duties include maintenance of complete inventory records for personal property of the national government and verification of these records through periodic physical inventories.

We conducted a limited review of Palau's property management records and found that the custody, condition, and disposition of government property frequently were not accurately reflected on official property records. We reviewed property files for 10 items valued at about $1,607,076 and found that none of the items had been physically inventoried. We determined that the files correctly noted the location and custody of 7 items and that the 3 items below had been incorrectly recorded.

- A Toyota van, valued at about $8,600, which had been reassigned from the Board of Health Services to the Board of Education without notification to property management officials.
- A fishing vessel valued at about $196,000 in 1975, which had been transferred without any documentation to a private citizen, who resold the boat a week later for $5,000.
- A ship originally purchased by the TTPI government in 1976 for $1.3 million and known as the Micronesian Princess, which had been sold in August 1986 for $81,675 without any notations on the inventory record of the ship's deteriorating condition or final disposition. Palau's Attorney General provided us with documentation that the ship had been sold.

Housing Guidance Inadequate

Palau's housing policy does not provide specific guidance on housing for the President and other government officials or the extent to which government funds can be used to pay for renovations to privately owned property leased for these officials. A new executive order, effective October 1, 1988, states that official residences for Palau's President and Vice President will be provided rent free as a matter of policy but contains no guidelines on the type of housing or on the extent to which executive branch funds may be used to finance renovations for government owned or privately owned property.

Questions exist about (1) who owns the house rented for President Salii during his term of office and renovated at government expense and (2) whether the expenditure of government funds for renovations exceeding $70,000 and rent of $750 per month for almost 3 years was proper. The government of Palau initially spent over $90,000 for the renovations but President Salii paid the government $20,000 of the total cost in January 1987. According to a Palau Department of Public Works official, renovations consisted primarily of changing the interior layout and extending the front of the house and were not for security purposes. We found that the woman who leased the house to the government claims to have purchased the house from Lazarus Salii in 1982 for $35,000 but has no proof of ownership. Also, the former President and the lessor's husband signed a letter to the Koror State Government on March 6, 1986, stating that the building was being sold back to President Salii and a partial payment had already been made.

We reviewed Palau Clerk of Court files from 1982 through November 1988 but found no documentation showing who owns the house or whether it had been sold since 1982. If Lazarus Salii owned the house while he resided in it as President, the lessor's acceptance of rent payments would have been improper and possibly fraudulent. In addition, it appears that the government of Palau will receive no permanent benefit from the $70,000 expended on renovations since the house is privately owned. Additional details on this issue are provided in the supplement to this report.

Problems With Major Contracts and Agreements

Palau's national and state governments and government-owned corporations signed contracts and agreements for major construction projects without (1) conducting independent feasibility studies, (2) obtaining required legislative authorization and appropriation of funds, and (3) making reasonable efforts to obtain competition. In addition, some projects and agreements were not included in Palau's national economic

development plan. Also, as described below, some contracts may have violated provisions of Palauan law.

Several of these contracts and agreements were canceled or allowed to expire following President Salii's death, thereby lowering Palau's potential long-term debt. However, Palau's national government still owes at least $44 million for the power plant and state government road contracts amount to at least $25 million. Also, several other contracts, including some which were terminated by the government, may result in obligations which Palau eventually will be forced to pay. The problems we identified with these contracts raise serious questions about Palau's ability to manage compact funds wisely, including at least $46 million for capital improvements. For these funds to have a developmental impact, they must be spent on projects that are well-planned, reasonable in cost, and consistent with Palau's economic development plans.

Insufficient Analysis

Several major contracts and agreements for infrastructure improvements were entered into without independent feasibility studies or sufficient discussion and analysis. For example, in June 1983, the government entered into two loans totaling $32.5 million to finance the construction of a 16-megawatt power plant and a 6-million gallon fuel storage facility. Palau's executive branch and bicameral legislature approved the project based on analyses developed by IPSECO International Power Systems, Ltd., the British firm that built the power plant. IPSECO projected that Palau would be able to pay off the loan through utility fees and sales of oil to foreign fishing fleets and merchant ships. Although warned by Interior's Inspector General and some Palauan officials, Palau did not conduct an independent feasibility study to determine whether IPSECO's assumptions and conclusions were realistic. In 1985, when the project failed to generate the projected revenue, Palau defaulted on the loans. Although the power plant has been in operation since 1986, the fuel storage facility had not been used as of November 1988 due to the lack of customers.

Also, in August 1987, President Salii signed a competitively awarded contract for the construction of a 22-mile road on Babelthuap island at a

cost of at least $26 million[1] . According to an Interior consultant, the short timeframe for preparing bids, coupled with the lack of survey drawings and other drawings, may have resulted in contractors including large contingency sums in their bids. We also believe that issuance of this contract was premature because the United States, under the terms of the compact and a related subsidiary agreement, is obligated to build a road in the same area at no cost to Palau. The government of Palau terminated this contract in September 1988.

On August 28, 1986, the Palau National Development Banking Corporation issued over $398 million in bonds to finance revenue-generating capital improvement projects, including a major housing project. We found no evidence that economic analyses were made prior to the bonds' issuance to determine whether these projects would generate sufficient revenue to pay off the bonds in 30 years. Board members of the corporation told us that the former President and his advisor gave them only 2 days to review the bond proposal. In January 1987, an Interior official informed the Justice Department that bonds issued by Palau and other U.S. territories in the Pacific completely exceeded the requirements of these islands and that their "ability to repay the bonds is, therefore, questionable." In December 1987, a federal grand jury in Guam indicted an official and a consultant of Matthews and Wright, the bond underwriters, for conspiring to defraud local governments throughout the United States, U.S. territories, and the Republic of Palau. Palau terminated its bond issue without incurring any liability. However, the U.S. Attorney for Guam believes that Palau's involvement with Matthews and Wright may have damaged its future ability to issue bonds.

Projects Not Included in Palau's Economic Development Plan

Palau's 1987-91 National Development Plan emphasizes "the rational allocation of scarce economic and financial resources available to the Republic in order to ensure ... maximum socio-economic development within the country." During this period, the government planned to fund development projects at the national and state levels totalling $94.74 million, using mostly compact funds. Some Palauan officials believe that state governments, by entering into projects not specifically included in

[1]The contract states that the contractor would finance the project and receive final payment in one of two ways. If the United States agreed to accept the 22-mile road project as part of its obligation to build a 53-mile road system, the contract states that the contractor would receive $29,567,453. However, if the United States did not agree to pay the contractor, the President of Palau agreed to introduce and "vigorously support" legislation for OEK appropriations to pay the contractor with capital improvement or other compact funds. In this instance, the contract states that the contractor would be paid $26,713,215.

the national development plan, may have jeopardized the national government's ability to fund higher priority projects specifically identified in the plan.

Some of Palau's state governments entered into agreements for major infrastructure projects not included in this plan, even though Palau had not received compact funds and the states lacked funds to pay for them. Specifically, four state governments awarded contracts to Japanese companies to construct road or road and water systems that will cost at least $25 million. As a practical matter, since the state governments depend on the national government for operating funds, the national government may have to find funds to pay for the state roads, some of which already have been completed. Thus, the national government may not be able to fund high-priority projects included in its national development plan.

Legislative Approval and Appropriations

Palau's President Salii entered into contracts that could have required future payment of funds without first obtaining OEK authorization and appropriation. For example, President Salii did not obtain OEK approval for the contract to construct the 22-mile road on Babelthuap. In November 1988, Palau's Attorney General told us that because the contract could have required an appropriation of funds, it can be argued that OEK approval should have been obtained prior to awarding the contract. OEK leaders stated that they were not even aware of the contract until after it had been signed. In September 1988, Palau sent the contractor a notice of termination based on the contractor's failure to comply with certain contract provisions. As of November 1988, Palau, in accordance with the contract, had not made any payments to the contractor.

The President also entered into three agreements involving plans to construct a new international airport and related tourism facilities without the OEK's knowledge. One of these agreements appears to have required legislative approval because it would have affected the development of Palau's natural resources. Although Palau's constitution grants the OEK authority to regulate the ownership, exploration, and exploitation of Palau's natural resources, the agreement was signed without the involvement of Palau's legislature. The agreement was canceled following President Salii's death.

Another contract, between the government of Palau and C. Itoh and Company, Ltd., was for an airport feasibility study. According to Palau's Attorney General, this contract may have violated Palauan law

because the President did not request the legislature to appropriate funds for the study and the contract did not include a certification of funds availability as required by law. Palau's Attorney General believes that even though certain provisions of the contract may have violated Palauan law, Palau may owe C. Itoh, which completed the study in August 1987, as much as $1.2 million.

Insufficient Competition

Except for the Babelthuap road project, the national government did not advertise for bids prior to awarding major contracts for goods and infrastructure improvements included in our review. For example, the government of Palau did not solicit competitive bids in awarding 5-year oil supply contracts to two firms. In our opinion, these contracts were subject to Palau's competitive bidding requirements since the value of each exceeded $5,000 and oil products appear to fall within the definition of "goods, commodities, and materials." (40 PNC 402, 403.)

Although competitive bidding was used in the Babelthuap road project, a former Palau Assistant Attorney General told us he believes the firms that received the contract were pre-selected and that efforts to obtain competitive bids were superficial at best. Also, an Interior consultant found that Palau followed unusual bidding procedures and included bid provisions which may have deterred bidders and resulted in Palau's acceptance of an expensive contract. At the request of the Deputy Assistant Secretary for TIA, Interior's Inspector General reviewed this contract and reported in May 1989 that Palau effectively limited competition to ensure that the joint venture of Calista Construction International and Keangnam Enterprises, Ltd., would be the successful bidder.

Stronger Deterrents Needed to Prevent Fraud, Waste, and Abuse

Palau's delay in implementing its special prosecutor law and hiring a permanent public auditor have adversely affected its ability to detect inefficient and improper spending. Palau's conflict-of-interest laws lack effective sanctions to deter improper actions by government officials.

Special Prosecutor

According to Palau's Attorney General, Palau's legislature created the Office of the Special Prosecutor in 1985 to (1) investigate and prosecute violations of Palau's laws by officials and employees of the national and state governments and (2) prosecute cases that the Ministry of Justice is

unable to prosecute because of possible conflict-of-interest considerations. The position has never been filled.

Several Palauan officials stated that a special prosecutor is needed to provide a way for addressing allegations of civil and criminal wrongdoing involving high level executive branch officials, including the President, as the need arises. Since Palau's Attorney General is appointed by the Minister of Justice and by contract can be terminated in 60 days, we agree that allegations involving high level executive branch officials should be addressed by a special prosecutor.

On May 26, 1989, the governments of the United States and Palau signed a new subisidary agreement to the compact that will require Palau to maintain and staff the offices of the special prosecutor and public auditor for at least the first 5 years following compact implementation. The United States will provide Palau with annual amounts not to exceed $300,000 per year for 5 years to staff and operate these offices.

Public Auditor

The Palauan constitution requires the appointment of a public auditor. Moreover, Palau's Public Auditing Act of 1985 (40 PNC ch. 2) establishes an Office of the Public Auditor as an independent agency to audit the receipt, possession, and disbursement of public funds by agencies of the government. The Palau Public Auditor's organizational independence compares favorably with GAO's Government Auditing Standards. However, Palau has been without a permanent Public Auditor since July 1987 due to delays in filling the position. As of June 1989, the executive branch had nominated someone to fill the position, but the House of Delegates had not yet confirmed the nominee. In the future, we believe the government of Palau should recruit for this position as soon as a vacancy occurs or is announced and the legislature should act promptly to confirm or reject executive branch nominees.

Some Palauan officials believe that funding constraints have adversely affected the Office of the Public Auditor. Funding for the Office was $129,000 in fiscal year 1987 and $120,000 in fiscal year 1988[2] ; in fiscal year 1987, Palau's President reduced the budget by 11.9 percent and the OEK cut it an additional 14 percent. In fiscal years 1988 and 1989, the President reduced the Public Auditor's budget request by 31.5 and 25.3 percent, respectively. A Palauan official stated that most legislators do

[2]Funding for fiscal year 1989 was pending during our November 1988 visit to Palau.

not give high priority to the Public Auditor when making budget decisions. The Acting Public Auditor told us that neither he nor his staff of three has much experience in conducting audits and there is no money in the current budget for additional training. Additional financial assistance included in the new subsidiary agreement to the compact signed on May 26, 1989, should help to alleviate funding constraints once the compact takes effect.

Conflict-Of-Interest Sanctions Lacking

Palau's National Code has a bribery statute that prohibits individuals from unlawfully and voluntarily giving or receiving anything of value in wrongful and corrupt payment for official acts (17 PNC 701). Palau also has a statute for misconduct in public office that prohibits public officials from committing illegal acts by using their office or from willfully neglecting to perform official duties (17 PNC 2301). It is not clear from this broad statute, however, what kinds of conduct would be punishable or what the penalties are. Palau has a 3-year statute of limitations for both these crimes and for most other criminal offenses.

Palau also has two conflict-of-interest statutes intended to deter government officials from engaging in misconduct or financially benefiting from government service. However, these laws are not as strong as U.S. provisions. Palau's criminal code does not contain conflict-of-interest provisions and its civil laws do not contain specific penalties for violations and they exempt numerous public officials, including those appointed by the President or Vice President as chiefs of staff, special advisors and assistants, and various contract employees.

We identified three situations in which former Palauan government officials' actions raised conflict-of-interest issues and demonstrated the need for Palau to develop effective conflict-of-interest legislation. A former Palau Assistant Attorney General for Civil Law concurrently was on the board of directors of Pacific Ventures, Inc. and, as Assistant Attorney General, approved as to form two noncompetitively awarded government contracts with the corporation. Although we do not know the extent of this individual's involvement in the corporation or whether and to what extent he may have received compensation, his public involvement in a matter regarding an entity for which he served as a board member raises a conflict-of-interest concern. His conduct was not clearly prohibited by Palauan law or subject to any particular sanction.

Second, a former Palau Attorney General informed us that corporations occasionally compensated him for his assistance in preparing documentation and processing applications for Palauan business permits. This compensation was provided while he was performing his official duties and was in addition to his government salary. Palau has no criminal or civil penalties for this, and it is not clear that its civil conflict-of-interest laws would apply to the Attorney General, since he was a contract employee of the government of Palau.

The third situation concerns conflict-of-interest and bribery issues involving Palau's power plant. (See p. 38.)

Alleged Corruption

Some Palauan officials, including several legislators, are concerned that fraud and corruption among high-level government officials in President Salii's administration may be an underlying cause of Palau's financial problems. While our review did not focus on investigating allegations of corruption, we believe that widespread internal control weaknesses related to procurement could enable fraud and corruption to occur and go undetected. We also identified questionable contractor payments to Palauan officials that in our opinion warrant investigation by Palauan law enforcement entities for possible misconduct, including bribery and tax violations.

From our discussions with Palauan officials, it appears that most contracts we reviewed were negotiated by a small group of high-level officials, including President Salii, an American who was a special assistant to the President, the president of Palau's National Development Bank, and a former Palau Attorney General. For the most part, these contracts appear to have been negotiated in relative secrecy without the involvement of other key executive branch officials, such as the Ministers of Administration and Natural Resources who should have been involved in the negotiation and review of some contracts.

In addition, some contracts were negotiated without the legislature's knowledge when legislative approval or appropriations appear to have been required. This exclusion of key individuals, combined with insufficient efforts to obtain competition and incomplete documentation of negotiations, are internal control weaknesses that could have created opportunities for improper actions.

An American businessman told us that during discussions held over several years, President Salii's American advisor asked the businessman to

pay $100,000 to $1 million to pave the way for establishing a gambling operation in Palau. The businessman refused to meet these repeated requests and negotiations for the project eventually collapsed.

The president of another American firm told us that his firm experienced difficulty in obtaining a foreign investment permit to establish a mining business in Palau. He stated that a special assistant to President Salii suggested that he was expected to pay bribes but did not make a direct request for money. In a letter to a U.S. congressman, an official of this firm stated

> "It is our distinct impression that we are being barred from getting this permit ... because we will not conduct our business in certain ways. Further, we feel we are being put at a disadvantage in Palau in favor of one or two Australian companies who might not be bound by the Foreign Corrupt Practices Act."

The firm's president told us that Palauan officials approved his firm's permit after several U.S. congressmen wrote letters on the firm's behalf.

We found that five Palauan officials and businessmen received questionable payments totaling $775,000 from IPSECO International Power Systems, Ltd. Three of the Palauans had a role in the power plant project. In addition to raising conflict-of-interest issues, these payments raised bribery and conduct in office questions. Although we did not determine whether taxes were paid on these payments, if they were not, Palau's tax laws could have been violated.

Also, a Palauan businessman who received funds from IPSECO said that he used the money to provide goods and services to IPSECO under the construction contract for the power plant/fuel storage facility. He told us, however, that he had no written contracts or other records showing that goods and services were provided. We therefore were unable to confirm through written records that this person provided goods and services for the project.

Appendix II contains more detailed information on the IPSECO payments to Palauans and their explanations.

Stronger U.S. Controls Over Compact Funds Needed

Palau has made little progress to date in correcting serious financial management problems to better ensure that compact funds will be used as intended. Therefore, in final negotiations to implement the compact, we believe the United States should consider the need for stronger controls to reduce the risk that compact funds may be spent inefficiently. A new subsidiary agreement to the compact, signed on May 26, 1989, should enhance the effectiveness of the compact's audit provisions. However, opportunities remain for strengthening controls over the $70 million investment fund.

Audit Provisions

On December 2, 1987, the United States and Palau signed a subsidiary agreement outlining procedures to implement U.S. economic assistance, programs, and services to be provided to Palau after the compact takes effect. The agreement states that economic assistance grants and program and service assistance may be audited by officials of the U.S. government. It also states that U.S. grants provided after the compact takes effect will be audited on the basis of Palauan laws and regulations for the most part.

