

Republic of Palau: Recent Economic Developments

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INTERNATIONAL MONETARY FUND

REPUBLIC OF PALAU

Recent Economic Developments

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Approved by the Asia and Pacific Department

November 30, 2001

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I. INTRODUCTION AND SUMMARY

1. **The Republic of Palau (hereafter Palau), located in the Western Pacific, is among the smallest of the Pacific islands and has a relatively high per capita GDP.**¹ The population is around 19,000, and per capita GDP is estimated at \$6,000 in 2000. Palau consists of eight main islands and some 250 smaller islands making up an archipelago that stretches over 650 km. The islands were part of a strategic trust of the United Nations, administered by the U.S. from 1947, and became self-governing in 1981 and independent in 1994, since then Palau has been in free association with the U.S. (Staff Report, Box 1).² Under the Compact of Free Association (Compact), Palau receives about \$600 million over 15 years to 2008/09. Palau faces many development constraints common among Pacific island economies, including a narrow resource base, geographical isolation, a small domestic market, a lack of infrastructure and skilled labor, and vulnerability to external and natural shocks.

2. **Palau has made a modest recovery in the last two years.** Real GDP growth has been about 1 percent in 2000 and 2001, after the recession brought about by the Asian crisis reached its trough of negative 5½ percent growth in 1999 (Table 1). This recovery was mainly due to grant-financed large infrastructure projects. However, the outlook on tourism, Palau's major industry, remains weak due to the events on September 11, and the expected El Niño, which also threaten the development of tourism-related private sector projects.

3. **Palau remains heavily dependent on grants from the United States to finance large fiscal deficits.** Compact grants have averaged 16 percent of GDP in the last six years, in addition to 8 percent of GDP in non-Compact U.S. grants and 3 percent of GDP in grants from other countries. The large upfront disbursements of Compact grants provided for an accumulated balance of unspent current and capital grants that form government financial assets (or reserve assets) a large part of which is tied to specific projects. With a relatively narrow tax base, low tax rates, and high current expenditure (averaging 55 percent of GDP in the last three years), the overall fiscal deficit after grants has averaged 9 percent of GDP in the last seven years, financed by grants and asset drawdown.³ Recognizing the need to generate domestic funds to replace the imminent loss of Compact grants, the new administration that took office in January 2001 is implementing tax and expenditure reforms.

¹ Out of 14 Pacific island countries (PICs), Palau is the fourth smallest in terms of population and has the second highest per capita GDP. Ten of the fourteen PICs are Fund members.

² Independence was achieved only after a number of hard fought referenda on the ratification of the Compact of Free Association—the main sticking point was whether Palau would be allowed to have nuclear-free status.

³ The deficits excluding grants have averaged 34 percent of GDP in the last seven years.

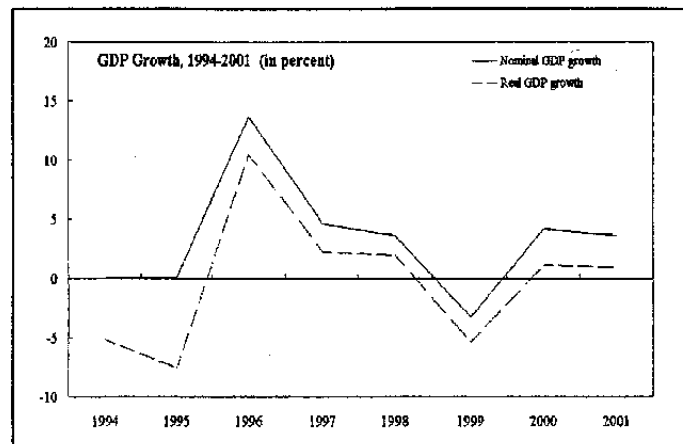
4. **With the decline in tourist receipts, the external current account has recorded large deficits in recent years.** Imports increased to accommodate the large infrastructure projects, and the export base remained narrow (tuna fish and garment exports). After benefiting from a period of bullish U.S. stock markets, investment income declined by 17 percent in 2000/01. Reserve assets have been temporarily boosted by \$30 million in capital inflows from Taiwan Province of China to finance public infrastructure (Table 2).

5. **Banking operations appear sound as the larger banks are subject to U.S. regulations and nonperforming loans are reported to be very low.** However, banking data is sparse and there is no supervisory framework in place. Banks appear to benefit from large interest rate spreads and very cautious lending practices (Table 3). Financial problems of the development bank resulted in a sharp reduction in lending, but this was reversed in 2000 following restructuring measures and a budgetary transfer. In June 2001, congress approved financial sector legislation that limits the scope for money laundering and provides a framework for banking regulation and supervision. A financial institutions commission is being set up to implement the new legislation.

II. OUTPUT, PRICES, AND EMPLOYMENT

A. Output

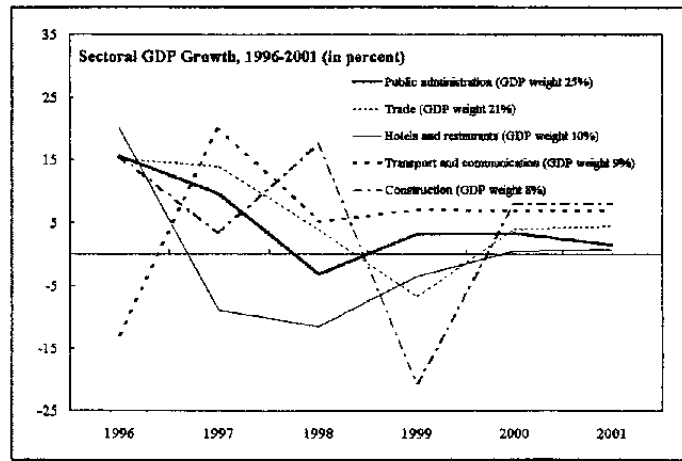
6. **Palau experienced a modest recovery of 1 percent real GDP growth in 2000 from a recession of negative 5½ percent growth in 1999.**⁴ The economic slowdown, which began in 1997, reached its trough in 1999 with the impact of the Asian crisis on tourism, the phasing down of U.S. grants under the Compact, and freezing of loan activity by the National Development Bank of Palau (NDBP). The rebound in 2000 was mostly driven by large infrastructure projects including the Compact Road (Babeldaob island's ring road), Koror-Babeldaob (K-B) Bridge, and National Capitol which began in late 1999, totaling over \$160 million to be spent over four years.



⁴ Real GDP estimates are based on nominal GDP data compiled to 1999 and estimates for 2000 and 2001. U.S. deflator is used until 1999 as Palau began compiling its CPI in 2000. See Annex of the Palau—Staff Report for the 2001 Article IV Consultation.

7. **Construction activity led the recovery, financed by higher foreign grants and the resumption of NDBP lending and guarantees.** The construction sector recorded a significant improvement of 8 percent in 2000 from negative 21 percent in 1999 (Table 4). As imports of heavy equipment for the new infrastructure projects rose sharply, the trade sector also rebounded from negative 7 percent to 4 percent growth in 1999. The finance and insurance sector recovered from negative 25 percent to 6 percent growth in 2000 as demand for loans increased. The growth in construction activity, combined with a recovery in the financial sector, had a positive effect on real estate and business services, which grew by 6 percent in 2000 from negative 30 percent in 1999. Transport and communication sectors also contributed to the recovery by sustaining 7 percent growth in 2000 reflecting growth in internet-related and mobile telephone services.

8. **Meanwhile, activities in the hotel and restaurant sector remained flat** as the number of tourist and business arrivals, which had declined significantly since the Asian crisis, recovered only marginally in 2000. Agricultural activity, which accounts for only 1 percent of GDP, remained stagnant (Table 5).



9. **Economic activity in 2001 is estimated to have grown by only 1 percent in real terms.** Although Palau seems to have stepped out of negative growth, the near-term prospects remain a concern. Most industries are anticipating growth levels similar to those of 2000, particularly following the events of September 11, 2001. Moreover, the expected El Niño in the spring of 2002 could also affect tourism and slow down the development of private tourism-related projects.

