OPINION ASIA

Sequestration in Paradise

Palau worries it will be collateral damage in Washington's budget fight.

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Feb. 28, 2013 12:35 p.m. ET

Koror, Palau

Drive north up the coast of Babeldaob Island, past the overgrown sinkhole and Melekeok village, and an apparition appears out of the jungle: The U.S. Capitol. The dome and portico of the Republic of Palau's statehouse is unmistakably an homage to the Washington original, and a tangible sign of the close ties between the U.S. and this Pacific island nation.

The relationship has been strained of late, however. The bickering in Washington over budget offsets and sequestration—which goes into effect Friday—has an outsized impact on this remote country 500 miles southeast of the Philippines. It relies on the U.S. government for many public services such as mail delivery, a holdover from Palau's postwar decades as a U.S. territory.

Most importantly, the country's 20,000 inhabitants are waiting for renewal of a treaty with the U.S. called the Compact of Free Association. The compact would provide Palau with $229 million in aid over 15 years, plus a number of other benefits, in exchange for U.S. defense privileges. These include military control of Palauan territorial waters, which are the size of Texas and sit astride important sea lanes and rich fishing grounds.

The U.S. Department of Defense warned in 2011 that failure to pass the compact would "jeopardize our defensive posture in the Western Pacific." That's because Palau gives the U.S. a check on China's naval ambitions as part of an arc of influence that runs from Japan to Australia.

Both U.S. Democrats and Republicans say they want to pass the compact, and it should have been a rare instance of legislative consensus for the divided U.S. government. Instead, it's become another casualty of the Obama administration and Congress's inability to reach a budget deal.

"We're embarrassed, we're frustrated," President Tommy Remengesau says of Congress's most recent failure to pass the compact. "We don't think a relationship that is strong between two countries should result in an action like this."

Mr. Remengesau's predecessor, Johnson Toribiong, told the U.S. in a 2012 letter that some in Palau had argued that the country should start taking money from China or Arab states instead. For now, no one in power wants that to happen. Palau has been something of a Little America ever since the bloody

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WWII Battle of Peleliu was fought here in 1944. Burgers and baseball have taken their place in Palauan culture alongside taro farming and spearfishing.

Farther from home, Palau votes with the U.S. in the United Nations more than any other country. And about 500 Palauans serve in the U.S. military, a higher percentage of the population than in America itself.

Palau signed its first 15-year Compact of Free Association with the U.S. in 1994, the year it gained independence. The agreement recognized the U.S.'s ongoing responsibility to aid the development of a nation that had languished under indifferent American administration.

Negotiations for a second 15-year compact intensified in 2010. U.S. Secretary of State Hillary Clinton urged Palau to agree to a deal by September of that year to get ahead of looming Congressional elections. Palau hurried to comply, and a deal was signed on Sept. 3 in Honolulu.

"At least I got Palau to third base," former President Toribiong says now. But the U.S. Departments of State and Interior failed to bring the compact home. They took too long to hammer out the legislation to authorize the compact's funding. The compact is negotiated by State but implemented by Interior, and approval to fund the compact traditionally has to come from Congress's natural resource committees.

Deficit-minded Republicans won back the House of Representatives in November 2010 and announced a new fiscal regime. New mandatory budget spending, such as the compact, would now have to be accompanied by a commensurate budget cut, or offset. Since then, compact renewal has been stuck in a farcical budgetary roundabout.

Over the past two years, the Obama administration has proposed several unpopular budget offsets for the compact—for instance, using revenue from resources extracted on federal lands. Republican and Democrat lawmakers reject these offsets because they would rather apply them toward U.S. states or use them to cut taxes.

In the meantime, the U.S. has agreed to give $13.15 million per year to Palau in ad-hoc discretionary appropriations. But that contribution does not include millions in promised annual support to seed trust funds for Palau.

What's more, the looming sequester cuts could knock off as much as 5% in funding for U.S. domestic programs that operate in Palau. If the U.S. government shuts down altogether later this month, Palau could lose some of the $6.5 million in discretionary funding yet to be provided for fiscal year 2013. That may not sound like much, but it's a big hit for a government with a $60 million annual budget.

Palau has plenty of budget woes of its own. Garden-variety overspending plus a few big infrastructure projects have put the country tens of millions of dollars in debt. Because Palau uses the U.S. dollar and has limited ability to borrow, it has to deal with this the old-fashioned way, by slashing spending and limiting new purchases.

One irony of the unapproved compact is that it would establish a joint local and U.S. budget oversight committee to ensure Palau's fiscal discipline. But before the U.S. is in any position to tell Palau how to fix its budget, it must first sort out its own mess.

Another irony is that one expense that put Palau in the red was its copy of the U.S. Capitol, part of a $45 million Babeldaob Island development project financed with favorable loans from Taiwan. The building is unsuited to the local climate, and earlier this year, a breakdown in the ventilation system caused a creeping infestation of mold that made workers sick.

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