The agreement states that U.S. auditors shall provide the government of Palau with at least 45 days to comment on draft audit reports prior to their issuance and shall include these comments in the report. However, it does not discuss whether Palau should make at least a good-faith effort to implement undisputed audit recommendations. On May 26, 1989, the governments of the United States and Palau signed a new subsidiary agreement to the compact that requires Palau to develop a plan to implement audit recommendations within 120 days after an audit conducted by the United States is submitted to Palau. This provision should help ensure that Palau takes action to correct internal control weaknesses.

Management of the Investment Fund

Within the first 3 years after compact implementation, the United States will provide Palau with $70 million to establish an investment fund to produce income. A subsidiary agreement to the compact requires Palau to retain a U.S. investment manager to manage the fund and make investments mutually acceptable to the United States and Palau. According to the compact, "the objective of this sum is to produce an average annual distribution of $15 million commencing on the fifteenth anniversary of this Compact for thirty-five years."

Our analysis of compact versus trusteeship funding shows that Palau will receive most of the compact funds during the first few years after the compact is implemented. Full details of our analysis are included in chapter 4. The first distribution from the investment fund will take place in year 5, when Palau may withdraw a minimum of $5 million. This distribution will supplement the annual U.S. grant for economic assistance, which effectively will decrease by $5 million in that year.

Unless Palau manages compact funds wisely during the first few years and significantly increases local revenues, it may not be able to maintain government operations at current levels and may try to borrow funds as it has in the past.

The compact and its related subsidiary agreements do not make clear whether the investment fund could be used as collateral for future government borrowing. In December 1987, Palau's Minister of Administration told us that such use had been the subject of discussions. Although we are not aware of specific plans to do this, we believe that using the fund as collateral could jeopardize the security of the fund and should be avoided.

Recommendations

To better ensure that U.S. economic assistance funds under the compact will be used as intended, we recommend that the Secretary of State negotiate with the Republic of Palau to preclude Palau from using the compact investment fund as collateral for loans.

Although the government of Palau must accept primary responsibility for addressing financial management weaknesses, we believe Interior can help in this process by offering increased advice and technical assistance to address problems with Palau's procurement and housing practices and help Palau develop legislation to strengthen procurement and conflict-of-interest laws. Therefore, we recommend that the Secretary of the Interior instruct the Assistant Secretary for TIA to

- (1) request Interior's Inspector General to review Palau's draft procurement manual to ensure that it includes requirements and procedures for conducting feasibility studies to assess needs, competitive bidding for major projects, recordkeeping by contractors and subcontractors, and other sound procurement principles, (2) ensure that all Inspector General comments are addressed adequately prior to the manual's completion, and (3) recommend that Palauan officials revise their procurement law to require competitive bidding for service contracts;

- advise Palau to (1) develop housing regulations that include more specific criteria defining the extent to which government funds may be used to pay for renovations to private housing rented for government officials and (2) request Palau's Acting Public Auditor to review the propriety of funds expended to lease and renovate a residence for President Salii; and
- advise Palau's President to (1) appoint a special prosecutor within a reasonable amount of time, (2) request the Attorney General or Special Prosecutor, if appointed in a timely manner, to investigate payments made by IPSECO to Palauan officials and determine whether sanctions under Palau's criminal or civil laws are warranted, and (3) develop more comprehensive conflict-of-interest legislation that includes criminal provisions, and reduces exclusions for certain categories of public officials with respect to civil provisions.

U.S. Financial Assistance to Palau

U.S. officials believe that the United States has provided Palau with adequate assistance during the trusteeship and stated that the financial assistance to be provided under the compact is equitable and will help to stimulate economic development if used wisely. In contrast, Palauan leaders we interviewed stated that U.S. funding during the trusteeship has not been sufficient to meet Palau's needs. Also, although over half of Palauan voters have supported the compact in six referenda, some Palauans stated that they will not support it unless U.S. funding is increased.

Our comparison of trusteeship versus compact funding shows that, assuming the compact is implemented in 1989, the estimated present value of compact funds is $247.7 million, which is $14.5 million less than the $262.2-million present value of funds we project Palau would receive if the trusteeship were to continue from 1989 to 2003. As a result of a compromise reached with congressional leaders in the closing hours of the 100th Congress, the State Department has notified congressional committee chairmen that it will take administrative action or seek appropriations for an additional $9.3 million during the first 6 years of the compact to meet high priority needs not included in the compact. This would offset much of the difference between the estimated values of the two funding packages. In addition, a new subsidiary agreement between Palau and the United States, signed on May 26, 1989, would change the annual energy production payments in the compact to a single payment. This would increase the present value of the compact in 1989, thus further offsetting the difference between the two funding packages.

In comparing the compact with continued trusteeship status, it should be noted that the compact will provide Palau will other non-quantifiable benefits, such as greater independence and more flexibility in planning for economic development. Also, about one-half of compact funding will be provided to Palau during the first 3 years. The United States expects that Palau will use compact funds wisely to help stimulate economic development and thereby generate sufficient local revenue to operate its government in later years. Thus, a decline in U.S. funding following compact implementation is compatible with Palau achieving greater independence to manage its resources and plan for its economic future.

Trusteeship Assistance

The United States has provided Palau with about $156 million in direct assistance and capital improvements since 1981. (See table 4.1.) Federal assistance to Palau in 1987 totaled about $16.7 million, which is roughly $1,206 per capita.

Table 4.1: Federal Assistance to Palau for Fiscal Years 1981-88[a]

Dollars in thousands

Year	Interior grants	Federal grants	Capital improvement projects	Total
1981	$8,293	$3,294	$2,000	**$13,587**
1982	9,278	4,363	3,190	**16,831**
1983	11,438	3,460	4,450	**19,348**
1984	12,947[b]	5,633	4,600	**23,180**
1985	11,016	4,330	2,270	**17,616**
1986	11,059	5,502	4,756	**21,317**
1987	10,787	5,943	0	**16,730**
1988	15,514[c]	3,908	8,000	**27,422**
Total	**$90,332**	**$36,433**	**$29,266**	**$156,031**

Source: Data provided by Interior and the government of Palau

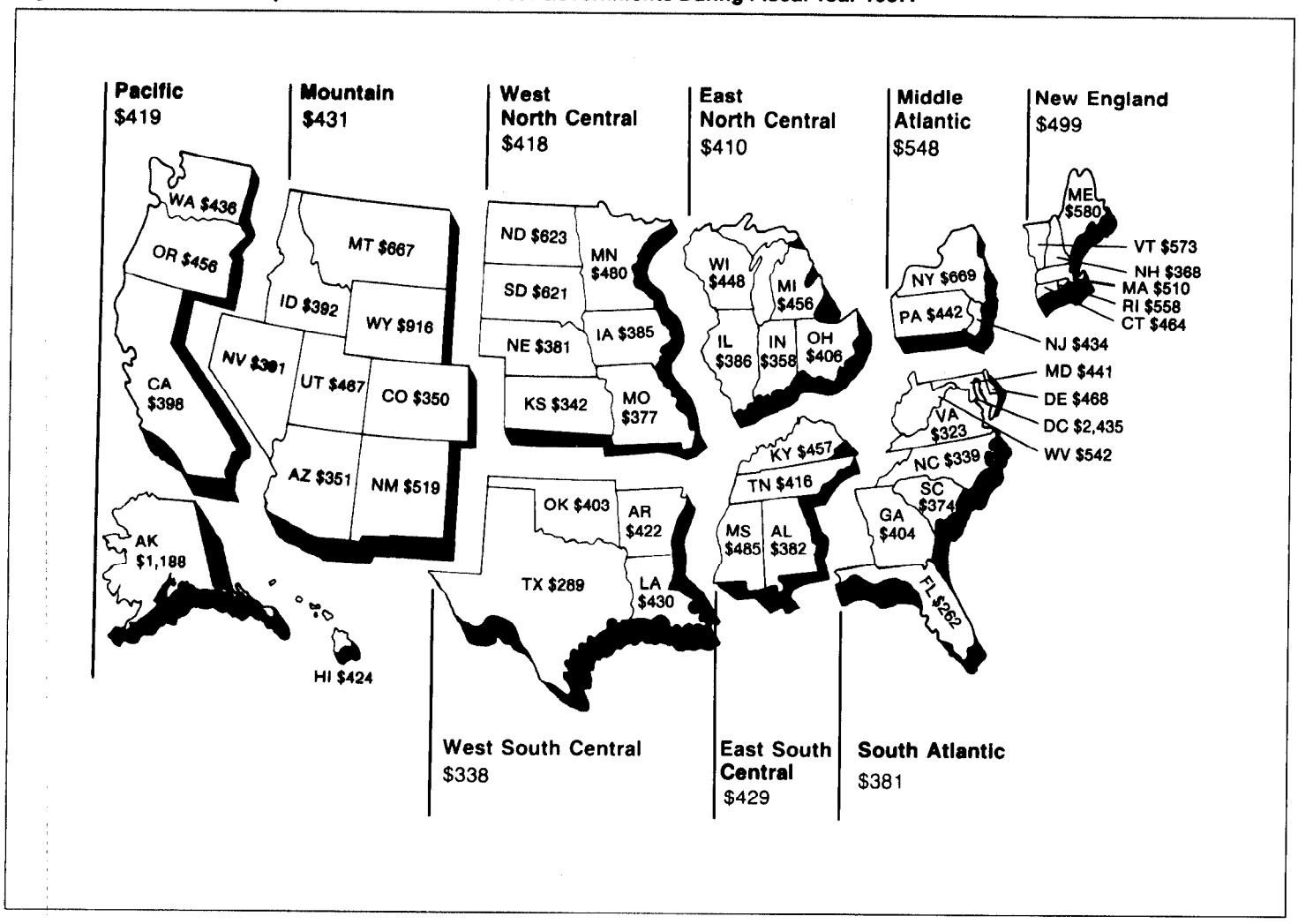
[a]Does not include the value of postal, weather, aviation, and aeronautics services or post-secondary education grants.

[b]Includes a $2-million supplemental appropriation.

[c]Includes $3.5-million reprogramming, which provided additional funds for general government operations.

For comparison purposes, fig. 4.1 shows federal per capita aid to state and local governments in 1987. Federal funds, which are used to supplement Palau's local revenue, support basic government services, such as education, health, and public works, and are subject to annual authorization and appropriation.

Figure 4.1: Federal Per Capita Aid to State and Local Governments During Fiscal Year 1987.



Source: Bureau of Census, Statistical Abstract of the United States 1989.

Between fiscal years 1981 and 1988, the Department of the Interior's grants to Palau totaled about $90 million, $84 million of which was to support government operations. The remaining $6 million came from grants from Interior's enhanced operations and maintenance program, which provided funds to maintain infrastructure, and from its technical assistance program, which is intended to improve government operations and capabilities.

As a trust territory, Palau is also eligible to receive program grants from other federal agencies, and since 1981 it has received about $36 million

in health, education, energy, and other federal program grants. According to an Interior official, prior to fiscal year 1987 these other federal program grants were made available to Palau through the TTPI government. However, since then, most of these grants have been made directly to the government of Palau.

In addition, the United States has financed the construction of about $29 million in capital improvement projects, such as education and health facilities, roads, docks, and utilities. Capital improvement projects are intended to provide facilities for basic services and to promote economic development. Generally, these projects have been managed and administered by the TTPI government and the Navy's Officer in Charge of Construction in Guam.

The United States also provides Palau, free of charge, the services of the U.S. Postal Service, U.S. Weather Service, and the Federal Aviation Administration. In addition, citizens of Palau are eligible to receive post secondary education grants to attend schools of higher education in the United States.

Views on the Adequacy of Funding

Interior's policy since 1981 has been to provide Palau with a relatively constant level of funds for government operations, in anticipation that Palau would finance increased government expenditures with local revenue. Interior officials have repeatedly warned Palau of the need to reduce expenditures or to generate additional local revenues. Interior believes it has provided adequate funds and that Palau's budget problems have been of its own making. Our review of Palau's financial management practices disclosed that Interior's concerns about Palau's ability to wisely manage U.S. funds are justified, given Palau's widespread internal control weaknesses.

Some Palauans believe that federal funding has been inadequate and that the United States is partially responsible for their country's growing financial problems. Certain Palauan officials have criticized Interior's funding policy as failing to consider Palau's growing needs and as inadequate to finance basic government services. Additionally, some Palauan legislators believe the United States has not provided sufficient funds for capital improvement projects needed to spur economic development. For example, although the United States has made available approximately $10 million for the construction of a new hospital in Palau, Palauan officials believe they need a larger facility that will cost about $20 million.

Compact of Free Association Assistance

The compact will provide Palau with U. S. economic and program assistance for 15 years after implementation; however, it will replace the assistance that Palau has received under the trusteeship. Approximately 80 percent of the financial assistance included in the compact carries a pledge of the full faith and credit of the United States. Were the United States in any year to fail to provide the annual amount covered by the pledge, Palau would be able to seek relief in the U.S. Claims Court which is granted jurisdiction for such purpose. Because it provides a guaranteed level of financial assistance, the compact will remove the uncertainty associated with Palau's annual budget request to the United States and facilitate long-term planning.

Under Title 2 of the compact, Palau will receive about $478.1 million in financial assistance from the United States through annual and one-time grants and the extension of some specific federal programs. Recurring economic assistance, over 15 years, will total approximately $319.4 million for general government operations, health and education programs, communications, and energy production. Palau will also receive one-time grants of $5.5 million for future defense rights and about $46 million[1] for capital improvements. The compact and a related subsidiary agreement also obligates the United States to construct a 53-mile road on the island of Babelthuap but does not grant funds to Palau for this purpose. However, the road represents a significant capital improvement to Palau. We estimate that it will cost about $36.9 million, based on Interior's budget estimate for a 6-year construction plan. The United States also will establish a $70-million investment fund for Palau, from which it will receive a minimum annual distribution of $5 million during years 5 through 15 of the compact. The goal of the investment fund is to produce an average annual distribution of $15 million for 35 years, commencing on the 15th anniversary of the compact, when its financial assistance provisions cease.

Table 4.2 summarizes federal economic assistance under the compact over the 15 years. Funding for government operations, energy, communications, and capital improvements, will be subject to an inflation adjustment. We calculated the adjustment for these programs using 1989 as the first year of compact implementation. Except for the Babelthuap road, our summary includes only federal assistance identified in the compact with specific funding levels.

[1] Includes inflation adjustment.

Table 4.2: Palau's Estimated Compact Receipts Dollars in Millions

Federal Economic Assistance	Projected 15-Year Total
Recurring Assistance	
Government operations and maintenance	$120.00
Energy production	28.00
Communication system acquisition and operations	3.75
Maritime enforcement, medical referral, and scholarship	9.47
Start up funding—maritime enforcement	.67
Distribution from investment account	55.00
Education and health care	38.70
Inflation[a]	63.84
	319.43
Capital Improvements:	
Capital improvement account	36.00
Inflation[a]	10.24
Babelthuap road estimate	36.92
	83.16
Future Defense Rights:	5.50
Investment Account:	70.00
Total	**$478.09**

[a]Calculated according to compact provisions, using April 1988 assumptions for the U.S. Gross National Product Implicit Price Deflator; inflation adjustment applies to compact funds for general operations, energy, communications, and capital improvement account.

The compact also extends other federal assistance but does not specify funding levels. For example, Palau will continue to receive, free of charge, the services of the U.S. Postal Service, U.S. Weather Service, and the Federal Aviation Administration. Interior's technical assistance grant program will also continue to be available. Although eligibility for many federal program grants is intended to be phased out during the first 3 years of the compact, several will be extended for 15 years. The subsidiary agreement signed on May 26, 1989, states that the United States and Palau shall enter into an agreement identifying whether and what federal program assistance shall be continued to offset any anticipated economically adverse circumstances.

Views on the Adequacy of Compact Funding

Although over half of Palauan voters have supported the compact in six referenda, some Palauans believe the assistance is not adequate and needs to be improved. For example, during our November 1988 visit,

some Palauan legislators stated they would not support compact implementation unless the United States agrees to provide more generous funding, and they cited the following problems.

- The compact does not provide adequate compensation in the event the United States exercises the defense rights provisions and uses privately owned land for military purposes. Land owners should be guaranteed fair market value for any land acquired for military purposes.
- The compact phases out Palau's eligibility to participate in many federal programs over 3 years; it should allow Palau to continue being eligible to participate in a wide range of federal programs for 15 years.
- The compact does not provide sufficient funds for capital improvements; it should include additional funds to help address deficiencies in Palau's infrastructure resulting from inadequate funding during the trusteeship. For example, the United States should provide adequate funds to construct a jail and hospital and help to settle the government's IPSECO debt.

Officials of the Departments of the Interior and State believe that compact funding levels are adequate to support Palau's government and stimulate economic development following the trusteeship's termination. These officials noted that the compact does not preclude the United States from increasing funding levels or extending Palau's eligibility for federal programs after the compact is implemented. Although State Department officials believe the existing level of funding in the compact is adequate, as a result of a compromise reached with congressional committees in the closing hours of the 100th Congress, the Department plans to take administrative action or seek appropriations for funds totaling up to $9.3 million to meet additional high-priority needs not specifically included in the compact, such as additional hospital funding. This and other planned actions included in the new subsidiary agreement signed on May 26, 1989 should help to address Palauan concerns.