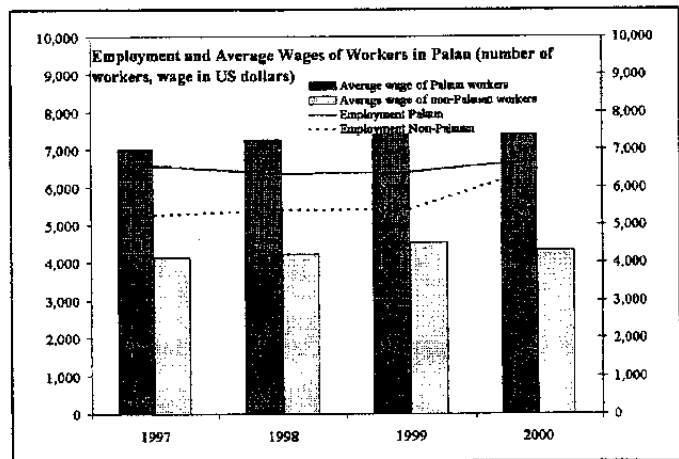
10. **Tourism remains the main source of future growth and its prospects depend on infrastructure development and foreign investment.** Tourist activity is currently limited to scuba diving and snorkeling, but there is a potential to also provide facilities for golfing, hiking, and sports fishing, especially with the development of Babeldaob, the largest island. Completion of the Compact ring road has been delayed due to rainy weather and unexpected soil conditions. On current plans, the K-B Bridge is expected to open in early 2002, and the Compact road by the summer of 2004. Their completion should greatly improve opportunities to expand tourist facilities and related commercial activities. In addition, private sector projects estimated at \$100 million have received permits and are planned for completion by mid-2003, including hotels, golf courses, and ancillary services.

B. Prices, Employment, and Wages

11. Palau began compiling quarterly CPI data for Koror from June 2000. The 12-month inflation rate to June 2001 was estimated at 2¼ percent, lower than for the U.S. The items registering the largest increase during this period were housing (7 percent), followed by clothing and footwear (4 percent), and food (3 percent). Prices of alcohol, tobacco, and betel nut declined slightly by less than ½ percent over the 12-month period.

12. Employment increased by 12 percent in 2000 mainly due to foreign workers in the construction and service sectors. Palauans constitute about 52 percent of the workforce, and more than half of those are government employees. Employment of Palauan nationals remained unchanged in 1999 and increased by 5 percent in 2000, following the resumption of NDBP lending and pick up in construction. Although the number for non-Palauan workers also remained constant in 1999, it increased by 21 percent in 2000. Workers from Philippines constitute the largest single country of origin, amounting to over one-half of total foreign workers.

13. As the share of foreign workers in the labor force increased, average wages declined by about 3 percent in 2000. The average wage of Palauans remained stable, but the average wage for non-Palauans declined by about 5 percent. Wages in the construction and service sectors are lower than average. The financial sector had the highest reported average gross wage in 2000 (\$16,700), followed by professional and related services (\$13,300), and public administration (\$11,400) (Table 6). The minimum wage scheme of \$2.50 per hour for Palauan workers, which was introduced by legislation in early 2001, may induce a further inflow of foreign workers who are willing to accept much lower hourly wages.



C. Foreign Direct Investment

14. A number of procedural obstacles limit foreign investment flows. The main obstacles include cumbersome foreign investment regulations, constraint on land use, labor shortages and regulations on foreign labor, and restrictions on the size of investment income in some sectors. As a result, only 23 Foreign Investment Approval Certificates (FIAC) were issued in 2000, 12 percent lower compared to 1999. Of those, three were for banking businesses; three for construction, engineering, and design; and two were for auditing and accounting services. The rest were for miscellaneous activities including architecture, restaurant, sports facilities, consulting services, health care services, Internet game sites,

water supply, and wireless communication. In the first nine months of 2001, a total of 14 additional FIACs were issued out of 16 applications.

15. **Foreign investments are regulated by the Foreign Investment Board (FIB), which was established in 1981.** The FIB is comprised of seven members, many of who are members of the local business community. The application procedures are reported to entail a number of different documents and agencies, which can span several months, and the cumbersome regulations have been criticized as discouraging for the interested investor.

16. **The inability to use land as collateral also acts as a significant barrier to foreign investment.** Foreigners are prohibited from owning land in Palau; instead, they are able to lease land for up to 50 years. However, even leasing can be a problem as land-ownership rights are poorly defined due to the historically communal form of ownership. The authorities expanded the Land Courts to expedite resolving existing court claims. However, it has been difficult for the Land Courts to resolve cases expeditiously. Out of a total of 8,540 cases recorded in 1989, only about 50 percent of all cases have been settled to date.

17. **Labor laws can also act to deter foreign investment.** The current foreign investment regulations stipulate the share of local employment for a number of activities, and those nationals must be paid the minimum wage of \$2.50 per hour. When hiring non-Palauan workers, foreign investors must pay an annual fee of \$500 per head, but this does not apply if the foreign workers are hired by Palauan investors. Foreign workers must contribute to social security, regardless of the length of their contract and their eligibility to receive benefits from the system at a later stage.

18. **Some sectors are restricted from foreign participation.** These include wholesale and retail trade, all tour-related businesses, ocean transportation, land transportation, and car rentals. For hotels, foreign investment is only allowed if the number of rooms exceeds 50.

19. **Foreign investors have resorted to ways to circumvent these restrictions.** In what has been commonly referred to as a so-called 'front,' the foreign investor provides capital and operates the business as a hired manager by the Palauan. The Palauan front is responsible for signing legal documents, and he/she receives a certain percentage of profits. This practice reduces transparency of business operations and complicates taxation. Moreover, it has been problematic for both the foreign investor and Palauan partners. Some foreign investors have difficulties in finding someone they can trust to act as local front, and this can discourage larger investments. For the Palauan, they can find themselves liable to large outstanding debts and liabilities once the foreign investor flees the country.

20. **Recognizing the need to remove impediments to foreign investment, a new foreign investment law is currently under committee review in congress.** The proposed law aims to provide a legal system that is simple, transparent, and non-discriminatory. It is also intended that the FIB be abolished and a one-stop foreign investment licensing unit be placed in the Ministry of Commerce.

D. Environmental Issues

21. **Palau shares similar concerns to those of other Pacific island countries on global climate changes and storm damage.** Climate changes may result in damage to infrastructure and the ecosystem of coastal areas, causing soil erosion, changes in biodiversity, coastal inundation, and extensive coral bleaching. Scientists expect another El Niño and a severe drought in the spring of 2002 in the region. Among other things, this could be expected to reduce the potential flow of income from tourism, although the severity of the impact is difficult to predict.

22. **Recognizing Palau's vulnerability to environmental damage, the authorities have accorded this issue the utmost priority.** A number of governmental organizations have recently been established including the Office of Environmental Response and Coordination (OERC), the Palau Conservation Society (PCS), and the Palau Environmental Quality Protection Board (PEQPB). Palau recently acceded to the 1995 Vienna Convention on Protection of the Ozone Layer and the 1987 Montreal Protocol on Substances That Deplete the Ozone Layer. The Ministry of Resources and Development, in coordination with the OERC, hosted a national workshop to review and assess vulnerability to climate and possible adaptation options for Palau. Meanwhile, the Drought Mitigation Committee in Palau has been educating the locals on El Niño and drought, water resources, sanitation and health, drought crops, fire prevention, and public safety. In early 2001, the United Nations recognized Palau's efforts in this area and selected it as one of the countries to be highlighted in the global synergies review process.

III. PUBLIC FINANCES

23. **The public sector in Palau consists of the national government, 16 state governments, and a number of nonfinancial public enterprises.**⁵ The national government is funded through tax revenue, nontax revenue, and foreign grants.⁶ Most public enterprises receive budgetary subsidies, while the noncommercial public enterprises rely on government transfers or direct federal contributions. The state governments receive some government transfers and have their own funding sources.

