



Republic of Palau
Aide Memoire
World Bank Petroleum Sector Mission
Koror, November 20-24, 2003

I. Introduction

A World Bank Petroleum Sector Mission (Silvana Tordo - Senior Energy Economist, Oil and Gas Policy Division) visited Koror between November 20 – 25, 2003. Scope of the Mission was to a) obtain an update of the status of discussion between the National Government, the State of Kayangel and Palau Pacific Energy Inc. (license holder of Velasco Reef Block); b) discuss the progress made on plans and institutional arrangements for oil sector development to date; c) provide advice on the future development of Palau's petroleum sector, including sector strategy, legislation, model contracts, fiscal terms, licensing and tendering, and environmental regulations; d) propose a road map for evaluation/implementation of a petroleum sector strategy; and e) discuss possible sources of funding and associated risk and timing.

The mission wishes to thank the President, the Olbiil Era Kelulau (OEK), the Ministry of Finance, the Environmental Quality Protection Board, Toribiong and Coughlin, and all other agencies visited for the cooperation and courtesies extended to it during its stay in Palau. A partial list of persons met is shown in Annex I.

The main findings and recommendations of the mission are summarized below

II Preliminary Observations

Except for geological and geophysical interpretation conducted by PPE within the Velasco Reef area, little is known today of the geological structure and prospectivity of Palauan subsoil, both onshore and offshore. There is a need for improving the understanding of Palau's prospectivity with a view to creating the basis for a possible decision to be made by the Authorities when the proper conditions have been established to allow/promote oil and gas exploration.

Given that Palau's economy relies upon environmentally sensitive industries like tourism and fishery, particular importance should be given to the creation of appropriate environmental and petroleum operations regulations, and to the delineation of areas to be open to prospection.



Considerations relating to the absorption capacity of the Palauan economy, and the possibility of creating business opportunities and employment in the archipelago through the promotion of hydrocarbon activities, should inform the design of the petroleum sector strategy.

Active participation of the population in the shaping of the petroleum sector, through opinion poll/attitude surveys, will ensure that the interests of the Palauan community are safeguarded in the best possible way.

III. Sector Issues and Outlook

Administrative structures for sector policy formulation, oversight and administration are still in the making. The Mission recommends that the OEK passes a resolution instructing the President to create an Oil and Gas Task Force which brief would be to prepare a) a report on the prospectivity of the Palauan offshore, and on the possible impact of oil exploration and production on Palauan environment, economy and community; and b) a draft legislation and relating regulations for presentation to the OEK. The Mission also recommends that one representative of the Tourism Association and one representative of the Fishery Association be appointed to serve as members of/advisors to the Task Force, to ensure that the priorities of Palau's business community are properly taken into consideration. At an appropriate time, once a decision is made on the opportunity/modality of diversifying the Palauan economy through the creation of an oil and gas sector, the Task Force could be dissolved, and a Government Agency could be created and tasked with the implementation of the relevant legislation, the promotion of the offshore to the oil industry, and the oversight and administration (including sector policies) of the oil sector.

Given the lack of local expertise in the petroleum sector, and the need for international experts, the Mission expressed concern over the sustainability of funding and skilled staffing for the agencies involved in the sector. Careful consideration should be given to the choice of sources of funds. Borrowing may create financial difficulties in the event of a lack of success in petroleum exploration. On the other hand, mobilizing funds through donors' grants eliminates the risk of financial exposure but may require a longer time frame.

In drafting the relevant legislation and regulations the Mission suggests that careful consideration be given to the requirement for local content in the petroleum sector as well as petroleum contribution to the development of non-oil sectors. Especially in the production phase, the size of supplies required by the industry can create imbalance in the economy and labor market if they were to be entirely or mainly supplied from Palau.



The Mission recommended that considerations relating to, inter alia, local administrative capacity inform the choice between a tax and royalty regime and a production sharing regime.

Issues of jurisdiction over the exploration and exploitation of natural resources between States and National Government should be addressed taking in due consideration the macroeconomic impact

IV. Next Steps

In light of the above considerations, the Mission suggested a phased approach towards the definition of sector strategy and policies, with a view to building consensus among the stakeholders and ensuring that, if a decision is made to proceed with the development of a petroleum sector, a legal, fiscal and regulatory framework is developed that includes suitable environmental, social and economic safeguards. The proposed project objectives, time frame for realization, work plan and a preliminary estimate of the funding needs, are described in detail in Annex II.

Koror, the 24th day of November, 2003