Comparison of Trusteeship and Compact Funding

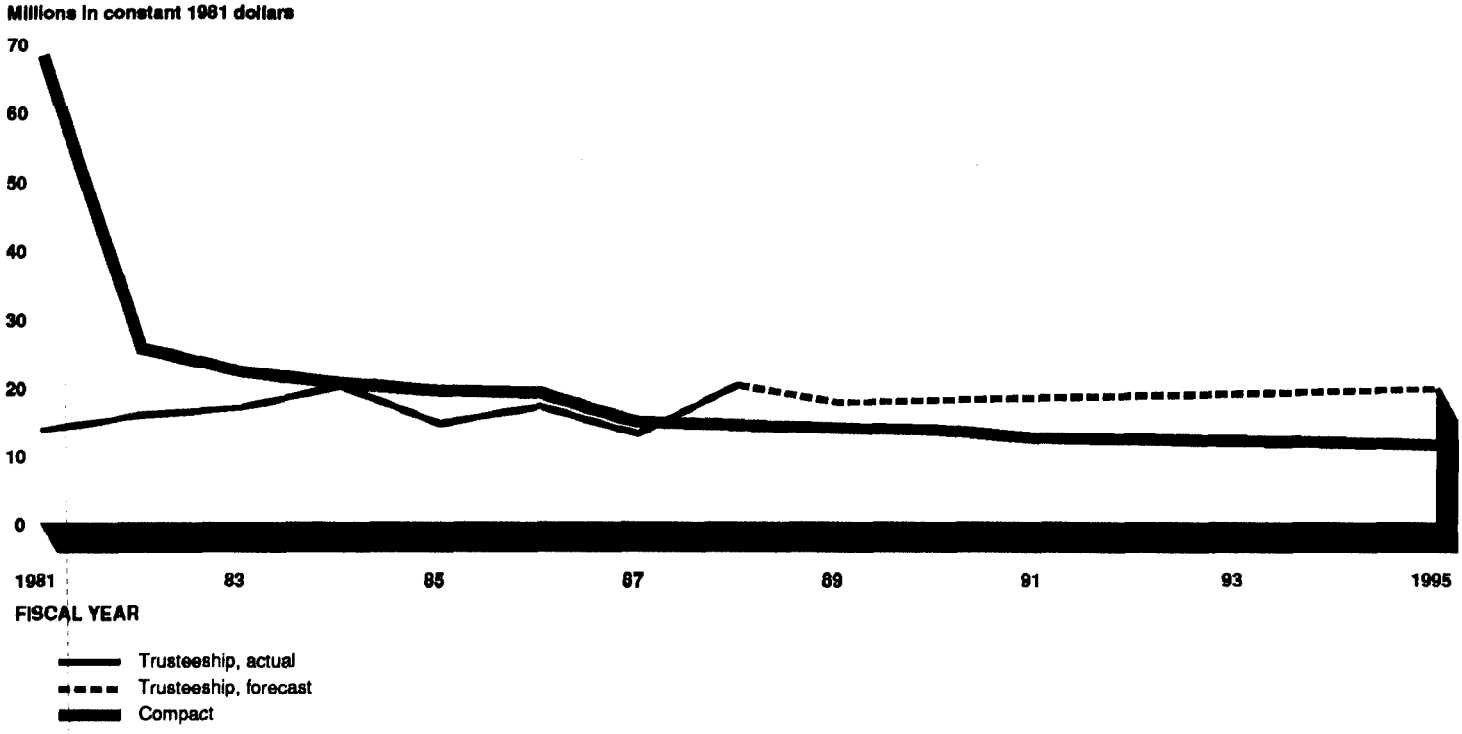
Using the compact and historical U.S. funding data, we estimated the 15-year flow of funds to Palau under the compact and under a continued trusteeship status. Because U.S. funds will be distributed over 15 years and because of changes in the value of money over time, we converted the flow of funds for both funding packages into present values for a more valid comparison of the two funding packages. Present value also permits a comparison of the funding packages for different compact implementation years. First, we calculated the present value using 1981 as the year of compact implementation because 1981 is the base year for

funding amounts specified in the compact. Once the compact is implemented, some funding provisions will be partially adjusted for inflation from 1981. Second, we calculated the present value using 1989 as the initial year of compact implementation.

Our projections for the 15-year flow of funds to Palau under the compact are based on assistance amounts identified in Title II of the compact, and summarized in table 4.2. We converted these amounts to 1981 constant dollars and calculated the flow of funds for 1981-95. We did not include the $70-million capitalization of the investment fund. The goal of the fund is to produce a $15-million annual distribution to Palau for 35 years beginning in year 16 when compact assistance ceases. Furthermore, Palau will receive a minimum annual distribution of $5 million during years 5 through 15 of the compact. This is included in our analysis. In our opinion, including the fund's principal would overstate the 15-year flow of compact funds. Also, we did not include federal programs and services for which funding levels are not specified in the compact.

To estimate the flow of funds that the United States would provide if the trusteeship remained in effect during 1981-95, we used the flow based on actual funding to Palau for fiscal years 1981-88, as described in table 4.1. Thus, our calculation for the first 8 years of trusteeship funding reflects actual funding converted to constant 1981 dollars. We calculated the average real growth of actual trusteeship funding over this period at 1.8 percent per year and used this figure to project funding levels for fiscal years 1989-95, which we then also expressed in constant 1981 dollars. Figure 4.2 shows the result of our flow of funds analysis.

Figure 4.2: Estimated Flow of U.S. Funds Received by Palau- Compact Versus Trusteeship



As shown, annual federal funding to Palau under the trusteeship is estimated to be evenly distributed with a slow real growth increase of about 1.8 percent per year. On the other hand, under the compact, a large share of federal funds will be provided to Palau during the first year of implementation, with subsequent compact payments decreasing over the remaining 14 years. Because such a large percentage of funds will be provided to Palau during the first few years, Palau must manage these funds wisely if it expects to have sufficient funds to operate its government in later years.

Table 4.3 summarizes the present values of the two funding packages based on different compact implementation dates.

Table 4.3: Present Value of Total Estimated U.S. Funds to Be Received by Palau - Compact Versus Trusteeship Millions in Constant 1989 Dollars

	Funding Level	
Implementation Year[a]	Compact[b]	Trusteeship
1981	$268.4	$202.4
1989	247.7	262.2

[a]Discount rates of 11.9 percent and 9.2 percent were used for the 1981 and 1989 analyses, respectively.

[b]Does not include the initial $70-million capitalization of the investment account.

Our analysis shows that the present value of the compact, as negotiated in 1981, is $268.4 million expressed in 1989 dollars. This is $66 million more than the $202.4-million present value of funds we project Palau would have received under the trusteeship during the same period.

However, because funding levels specified in the compact are not adjusted fully for inflation and trusteeship funding is estimated to increase by 1.8 percent more than inflation each year based on our calculation of real growth that occurred between fiscal years 1981 and 1988, compact funding is now less generous than we project Palau would receive if trusteeship funding were continued for the next 15 years. Assuming the compact is implemented in 1989, we estimate the present value of compact funds at $247.7 million, $14.5 million less than the $262.2-million present value of funds we project Palau would receive if the trusteeship were to continue from 1989 to 2003[2]. As noted earlier, the State Department plans to take administrative actions or seek appropriations to obtain up to $9.3 million in additional funds for Palau. Furthermore, the new subsidiary agreement to the compact signed on May 26, 1989, which would change annual payments for energy production to a single payment, would increase the present value of the compact. These actions would largely offset the difference in estimated present values of the funding packages.

[2]The present value of the compact, were it implemented in 1989, is not statistically different from the present value of the estimated trusteeship at a 95-percent confidence level. On the other hand, the present value of the 1981 negotiated compact exceeds the present value of the estimated trusteeship at a statistically significant 97.5-percent confidence level.

Law Enforcement Issues

Under the trusteeship agreement, the United States is responsible for protecting the rights of all Palauans and for controlling drug and arms trafficking. Throughout most of the trusteeship, the TTPI government had authority to investigate crimes and crimes were prosecuted in the TTPI court system. In 1979, while retaining all authority necessary to fulfill U.S. trusteeship obligations, Interior delegated to Palau the responsibility for administering most of its government functions, including maintaining law and order. Palau assumed this authority in 1981 when its constitution took effect.

Palau's law enforcement officials, however, were not prepared to meet their new responsibilities without assistance. Interior and U.S. law enforcement agencies have provided Palau's public safety officers with technical and investigative assistance[1] and training in basic investigative techniques and police procedures. However, cultural constraints, lack of experience and funding, unfilled key enforcement positions, and the need for further training and assistance from U.S. law enforcement agencies and Interior continue to hinder Palau's overall law enforcement capability. During Palau's ongoing transition from trust territory to freely associated state, the roles of U.S. law enforcement agencies in Palau have not been clearly defined and the resulting uncertainty has affected the dependability and type of law enforcement assistance provided to Palau. Also, Palau's officials have limited resources to handle such criminal problems as drug trafficking.

Interior's Authority and Role in Palau

The trusteeship agreement requires the United States to promote Palau's self-government while also (1) protecting the rights and fundamental freedoms of all elements of the population without discrimination, (2) controlling drug and arms trafficking, and (3) instituting regulations necessary to protect inhabitants from social abuse. The agreement permits the United States to apply U.S. laws when deemed appropriate to fulfill its responsibilities. Under Secretarial Order 3039, Interior delegated responsibility to the Micronesian governments for administering most government functions, which in effect included maintaining law and order and administering justice. It also retained "all authority necessary to carry out the obligations and responsibilities of the United States" under the trusteeship agreement. Under Secretarial

[1]Investigative assistance includes questioning witnesses, reviewing evidence, and offering advice and consultation; technical assistance includes arranging for or providing laboratory tests, ballistics analyses, and equipment and supplies.

Order 3039, the Trust Territory High Court retained jurisdiction by writ of certiorari[2] to entertain appeals from Palau's court of last resort.

Secretarial Order 3119, dated July 10, 1987, superseded Order 3039 and essentially preserved Interior's broad authority to carry out U.S. responsibilities and obligations under the trusteeship but further diminished the role of the Trust Territory High Court. Under this order, the High Court retains only limited functions, and absent an amendment to this order, criminal prosecutions for violations of Palau's law generally can no longer be appealed by writ of certiorari to the Trust Territory High Court.

We believe that if events in Palau endanger the U.S. trusteeship obligations, Interior has the authority to take administrative action, such as more directly asserting its current authority under Order 3119 or redelegating to itself whatever authority it deems necessary. Interior officials stated that Interior, under its existing authority, can independently investigate alleged criminal activity in Palau. They said that Interior's Law Enforcement Coordinator for Micronesia can conduct investigations at the request of the Deputy Assistant Secretary of TIA and that Interior's Inspector General investigators have authority to conduct investigations. The Assistant Inspector General for Investigations told us that his office has conducted some investigative work in Palau but not full-scale investigations because the U.S. Attorney for Guam and the Northern Mariana Islands told him that the U.S. Attorney has no jurisdiction in Palau. For example, his office gathered some information on the IPSECO power plant project but did not pursue an investigation because there is no avenue for prosecution.

TIA officials stated that they have regarded Palau as self-governing since its constitution took effect in 1981, and TIA's policy is to provide training and technical assistance to enhance Palau's law enforcement capabilities rather than to conduct independent investigations. Interior's Law Enforcement Coordinator for Micronesia arranges for training and may provide or arrange for investigative assistance when the government of Palau requests assistance.

[2]A writ of certiorari is a writ issued by a superior court to an inferior court of record requiring the certification and return of the record and proceedings so that the record may be reviewed and corrected in matters of law.

Law Enforcement in Palau

It appears that the Micronesian governments' law enforcement capabilities were not adequately developed when their constitutions took effect; however Interior has provided training and technical assistance in recent years to improve these capabilities. Although Palau public safety officers have demonstrated that they understand basic investigative techniques, they still rely on U.S. assistance in more difficult cases.

Palau's Law Enforcement Capabilities Are Limited

Numerous factors work together to constrain Palau's law enforcement capabilities. Public safety officers are inexperienced and must perform their responsibilities in a closely knit, interrelated society and are expected to enforce Palau statutes that may adversely affect family members or conflict with tradition. For example, clan chiefs have retained some power and public safety officers may be reluctant to enforce a law that would have a negative impact on these traditional leaders. Inadequate funding caused by competing priorities in the Palau budget has constrained purchases of supplies and equipment, such as drug testing kits, replacement parts for patrol cars and motorcycles, and reliable radios, according to the Public Safety Director, and has prevented Palau from hiring trained customs officers to intercept drugs and arms entering the country through the airport. Finally, a U.S. official said that more aggressive leadership is needed to enhance the performance of public safety officers. The supplement to this report contains additional information on Palau's law enforcement structure.

We noted problems in Palau's handling of narcotics cases. According to public safety records, officers initiated 37 narcotics investigations in 1987 and 1988. The records identified 22 of these cases as still under investigation as of November 1988, and 15 as referred to the Palau Attorney General for prosecution. Two of these 15 cases had resulted in convictions and 1 had been scheduled for trial. Also, 4 cases were delayed because Palau does not have the facilities to test illegal drugs and relies on the Guam police lab for testing. Palau officials wait 3 to 4 months for test results and have, on occasion, temporarily dismissed cases until the results arrive. In the remaining 8 cases, we found numerous discrepancies between Bureau of Public Safety and Attorney General records, including 2 cases that were lost in the referral process. An official in the Attorney General's office said prosecution of 3 of the 8 cases was delayed due to insufficient evidence and inadequate control over existing evidence.

Interior's Efforts to Strengthen Law Enforcement

The United States has been responsible for developing local police departments capable of enforcing the law and supporting their governments upon independence, according to a 1983 memo written by an Interior official. Until 1984, the TTPI funded a bureau to conduct investigations, provide technical assistance, and coordinate training for the Micronesian governments. The three-man staff was responsible for a large geographic area and could focus on only the most serious criminal problems, according to a report resulting from a 1982 law enforcement conference sponsored by Interior. In 1983, 4 years after responsibility for self-government was delegated to the Micronesian governments, an Interior memo concerning the TTPI law enforcement program stated that (1) the United States had not accomplished its law enforcement mandate, (2) leadership in the local police departments was weak, and (3) these departments were not strong enough to support independent governments. One Interior official expressed the view that the TTPI government provided law enforcement services to the Micronesian governments until their constitutions took effect and then Interior abruptly delegated law enforcement responsibilities to the unprepared governments.

In 1983, the TTPI government initiated a technical assistance program to strengthen Micronesian law enforcement capabilities, which included developing a multi-year training plan. This 1983-87 plan focused on providing Micronesian law enforcement personnel with basic skills, such as report writing and evidence collecting. The fiscal years 1988-90 training plan developed by Interior continues to emphasize basic skills and also includes specialized training in anti-drug programs and white collar crime. Recently hired public safety officers attend the annual Micronesian Public Safety Academy, a regional training program funded through Interior's technical assistance program with support from three participating Micronesian governments, including Palau. A total of 41 public safety officers from Palau have attended the academy since it was established in 1983. U.S. law enforcement agencies, including the DEA and FBI, provide training through the academy and the FBI also provides training directly to Palau. Interior also helped form and fund the Micronesian Chiefs of Police Association to provide evaluations and recommendations for the regional training.

In October 1987, Interior began funding a Law Enforcement Coordinator to arrange for regional training and to give technical assistance to the Micronesian governments. Also, since June 1988, Interior has funded an advisor through technical assistance grants to work directly with Palau's Bureau of Public Safety for 2 years. The advisor monitors the

Bureau's daily operations and has developed a plan to upgrade law enforcement in Palau. The plan calls for revising minimum requirements for new hires, computerizing all records, and appointing a full-time training officer.

Palau Still Relies on U.S. Assistance in Some Cases

Some FBI and Interior officials told us that Palau's public safety officers are now capable of handling routine law enforcement matters but rely on U.S. direction and assistance in non-routine cases that require sophisticated investigative techniques, are politically sensitive, or pose a conflict between police procedures and cultural norms.

We reviewed five non-routine politically sensitive investigations conducted by Palau public safety officers and found that, in general, the officers demonstrated an understanding of basic investigative techniques. In all five cases, they visited the scenes of the crimes, interviewed witnesses, collected evidence, and arranged for ballistics analyses when appropriate. FBI and Interior officials assisted Palau in three of these five cases. The supplement to this report includes a detailed description of the five non-routine politically sensitive cases we examined. When U.S. assistance is not consistently available, problems can occur. For example, in the investigation of an apparently politically motivated murder committed in 1987, Palau's public safety officers have not interviewed the prime suspects, have been accused of a lack of aggressiveness by Palau's Attorney General, and no longer have officers assigned to the case.

U.S. Law Enforcement Agencies' Authority Is Limited and Not Clearly Defined

Palau's prolonged transition from trust territory to freely associated state has created an environment where the roles and responsibilities of U.S. law enforcement agencies are not clearly defined. Title 48 of the U.S. Code authorizes Interior to request assistance from U.S. agencies and Executive Order 11021, dated May 9, 1962, requires federal agencies to cooperate with Interior in implementing the terms of the trusteeship agreement. The U.S. law enforcement agencies included in our review agree that they have authority to send personnel to Palau to provide training and they have also provided some technical assistance. However, the Justice Department has not authorized the FBI to provide even basic investigative assistance requested by Palau in 1987, thus creating a gap in needed law enforcement assistance. Also, U.S. agencies have differing views on the applicability of U.S. laws in Palau and therefore on U.S. authority to conduct investigations or make arrests there.

Applicability of U.S. Laws According to Interior, Justice and State

U.S. agencies disagree on the applicability of U.S. criminal law in Palau when the law does not specifically refer to the trust territory or Palau. According to a memorandum prepared by Interior's Office of the Solicitor, U.S. criminal laws generally apply to Palau because, as provided by the trusteeship agreement, Palau is subject to the jurisdiction of the United States. However, consistent with its policy of non-intervention, Interior does not conduct independent investigations in Palau or involve U.S. law enforcement agencies unless requested by Palau. When requested by Palau's officials, Interior's Law Enforcement Coordinator may provide advice and investigative assistance, or Interior may request assistance from U.S. law enforcement agencies.