⁵ The executive branch consists of the Office of the President, the Office of the Vice-President, and eight cabinet ministries (Administration, Commerce and Trade, Community and Cultural Affairs, Education, Health, Justice, Resources and Development, and State); the legislative branch consists of two houses, the Senate and the House of Delegates.

⁶ Revenue is placed in, and expenditure allocated from, four main funds: (1) the General Fund; (2) the Special Revenue Fund; (3) the Capital Project Fund; and (4) the Debt-Service Fund.

A. General Government Overview

24. **Budget deficits have averaged 9 percent of GDP (after grants) in the last six years, financed by Compact grant disbursements**, about half of which were associated with capital projects, while the remainder was intended to finance current operations. Large up-front grants helped to generate an overall budget surplus of 105 percent of GDP in 1994/95, which became the stock of government assets used to finance deficits in the following years (Table 7).⁷ The deficit in 2000/01 is estimated to have reached 15 percent of GDP, with an increase in tax revenue and sharp reduction in expenditure being more than offset by a dramatic fall in investment income and much smaller level of grants realized than was expected in the budget. The 2001/02 budget approved by congress would yield an overall deficit of 7½ percent of GDP, but tax measures are under consideration to bring it to below 5 percent of GDP.

25. **Under current practice, the budget presented to congress excludes the majority of grant-financed capital projects, which are included when reporting fiscal operations to the Fund.** The authorities' rationale is that these specific projects would not exist unless they secure new capital grants or can utilize unspent balances of capital grants for these capital projects. Thus, the 2001/02 budget, presented to congress targeted a zero balance, whereby expenditures were limited to the total of domestic revenue and Compact grant receipts. The deficit as shown in Table 2 represents staff adjustments to budget assumptions, as well as the excess of capital spending over capital grants, which are to be financed by new non-Compact capital grants and drawdown of assets (unspent balances of capital grants received in previous years).

Revenue and grants

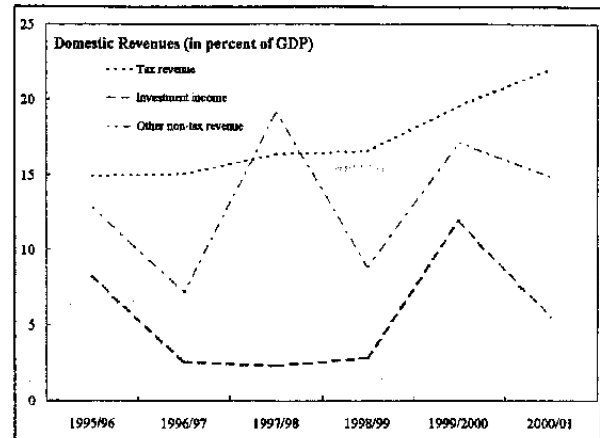
26. **Tax revenue, mainly from the gross receipts tax (GRT), salaries and wages tax, and the general import tax,⁸ increased significantly in 2000/01, reaching 21 percent of GDP.** GRT is paid by businesses at 4 percent on gross revenues (with the exception of financial institutions which pay 4 percent on receipts net of certain deductible expenses). GRT accounts for one-quarter to one-third of total tax revenue, equivalent to 5–6 percent of GDP. Wages and salaries tax is paid by all workers in Palau and accounts for about a quarter of total tax revenue. Revenue from this tax has clearly trended upward: there has been no change in the rate, and the increased yield in recent years reflects improvements in tax

⁷ A surplus was registered only in 1997/98 due to a one-time revenue gain in the form of a large legal settlement (\$13¼ million) pertaining to the collapse of a bridge.

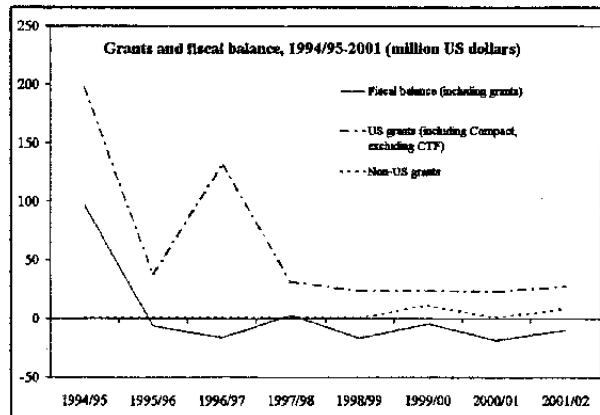
⁸ Other taxes include hotel occupancy room tax, fish export tax, travelers' head tax (exit tax), vessel cabin and foreign water vessel tax, road-use tax, delinquency tax, tax penalty and interest penalty. Table 15 provides a summary of the various rates.

administration and collection (see below). Revenue from import tax has increased steadily since the mid-1990s as tax rates were raised on cigarettes and alcohol in 1996 and 1998, and a new Customs recording system was introduced in 1999.

27. **Nontax revenue has fluctuated, depending on investment income earned on government assets consisting of unspent grant balances (Table 8).**⁹ The unspent balances of current and capital grants are invested largely in the U.S. and returns constitute investment income.¹⁰ Investment income peaked in 1999/00 at about \$14 million (reflecting the strong U.S. stock market performance). The remaining nontax revenue mainly comprises license and permit fees, interest income on domestically held assets, local trust funds, and court fines. These miscellaneous nontax revenues have increased significantly since the mid-nineties.¹¹ There has been an upward trend in fees and charges since the mid-1990s—a large part of which is permits for foreign workers—and the peak in 1998/99 reflects the increase in fees for foreign workers' permits.



28. **With the step down in Compact grants in 1998/99, tax revenue surpassed grant receipts for the first time in 2000/01.** As scheduled, Compact grants were steady at over \$20 million from 1995/96–1997/98 and then declined to about \$13½ million in 1998/99—the level at which they will remain (with inflation adjustments) through to the end of the Compact period in 2009. Other non-



⁹ Following staff's advice, unrealized investment gains and losses (amounting to plus or minus 13 percent of GDP) were taken out of nontax revenue and the fiscal balance was revised from 1994/95 onward.

¹⁰ Investment income from the Compact Trust Fund is not included in the budgetary accounts and is treated separately (see below).

¹¹ Local trust funds consist of the K-B Bridge and Operations and Maintenance Trust Fund (from 1997/98), the Hospital Trust Fund, and the Airport Trust Fund. The Palau Visitors' Authority was included as a local trust fund between 1994/95 and 1996/97.

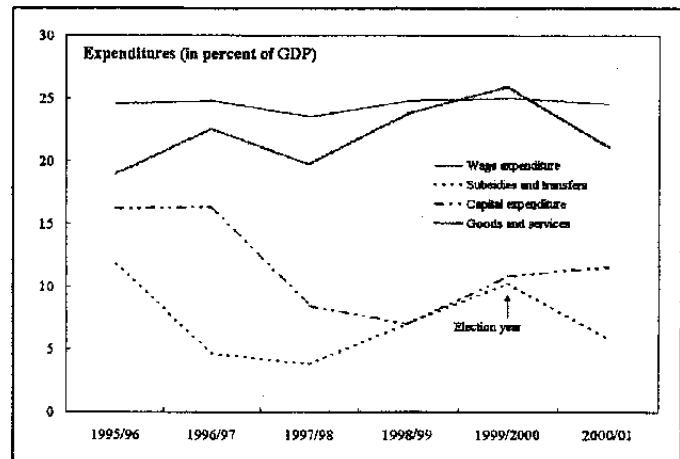
Compact grants have fluctuated—ranging from \$7½ million to \$18½ million, reflecting the lumpy nature of project related grants. The largest single non-U.S. grant has been the \$10 million grants from Taiwan Province of China in 1999/00. Direct grants for the three large infrastructure projects are not included in budgetary grants because the authorities do not have reliable disbursement information.

Expenditure

29. **Current expenditure has fluctuated between 47 percent of GDP and 61 percent of GDP in recent years.** The increase in 1999/00 reflects a tripling of subsidies and transfers over two years to the pension fund in 1999 and 2000 (\$4¼ million and \$3½ million, respectively) to cover increased benefits and the earlier mentioned one-off transfer to the NDBP (of \$3 million) in 2000. Purchases of goods and services also increased sharply in these years, representing supportive expenditure by the government during the economic slowdown in 1998/99 and pre-election spending in 1999/00 (Table 9).