The Justice Department maintains that Palau is not within the special territorial jurisdiction of the United States and thus U.S. criminal laws do not apply there unless Congress specifically intends them to apply. In a March 1989 letter and accompanying memorandum to the U.S. Attorney for Guam and the Northern Mariana Islands, Justice noted that while the United States has the power under the trusteeship agreement to apply its laws to Palau if it would further the goals of the trusteeship, Justice believes that the agreement "was not intended to effect a wholesale transfer of United States criminal laws to activities occurring in Palau."

The State Department's position on jurisdiction is similar to that of Justice. State maintains that U.S. laws apply only when Palau is specifically included by U.S. statute, regulation, or administrative action. According to State, federal intervention in matters of Palauan criminal law or the superimposition of U.S. law onto Palau's legal system would "reverse fifteen years of legal procedure and require new regulatory, and possibly even statutory measures, to clarify legal relationships between United States and Palauan governmental entities."[3]

There has not been a specific court decision on the general applicability of federal criminal laws to Palau. However, in Gale v. Andrus[4], the court stated that U.S. laws do not automatically apply to the trust territory unless they are specifically made applicable by the Congress.

[3]This statement was taken from a March 1988 letter from Assistant Secretary of State, Legislative Affairs.

[4]Gale v. Andrus, 643 F.2d 826, 830 (D.C. Cir. 1980).

The U.S. anti-drug laws (21 U.S.C. 802(26), 951(b)) apply in Palau because Congress made them specifically applicable to the trust territory. In these laws, the trust territory is treated as a state, and Interior and all U.S. law enforcement agencies we spoke to about anti-drug laws agreed that these laws apply to Palau.[5]

Arrest Authority and Court Jurisdiction

In the circumstances where U.S. law applies in Palau, officials disagree over how law enforcement authorities could obtain custody of the offender and where the prosecution could occur. Palau is not within the jurisdiction of any U.S. federal district court, but Interior maintains that suspects arrested in Palau by U.S. law enforcement agencies for violations of applicable laws can be prosecuted in the nearest U.S. district court, which is Guam. However, in November 1988, the U.S. Attorney for Guam told us that he did not believe he had authority to order investigations or to prosecute for violations of U.S. law in Palau, including violations of the U.S. anti-drug laws, unless the violation also includes an area under his jurisdiction—Guam or the Northern Mariana Islands. In its March 1989 letter and memorandum to the U.S. Attorney for Guam, Justice suggested that the U.S. Attorney could prosecute for violations of U.S. law committed in Palau once an offender is brought to Guam. However, this would be difficult because, according to Justice, U.S. law enforcement officials do not appear to have the power to make arrests in Palau and must depend on the cooperation of the Palauan government to obtain custody, with minor exceptions. Subsequently, Justice Department officials informed us that the letter and memorandum primarily relate to U.S. criminal laws that do not specifically apply to Palau. They said that Justice has not yet determined whether U.S. law enforcement agencies have authority to conduct investigations and make arrests in Palau when U.S. criminal laws, such as the anti-drug laws, specifically apply to Palau or the trust territory.

We agree that the U.S. Attorney for Guam and the Northern Mariana Islands does not have authority to order investigations in Palau for violations of U.S. laws involving only Palau. The authority of U.S. attorneys to order investigations generally is limited to the districts for which they were appointed. Thus the U.S. Attorney for Guam and the Northern Mariana Islands generally would be authorized to order investigations only of violations of U.S. law that involve those two districts.

[5]In addition to the anti-drug laws cited above, section 9307 of the Anti-Drug Abuse Act of 1988, P.L. 100-690, 102 Stat., 4181, 4538, authorizes specific U.S. law enforcement agencies to investigate violations of U.S. criminal laws applicable in Palau at the request of the Palauan President.

We also believe that under U.S. anti-drug laws and any other criminal laws specifically applicable to Palau or the trust territory, other U.S. law enforcement officials have authority to investigate and make arrests in Palau for criminal drug activity conducted solely in Palau. Once a law is made specifically applicable to Palau or the trust territory, Palau is within U.S. jurisdiction for that purpose, and U.S. law enforcement officials would have authority to investigate and make arrests there in substantially the same manner as they do in other parts of the United States.

DEA and U.S. Drug Laws

Since U.S. anti-drug laws do apply in Palau, DEA officials told us that they have authority to independently investigate and make arrests[6] for violations of this law in Palau, including violations that involve activities solely in Palau and those that extend beyond Palau to other areas under U.S. jurisdiction. Palau's Attorney General agrees that the DEA has this authority.

However, the DEA has one agent in Guam who only investigates drug cases related to Palau if they involve transshipment and reach beyond Palau. DEA's policy is to conduct investigations in Palau in cooperation with the government of Palau. Palauan law (34 PNC 3301 and 3302) prohibits the possession or trafficking of controlled substances, including marijuana and heroin, and DEA expects Palau's law enforcement officials to investigate and prosecute local drug use and sales. DEA officials stated that this policy parallels the relationship the DEA has with U.S. state and local authorities, who prosecute many drug violations under their own laws.

FBI's Assistance to Palau Has Decreased

Questions about jurisdiction have adversely affected the FBI's role in assisting Palau. FBI agents told us that they act as though U.S. criminal laws, except drug laws, do not apply in Palau and that FBI assistance is guided by Executive Order 11021, which requires federal agencies to cooperate with Interior in fulfilling U.S. trusteeship obligations. In 1985, at the request of the TTPI, the FBI helped Palau investigate the assassination of President Haruo Remeliik. This assistance included investigative advice from two agents assigned to the case, polygraph exams, and laboratory analyses. This case was prosecuted in Palau's judicial system.

[6]DEA officials made this statement prior to the release of Justice's March letter and accompanying memorandum to the U.S. Attorney in Guam, which questioned U.S. officials' arrest authority in Palau.

Congressional concerns subsequently were expressed regarding the role of the FBI and the fact that the accused were not afforded a trial by jury.

In October 1987, Palau and Interior requested similar FBI assistance in the investigation of an apparently politically motivated murder. The FBI sought clarification from Justice on the nature and permissible extent of FBI assistance in this matter. FBI and Justice officials met with Interior in November 1987 to discuss the request, and Justice agreed to research FBI jurisdiction in Palau. FBI officials stated that Justice has not responded to the FBI's request for clarification of its authority to provide investigative assistance in this case. Therefore, although the FBI's Washington headquarters provided ballistics and fingerprint analyses, the FBI has not provided any agents to assist Palau in this investigation. This murder case remained unsolved as of November 1988, and Palau's public safety officials have been criticized for their handling of the case.

Although the FBI has concurrent jurisdiction with the DEA over drug matters, FBI agents have not worked drug cases in Palau on their own or with the DEA due to uncertainty about their authority there, according to FBI and DEA field agents. Officials at FBI headquarters stated that it is FBI policy to limit drug investigations to cases involving major drug trafficking organizations, and that even if the FBI clearly had authority in Palau, Palau cases would probably not meet this criteria.

Secret Service and U.S. Counterfeiting Laws

The Secret Service maintains that U.S. counterfeiting laws (18 U.S.C. 471, 485) do not apply in Palau because these laws specifically do not include Palau or the trust territory. This is consistent with the views of State and Justice. When counterfeit U.S. notes were found in Palau in 1987 and 1988, Secret Service agents provided laboratory analyses and expert testimony, but did not conduct an independent investigation. A Palauan legislator who requested assistance in addressing counterfeit note circulation believed that the Secret Service had the authority to and should have investigated the matter.

U.S. Law Enforcement Assistance Under the Compact

When the compact takes effect, Palau will still be eligible to receive law enforcement training and technical assistance from Interior and other federal agencies. Future training to be provided is spelled out in multi-year plans and is based on needs identified by Interior and input from the recipient government.

Under the compact, U.S. laws generally will not apply in Palau, including the anti-drug law, which only applies to Palau as a trust territory. Joint law enforcement activities will be governed by subsidiary agreements to the compact that provide the framework for cooperation in preventing, investigating, and prosecuting crimes. The agreements authorize U.S. assistance, including training, funding, criminal investigative support, and forensic laboratory services. Palau may request U.S. assistance in conducting investigations, but the United States may not require Palau to conduct particular investigations or insist on U.S. participation. The agreements' effectiveness will depend largely on whether and to what extent (1) Palau requests and uses assistance and training and (2) Interior and U.S. law enforcement agencies respond to Palau's requests.

Special Law Enforcement Concerns

At the request of the House Committee on Interior and Insular Affairs, we developed information on the presence of and efforts to control arms use and trafficking, the circulation of counterfeit notes, and drug use and trafficking in Palau. Firearms are present in Palau, but U.S. and Palau officials have no evidence of arms transshipment through Palau. The Secret Service and Palau officials identified three instances of counterfeit note circulation in 1987 and 1988 warranting investigation by Palau's law enforcement officials. Reportedly, heroin is available in small quantities and marijuana is plentiful in Palau. We include information on drug use and trafficking in this chapter because their presence can have a more significant negative impact on Palau. The supplement to this report contains additional information on counterfeiting and firearms, and on drugs.

Illegal Drugs in Palau

Even small quantities of illegal drugs can have a negative impact on Palau, with its small population and its nascent law enforcement system. DEA has only one agent in Guam, and the efforts of Palau public safety officials to address the drug problems are hampered by inexperience and a lack of resources.

Views on the magnitude and seriousness of Palau's drug problem varied. Although the DEA Administrator estimated in an October 1987 letter that there were over 400 heroin addicts in Palau and that Palau was a transshipment point for heroin smuggled from Southeast Asia to the United States, U.S. law enforcement officials in Washington and Hawaii stated that the volume of drugs transshipped through Palau is insignificant relative to the overall U.S. drug problem. Also, DEA agents and Palau law

enforcement officials believe that 400 addicts is too high an estimate. The DEA agent in Guam said that the DEA Administrator's estimate of 400 addicts was not an independent estimate but was based on a single conversation between a former agent and a Palau legislator. Palau's Attorney General stated that the number of heroin users fluctuates according to the availability of heroin. According to a DEA agent, Palau public health and safety officials estimated that there were 100 to 150 addicts in Palau in November 1987. One year later, the same officials told us that the availability of heroin had decreased and estimated that there were 40 to 60 addicts in Palau. Officials offered varying reasons for the decrease, suggesting that it may be due to increased efforts by Palau law enforcement officials or the focus on Palau resulting from the highly visible compact approval process. Even with these lower estimates, Palau's Public Safety Director expressed the opinion that drugs are a problem in Palau. Also, key legislators stated that they believe drugs pose a serious problem for Palauan society.

Marijuana is grown in Palau and is readily available. However, Guam Customs, DEA, and Palau officials could not estimate the amount grown or exported.

In March 1987, Palau created a narcotics task force. Some officials believe this task force helped to reduce the amount of heroin available in Palau, but its effectiveness has been limited by delayed prosecutions pending receipt of drug tests from Guam and errors reflecting the inexperience of public safety officers, such as insufficient and poorly controlled evidence. Also, Palau does not have trained customs officers at its airport. Although revenue agents and agricultural inspection officers are stationed there, they are not trained to detect drug trafficking and cannot make arrests. Public safety officers are assigned to the airport during flight arrivals, but they do not have authority to open and inspect baggage and cargo without search warrants or probable cause, according to Palau's Public Safety Director. In 1987, the Director recommended to the Minister of Justice that action be taken to solve this problem. According to a subsidiary agreement signed by U.S. and Palau officials in May 1989, (1) the United States will provide up to $400,000 annually for 5 years for narcotics enforcement and drug abuse treatment programs, (2) Palau will employ customs officers who will be trained and equipped to detect narcotics, and (3) Palau may request drug enforcement assistance from U.S. law enforcement agencies on a long term or case-by-case basis. To prevent an increase in heroin availability, law enforcement officials must maintain constant pressure on drug traffickers, according to the Assistant U.S. Attorney for Guam.

Interior arranges for drug enforcement training through the Micronesian Public Safety Academy. It also allocated $125,000 in technical assistance funds for an anti-drug program for Palau and the freely associated states. This program included a 3-week training course for public safety officers, a public education component, and funds for DEA participation.

The DEA agent in Guam told us that he is unable to do any undercover work in Palau because he works alone and is highly visible. He can, however, request help from the DEA in Los Angeles and Honolulu. DEA officials stated that the decision to assign only one agent to Guam was based on an assessment that the drug problem in the area was less serious than in other DEA regions. The U.S. Attorney for Guam expressed the view that the DEA presence in Guam is inadequate. He noted that although the quantity of illegal drugs there may be smaller than in large cities, the relative impact is equally serious due to the small population. Also, he stated, the sole DEA agent is in a dangerous position due to the lack of available back-up. As previously discussed, FBI agents in Guam do not work with the DEA agent in these cases.

Allegations have been made that public officials in Palau were involved in drug trafficking. On July 11, 1989, DEA agents from Guam and Honolulu, with assistance from other U.S. and Guam law enforcement agencies, arrested 13 persons in Palau on charges related to heroin and marijuana transshipment and distribution, according to the DEA agent in Guam. Two of those arrested are former Palau legislators.

Recommendations

To resolve the current uncertainty about U.S. law enforcement agencies' authority in Palau until the compact is implemented, we recommend that the Attorney General finalize and formally distribute the Justice Department's opinion on federal criminal jurisdiction in Palau to all relevant U.S. agencies. While finalizing his opinion, we recommend that the Attorney General determine whether U.S. law enforcement agencies have authority to conduct investigations and make arrests in Palau for violations of U.S. criminal laws that specifically apply to Palau or the trust territory, such as the anti-drug laws. In this regard, we recommend that the Attorney General consider our view that U.S. law enforcement agencies other than the U.S. Attorney for Guam do have this authority. Also, in our opinion the Attorney General should authorize the FBI to provide investigative assistance to Palau upon request from the Department of the Interior, including providing the assistance requested regarding the 1987 murder.

Problems With 1987 Compact of Free Association Referenda

Before the Compact of Free Association can take effect, Palauans must approve it according to requirements in their constitution. In 1987, Palau's legislature authorized a referendum to amend the constitution, which was intended to reduce the compact approval requirement from 75 percent to a simple majority, and a subsequent referendum on the compact. Both referenda achieved 73-percent voter approval in August 1987. However in 1988, Palau's Supreme Court ruled that the referendum to amend the constitution was null and void because the law authorizing the referendum was procedurally flawed. As a result, Palau's voters have not yet approved the compact.

In July 1987, the President of Palau furloughed two-thirds of Palau's executive branch employees because of a cash shortfall that would have been alleviated by the receipt of compact funds. During the 1987 attempt to implement the compact, actions by the furloughed workers and anonymous threats and intimidation may have influenced some anti-compact legislators' votes on a compact-related bill and appear to have been a significant factor in the withdrawal of a lawsuit challenging the constitutionality of the August 1987 compact approval process. This lawsuit was subsequently refiled and resulted in a Supreme Court decision that nullified the compact approval process.

In addition, Palau's executive branch took some actions that favored compact proponents. For example, we found that the distribution of some compact education and referenda funds favored compact supporters, the President of Palau provided furloughed workers who supported the compact with funds and permitted them to use government vehicles but did not provide similar support to compact opponents, and executive branch officials pressured government employees to support compact implementation by issuing notices instructing employees to campaign for the compact and by permitting the furloughed workers' committee to attach pro-compact notices to government paychecks.

This chapter summarizes problems related to Palau's 1987 compact referenda. The supplement to this report provides additional details on these issues.

Background

Palau's constitution prohibits the use, testing, storage, or disposal of nuclear, chemical, or biological weapons unless approved by 75 percent of the votes cast in a referendum. The compact negotiated by President Salii allows the United States to operate nuclear capable or propelled vessels and aircraft in Palau without either confirming or denying the

presence of nuclear weapons. Before August 1987, Palauans voted on the compact five times, and although a majority voted to implement the compact each time, none of the referenda achieved the required 75-percent popular vote. Opposition to the compact is based on several reasons, such as concerns about the level of funding guaranteed by the compact, the compact's nuclear transit provisions, and U.S. rights to use Palauan land for defense purposes. In 1986, Palau's Supreme Court in effect ruled that U.S. nuclear transit rights included in the compact must be approved by 75 percent of voters.

Palau's executive branch wanted to implement the compact because it would give Palau greater independence and because officials anticipated a cash shortfall during fiscal year 1987 which could have been averted by the receipt of compact funds. After the fourth referendum, compact supporters decided that, if the fifth referendum also failed, they would attempt to reduce the compact approval requirement from 75 percent to a simple majority by amending Palau's constitution.

When the fifth referendum in June 1987 failed, the executive branch furloughed over 900 of more than 1,300 public employees from July 8 until October 1. The furloughed workers conducted a continuous demonstration at Palau's legislature from July 7 to September 30, 1987, demanding that the legislators either obtain funds to end the furlough or support legislation authorizing referenda to amend the constitution and approve the compact.

Legislators' Concerns

Anti-compact senators and delegates informed us that they experienced significant pressure and were subject to intimidation from furloughed workers and other compact supporters while considering legislation to authorize the August 1987 referenda to amend the constitution and approve the compact. Furloughed workers' demonstrations and letters were legitimate vehicles for exercising constitutional rights to assemble and petition elected officials. However, several anti-compact legislators also told us they experienced threats and property damage which may have led them to vote against their consciences in favor of legislation authorizing the referenda.

The Palauan legislature has two houses, a Senate and a House of Delegates. In the summer of 1987, the Senate had a pro-compact majority with 8 of 14 members supporting the Salii-negotiated compact while the House of Delegates had an anti-compact majority with 11 of 16 members opposing the compact. On July 19, 1987, legislators approved a bill,

RPPL 2-30, authorizing two referenda, one to amend the constitution and one to implement the compact.