30. **Fiscal consolidation efforts by the new administrations are geared toward reducing current expenditure relative to GDP.** Current expenditures declined to an estimated 52 percent of GDP in 2000/01, and a further reduction to 46 percent of GDP is planned for 2001/02. The decline in 2000/01 is largely explained by cuts in expenditure on goods and services and in subsidies and transfers, particularly to the Civil Service Pension Fund and the Public Utilities Corporation.

31. **Capital expenditure has picked up to 11½ percent of GDP in 2000/01 from a low of 7 percent of GDP two years earlier.** The increase reflects efforts to secure additional capital grants to supplement the \$2 million received annually under the Compact, since a large part of the initial \$63 million Compact capital allocation has been spent. Rehabilitation spending following Storm Utor, financed by Taiwan Province of China and U.S. assistance, also contributed to boosting capital



spending. Budget-reported capital expenditure excludes directly financed projects, namely the Compact Road, K-B Bridge, and the new airport terminal building.

B. State Governments

32. **State government accounts are sketchy.** Only two state governments have reported their activities to the national authorities since 1998/99 (Table 10). In addition to small transfers from the general government, state governments are mainly funded by 85 percent of

the fishing rights fees, and some local fees and charges (such as motor vehicle registration fees). Expenditures typically cover local wages and salaries, municipal and civic services, and small-scale capital expenditures. The authorities indicated that only two local governments have the authority to borrow, namely Koror (the current capital) and Melekeok (the site of what will be the new capital). Otherwise, states are required to keep spending within available resources, i.e., local revenues plus grants from the national government.

C. Trust Funds

33. **There are three trust funds administered by the government: the Compact Trust Fund (CTF), the Social Security Fund (SSF), and the Civil Service Pension Fund (CSPF).** Under the Compact Agreement, the CTF received an initial allocation of \$66 million and an additional \$4 million in 1996/97, and returns were to be largely re-invested until 2009 so as to create a sizable trust fund that would thereafter provide a flow of income to help offset the scheduled loss of Compact grants (Table 8). While there was a provision in the Compact agreement allowing for use of some part of the CTF investment income (\$5 million a year from 1998/99 onward, adjusted for inflation at 5 percent), none has so far been used.

34. **The CTF grew by an average rate of 13 percent from its inception to June 2001, when its market value was \$147 million.** However, its value dropped to \$135 million in September 2001, following the substantial correction in the U.S. stock market. The CTF is managed by a number of U.S. fund managers and must be invested only in U.S. equity and fixed income instruments¹² (Table 11).

35. **The SSF, set up under a law enacted in 1991, is self-financing by law and is funded by employee and employer contributions** (each of 6 percent on all remuneration paid up to a maximum of \$3,000 a quarter).¹³ The fund covers employees of public and private employers in Palau, and benefits include old-age insurance benefit (available after the age of 60), disability insurance benefit, and survivor insurance benefit.

36. **The SSF grew by an average annual rate of over 20 percent between 1993/94–1999/00** (Table 12). The funds were invested in U.S. assets, under U.S. fund managers, in the approximate ratio of 35 percent fixed income and 65 percent equity. Annualized returns on

¹² The authorities' CTF investment strategy targets investment return of CPI plus 7 percent on equity and CPI plus 3½ percent on fixed income assets. It also sets forth "desired asset class target allocations," with that for equity 65 percent (with a lower limit of 55 percent and upper limit of 75 percent) and that for fixed income 35 percent (with respective lower and upper limits of 25 percent and 45 percent).

¹³ The employee and employer each contributed 4 percent of remuneration under the maximum until September 30, 1996; 5 percent from October 1, 1996 through to September 30, 2001; and 6 percent beginning October 1, 2001.

equity and fixed income averaged 17 percent and 5 percent, respectively. However, these turned negative in the past year.

37. **Although SSF can continue meeting its current obligations from these surpluses, recent changes to benefits have increased its unfunded liability from \$15 million to over \$20 million.** An actuarial study in 2000 (based on 1999 data) indicated that the Social Security System's funding deficiency had decreased from approximately \$19.3 million as of October 1, 1995, to approximately \$15.3 million as of October 1, 1999, primarily due to increased contributions. However, based on the changes to benefits in 1999, the unfunded liability is estimated to have increased to \$20.2 million. These benefit changes include: (i) allowing individuals to receive double benefits (e.g., a retiree could also receive surviving spouse benefits); (ii) removing the incremental reduction in benefits related to income earned; and (iii) tax-exempting the contributions of government to those with titles. There is proposed legislation pending that may successfully reverse parts of the changes, such as the earnings test and the tax-exemption.

38. **The Pension Fund has received large government transfers over the past few years (totaling around \$13 million since 1998) to offset the impact of higher benefits on the unfunded liabilities.** The civil service pension plan, set up in October 1987, provides retirement, death, and disability benefits to civil servants and their families. The CSPF is financed by contributions from government and employees at 6 percent each. The size of the CSPF also grew rapidly over the 1990s, with revenues much higher than expenditures (Table 13).

39. **Investment income on the CSPF has also been high, but unfunded liabilities have increased as the benefits under the plan have been expanded.**¹⁴ Actuarial valuations have been performed periodically, and the latest (seventh) valuation for the fiscal year 2000 indicates that at end-October 1999, the level of under funding was \$24 million, compared to the previous level of \$14¾ million as of end-October 1997. This increase relates to the government's change in the retirement qualification from the age of 60 to 30 years of service (or which ever came sooner) without reduced benefits before the age of 60, which became effective on July 1, 1999.

40. **The level of under funding is expected to have increased further in 2001, with the rise in benefits as a result of the cost of living adjustment.** This is expected to require

¹⁴ In 1988, early retirement was permitted at the age of 55 or 20 years of service (with an associated reduction in benefits for early retirement) and the requirement that retired members contribute 6 percent of benefits was removed; in 1989, various former government workers were brought into the plan; in 1994, the Board of trustees provided for a minimum benefit of \$50 per month; in 1999, the retirement qualification was changed to either 60 years of age or 30 years of service.

a lump sum transfer of \$7¼ million to the fund to leave the level of under funding unchanged. In 2000/01, a \$1½ million transfer was made to the fund but there is no allocation in the 2001/02 Budget. The authorities indicated that part of the lease income from the two Internet gaming concessions (totaling \$2.5 million annually) would be earmarked for the CSPF. Moreover, the authorities have presented some options to congress for financing the unfunded liabilities.

D. Performance of Nonfinancial Public Enterprises

41. **The largest nonfinancial public enterprises include** the Palau National Communications Corporation (PNCC), Palau International Coral Reef Center, the Public Utility Corporation (PUC), Belau National Museum, the Palau Visitors' Authority, and the Palau Housing Authority (PHA). All but PNCC have received budgetary transfers in recent years. Total transfers to public enterprises amounted to 3 percent of GDP in 2000/01 (Table 14).

42. **PNCC recorded a small profit in 2001.** This was due to improvements brought about by new management and increased demand for telecommunication and cellular phone services influenced by the recent construction activities in Palau. Higher profits are expected if PNCC becomes a member of National Exchange Carrier Association (NECA) of U.S.¹⁵

43. **After incurring relatively large losses in the past six years to 1999/00, PUC expects to have covered their cost of operation for 2000/01.** In the past year, wage expenditure declined and tariffs were increased while consumption of electricity rose by 3-4 percent. However, further tariff increases would be needed to avoid a worsening of the financial position in 2002, as the request for subsidy from the government was declined recently and PUC may be required to expand utility services to more remote parts of the islands.

44. **PHA recorded negative operating profit in both 1998/99 and in 1999/00.** PHA receives a small subsidy annually to provide low-cost housing for Palauan families, and has registered a small surplus since 1994/95. Recently, U.S. federal contributions, its largest source of revenue, were halted.

E. Public Sector Reforms

45. **A number of public sector reforms have been initiated or are being planned in the near future, as outlined in the government's Management Action Plan (MAP)**

¹⁵ Formed in 1983 by the Federal Communications Commission (FCC) as a not-for-profit membership corporation, NECA administers the FCC's access charge plan that helps ensure that telephone service remains available and affordable in all parts of the U.S., including remote areas.

document issued in March 2001. Legislation was presented to congress in 2001 to introduce tax reforms and to improve its efficiency through performance budgeting and outsourcing functions that can be better performed by the private sector.

46. **Proposed new tax legislation includes administrative provisions for tax and customs and revised import taxes.** The tax administration portion of the legislation will formalize improved practices that have already been partly implemented. The legislation also proposes changes to the current tariff structure that would reduce the number of duty bands to a flat rate of 5 percent; remove certain duty exemptions; switch to valuation imports on a c.i.f. basis from the current use of f.o.b. valuation; and introduces excises on tobacco, alcohol, fuel, boats, and vehicles (Table 15).

47. **The passage of the Budget Reform Act, signed into law on July 31, 2001, established performance budgeting and thus provides a system in which government performance can be more readily evaluated.** The system is intended to eliminate the duplication of services and ensure the productivity of expenditures. Performance budgeting requires the establishment of program goals and objectives at the agency level, and requires the development of performance indicators as a means of reviewing performance. Such indicators are intended to allow a shift in focus from expenditure on specific line items to the performance of that expenditure and consistency with the overall objectives.

48. **As part of the effort to control the public sector wage bill, there has been an Executive Branch wage and hiring freeze since June 2001.** The wage and hiring freeze is part of the medium-term objective of "right-sizing" government. Under this decree, positions can only be filled by presidential decree. The hiring freeze is expected to remain in force until a final reorganization structure is in place and a long-term fiscal strategy has been developed. Since June 2001, there is also a moratorium on executive travel, preliminary to the implementation of a comprehensive travel policy. Over the coming year, the right-sizing program will set rules for reorganization by attrition, for retraining and placement programs, and for a severance pay program.

49. **Another initiative aiming to right-size government is the planned out-sourcing of services.** The Ministry of Administration is currently identifying services that the private sector can provide more efficiently than the public sector. The MAP document refers to the privatization of appropriate government functions, where economically feasible, such as security and janitorial services, maintenance services, and basic infrastructure services to include water and sewer services, solid waste disposal, and large government contracts. Other candidates for outsourcing include road repairs, broadcasting, airport operations, and seaports.

50. **There are on-going efforts to improve the delivery of health and education services by focusing on cost reduction and increasing the quality of services.** Despite declining government transfers in recent years, the hospital has succeeded in increasing medical services by imposing fees equal to about 25 percent of medical costs. Much scope

remains for improving the quality of education and the cost-effectiveness of government spending. Private as well as public schools currently receive transfers for school lunches. There is a severe shortage of qualified teachers due to recent changes in retirement criteria while student enrollment is increasing.

51. **A number of governance reforms are also under way.** The Reapportionment Committee reduced the number of Senators from 14 to 9 in January 2001, which is intended to streamline the decision-making process. A constitutional amendment has been proposed to combine the Senate and House of Delegates. Moreover, the National Planning Committee has been reactivated with the objective of providing a more cohesive planning structure within the Executive Branch. This committee has been inactive for several years.

52. **The Statistics Act before congress is aimed at strengthening Palau's capacity to collect the necessary data for performance assessment and policy formulation.** Notable progress on the compilation and availability of statistics in Palau include: (i) the new GDP data series based on social security data, tax revenue data, and corporate questionnaires; (ii) the compilation of a CPI series since June 2000; and (iii) an on-line processing system for Customs which provides imports data. In addition, the new Financial Institutions Act (FIA) will facilitate regular reporting of banking data, and the new investment regulations will require collection of some basic information on foreign investments.

IV. MONETARY AND FINANCIAL SECTOR

53. **The banking sector comprises about 12 operating full service commercial banks, 1 development bank, and some 11 other financial institutions, as well as numerous small credit unions.** Palau uses the U.S. dollar as its official currency, and has no central bank or monetary survey. Three out of the 12 operating banks are branches of U.S. banks and subject to U.S. banking regulation. Four other banks are branches of Asian banks, and the remaining five are locally chartered. Of the 11 nonbank financial institutions, three are not in operation, and eight provide limited financial services.

A. Commercial Banks

54. **The largest three U.S.-based banks that account for nearly 80 percent of deposits are insured under the FDIC.** The Bank of Hawaii alone accounts for more than 60 percent of total deposits. The U.S.-based banks place the majority of their deposits at their headquarters abroad. Most of their local loans are in the form of well-secured consumer loans rather than business loans. Increasing loan activity by these banks would depend on improved financial accounting and disclosure by borrowers and clarification of land ownership and lease rights to facilitate use of land and leases as loan collateral.

55. **Banking operations continue to be profitable, based on the large spread between deposit and lending rates.** Deposit rates for the period 1997-2000 on 30-day time savings accounts were in the range 2¼-5 percent and on certificates of deposit were in the range of

4–8 percent (Table 3). This compares with lending rates for the same period of between 10–18 percent for consumer loans and 9¼–13 percent for commercial loans.¹⁶ A large share of bank lending is consumer loans; these are thought to be safer, and because they can be typically serviced through direct withdrawals from salary deposits, the level of nonperforming loans is generally low. Available data from corporate reports for nine of the major banks that had submitted their 2000 reports by mid-September 2001 indicated that total deposits were around \$154 million and total loans were \$56 million (in 2000) and that in aggregate, profit (the excess of income over expenditures) was positive. The balance of deposits continue to be accumulated and used offshore, suggesting the continued lack of incentives to increase lending in Palau.

B. National Development Bank of Palau

56. **The balance sheet of the National Development Bank of Palau (NDBP) has improved following restructuring by a new management team.** A severe deterioration in its balance sheet had sharply curtailed its lending activity in 1999–2000. At the worst point, around 30–40 percent of the loan portfolio was in arrears of up to two years. However, with the recent more aggressive approach to collecting, many of these are now serviced and all bad or doubtful loans have been fully provisioned. Its loan guarantees have also been resumed, facilitating lending by foreign banks that cannot accept land as collateral. Proposed legislation in congress aims to help the bank become self-sustaining by allowing it to accept deposits under the same prudential guidelines as other deposit-taking commercial banks, and to issue bonds, which will be guaranteed by the government.

57. **The size of NDBP's loan portfolio is currently about \$7 million, in addition to about \$2 million of approved undisbursed loans** (Tables 16–18). About one-third of the portfolio is in residential housing. In the last year, NDBP has begun to provide the government with quarterly reports of its operations. Loans in arrears for over six months are called *judgment loans* and these stand at about \$0.7 million. An urgent priority of the bank is to get a system of credit classification in place. There has been a recent dialogue with the government about the strategic direction of loans that should be made by NDBP and priority areas under consideration include agriculture, aquaculture, and tourism in addition to housing.

C. Regulatory and Supervisory Framework

58. **Palau has recently put in place legislation to combat money laundering and increased surveillance practices.** The Financial Institutions Act (FIA), approved in 2001, will form the basis for the financial regulation and supervision. Upon reviewing the new

¹⁶ There is an interest ceiling of 18 percent on consumer loans and a ceiling of prime plus 4 percent on commercial loans.

legislation in September 2001, the Financial Action Task Force (FATF) decided not to list Palau among the noncooperation countries and territories in the context of money laundering. Palau's review by the FATF had been postponed pending approval and review of the new legislation.

59. **The Financial Institutions Commission (FIC) will oversee implementation of the Act.** One of its first tasks will be to review the documentation of existing banks against the new guidelines, and to establish banking regulations that will further clarify and strengthen the FIA's provisions. The Act also requires banks to disclose financial statements and to provide regular reports that can form the basis for banking system data to be publicly available in Palau for the first time.