We met with five anti-compact delegates and three anti-compact senators.[1] These legislators questioned the validity of the legislation and stated that they voted for it against their consciences because they were intimidated by furloughed workers' actions and anonymous threats and acts of violence. These legislators said they received threatening letters and telephone calls and were threatened with physical violence. One legislator said a group of 30 furloughed workers and a pro-compact legislator came to his home and forced him to go to the legislature to vote for RPPL 2-30. Some legislators stated that they suffered property damage to their cars and homes. For example, one legislator told us that a colleague's home was burned and another stated that an arsonist attempted to burn his home. One legislator stated that the tires of his car were slashed in the parking lot of the legislature. Some furloughed workers remained on the legislature's grounds after RPPL 2-30 was passed. On September 6, 1987, bullets were fired at the House Speaker's home. Some anti-compact legislators also alleged that Palau's law enforcement officials did not aggressively investigate these violent acts and threats, did not provide adequate protection, and did not enforce the midnight to 6:00 a.m. curfew in Koror.

Four pro-compact legislators we met with stated that the furloughed workers had a right to present their demands to legislators through letters, meetings, and peaceful demonstrations. Also, executive branch officials said they investigated actions directed against the legislators. Public safety officials, with some investigative assistance from Interior, arrested three suspects who were tried and convicted of the shooting at the House Speaker's home. In February 1988, the Palau Supreme Court Trial Division found three government employees guilty of (1) unlawful use and possession of a firearm, (2) unlawful use and possession of ammunition, and (3) riot. Public safety officers provided police protection to the Speaker and his family from December 1987 to November 1988 after the Chairman, U.S. House Subcommittee on Asian and Pacific Affairs, questioned President Salii about compact-related violence and specifically referred to the need for protection for the Speaker in a public hearing.

[1] We scheduled separate meetings with pro-compact and anti-compact legislators in December 1987 which all legislators were invited to attend.

Challenges to the Approval Process

Some Palauan citizens challenged the constitutionality of the compact approval process through two lawsuits. Both suits alleged that the passage of RPPL 2-30 did not comply with procedures for amending Palau's constitution and that, since this would invalidate RPPL 2-30, the constitutional amendment was null and void. The first suit was withdrawn voluntarily based on an agreement between the Ibedul and former President Salii. In this agreement, the Ibedul agreed to cause the suit to be dismissed and, in return, the President agreed to certain provisions offering land owners some protection against the U.S. military land use rights in the compact.

The second lawsuit was originally filed by 38 female plaintiffs as Ngirmang v. Salii. On September 3 and 8, 1987, 15 women filed motions to dismiss the suit in view of the agreement between the President and the Ibedul. Also on September 8, the remaining plaintiffs failed to appear at the scheduled hearing. The two lead plaintiffs signed a stipulation for dismissal and obtained the signatures of the remaining plaintiffs. A lead plaintiff stated that the government provided a police vehicle with a driver who remained in the vehicle while she went to the plaintiffs' homes to obtain signatures.

We met with 12 of the plaintiffs who signed the stipulation. They stated that they were afraid to pursue the suit because of (1) pressure from the Ibedul, (2) the actions of the furloughed workers, and (3) rumors of impending violence against them. According to these plaintiffs, a busload of furloughed workers visited the homes of several plaintiffs and workers placed pressure on the plaintiffs' families by threatening that violence would occur if the suit was not withdrawn. Although none of the plaintiffs were physically attacked or experienced serious property damage, they said they were frightened by acts of violence that occurred during unscheduled power outages on the weekend preceding the court hearing. These acts included the murder of the father of an anti-compact activist who helped the plaintiffs prepare their complaint, shots fired at the House Speaker's home, and an explosion in a field near a plaintiff's home. Several plaintiffs told us that the Minister of Justice offered to provide them with a police escort to attend the September 8 hearing, but they did not accept this offer because they (1) lacked confidence in the government's ability to protect them, (2) believed that government officials supported the furloughed workers' pressuring them to withdraw the lawsuit, and (3) were afraid that their appearance would cause the furloughed workers to become violent.

Also, 11 of the 12 women said that although they signed the petition to dismiss the suit, they did not read it and thought they were signing a request to postpone the action until they found a lawyer and the violence subsided. In affidavits, several women stated that the policeman assigned to accompany the lead plaintiff in gathering signatures hurried them into signing the document.

In a memorandum, the judge who presided over a hearing to dismiss the suit included a provision to allow the plaintiffs to refile in the event that their decisions to withdraw were based on intimidation. On March 31, 1988, plaintiffs moved to set aside their withdrawal and the court granted the motion on April 5, 1988. The suit was reinstated as Fritz v. Salii due to some changes in persons bringing the action. In April 1988, the Trial Division of Palau's Supreme Court ruled that RPPL 2-30 was not properly enacted and the attendant referendum on amending the constitution was null and void. The Supreme Court Appellate Division upheld this decision in August 1988. Because the attempt to amend the constitution was unsuccessful, the 73-percent voter approval obtained in the August 1987 referendum on the compact was not sufficient to approve the compact.

Executive Branch Actions

Compact opponents alleged that executive branch officials' actions were improper. They allege that these officials (1) furloughed workers and cut services to gain support for compact approval rather than because of financial problems, (2) favored compact proponents, and (3) pressured anti-compact employees into supporting the compact. We found that Palau was experiencing a cash shortfall in 1987 and cost reductions were needed. Although U.N. observers concluded that the June 1987 compact education program was conducted fairly, we found that there were limited controls on the distribution of compact education and referenda funds and that executive branch officials favored compact supporters in the distribution of some of these funds. Also, the executive branch permitted furloughed workers campaigning for compact implementation to use government funds and property but did not provide similar opportunities to compact opponents and, in some cases, pressured government workers to support compact implementation through memoranda and notices instructing them to campaign for the compact.

Efforts to Curtail Expenditures

Palau's President Salii, its auditors, and Interior Inspector General officials agreed that cost reduction measures were needed in 1987. In January 1987, President Salii reduced government expenditures by 20

percent and deferred payment for 8 of each 40 hours worked by government employees. Palau officials requested additional operating funds from Interior, but Interior officials denied the request because they had warned Palau in advance that cost-saving measures were necessary. In July 1987, after the failed fifth compact referendum, the President furloughed over two-thirds of the executive branch employees including employees of some federally funded programs. According to Interior, Palau is responsible for administering federal program funds and, consistent with Interior policy, Palau had authority to use the funds as necessary.

Actions Favoring Compact Proponents

U.N. observers concluded that the June 1987 compact education program was conducted fairly, but compact opponents and supporters expressed conflicting views on this subject. Interior provided a portion of the funds used for compact education and referenda. We found that some of these funds, particularly those provided to individuals, were not subject to adequate control because neither Palau nor Interior imposed strict requirements for their use or accountability. Moreover, distribution of some of these funds favored compact supporters. Records indicate that the executive branch provided Palau's Senate president with $17,000 for compact education in 1987; he said he distributed funds only to pro-compact senators and other individuals. He provided us with copies of 19 canceled checks to various individuals; funds were reportedly used for barbecues and other activities to promote compact support. The Speaker of the House of Delegates, who was an opponent of the Salii-negotiated compact in 1987, told us that the executive branch did not provide him or other anti-compact legislators with compact education funds.

Also, government subsidiary account records show that the chairman of the furloughed workers' committee received a total of $10,000 in August and September 1987. The government of Palau did not require documentation on how these funds were spent. Palau's President also told us he permitted furloughed workers to use government vehicles, and we found one example where furloughed workers used vehicles purchased with U.S. grant funds and intended to be used for authorized program purposes. The vehicles were reportedly returned damaged.

We found several instances where government employees were pressured by letters and notices to support compact implementation or where executive branch actions caused employees who opposed the compact to fear reprisal, possibly conflicting with Palau's public service

regulations. Prior to the December 1986 referendum, government employees were notified in writing that they were expected to vigorously campaign for the compact. This statement was partially retracted when the Minister of State assured employees that the government would not take reprisals against anti-compact employees. However pro-compact employees were permitted to campaign during work hours and to use government property. In August 1987, government workers were notified in writing of a furloughed workers' demonstration and that failure to participate could result in adverse action against them. Finally, a teacher who opposed the compact was transferred to a U.S.-funded grant program. He unsuccessfully contested the transfer, claiming that the program is scheduled to be terminated upon compact implementation.

U.S. Agencies' Responses

Interior adhered to a policy of non-interference during the compact-related events and lawsuits in 1987 and 1988. It did not intervene when Palau's legislature voted on the compact implementation legislation or when Palau's courts ruled on the constitutionality of the amendment referendum. Interior officials said that the violence and alleged intimidation associated with both RPPL 2-30 and the Ngirmang lawsuit were matters to be resolved through Palau's law enforcement system. Interior provided some investigative assistance in the case involving shots fired at the House Speaker's residence.

The President of the United States accepted President Salii's certification that the compact had been approved according to Palau's constitution. State Department officials viewed the violence following the compact vote as an internal matter which Palauans must address. State also said that Palau's Supreme Court should interpret Palau's constitution and that the legal issues raised by the two lawsuits did not justify U.S. intervention. When Palau's Supreme Court ruled that the referendum to amend the constitution was null and void, State accepted this decision.

In view of Interior's prior warnings to Palau to control expenditures, it did not reprogram funds to supply Palau with additional funds during the 1987 service cutback and furlough and it gave Palau officials leeway to select cost-saving measures. Interior did not investigate allegations that compact opponents were treated unfairly and, except for a 1983 audit, did not monitor how funds for compact education and referenda were spent.

Construction of Palau's Power Plant

In May 1983, the Republic of Palau awarded a contract for $27.5 million to IPSECO International Power Systems, Ltd., of London, England, to construct a 16-megawatt power generating plant and a 6-million gallon fuel storage facility. In June 1983, Palau completed the following arrangements with two British banks to borrow $32.5 million to finance this construction.

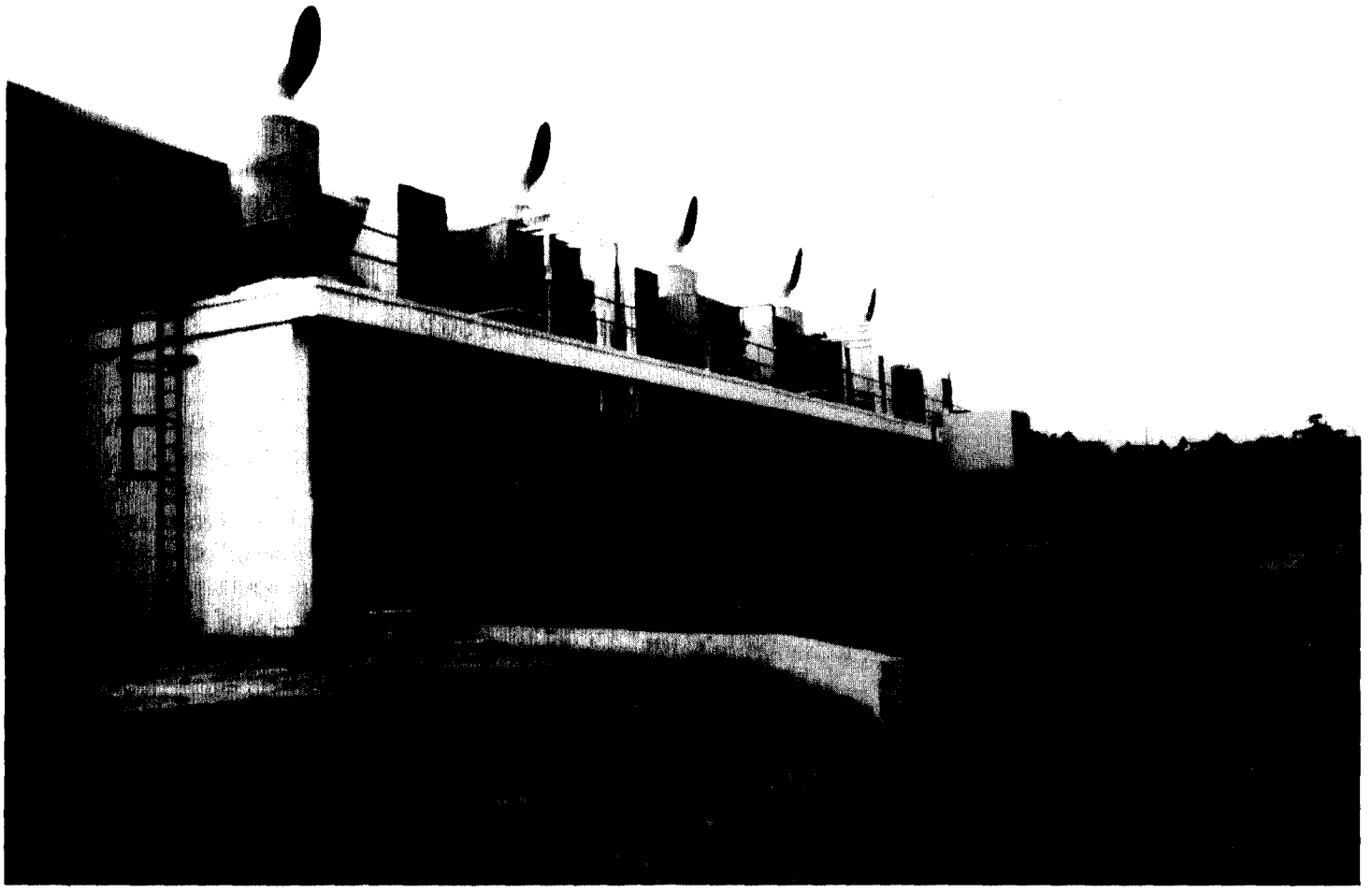
- $24.3 million from National Westminster Bank at 11.25 percent interest, with repayment to be made over 7 years beginning in September 1985.
- $8.2 million from County Bank, Ltd., at 7/16ths of one percent above the floating London Interbank Eurocurrency Market rate, with repayment to be made over 5-1/2 years beginning in March 1985.

The $5-million difference between the contract amount and the amount borrowed was to cover bank fees and costs of delaying interest payments on the loans for almost 2 years. Repayment of the loans was guaranteed by a syndicate of five international banks.

Originally, the power plant/fuel storage facility was to be constructed on the island of Koror. The power plant was to include five engines, each generating 3.2 megawatts of electricity. In September 1983, Palau requested IPSECO to cancel one engine and apply the savings toward costs of preparing the dock area at a new project site to off-load equipment and machinery. This work had to be done because the High Chief of Koror opposed the project and Palau changed the site from the island of Koror to the island of Babelthuap. IPSECO agreed to the request and built the power plant on Babelthuap with four engines having a total capacity of 12.8 megawatts. Construction was completed in 1985, but the power plant did not become operational until one year later due to the lack of a transmission system, for which IPSECO was not responsible.

IPSECO projected that revenues from sales of oil from the fuel storage facility to fishing fleets and merchant ships and sales of electric power to users would enable Palau to make the loan payments. These revenues did not materialize, and Palau defaulted on the loans in March 1985 without making any payments of principal or interest. The guarantors paid off the loans and in December 1985 filed a law suit against the Republic of Palau to recover the loan amounts. In August 1988, the U.S. District Court, Southern District of New York, entered a judgement in favor of the guarantor banks against Palau for about $44 million. Later in 1988, attorneys for Palau requested the trial court to reconsider the judgement.

Figure I.1: Palau's Power Plant



Source: Department of the Interior

Missed Opportunities to Reduce Costs in Meeting Power Needs

U.S. government trustee officials and Palau government officials missed at least five opportunities to reduce power plant costs and mitigate Palau's financial crisis caused in part by its defaulting on the IPSECO loans. There were opportunities for

- Palau and TTPI officials to accept an Army Corps of Engineers proposal to satisfy Palau's short-term electric power needs and assist in planning for long-term requirements;
- Interior and Office for Micronesian Status Negotiations (MSN) headquarters officials to oppose the IPSECO project in light of concerns expressed

by field representatives about Palau's ability to assume the financial burden involved;

- Palau officials to obtain an independent assessment of needs for electric power and fuel storage space, acquire those needs by soliciting competitive bids, and seek better terms for financing project construction;
- TTPI officials, after consultation with Interior officials, to veto Palauan legislation authorizing the waiver of competitive bidding requirements in awarding the IPSECO contract and require Palau to follow sound procurement procedures; and
- MSN and Interior officials to advise prospective lenders about the difficulty Palau would have in making loan payments and U.S. concerns over poor procurement procedures used by Palau.

Proposal to Assist in Meeting Palau's Electric Power Needs Not Accepted

In September 1981, the U.S. Army Corps of Engineers made a proposal to (1) sell Interior a power plant to meet Palau's short-term needs for electricity and (2) provide technical assistance to Palau in planning for long-term requirements. TTPI grant funds were available to accept this proposal, but apparently it was not accepted because of poor communications between officials of the Republic of Palau and TTPI. Palau does not appear to have pressed TTPI about the availability of funds to purchase the Army generators, and TTPI does not appear to have made it clear to Palau that funds were available for this purpose.

The Palauan legislature in a 1979 resolution stated that (1) the supply of electric power in Palau had been limited and unpredictable in the 30 years of U.S. trusteeship, (2) recent mechanical failures had forced rationing of electric power, and (3) efforts to develop economically were paralyzed by deteriorated capital assets, the most serious of which included the electric power system. The legislature asked the TTPI High Commissioner to declare Palau a disaster area with regard to electric power and to take whatever action was necessary to rectify the problem.

On May 16, 1979, Interior asked the Army Corps of Engineers to lend it a 1.5-megawatt power plant (three generators with 0.5-megawatt capacity each) and the Corps agreed to lend this plant to Interior for use in Palau for one year beginning on June 1, 1979. Effective June 1, 1980, and June 1, 1981, the Corps agreed to one-year extensions of the loan.

On July 23, 1981, the President of Palau appointed a task force of six executive branch officials, chaired by the Vice President, to study the power problems and recommend short-term and long-term solutions.