60. **The authorities intend to strengthen the FIA legislation** by: (i) removing potential sources of conflict of interest; (ii) clarifying the definition of regulatory capital and raising the capital adequacy requirement to international norms; (iii) requiring adequate record-keeping, reporting, and external certified auditing of all banks, not only foreign banks; (iv) clarifying the FIC's mandate to request additional reports and conduct on-site inspections, and completing an initial evaluation of all existing banks against the new regulations; and (v) limiting the scope of the banking license granted to banks whose paid-up capital is between the minimum level of \$0.5 million and \$5 million. The authorities intend to amend the legislation and/or address these issues through FIC regulations before the end of 2001. Technical assistance from Pacific Financial Technical Assistance Centre (PFTAC) is planned to help achieve this objective.

V. EXTERNAL SECTOR

61. **Palau, like several other small Pacific islands, relies heavily on grant receipts to avoid external imbalances.** Palau maintains a large trade deficit. Its export base is narrow, while consumption and investment are highly dependent on imported goods. Tourist receipts, which generate a large share of income in Palau, remain vulnerable to changes in the external environment. External sector data is extremely weak because of the lack of adequate reporting mechanisms; current and capital private transactions are not fully captured as banks and businesses are not required by law to submit such data.

A. Current Account

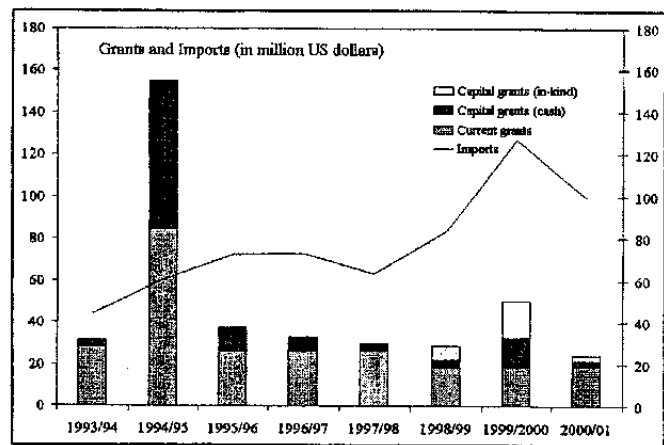
62. **The current account deficit (excluding grants) nearly doubled, exceeding 50 percent of GDP in 1999/00** (Table 4). The deficit widened mainly due to a sharp increase in imports associated with construction of infrastructure projects. In 2000/01 the current account deficit is estimated to have returned to the level of two years earlier as the imports dropped significantly, while service receipts remained relatively flat. Investment income also declined sharply as Palau invests much of its assets in the U.S. stock market. Current grants have remained stable at 15 percent of GDP in the last three years. The current account deficit

including grants was 37 percent of GDP and 13 percent of GDP in for 1999/00 and 2000/01 respectively.

Merchandise trade

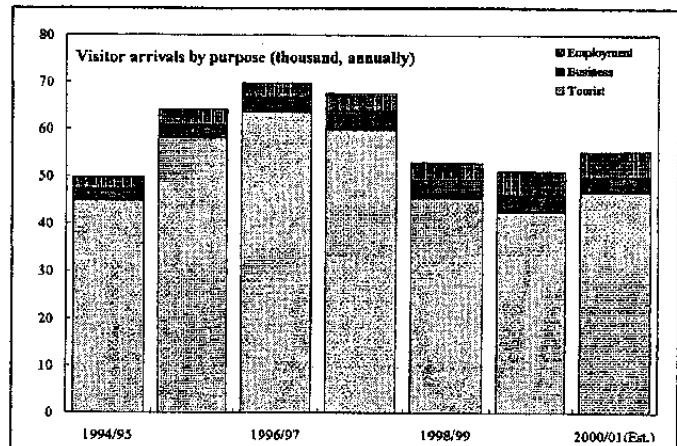
63. **Palau's exports, accounting for about 10–15 percent of GDP, consist mostly of fish (sashimi-grade tuna headed for Japan) and garments manufactured by a foreign company.** Fish exports had declined in 1997/98 by about 20 percent compared to 1995/96 due to fish migration after El Niño and because Palau began to request all the fishing vessels to install Vessel Monitoring System (VMS) according to international standards. Subsequently, fish exports rose by 23 percent in 1998/99 as some neighboring countries also began to request fishing vessels to install VMS. In 2000/01, fish exports are estimated to have fallen again by about 33 percent (due to bad weather) to about \$7 million, compared to a peak of \$13 million in 1994/95. Garment exports have become the second largest commodity export in recent years as Chinese investors take advantage of Palau's preferential access to U.S. markets.

64. **There was a sharp increase in imports in 1999/00, reaching nearly 110 percent of GDP.** After increasing by one-third in 1998/99, imports jumped up by one-half again on account of capital goods needed for major grant-financed infrastructure projects. The largest category of imports is metal products, machinery, and equipment, accounting for 40 percent of total imports. Imports of fuel, food, and beverages, which together account for 28 percent of total imports, also increased by about 45 percent in 1999/00 (Table 19). The U.S., including Guam account for over 50 percent of total imports (Table 20). Imports are estimated to have declined by 25 percent in 2000/01, as most construction-related goods required this year had already been imported.



Services, income, and transfers

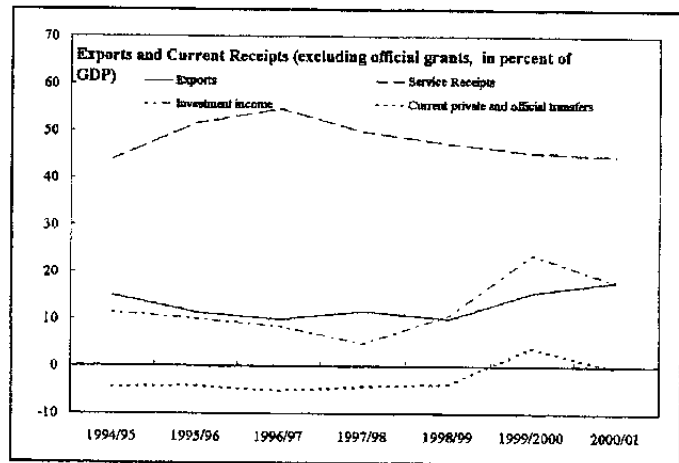
65. **Service receipts, which amount to 40–55 percent of GDP, consist of tourist receipts, freight and insurance payments, and official travel expenses.** Service receipts declined slightly in the previous two years before recovering in 2000/01. Tourists from Japan and Taiwan



Province of China have declined since the Asian crisis, partly reflecting the relative appreciation of the U.S. dollar compared to Asian currencies. Accordingly, the number of tourist arrivals has not recovered to the level of 1996/97. Service account payments comprise mostly freight and insurance costs, amounting to 17–20 percent of the f.o.b. value of imports.

66. **There was a sharp decline in investment income receipts in the year ending September 2001.** Investment income consists of income from Compact grants (excluding the Trust Fund), the SSF, and CSPF. Investment income from the SSF and CSPF increased substantially by about 120 percent annually in 1998/99 and 1999/00 before falling to 22 percent in 2000/01. Profit remittances by the foreign fishing and garment companies are estimated at 5–10 percent of GDP annually.

67. **Current transfers have fluctuated in recent years, declining by 31 percent in 1998/99 reflecting the reduction in official transfers, mainly grants.** Current official transfers include fishing rights fees, FIB permit and employee fees, foreign labor permits, airport uses fees, and port use fees for business licenses and fees. There was an increase in net current transfers by 67 percent in 1999/00 due to a jump in net private inflows, but net transfers declined by 23 percent in 2000/01.



B. Capital Account and External Debt

68. **Data on capital account transactions continue to be scarce because foreign commercial banks are not required to submit banking statistics to the authorities.** The capital and financial account recorded a balance of \$51 million in 1999/00 from \$7 million in the previous year due to new borrowing of \$20 million from Taiwan Province of China for the capital relocation project, an increase in grants received for capital improvements, and directly paid in-kind grants. It declined in 2000/01 to about \$6 million.

69. **In 2000/01, Palau repaid all the debt from financing a power plant.** The original debt of \$67 million was renegotiated in 1993 into an interest-free debt of \$20 million, with a repayment stream of around \$3–4 million for five years starting in 1995 (Table 21). From 2004/05, Palau will begin to make repayments on the loan from Taiwan Province of China.

70. **No official data are available for foreign direct investment,** and the Foreign Investment Board does not collect information on foreign investments. However, foreign

investment and other private flows are estimated at 2–12 percent of GDP annually as several tourism-related projects are either wholly or partly financed by foreign private capital.

71. **Although Palau has considerable financial holdings, freely usable government assets are small.** There is no definition of official reserves in use. Total financial holdings, excluding the CSPF and SSF assets amount to about \$180 million (Table 22). However, the largest component of this is the \$135 million balance of the CTF, of which \$5 million (inflation adjusted) can be drawn annually. Most of the remaining assets are held abroad, thereby accruing investment income, and are associated with specific capital projects. Accordingly, freely usable reserves are estimated at about \$8 million.

C. Exchange and Trade System

72. **Palau uses the U.S. dollar as national currency.** The authorities do not transact in foreign exchange. Most commercial banks handle foreign exchange transactions and buy and sell foreign currencies based on rates quoted in the international markets. There are no taxes or subsidies imposed on the purchase or sale of foreign exchange. Palau accepted the obligations of Article VIII, Sections 2, 3, and 4 on December 16, 1997.

73. **Imports are not subject to any licensing requirements,** but importers must obtain a business license to engage in importing activities. Specific and ad valorem taxes are levied under the Customs Rules and Regulations. Most imports are subject to a 3 percent tariff rate. Specific duties are levied on cigarettes, alcoholic products, and other beverages. Proposed legislation, if approved, would convert the specific duties to excise taxes on domestic as well as foreign products.

74. **There are no surrender requirements for export proceeds.** Exports are not subject to licensing requirements, except with regard to the export of fish. There are no taxes or quantitative restrictions on exports, except that, under the Fish Export Tax Law, a tax is levied on the export of any species of tuna and any species of billfish at the rate of \$0.25 per kilogram.

75. **There are no restrictions on the payments for or receipts from invisibles.**

76. **Foreign investors are required to submit applications to the Foreign Investment Board and obtain an approval certificate to engage in business or to acquire an ownership interest in a business in Palau.** As noted earlier, some business activities are reserved exclusively for Palauan citizens or business enterprises wholly owned by Palauan citizens. There are no special financial incentives offered to foreign investors, except those available under certain provisions of the Compact (for example, duty-free access to the U.S. markets for some products). As noted earlier, foreign ownership of real estate is prohibited, but foreigners can obtain long-term leases extending up to 50 years. There are no restrictions on the repatriation of profit or capital. Recently proposed legislation may relax some of the restrictions on foreign investment.

Table 1. Republic of Palau: Selected Economic and Financial Indicators, 1993/94–2000/01 1/

Nominal GDP (2000): US\$118.2 million
 Population (2000): 19,129
 GDP per capita (1999): US\$6,179

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	Est. 2000/01
(In millions of U.S. dollars, unless otherwise specified)								
Real sector								
Nominal GDP 2/	83.5	95.2	108.2	113.2	117.3	113.5	118.2	122.5
(Percent change)	10.1	14.0	13.6	4.6	3.6	-3.3	4.2	3.6
GDP deflator 3/	2.6	2.8	2.9	2.3	1.6	2.2	3.0	2.6
Real GDP (percent change)	7.3	10.9	10.4	2.3	2.0	-5.4	1.1	1.0
Nominal GDP (FY)	81.6	92.3	105.0	112.0	116.3	114.4	117.0	121.4
Business and tourist arrivals	37,578	47,023	60,719	66,441	63,656	49,170	45,932	49,731
Tourist spending	29.4	40.6	54.2	61.2	58.0	54.1	53.2	54.3
Public finance								
Central government								
Revenues	49.6	165.1	66.5	58.0	71.3	51.0	75.0	61.6
Domestic	18.8	22.1	29.1	24.9	41.3	29.0	42.9	40.2
Grants	30.9	143.0	37.5	33.2	30.0	22.0	32.1	21.4
Expenditures	50.4	65.3	75.1	76.5	64.6	71.7	84.5	77.2
Current	47.4	56.7	58.1	58.3	54.8	63.7	71.8	63.1
Capital	3.0	8.5	17.0	18.3	9.9	8.0	12.7	14.1
Overall fiscal balance (including grants)	-0.4	97.3	-6.6	-16.3	2.4	-16.8	-4.7	-18.5
(In percentage of GDP)	-0.5	105.4	-6.3	-14.5	2.1	-14.7	-4.0	-15.2
Overall fiscal balance (excluding grants)	-31.2	-45.7	-44.1	-49.5	-27.5	-38.8	-36.7	-39.9
(In percentage of GDP)	-38.3	-49.6	-42.0	-44.2	-23.7	-33.9	-31.4	-32.9
Compact Trust Fund (CTF) balance 4/	0.0	70.8	77.2	105.5	122.4	141.1	161.8	135.0
Revenues	...	71.0	7.0	28.9	17.6	19.6	21.5	-25.8
Expenditures	...	0.3	0.6	0.5	0.8	0.8	0.8	1.0
Government assets (non-Trust Fund assets)	0.5	97.5	84.1	81.0	85.1	67.0	77.7	44.0
Balance of capital grants 5/	...	61.6	55.9	44.7	38.4	33.8	53.8	41.9
Balance of current grants 5/	...	38.2	35.3	31.1	44.1	28.0	18.5	14.7
Balance of usable reserves (excluding CTF) 6/	...	35.1	30.3	36.1	43.4	38.9	29.4	7.6
Balance of payments								
Trade balance	-31.7	-46.6	-58.5	-61.1	-52.1	-70.3	-115.6	-80.8
Exports (f.o.b.)	12.6	13.9	13.9	11.8	11.1	13.6	11.5	18.3
Imports (f.o.b.)	-44.2	-60.4	-72.4	-72.9	-63.2	-83.9	-127.1	-99.1
Current account balance (including grants)	2.8	60.7	1.4	4.2	9.7	-14.3	-42.7	-15.7
(In percentage of GDP)	3.4	65.8	1.3	3.7	8.4	-12.5	-36.5	-12.9
Current account balance (excluding grants)	-25.6	-23.9	-24.8	-21.9	-16.7	-33.0	-62.0	-34.8
(In percentage of GDP)	-31.3	-25.9	-23.6	-19.6	-14.4	-28.8	-52.9	-28.7
Overall balance	-0.8	92.8	-9.6	-16.6	-1.2	-20.9	13.9	-18.5
External debt	20.0	15.5	12.5	9.1	5.5	1.4	20.0	20.0
External debt service	...	4.5	3.0	3.4	3.6	4.1	1.4	0.7

Sources: Data provided by the Palauan authorities; and Fund staff estimates.

1/ Fiscal year beginning October 1.

2/ On a calendar year basis. The column 1995/96 refers to 1996, and so forth.

3/ U.S. CPI is used as GDP deflator for 1995 to 1999. Palau began compiling CPI from June 2000, therefore, GDP deflator for year 2000 is the average of U.S. deflator and Palau CPI. For 2001, Palau CPI is used as deflator.

4/ Covers operations of the Trust Fund from 1994/95.

5/ Staff estimate of the unused balance of grant receipts. Capital and current balance do not add to total because of valuation losses in 2001.

6/ Usable reserves estimated as the government financial balance plus annual drawable amount from CTF less the balance of capital grants.