The task force concluded that the Corps power plant was a possible solution to Palau's short-term requirements and recommended that it be retained. On August 10, 1981, the Palauan President asked the TTPI acting Deputy High Commissioner to advise Interior and Corps of Engineers officials that Palau wanted to retain the Army generators after the second loan agreement extension expired in June 1982. As for long-range plans, the Palauan President advised the acting Deputy High Commissioner that Palau had entered into discussions with IPSECO for a facility similar to one it was constructing for the Marshall Islands.

In late August 1981, two members of the task force visited the Marshall Islands to discuss with government officials the IPSECO facility being constructed there. The Marshall Islands officials told the Palauans that IPSECO's project manager was well known in his field and had put together a "package" for the project that included financing. The Palauans visited the project site and concluded that everything appeared to be well organized.

Task force members then met with the IPSECO project manager and his associates to further discuss Palau's needs. IPSECO offered to build a 16-megawatt power plant capable of servicing Babelthuap and Koror and a 6-million gallon fuel storage facility. This fuel would not only supply the power plant but also could be sold at a profit to fishing boats and merchant ships which call on Palau. The proposed construction cost for the entire package was $26.7 million. This amount was later increased to $27.5 million to include a 3 percent gross receipts tax imposed by Palau.

Army Corps of Engineers Proposal

On September 24, 1981, the President of Palau, the TTPI acting Deputy High Commissioner, task force members, and Corps of Engineers officials discussed a proposal for meeting Palau's needs for electric power. The Corps projected that, with Palau's airport expansion program and other needed utility upgrading, Palau needed 5.2 megawatts of electric power. The Corps offered to sell the 1.5-megawatt plant to Interior and to provide professional engineers and technicians to assist the Palau task force in solving short-term power requirements and preparing long-range plans. The cost of the Corps proposal was $490,000. The Corps further projected that by operating the Army plant and existing Palauan units at 80 percent of capacity, Palau would have sufficient capability (5.6 megawatts) to meet its power needs, plus 2.5 megawatts of backup power from older units.

According to a Corps official at these discussions, the Palauans expressed interest in the proposal, and upon returning to Washington, the Corps members briefed Interior officials on the proposal.

On September 29, 1981, the President of Palau issued a letter of intent to award a contract to IPSECO for a power plant and fuel storage facility in accordance with IPSECO proposals. Execution of the contract was conditional on successfully negotiating terms and completing financing arrangements.

On November 4, 1981, the task force on electric power submitted a report to the President of Palau stating that (1) because of the lack of funds the Army had not been formally approached on selling the power plant to Palau and (2) Palau's other generators were overdue for overhaul. Therefore, since its concern about short- term electric power requirements was not fully satisfied, the task force recommended accepting an offer by IPSECO to provide free-of-charge a 3-megawatt mobile generator for temporary use as a backup unit. The task force stated that purchase of the Army generators should be further studied. As for long-range plans, the task force stated that it was negotiating with IPSECO for a new power plant and fuel storage facility.

In a November 5, 1981 memo to the acting Deputy High Commissioner, the TTPI Special Assistant for Construction and Management stated that $500,000 could be made available to Palau for power generation units. This amount would be Palau's share of $1.9 million available for overhaul of electric generators in Micronesia.

A Corps of Engineers official said that the Corps never heard anything more from Palau, TTPI, or Interior about its proposal. Interior officials said that the Corps proposal was not accepted because the generators were old and in need of repairs. We found no evidence in the files to support this position, and in response to our request the Interior officials could provide none.

On February 2, 1982, Palau and IPSECO entered into a $27.5-million contract for a 16-megawatt power plant and a 6-million gallon fuel storage facility, conditional on Palau's completion of a loan agreement. Palau accepted IPSECO's offer to provide a mobile generator, and it became operational in April 1982. In late 1982, the Corps generators were removed from Palau.

Lack of Strong and Timely U.S. Objection

On three occasions in late 1981 and early 1982, Interior Department and MSN officials in Washington, D.C., were advised by TTPI and a MSN regional official of their serious concerns over the financial burden Palau would assume if it proceeded with the IPSECO power plant/fuel storage project. U.S. headquarters officials, however, took no action to address these concerns. They did not express strong opposition to the IPSECO deal directly to Palauan officials or instruct U.S. regional officials to formally communicate this opposition to the Palauans.

On October 16, 1981, the TTPI acting Deputy High Commissioner informed Interior's Deputy Assistant Secretary for Territorial and International Affairs (TIA) that Palau had issued a letter of intent to contract with IPSECO for a power plant to be financed by a loan from a British bank. The acting Deputy told the Assistant Secretary that "Given the dire financial situation in which Palau finds itself for FY 82, and the future level of operational funding available to Palau under the Compact, I seriously doubt that they have the capability to handle a loan of this magnitude." The acting Deputy concluded that Palau simply did not have funds from either Interior grants or local revenues to consider the IPSECO proposal and loan undertaking. He stated that if revenues were generated through fuel oil sales, there might be some possibility for success, but in his opinion this was an untested market.

On December 7, 1981, the acting Deputy again expressed concern to Interior's Deputy Assistant Secretary for TIA about the IPSECO project. He advised the Deputy Assistant Secretary that millions of dollars in principal and interest would be required annually to repay the loan and that "the assumption of this burden is, in our opinion, ill advised."

In a January 28, 1982, cable to both Interior headquarters and the Office for MSN, the MSN Status Liaison Officer (LNO) in Saipan called attention to the need for the United States to decide whether it would seriously oppose the IPSECO deal, stating that the

> "Time is approaching when USG must decide whether we will seriously object to this deal, or let events take their course. Status LNO has had a number of conversations with Palauan leaders (including President Remeliik and Special Adviser Uherbelau) noting the awesome liabilities Palau would incur."

The LNO further stated that the Palauans believed the debt could be repaid by sale of electricity to consumers and resale of oil from the fuel storage facility. He noted that the Palauans "have the optimism of a

youthful nation, and it is impossible to convince them their plans are unrealistic."

The LNO concluded the cable to headquarters by stating that

"USG must decide whether, under our continuing trusteeship responsibilities, it is our duty to insure sensible Palauan financial management in this instance and, in effect, protect the Palauans from themselves... If, after evaluation of the evidence, USG decides to object to the deal we should do so forthrightly and quickly, but we should be prepared for accusations that we are hamstringing Palau's economic development. Cautionary comments to the Palauans, British, and IPSECO seem so far to have had no effect on events, although the USG position on non liability is clear."

We found no record of any Washington response to these concerns, and an official of the State Department's Office of Freely Associated State Affairs (successor to Office for MSN) told us that there was disagreement in Washington as to what U.S. policy should be concerning the proposed IPSECO project. He said that U.S. policy was not formulated until May 1983, when a message supporting Palau's efforts to meet electric power needs was sent to prospective project lenders.

No Independent Assessment of Needs or Competitive Bidding Procedures

Executive and legislative officials of the Palau national government did not follow sound procurement procedures before proceeding with the power plant/fuel storage project. Sound procedures were not followed despite warnings from U.S. government auditors and Palau state government officials in April 1983 that they were essential to ensure that Palau's legitimate needs for electric power and fuel storage space were identified and obtained at the lowest cost.

Inspector General Audit

In early 1983, at the request of Interior's Assistant Secretary for TIA, Interior's Office of the Inspector General audited Palau's efforts to obtain an electric power plant and fuel storage facility. The audit disclosed that (1) no feasibility study had been made to identify Palau's electrical power and fuel storage needs, (2) the construction contractor had not been selected on a competitive basis, and (3) arrangements for financing the project had been completed by the contractor. The auditors concluded there was no assurance that (1) a 16-megawatt power plant and 6-million gallon fuel storage facility were needed, (2) the best contract price had been obtained, and (3) the most favorable credit terms had been secured.

On April 15, 1983, the Inspector General's staff discussed the audit findings with Palau's Vice President and other officials, who stated that funds were not available for a feasibility study. The auditors responded that such a study might reduce project costs and that sound management practices required one before important decisions were made about long-term needs.

The Palauan officials stated that, although they did not publicly advertise the construction project, they did contact other contractors[1] but these other contractors were interested only in construction and not in helping to obtain financing. IPSECO was willing to assist in both endeavors. The officials acknowledged that they did not contact other lending institutions in an effort to secure better loan conditions. IPSECO originally indicated to Palau that 8.75 percent financing could be obtained for the larger loan, however, the actual rate IPSECO arranged for the $24.3-million loan was 11.25 percent.

We noted that another firm expressed interest in meeting Palau's needs for electric power and in assisting with financing. In November 1981, Mirrlees Blackstone (Stockport), Ltd., submitted a proposal to the Palauan President's legislative counsel to (1) construct a 15-megawatt power plant for $13.6 million and (2) obtain 85 percent financing over 9 years, beginning 6 months from the plant's commissioning date, at 8.75 percent a year or the rate in effect when the contract was signed. Since Palau would have to fund 15 percent of the contract value in advance of construction, Mirrlees Blackstone offered to try to arrange a front-end loan from its bankers. The proposal did not include a fuel storage facility. We could not determine the consideration, if any, given to this British firm's proposal by Palauan officials.

Koror State Concerns

In an April 18, 1983, letter, the Ibedul of Koror State made recommendations similar to those of the Inspector General's directly to the President of Palau; he also brought to the President's attention an unsolicited proposal made by Chinaseaco Engineers and Developers, Ltd., for meeting Palau's power needs. Chinaseaco proposed to construct a 22.5-megawatt power plant for $10 million. The proposal did not include a fuel storage facility. It indicated that financing at 8.5 percent over 20 years could be obtained.

[1]The November 4, 1981, report of the Palauan task force states that one other contractor—a Japanese firm—was contacted.

The Ibedul told the Palauan President that Chinaseaco's proposal indicated that options to the IPSECO project existed and should be explored. The Ibedul acknowledged that Palau did not need a 22.5-megawatt system, but pointed out that the price of the IPSECO project appeared to be more than Palau needed to commit itself for a reliable power system.

The Ibedul urged the President to engage an independent engineering firm to assess Palau's present and future power needs and to recommend a system, including specifications, to provide power throughout the Republic. The Ibedul said there should be open international competitive bidding for the recommended system and that the engineering firm making the assessment should not benefit financially from the recommended system. He concluded his letter to Palau's President by stating that "I am confident that if the above approach is followed, the Republic of Palau would be in a position to obtain reliable power at a cost more realistically consistent with its financial abilities."

On April 21, 1983, the Palau National Congress passed legislation authorizing the President of Palau to waive competitive bidding requirements for the power plant/fuel storage facility project, award the construction contract to IPSECO, and waive Palau's sovereign immunity from law suits. Before this legislation was passed, the Palau Senate conducted a hearing at which representatives of Koror State attempted to persuade the Senate to follow sound management procedures in meeting Palau's legitimate needs for electric power/fuel storage space. These representatives noted that the only assessment of Palau's needs was prepared by IPSECO and stressed the importance of soliciting competitive bids for the construction contract. They argued strongly against waiving Palau's competitive bidding laws for large public projects.

Nevertheless, the Palau National Congress passed Republic of Palau Public Law (RPPL) 1-54 on April 21, 1983, authorizing waiver of competitive bidding requirements and award of the construction contract to IPSECO. RPPL 1-54 also authorized the waiver of Palau's immunity from law suits. The Palau President approved the legislation on April 22, the IPSECO contract was executed on May 17, and financing arrangements were completed on June 8, 1983.

Legislation Waiving Competitive Bidding Requirements Not Suspended

The TTPI High Commissioner suspended legislation authorizing Palau to waive its sovereign immunity from law suits, but she did not suspend legislation authorizing Palau to waive its competitive bidding requirements and award the power plant contract to IPSECO. Prior to taking this action, the High Commissioner consulted with Interior's Assistant Secretary for TIA and he supported her decision.

As required by the then applicable Interior Secretarial Order 3039, the President of Palau on April 22, 1983, submitted RPPL 1-54 to the High Commissioner for review and approval and she had 20 days—until May 12, 1983—to inform Palau whether she would suspend RPPL 1-54.

On April 25, 1983, the High Commissioner informed Interior's Assistant Secretary for TIA that she had received RPPL 1-54 and that its purpose was to waive a number of procedural requirements with which the Palauan President failed to comply prior to signing certain contract and loan documents for the power plant project. She stated that Palau National Congress committee reports suggested that Palau relied almost exclusively on representations by IPSECO concerning the project's viability.

The High Commissioner told the Assistant Secretary that her review of the legislation pursuant to Order 3039 was relatively narrow, but she was concerned about the section authorizing the President to waive Palau's immunity from suit, attachment, or execution. She said it raised the question of whether or not Interior's grant funds could be subject to execution or attachment in the event of default on project loans. The Interior Assistant Secretary supported the High Commissioner's decision to suspend the waiver of immunity provision in RPPL 1-54.

On April 28, 1983, the Status LNO in Saipan sent a cable to the Office for MSN in Washington that included the text of the High Commissioner's April 25 message to the Assistant Secretary regarding RPPL 1-54 and that noted

"As HICOM points out, apart from strict legal issues, there are continuing questions about soundness of venture, lack of feasibility data is one aspect, Palau's ability to pay is another. Following is revealing quote from report by Vice Chairman ... of Palau Senate Committee on Resources and Development. ...'If we default, the plant cannot be repossessed, and the United States will pay. It is debatable whether the United States would indeed pay but in light of the need for reliable electrical power to develop Palau, the risk may be one worth taking.'"

On May 5, 1983, the High Commissioner notified the President of Palau of the decision to suspend the waiver of immunity provision of RPPL 1-54 and advised him that "exercise of the authority to waive immunities from suit, attachment, and execution will preclude the President from making an unqualified acceptance of terms and conditions of future grants since the funds would be subject to diversion to a use not authorized thereby."[2] The High Commissioner stated that possible diversion of grant funds for unauthorized purposes was inconsistent with her authority to impose terms and conditions for use of these funds mandated by Secretarial Order 3039.

Secretarial Order 3039 authorized the High Commissioner to require the Republic of Palau, after audit by U.S. government auditors, to comply with proper accounting procedures and audit recommendations. On March 9, 1983, the Interior Assistant Secretary for TIA requested Interior's Inspector General to audit financial conditions in Palau. On March 24, 1983, the Inspector General informed the Assistant Secretary that a 1982 audit of proposed financing arrangements for the power plant/fuel storage project was suspended because there was no final contract between Palau and IPSECO for construction. The Inspector General stated that the contract and financial package for the project had now been completed and, pending receipt of the documents from Palau, the audit would be resumed during the last week in March 1983.

On May 6, 1983, the Inspector General submitted a fact sheet on the audit to the Assistant Secretary for TIA which included the following audit findings.

- Palau's contract with IPSECO was let without formal advertising and solicitation of bids and without documentation to show that Palau negotiated with IPSECO for the best possible price.
- Documentation was unavailable to show that Palau (1) contacted lending institutions, other than two British banks, to secure financing for the proposed facilities and (2) negotiated with the British banks to secure better loan conditions.
- Palau's ability to repay the proposed loans was highly questionable. First, revenue projections to repay loans reportedly prepared by IPSECO

[2]In the law suit brought by the loan guarantors against Palau, the Republic noted the High Commissioner's suspension of waiver of sovereign immunity contained in RPPL 1-54 and asserted sovereign immunity as a defense to the suit. The court rejected this defense, stating that Palau agreed with the guarantors that it was engaging in commercial activities and "waiver of sovereign immunity" shall be governed by the U.S. Foreign Sovereign Immunities Act of 1976. The Act provides that commercial activity constitutes a waiver by a sovereign of its immunity.

were unsubstantiated; Palau did not analyze the feasibility of the projections. Second, Palau had operated at a deficit during fiscal years 1981 and 1982 and probably would have to seek additional funds from the United States or borrow funds to finance its general operations for fiscal year 1983.

High Commissioner Did Not Use Authority

Under Secretarial Order 3039, the TTPI High Commissioner could have vetoed legislation inconsistent with provisions of the trusteeship agreement or the order. Under the trusteeship agreement, the United States is responsible for promoting Palau's economic development. In our view, it seems essential that in carrying out this responsibility the United States should have required sound financial management by Palau in meeting its developmental needs. The High Commissioner could have considered waiving Palau's competitive bidding requirements and uncertainty about the availability of funds for the IPSECO project as conflicting with the U.S. trust responsibility to promote Palau's economic development. The High Commissioner, however, with the support of the Assistant Secretary for TIA, did not veto legislation authorizing waiver of competitive bidding requirements and award of the power plant/fuel storage contract to IPSECO.

A Palauan legislator and Interior's Inspector General both indicated that Palau would need U.S. financial assistance to repay loans for the proposed IPSECO project. The High Commissioner could have also vetoed this legislation and requested Palau to obtain competitive bids for the project, consistent with her authority to set terms and conditions for providing U.S. financial assistance. This would have helped assure that any needed U.S. funds would be used for a soundly planned project to meet Palau's electric power needs.

The results of the Inspector General's audit were available 6 days before the United States was required to advise Palau whether or not RPPL 1-54 would be suspended. The Assistant Secretary for TIA and the High Commissioner could have obtained the audit results and used them as a basis for requiring Palau to follow sound procurement procedures in meeting its needs for electric power and fuel storage space. The High Commissioner could have advised Palau that before proceeding with the project, it obtain (1) an independent assessment of needs, (2) competitive bids for the construction contract, and (3) reasonable assurance that financing arrangements for the project were the best available.

Concerns About Ability to Pay and Procurement Procedures Not Made Known to Lenders

Shortly before financing arrangements were completed, U.S. officials had one final opportunity to oppose the IPSECO project. In a message to proposed project lenders, MSN and Interior officials stated that with present and future U.S. financial assistance Palau should be able to meet loan service obligations for the IPSECO project. This advice was given despite the fact that during the trusteeship period, Palau could not service the loans with U.S. assistance funds. Even with future compact funds Palau would have difficulty making loan payments, if other urgent energy-related and capital needs were to be met. Also, the message did not state that Interior's Inspector General reported that it was highly questionable that local revenues would be available for Palau to repay the loans.

In addition, the message to proposed lenders fully supported Palau's efforts to improve its electric power generating capacity, but it did not mention U.S. concerns about the unsound procurement procedures used by Palau in these efforts. A U.S. warning about Palau's ability to repay the loans and an expression of U.S. concern over the way Palau was proceeding to meet power needs could have convinced prospective lenders that the IPSECO project was not viable and should not be financed.

On May 18, 1983, the U.S. Ambassador for MSN and the Assistant Secretary for TIA met in Washington with Palau's Vice President and its Ambassador for Status Negotiations (who later became Palau's second president) to discuss the background and rationale for the proposed IPSECO project. IPSECO's project manager, who was the company's managing director and principal stockholder, also attended the meeting. The U.S. officials stated that the High Commissioner's suspension of Palau legislation authorizing waiver of immunity to law suit in a loan default would not be reversed and that the United States had no legislative authority to guarantee the proposed IPSECO loan before or after the Compact of Free Association took effect. The Palauans and the project manager asked the U.S. officials to reconsider their position or to consider other ways in which the IPSECO project might proceed.

On May 25, 1983, the U.S. Ambassador for MSN sent a message to the American embassy in London summarizing the results of U.S. consideration of ways the IPSECO project could proceed. The message requested that the following information be made known to British banks interested in financing the IPSECO project and to the Export Credits Guarantee Department, an agency of the British government that agreed to guarantee the National Westminster Bank loan if the private guarantors did not honor their obligations.

- The United States and Palau have negotiated a Compact of Free Association which was approved by the people of Palau in a February 10, 1983, plebiscite. After its approval by the Government of Palau, the compact will be submitted to the U.S. Congress for approval. It is contemplated that the compact will come into effect simultaneously with the termination of the trusteeship agreement.
- The Compact of Free association will provide direct U.S. grant assistance to Palau in the form of annual payments, some of which are programmed for general government operations and some for capital and economic development.
- Palau will receive operational funds of $28 million at the rate of $2 million a year for 14 years to be used for energy-related activities. Palau will receive $36 million in the first year of the compact for capital needs. The United States would view application of the operational funds and a reasonable portion of the capital funds for the proposed IPSECO project as being consistent with the intent of the compact.
- During the remaining period of the trusteeship before the compact comes into effect, the United States will also provide financial assistance for energy-related needs to Palau. Historically, the Congress had appropriated from $1.5 million to $2 million a year for this purpose. The United States will view use of these operational funds for the proposed IPSECO project as being consistent with the general purpose for which these funds were provided.

The message concluded

"the Government of Palau should be able to meet its scheduled debt-service obligations in light of present and future funds granted to the Government of Palau by the USG ... Please be assured that the Office for Micronesian Status Negotiations and the Office of Secretary of the Interior for Territorial Affairs fully support the efforts of the Government of Palau to improve its present power-generating capability."

On June 8, 1983, the lending institutions, encouraged by the message that U.S. funds would be available to repay the loans, completed financing arrangements with Palau for the IPSECO project.

The U.S. Ambassador for MSN told us that the message to London was extensively reviewed by Interior and MSN staff before being sent and its optimistic language about Palau's ability to repay project loans could have been based on staff economic analyses. A former MSN staff member and presently Director of State's Office of Freely Associated State

Affairs told us that language in the message to the effect that with present and future U.S. grants Palau should be able to service the loans was merely intended to convey the U.S. position that use of grant funds to repay the loans would be considered a legitimate use of these funds.

In February 1988, State informed the Senate Committee on Energy and Natural Resources that the purpose of the U.S. message to London was to provide the British bankers, the government of Great Britain, IPSECO, and the Palauans with an accurate statement of the funding expected to be available to Palau during the trusteeship and under the compact for purposes which might include the proposed power plant project. State advised the Committee that the message explicitly stated that the use of compact funds consistent with the terms of the compact would be within the authority of the government of Palau and that the availability and use of funds during the trusteeship was subject to congressional appropriation authority. State said that the intention of the message was to make a neutral statement which neither discouraged nor encouraged the parties.

The agreements with the lending banks provided for Palau to pay $47.0 million over 9 years for financing the IPSECO project—$32.5 million in principal; $13.5 million in interest; and $1.0 million for guarantor and agent fees. Our comparison of funds Palau would need to service the loans with funds the U.S. government would provide for energy and capital needs in the repayment period shows that during the trusteeship Palau could not service the loans with U.S. assistance funds. Even with compact funds, it would have been difficult to service the loans if other energy-related and capital needs were to be met.

Less than 3 months before the U.S. message to London, a member of Palau's House of Delegates urged the Palauan President not to commit any of the $36 million in compact funds for capital needs to service the IPSECO project loans. The Delegate cautioned the President that any such use of capital funds would substantially cripple Palau's program for desperately needed schools, a hospital, dispensaries, water and sewer systems, roads, sidewalks, docks, piers, and an airstrip on Peleliu—a southwest island of Palau.

Savings Could Have Been Attained in Project Construction

In October 1988, we asked the engineering firm of Keller and Gannon of San Francisco, California, to prepare an estimate of what Palau's power plant/fuel storage facility should have cost. Representatives of the firm visited Palau in November 1988 to survey the installation and obtain construction drawings and information on local materials and costs. The firm issued a report to us in January 1989.

The engineering firm estimated that by using competitive procurement and contracting procedures, Palau could have saved $4.3 million in construction funds for the installation. The fuel storage facility consists of eight 750,000-gallon tanks. Two tanks supply oil to the power plant, and six tanks were intended to store oil to be sold to fishing fleets and other customers. As of November 1988, there were no customers for oil. The firm estimated that an additional $3.4 million could have been saved if the six unused tanks had not been constructed. Thus, Palau could have saved $7.7 million in construction costs plus several million dollars in interest and related costs in borrowing requirements.

The engineering firm's independent estimate included design, construction, and shipping costs for the power plant/fuel storage facility. In preparing its cost estimate, the firm assumed that plans and specifications for the installation were drawn up by a qualified engineering firm, they were used to obtain competitive bids in 1983, and construction was completed in 1985. The need for and cost of financing the installation were not considered in the estimate.

Conclusions

The Republic of Palau did not follow sound procurement procedures in efforts to meet its needs for electric power and fuel storage space. U.S. oversight officials were aware of this and the fact that Palau would have difficulty in meeting its financial commitments. They did not take action to stop the project, however, despite numerous opportunities. Had sound procedures been used, costs could have been reduced and Palau's financial crisis, caused in part by its inability to make IPSECO loan payments, could have been mitigated. To help avoid financial crises in the future, Palau must follow procedures that ensure that only legitimate needs are acquired at the lowest prices available and funds are available to pay for these needs. Interior must ensure that these procedures are followed.

IPSECO Payments to Palauan, Marshall Islands, and Former U.S. and American Samoa Officials

In March 1986, IPSECO filed for bankruptcy and the British courts appointed a London firm to liquidate the company. We reviewed IPSECO records seized by the liquidator to determine if allegations that the company made questionable payments to Palauan officials in 1983 and 1984 could be substantiated. Although available records were incomplete and not very detailed, we identified IPSECO payments to five Palauan officials, two former U.S. government officials, the President of the Marshall Islands, and a former governor of American Samoa. The payments totaling $1,182,000 were made from an account created for deposit and disbursement of the National Westminster Bank loan for Palau's power plant project. The liquidator did not have records on $3.8 million of the County Bank, Ltd., loan disbursed directly to IPSECO.

We reviewed the purpose of the IPSECO payments and the ethical questions they raised. We obtained information from the Palauan officials, the former U.S. officials, and the former governor of American Samoa on circumstances surrounding the payments. The IPSECO project manager who made the payments was not available to discuss them with us.

We also noted from IPSECO records that the company obtained airline tickets for a U.S. official and we interviewed this official about the tickets.

Bribery and Conflict-Of-Interest Issues Raised by Payments to Palauans

Palau's National Code (17 PNC 701) includes a bribery statute that prohibits individuals from unlawfully and voluntarily giving or receiving anything of value in wrongful and corrupt payment for official acts. The Code also includes a statute (17 PNC 2301) for misconduct that prohibits public officials from using their office to commit illegal acts or from willfully neglecting to perform official duties, but this broad statute does not clarify what kinds of conduct would be punishable. Also, Palau has a 3-year statute of limitations for both these crimes as well as for most other criminal offenses.

Palau has no criminal conflict-of-interest statutory provisions or strong and comprehensive civil conflict-of-interest laws governing the conduct of public employees. Moreover, Palau's civil conflict-of-interest laws do not contain specific penalties for violations and there are numerous exemptions for public employees, including officials appointed by the President with Senate consent, elected officials, and members of the Council of Chiefs.

In reviewing records in the custody of IPSECO's liquidator, we identified five Palauans who accepted payments totaling $775,000 from IPSECO between July 1983 and November 1984. Three of the Palauans were high-ranking government officials and were also in private business or professions; a fourth Palauan was a traditional leader; and the fifth Palauan was a businessman who held no government position at the time of payment. Two of the government officials and the traditional leader were involved in the project as follows.

- The Ambassador for Trade Relations and Status Negotiations, who later became President of Palau, was involved in securing financing that enabled the project to proceed.
- The Speaker of Palau's House of Delegates signed legislation permitting noncompetitive award of the construction contract to IPSECO and, in an ethics complaint filed against him, was alleged to have drafted the legislation. He was IPSECO's attorney in Palau at the time.
- The Ibedul of Koror State originally opposed the project but decided to support it while construction was in progress and after receiving the money.

The Ambassador for Status Negotiations and the House Speaker both were paid by IPSECO after they helped to obtain approval for the project. This raised questions both about whether the payments had anything to do with their supporting the project and whether they used their public offices for private gains. Both officials stated they received the money in connection with their private business and professional dealings with IPSECO. The Ibedul's change of position occurred after the project was approved and underway, but his conduct still raised a question as to whether receipt of the funds from IPSECO caused him to lose independence and to perform his public duties differently than he otherwise would have performed them.

Ambassador for Status Negotiations

Palau's Ambassador for Status Negotiations accepted $200,000 from IPSECO; $100,000 on July 19 and $100,000 on September 20, 1983. The Ambassador was appointed to the position on April 29, 1982, by the President of Palau with the consent of Palau's Senate. The Ambassador had full authority to represent, negotiate, and commit Palau to agreements relating to the Compact of Free Association, subject to Presidential assent and legislative ratification. He had similar authority to negotiate trade and economic assistance agreements with sovereign nations or international organizations. The executive order appointing the Ambassador provided that he serve without compensation, except

for per diem and official expenses necessary to accomplish his responsibilities. The Ambassador later served as Palau's president from September 1985 until his death in August 1988.

The Ambassador and Palau's Vice President attended a meeting in Washington on May 18, 1983, with the Interior Assistant Secretary for TIA and U.S. Ambassador for MSN to provide background and rationale for the proposed IPSECO arrangement. IPSECO's project manager also attended the meeting. At the meeting, the Palau and IPSECO representatives requested U.S. government officials to reconsider their suspension of Palauan legislation waiving sovereign immunity from law suit in case of loan default or to consider other ways the IPSECO arrangement might proceed.

U.S. officials did not reconsider the suspension of the legislation but did consider other ways the IPSECO project could go forward. They concluded that use of U.S. grant funds to service the loans was such a way. This information was transmitted to the prospective lenders on May 25, 1983, and Palau completed project financing arrangements with the British banks on June 8, 1983.

On December 17, 1987, the Ambassador for Status Negotiations, who was then President of the Republic of Palau, testified before the Subcommittee on Asian and Pacific Affairs, House Committee on Foreign Affairs, about the funds he received from IPSECO and gave the following explanation.

"In 1983, I was interested in the establishment of an airline in Palau on a private venture basis. At that time I was owner of Belta Travel Agency and proposed with Gordon Mochrie (the IPSECO project manager) that we joint venture this airline. Mochrie agreed to provide funds to Belta to provide on-island facilities, gather data and prepare the base for the airline.

"At this time I was Ambassador on Status Negotiations. I had no authority to negotiate the IPSECO power plant. That was the responsibility of a Task Force which had already concluded the power plant contract. I was not on the payroll of the government at the time.

"This was purely a business venture, not in any way connected to the IPSECO Power Plant. The money advanced was for the services of the BELTA Travel Service Company which was a privately owned and licensed Palauan company.

"After the failure of the Compact in the first referendum held that year and the political uncertainties for Palau that ensued as well as the various difficulties that

Mochrie began to encounter, the project was not aggressively pursued. The project has been dormant since then."

Earlier in December 1987, the Ambassador had given us essentially the same explanation for the IPSECO payments and said that he had no written contract with IPSECO.

Although the Ambassador may have had no role in negotiating the IPSECO power plant contract, he did have a role in securing approval for financing that permitted the project to proceed. Acceptance of funds from IPSECO after his successful efforts to obtain approval of project financing raised questions about whether the money was paid and received as a bribe and if he used public office for private gain. We question whether the business relationship described by the Ambassador would have been carried out without a contract or other documentary evidence.

Speaker of the House of Delegates

The Speaker of Palau's House of Delegates accepted payments of $250,000 from IPSECO—$100,000 on July 18, 1983, $75,000 on March 9, 1984, and $75,000 on November 2, 1984. The Speaker was in office from 1981 through 1984. He was at the time and still is a practicing attorney in Palau.

On April 12, 1983, a bill was introduced in Palau's House of Delegates authorizing Palau to waive its competitive bidding requirements for the power plant/fuel storage project and to award the construction contract to IPSECO. On April 21, 1983, Palau's House of Delegates and Senate both passed the bill. The Speaker signed the legislation for the House of Delegates. On April 22, the President of Palau approved the legislation, and on May 17, 1983, the contract was executed.

On November 29, 1985, the special consultant to Palau's legislature filed an ethics complaint against the Speaker of the House of Delegates with the Supreme Court of the Republic of Palau. The complaint alleged that he improperly accepted $1.5 million in fees from IPSECO while he held the government position and did not pay income tax on the fees. The complaint also alleged that he improperly shared the fees with persons who were not attorneys and that there was no public record about the legal work he performed for IPSECO. The Speaker acknowledged that he was IPSECO's attorney at the time of his government service but denied allegations of impropriety and unethical behavior. He stated that he

agreed to a $150,000 annual retainer fee, subject to review every 2 years, but he denied agreeing to $1.5 million over 10 years.

On March 12, 1986, the Chief Justice of Palau's Supreme Court appointed a private attorney from Saipan to investigate the allegations of misconduct against the House Speaker. In a statement provided to the private attorney on April 25, 1986, the special consultant filing the ethics complaint alleged that the legislation waiving Palau's competitive bidding requirements for the IPSECO project was drafted by the Speaker and there were no public hearings in the House of Delegates on the legislation.

In November 1988, the Chief Justice told us that the attorney's ethics investigation of the House Speaker was incomplete; the attorney had submitted an interim report in early 1988, but had not interviewed the project manager of defunct IPSECO. The Chief Justice said that, in connection with the IPSECO liquidation proceeding, a British court issued a restraining order prohibiting the attorney from talking to the project manager; the attorney in September 1988 asked the court to lift the restraining order and was optimistic that it would comply with the request.

The Chief Justice told us that, depending on the results of the ethics investigation, (1) the Speaker could be cleared of the charges, disbarred, suspended, or reprimanded and (2) the matter might be referred to Palau's Attorney General for possible criminal prosecution for other than conflict-of-interest charges.

During our November 1988 visit to Palau, we interviewed the House Speaker about the purpose of payments he received from IPSECO. He gave us the following information.

In 1982, the IPSECO project manager asked the Speaker to provide legal services to IPSECO in connection with an electric generator IPSECO had loaned to Palau free of charge for use until the IPSECO power plant was constructed. IPSECO wanted to be sure its rights to the generator were protected and the generator would be returned when the plant was completed. The Speaker agreed to provide these legal services for a fee of $50,000.

Subsequently, IPSECO asked the Speaker to provide legal services in connection with obtaining sites to construct housing for IPSECO employees in Palau and making arrangements to sell oil in the region. The

Speaker also agreed to help IPSECO make business contacts for potential oil sales. He said that as a former TTPI employee, he was well known in Saipan, Samoa, and the Marshall Islands.

The Speaker said his fee was increased from $50,000 to $250,000 when he agreed to provide additional legal and marketing services to IPSECO. He said he had a written contract with IPSECO, but it was not very detailed. He agreed to give us a copy of the contract, but despite our repeated follow-ups with his office, he did not do so.

In conclusion, the Speaker of the Palau House of Delegates signed and may have drafted legislation permitting Palau to waive its competitive bidding requirements and award the power plant contract to IPSECO. The Palau Supreme Court is investigating allegations that he drafted the legislation. In our opinion, the Speaker's known and alleged involvement in securing passage of this legislation at the time he was IPSECO's attorney raised bribery and conflict-of-interest issues. Hopefully, the Palau Supreme Court's investigation will assist in resolving these issues.

Ibedul of Koror State

The Ibedul is one of two paramount traditional leaders in Palauan society. He is also an administrative official of Koror State and is referred to as the Mayor of Koror.

On March 16, 1983, the Ibedul filed a motion with the Supreme Court of Palau to restrain Palau's President from proceeding with the IPSECO power plant/fuel storage project, contending that the President had no authority to (1) award the construction contract without soliciting competitive bids, (2) borrow funds from public lenders,[1] and (3) use unappropriated funds to finance the project. In filing the lawsuit, the Ibedul stated that, while he abhorred a legal confrontation with the President, it was necessary if he was to adequately and honorably discharge his duties to the people of Palau as a traditional leader.

On April 12, 1983, the Ibedul withdrew his lawsuit because the President of Palau informed him that the National Westminster Bank and the Export Credits Guarantee Department would not sign the loan agreement until certain other agreements had been negotiated and appropriate legislation passed. On April 21, 1983, Palau's National Congress

[1]The motion stated that the Export Credits Guarantee Department had been the dominant entity in structuring the $24.3 million loan from the National Westminster Bank and therefore, for all practical purposes, the President would be borrowing from a public entity, contrary to RPPL 1-20.

passed RPPL 1-54 which satisfied the financial institutions about the legality of the project, but did not completely resolve the Ibedul's concerns about the project. RPPL 1-54 authorized the President of Palau to waive the law requiring competitive bidding for public projects. The Ibedul's representatives testified unsuccessfully against waiving these requirements at the Senate hearing prior to passage of RPPL 1-54.

On June 4, 1984, IPSECO paid the Ibedul $100,000. The power plant was then under construction. On November 4, 1984, 5 months later, the Ibedul reversed his position on the plant and told the IPSECO project manager that he had decided to support it, stating

"This decision has come after a careful review and analysis of the overall development needs for the Republic of Palau. This power plant project, through the expertise and assistance provided by IPSECO, will be greatly beneficial and a key part of the growth of our young nation."

The Ibedul informed the project manager that he was prepared to work with the national government to organize an effective method of bringing electrical power from the plant to the citizens of Koror and the entire Republic. He offered to provide any assistance he could to ensure the success of the project.

The Ibedul told us that the money he received from IPSECO was intended as a contribution to his campaign for the Presidency of Palau. A member of his staff who was present when the money was received told us that the funds were intended as a political contribution. The following additional information about the IPSECO payment was obtained in discussions with both the Ibedul and his staff member.

The payment was made during a 1984 visit to London. The Ibedul had been in Stockholm, Sweden, to accept a humanitarian award for his position on wanting Palau to be a nuclear free republic. On the way home, he and his staff member stopped in London at the IPSECO project manager's request to discuss ways loans could be obtained to finance a copra plantation in Palau. They also visited the museum commemorating the long friendship between Great Britain and the Republic of Palau. During a meeting, the IPSECO project manager was informed that the Ibedul was running for President of Palau and the manager offered a campaign donation and wished him success. He issued a check for $100,000 to the Ibedul.

The Ibedul did not know why the IPSECO project manager would make a campaign contribution to him in view of his opposition to the IPSECO project. The staff member who was present when the payment was made had the impression that the project manager intended the contribution to heal wounds and establish a friendship with the Ibedul.

In conclusion, there is a conflict of interest whenever a private financial interest might cause a government official to perform his official duties in a way other than if he did not have the private interest. In the Ibedul's situation, we recognize that he opposed the project and changed his position only after the project was underway. Nevertheless, it could be perceived that receipt of funds from IPSECO caused him, in his role as a traditional leader, to change his position on a controversial public project from opposition to support.

Palauan Businessman

On July, 18, 1983, IPSECO paid $50,000 to a Palauan businessman who at the time held no national or state government position. The man was a member of Palau's Senate from 1985 through 1988 and was defeated in his campaign for reelection in November 1988.

During our visit to Palau in November 1988, we interviewed the businessman about the purpose of the payment he received from IPSECO. He gave us the following information.

He is a cousin of the president of Palau's Economic Development Bank. In 1983, his cousin introduced him to the IPSECO project manager and the two men became friends. After IPSECO was awarded the power plant contract, the project manager asked the businessman to help IPSECO obtain local office space and transportation to the power plant project site. He provided these services and was paid $121,000 by IPSECO—$71,000 by IPSECO officials in Palau and $50,000 from London.

The businessman leased space in a building he owns in Koror to IPSECO, who used it as an office for the project. The lease ran for about 2 years during plant construction; IPSECO was supposed to pay $2,000 a month, but paid only $1,000 a month. He received over $20,000 in rent from IPSECO.

He also sold IPSECO three boats for $65,000 and three jeeps for $36,000 to transport materials from Koror to the construction site in Babelthuap.

IPSECO used his barge in Koror for 6 months without paying him anything for it.

The information given us by the Palauan businessman shows that he was in essence a subcontractor to IPSECO. He told us, however, that he had no written contract or other documents to support his dealings with IPSECO and that his relationship with the project manager was based on friendship. Therefore, it was not possible to confirm his statements through written records.

President of Economic Development Bank

IPSECO paid $175,000 to the President of Palau's Economic Development Bank—$100,000 on July 18, 1983, and $75,000 on March 9, 1984. The Bank President was also Palau's Diplomatic Envoy to Status Negotiations and a private businessman.

We could not determine whether the Bank President had any government or business involvement with the IPSECO project, what the funds were used for, and whether his actions involved any misconduct. During our November 1988 visit to Palau, we asked him to meet with us to discuss the purpose of the IPSECO payments but he declined to do so.

Palau Officials Recognize Need for Conflict-Of-Interest Law

The Chief Justice of Palau's Supreme Court told us that he believed Palau needs its own unique conflict-of-interest law that would consider the customs of the Republic and the close relationships among its people.

A former Palau Attorney General stated that the issue of a practicing attorney being a member of a legislative body is troublesome but common, not only in Palau but also in the United States. In Palau, the relatively small population dictates that such relationships are going to happen; virtually every member of Palau's Congress does business with the Republic. The former Attorney General added that while such a situation is not ideal and certainly contains potential for abuse, the fact is that it is necessary.

The Ibedul of Koror State, in his unsuccessful 1984 campaign for the Presidency of Palau, advocated establishing and enforcing a Code of Ethics for government officials and employees.

President of Marshall Islands

In August 1983, IPSECO paid $200,000 to the President of the Marshall Islands from the account established for Westminster Bank loan funds for Palau's power plant project. We were unable to determine the purpose of this payment.

IPSECO constructed an electric power plant/fuel storage facility for the Republic of the Marshall Islands before it built a similar installation for the Republic of Palau. IPSECO began the Marshall Islands project in about mid-1981 and completed it by early 1983. The Marshall Islands power plant can produce 12.8 megawatts of electricity from four generators, each with a capacity of 3.2 megawatts of power. Its fuel storage facility consists of eight tanks with a total capacity of 6 million gallons of fuel.

Trip reports showed that Palauan representatives visited Majuro to discuss with Marshall Islands officials their power plant/fuel storage facility and to tour the project site. Visits were made in August 1981, shortly after the project got started, and in February 1983, shortly after construction was completed. During the first visit, the Palauans were told that the Marshall Islands relationship with IPSECO began when IPSECO's project manager was asked to come to Majuro to discuss a new power plant. The project manager was invited because he was well known in the field; negotiations between the parties culminated in an agreement for the project. During the second visit, Marshall Islands officials praised IPSECO's work.

In September 1988, we made a request through the State Department for an explanation from Marshall Islands officials of the purpose for IPSECO's payment to the President. We have received no response to our request.

U.S. and Former U.S. Officials

There are restrictions on what employees can do after leaving the U.S. government. A former employee is permanently barred from representing any other person before a federal court or agency with respect to a matter involving specific parties in which the United States has an interest and in which he/she participated personally and substantially as a government employee. Within 2 years after terminating employment, a former senior employee may not aid or assist in representing by personal appearance any other person before the United States in a matter involving specific parties in which he/she participated personally and substantially as a government employee. Also, for 2 years after terminating employment, a former employee may not represent any other

person in a matter involving specific parties which was pending under his/her official responsibility within one year prior to terminating employment. Effective in 1985, both 2-year restrictions were increased to 3 years for former Office for MSN employees.

Two former U.S. government officials received $252,000 from IPSECO for services performed and to pay operating expenses for the company after they left the government. Of this amount, $192,000 came from the National Westminster Bank loan power plant account. We did not make a detailed investigation of the circumstances surrounding these payments, but we did obtain the following information on them from the former officials involved and from IPSECO bankruptcy records.

- The former Legal Counsel of the Office for MSN upon retiring in the fall of 1983 became a partner in a law firm that provided litigation and corporate legal services to IPSECO. The company paid the law firm $142,000 for these services from the power plant account. The former counsel said that the firm did not represent IPSECO before the U.S. government in any matter in which the U.S. government had an interest.
- The former TTPI Deputy High Commissioner took a position with IPSECO about 2 years after resigning from government service in August 1982. IPSECO deposited $100,000 in an account for his use in operating a new office in Honolulu, $50,000 of which came out of the power plant account. He used the funds to operate the office and submitted an accounting to IPSECO. In addition, he received $10,000 from IPSECO for services rendered. The former Deputy High Commissioner said that while with TTPI he had no direct involvement with IPSECO. We noted, however, that in correspondence to Interior headquarters he questioned whether Palau would be able to assume the debt burden of the IPSECO project.

Former Office for MSN Legal Counsel

The former Legal Counsel for the Office for MSN is an attorney and a retired U.S. Navy Commander. From August 1977 until shortly before retiring on November 1, 1983, he was on detail from the Navy to MSN. As legal counsel to MSN, he assisted in negotiating separate agreements to the Compact of Free Association. Upon retiring from the Navy, he joined a Washington, D.C., law firm as a partner.

Before retiring from the Navy, the former MSN Legal Counsel stated that he requested advice from the U.S. Office of Government Ethics and the Department of Defense General Counsel's Office about restrictions on his conduct when he joined the law firm. The former Counsel said that

he was told there is a lifetime ban on his representing any party in a matter in which the United States had an interest and in which he was personally and substantially involved as a government employee. He would not be banned from providing indirect, in-house assistance to a law firm involved in matters in which he had participated in as a government employee.

Specifically, upon joining the law firm, the former MSN Legal Counsel could not represent Palau, the Marshall Islands, or any of the other former trust territories in legal proceedings involving MSN since he was personally involved in negotiating compact-related agreements with these entities. The former Counsel stated that he had not participated in any such legal proceedings since he retired from the government.

The former MSN Legal Counsel said that he met the IPSECO project manager on one occasion before retiring from government service. In September 1983, he attended a meeting with the project manager, another IPSECO representative, and two MSN officials at which the IPSECO representatives briefed the U.S. government officials on the company's plans for providing electric power in the South Pacific. Someone mentioned that he planned to retire soon and join a private law firm.

In November 1983, the IPSECO project manager asked the firm through the former Counsel to represent the company in a civil law suit brought against it by a U.S. citizen. The firm agreed and the case, which involved breach of contract and tort issues, was tried in the Marshall Islands. IPSECO made a financial settlement with the plaintiff in the case. This law firm also provided services to IPSECO when the company incorporated in Delaware and qualified to do business in Hawaii. According to the former Counsel, he was not prohibited by post-government employment restrictions from defending IPSECO in the law suit or providing the corporate legal services.

From late September 1983 to early May 1985, IPSECO paid the former MSN Counsel's law firm $142,000 for legal services. We questioned the former counsel about the reasonableness of these fees. He said that litigation is expensive and the firm encouraged clients to settle controversies out of court. He added that extensive work was required to get ready for the trial in the civil case. At one time, five attorneys were conducting research on the issues and preparing the legal brief. The firm's attorneys charged their time in 15-minute increments, and records for time charges during the period services were provided to IPSECO are probably still available in the archives.

Former TTPI Deputy High Commissioner

The former TTPI Deputy High Commissioner[2] resigned from the government on August 31, 1982. In the 1984-85 timeframe he was the President and a stockholder of IPSECO (U.S.). We were told by Interior's Deputy Ethics Officer that before joining IPSECO the former Commissioner had met with Interior's attorneys to discuss potential conflict-of-interest and ethics issues that could be involved by his accepting a position with the company. The discussions focused on post-employment restrictions for government employees.

The former Commissioner told us that as a government employee he met the IPSECO project manager on one occasion, in the dining room of a Palauan hotel. He said that in performing his TTPI duties he had no direct involvement with IPSECO and first met with IPSECO officials to discuss the possibility of working with them in April 1984. Later in 1984, he entered into a business relationship with IPSECO management. IPSECO (U.S.) was incorporated in Delaware and authorized to do business in Hawaii. He was President of IPSECO (U.S.).

When the former Commissioner joined IPSECO, a special account was established in his name. IPSECO made two deposits totaling $100,000 into the account, $50,000 on August 29, 1984, and $50,000 on January 28, 1985. The former Commissioner said that this was a business account, used to furnish and operate IPSECO's new Honolulu office, not for his personal gain. He provided us with a copy of his accounting to IPSECO for use of the funds, which shows that $2,900 was returned to IPSECO. Aside from the special account, he said that IPSECO reimbursed him for his expenses and paid him two retainer fees of $5,000 each in mid-1985. He resigned from IPSECO (U.S.) in October 1985.

In our opinion, conflict-of-interest laws did not prohibit either the former MSN Legal Counsel or the former TTPI Deputy High Commissioner from taking positions with or providing services to IPSECO, as long as they did not represent the company before a federal entity in a matter of interest to the United States and in which they had participated or had responsibilities as government employees.

U.S. Ambassador for MSN

U.S. government employees may not accept gifts or other items having monetary value from certain persons. They are prohibited from accepting gifts, gratuities, favors, entertainment, loans, or any other

[2]He was TTPI Acting Deputy High Commissioner from May 1, 1981 to May 27, 1982.

item of monetary value from anyone whose interests may be substantially affected by the performance or nonperformance of an employee's official duty.

We noted from IPSECO records in the custody of the company's liquidator that on June 28, 1984, IPSECO obtained round-trip London to Edinburgh airline tickets for the MSN ambassador and his wife. The tickets cost 232 pound sterling, or $314 using the U.S. dollar-pound sterling exchange rate at the time. The ambassador left MSN in 1987. Although we did not make a detailed investigation of this matter, we asked him about these tickets and he gave us the following information.

In the June-July 1984 timeframe, the ambassador, accompanied by his wife, made a combination business and pleasure trip to France and Great Britain. Initially, they spent vacation time in France and then went to London for his official business. In London, he briefed U.S. embassy officials and British bankers on the terms of the Compact of Free Association. He explained to the parties that under the compact, the United States was not responsible for the loans made by British banks to finance Palau's power plant/fuel storage facility and could not guarantee the loans.

In London, the ambassador met socially for lunch with IPSECO's project manager and at that time expressed an interest in getting tickets for the British Open Golf Tournament in Scotland. IPSECO officials obtained tournament tickets and round-trip London/Edinburgh airline tickets for him and his wife and arranged housing accommodations at a private residence near the tournament site. He issued a check to an IPSECO official in the amount of $1,237 for the airline and tournament tickets and housing accommodations. We examined and made a copy of the ambassador's canceled check which was dated July 18, 1984.

Former Governor of American Samoa

The term of office for the former governor of American Samoa was from January 1981 to January 1985.[3] He joined IPSECO as a marketing consultant in February 1985. During 1985, IPSECO paid him $45,000 for his services in three installments of $15,000 each. The first $15,000 payment, in February 1985, was made from the IPSECO account for Palau's power plant project.

[3]After an absence of one term, the former governor was elected again in November 1988, and began a new term in January 1989.

The former governor told us that he first met IPSECO officials in October 1982 at a conference of South Pacific countries held in Samoa. Contractors in the region attended the conference. He met the IPSECO officials again at the regional conference in October 1984, this time in Caldonia, where they approached him about joining the company. He said that he told them he would not consider taking a position with the company until his term as governor expired in January 1985.

The former governor said that in February 1985, after leaving office, he visited London for further discussions with IPSECO about joining the company. As a result of these discussions, he accepted a position to provide consulting services to assist IPSECO in expanding operations in locations such as Samoa, Tonga, and the Solomon Islands. The former governor was to receive quarterly payments of $15,000 for his services. He received three such payments before terminating his relationship with the company when it started to have financial problems later in 1985.

We found no indication that the former governor was involved with the IPSECO power plant project in Palau.

Conclusions

Acceptance of funds from IPSECO by Palauan officials raised serious ethical issues and concerns about possible criminal violations. Palauan law enforcement officials should investigate the IPSECO payments to resolve whether any misconduct, including bribery or tax violations, occurred. Palau's Attorney General or a special prosecutor, if appointed in a timely manner, would be appropriate officials to investigate these matters to determine whether sanctions are warranted.

Also, acceptance of funds from IPSECO by the Ambassador for Status Negotiations, the Speaker of the House of Delegates, and the Ibedul demonstrated the need for Palau to develop stronger and more comprehensive conflict-of-interest legislation, including criminal provisions. Existing civil legislation does not contain specific penalties and there are numerous exemptions, including, it appears, for the three Palauan officials. The legislation should recognize that many Palauan public officials are also in private business and the potential for abuse this creates. Guidance is needed for dealing with ethics problems caused by concurrent public duties and private interests.

Palauan businessmen having prime or subcontracts with the Republic should be required to keep records for goods and services provided and to retain the records for audit upon request.

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.

Nancy R. Kingsbury, Director, Foreign Economic Assistance Issues. (202) 275-5790
Thomas R. Brogan, Assistant Director
Janet A. St. Laurent, Project Manager
Robert F. Burns, Evaluator
Kay E. Brown, Evaluator
Madelon B. Savaides, Evaluator
Dianne L. Rawl, Evaluator
Juan Tapia-Videla, Evaluator
Bruce L. Kutnick, Economist

Office of the General Counsel

Richard Seldin, Senior Attorney

Office of Special Investigations

Houston R. Fuller, Special Agent
William L. Davis, Special Agent
Donald G. Fulwider, Special Agent

Far East Office, Honolulu, Hawaii

Edmond E. Menoche, Evaluator
Glenn J. Chaney, Evaluator
Sharon O. Byrd, Evaluator
Robert C. Howes, Evaluator
Nancy E. Pendleton, Evaluator
Linda K. Willard, Evaluator

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