Table 2. Republic of Palau: Balance of Payments, 1994/95-2000/01

(In thousands of U.S. dollars)

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	Est. 2000/01
Trade balance	-46,569	-58,517	-61,082	-52,127	-70,278	-115,619	-80,837
Exports, f.o.b.	13,868	13,907	11,812	11,094	13,574	11,508	18,267
Imports, f.o.b. 1/	-60,438	-72,424	-72,894	-63,222	-83,852	-127,127	-99,104
Services account	23,958	34,447	41,203	40,292	35,443	25,794	32,756
Receipts	40,554	54,213	61,220	58,003	54,144	53,240	54,307
Travel	40,554	54,213	61,220	58,003	54,144	53,240	54,307
Payments	-16,596	-19,766	-20,016	-17,711	-18,701	-27,445	-21,551
Freight and insurance	-15,109	-18,106	-18,223	-15,805	-16,770	-25,425	-19,821
Travel	-1,487	-1,660	-1,793	-1,906	-1,931	-2,020	-1,730
Income	2,832	3,788	3,872	271	6,215	23,236	14,028
Investment income 2/	10,458	10,522	9,410	5,608	12,204	27,782	21,575
Income and interest payment 3/	-7,626	-6,734	-5,538	-5,337	-5,989	-4,546	-7,547
Current transfers	80,499	21,659	20,180	21,306	14,288	23,926	18,368
Private	-4,818	-5,408	-6,404	-6,062	-5,680	3,272	-1,899
Inflows	880	983	1,062	1,129	1,500	11,135	5,686
Outflows	-5,698	-6,391	-7,466	-7,190	-7,180	-7,862	-7,585
Official	85,317	27,067	26,584	27,368	19,968	20,654	20,267
Business licenses and fees	1,001	1,000	867	1,724	1,915	1,933	1,728
Grants	84,643	26,161	26,098	26,435	18,624	19,298	19,128
Other 4/	-327	-95	-381	-791	-571	-577	-589
Current account (includes official grants)	60,720	1,377	4,173	9,742	-14,332	-42,663	-15,685
Current account (excludes official grants)	-23,923	-24,784	-21,925	-16,693	-32,956	-61,961	-34,813
Capital and financial account	65,674	10,291	5,674	14,146	7,003	51,484	6,144
Public sector	65,674	8,291	3,674	-54	6,003	49,484	5,144
Capital grants 5/	70,174	11,291	7,074	3,546	3,369	12,764	2,179
In-kind capital grants	...	...	...	...	6,701	18,154	2,965
Gross borrowing	...	...	...	...	...	20,000	...
Loan repayments	-4,500	-3,000	-3,400	-3,600	-4,067	-1,434	0
Private Sector	...	2,000	2,000	14,200	1,000	2,000	1,000
Foreign direct investment 6/	...	2,000	2,000	1,000	1,000	2,000	1,000
Other private inflows	...	...	...	13,200	...	...	...
Current plus capital account	126,394	11,667	9,847	23,888	-7,329	8,821	-9,541
Error and omissions 7/	-33,618	-21,284	-26,481	-25,051	-13,524	5,078	-8,938
Overall balance 8/	92,776	-9,616	-16,633	-1,163	-20,853	13,899	-18,479
Memorandum items:							
Imports/GDP (in percent)	-65.5	-69.0	-65.1	-54.4	-73.3	-108.6	-81.6
Import duties/GDP	3.4	3.1	3.4	3.8	4.3	5.5	5.3
Current account/GDP (in percent)							
Including official grants	65.8	1.3	3.7	8.4	-12.5	-36.5	-12.9
Excluding official grants	-25.9	-23.6	-19.6	-14.4	-28.8	-52.9	-28.7
Service receipts/GDP (in percent)	43.9	51.7	54.7	49.9	47.3	45.5	44.7
REER appreciation (12 month basis)	1.1	3.1	5.4	11.1	-6.5	2.8	8.0
Reserves in months of imports	19.2	14.3	13.3	15.5	9.7	7.4	5.3
External debt/reserve ratio	0.2	0.1	0.1	0.1	0.3	0.3	0.5

Sources: Data provided by the Palau authorities; and Fund staff estimates.

1/ Includes direct financed aid project imports and other tax-exempt imports.

2/ Includes realized investment gains and losses.

3/ Includes estimates of profit repatriation by foreign fish and garment export companies.

4/ Contribution to international and regional organizations.

5/ Includes \$13 million in 1997/98 for K-B bridge settlement and excludes grants-in-kind.

6/ Staff estimates on investments in new hotels/resorts for 1999/00 and 2000/01.

7/ Large error and omission in 1994/95-1998/99 reflect underreporting of imports prior to April 1999 when new customs system was implemented. In addition, net private current inflows are underestimated as inflows are only reported by one bank in Palau.

8/ Reflects the changes in the financial holdings of the government excluding Compact Trust Fund's non-Trust Fund Asset (NTFA).

Table 3. Republic of Palau: Structure of Interest Rates, 1997-2000

(In percent)

	1997	1998	1999	2000
National Development Bank of Palau				
Lending rates				
Commercial loans (one year)	...	0.0	0.0	10.0 - 12.0
Residential housing loans				
30-year, fixed (maximum 20 year)	...	0.0	0.0	8.0 - 12.0
15-year, fixed	...	12.0	12.0	12.0
Government-directed scheme 1/	0.0	0.0	0.0	8.0
Normal loan scheme	...	12.0	12.0	12.0
Summary of Commercial Banks				
Deposit rates				
Checking account (with minimum balance)	0.00 - 4.50	0.00 - 5.00	0.00 - 5.00	0.00 - 5.00
Savings account	2.25 - 5.00	2.25 - 4.75	2.25 - 4.75	2.25 - 4.75
Time savings account				
30 days	2.25 - 5.00	2.25 - 4.75	2.25 - 4.75	2.32 - 4.75
One year	4.50 - 6.00	4.65	3.65	5.35
Certificates of deposit				
Six months	4.12 - 5.00	3.75 - 5.00	3.02 - 5.00	3.65 - 5.00
One year	2.25 - 6.00	2.25 - 6.00	2.25 - 6.00	3.75 - 6.00
Two years	4.25 - 7.00	4.36 - 7.50	3.35 - 7.50	3.95 - 7.50
Three years	4.31 - 8.00	4.36 - 8.00	3.75 - 8.00	4.00 - 8.00
Lending rates				
Consumer loans	15.00 - 18.00	15.00 - 18.00	11.00 - 18.00	9.90 - 18.00
Commercial loans (one year) 2/	9.50 - 12.75	9.50 - 12.75	9.25 - 12.50	9.75 - 13.00
Residential housing loans				
30-year, fixed 3/	12.00	12.00	9.00	9.00
15-year, fixed 3/	12.00	10.00	8.00	8.00

Sources: Data provided by the Palau National Development Bank (PNDB) and individual commercial banks.

1/ Under government-directed loan scheme, loan is provided to Palauans who have never owned a house.

2/ Bank of Hawaii commercial loan rates follow the highest New York Prime plus 4 percent, between 1998 and 2001.

3/ Rates between 1998-2000 are those for Bank Pacific Ltd. (Guam Savings Bank).

Table 4. Republic of Palau: Gross Domestic Product, 1995–2001

	1995 1/	1996 2/	1997	1998	1999	2000	2001 Est.
	(In thousands of U.S. dollars)						
Agriculture	1,579	1,231	1,312	1,398	1,358	1,372	1,399
Fisheries	3,918	2,973	2,057	2,038	3,148	3,290	3,388
Mining and quarrying	301	158	138	176	218	229	245
Manufacturing	851	997	1,403	1,702	1,609	1,706	1,808
Electricity, gas, and water	303	-8	-388	2,360	3,393	3,610	3,863
Construction	7,395	8,545	8,834	10,389	8,249	8,909	9,621
Trade	18,238	20,995	23,913	24,837	23,165	24,091	25,175
Hotels and restaurants	12,794	15,360	13,986	12,370	11,938	11,998	12,082
Transport and communication	8,345	7,270	8,734	9,191	9,846	10,535	11,272
Finance and insurance	4,210	5,294	6,573	5,706	4,297	4,554	4,828
Real estate and business services	6,262	7,570	6,298	6,555	4,611	4,888	5,108
Public administration	23,203	26,813	29,401	28,462	29,374	30,373	30,816
Other services	6,480	9,807	9,211	9,907	9,691	10,059	10,260
Subtotal	93,879	107,006	111,471	115,091	110,897	115,614	119,867
Less: Imputed bank service charge	1,743	2,100	2,101	2,640	2,384	1,250	1,250
Plus: Import duties	3,101	3,298	3,842	4,869	4,972	3,842	3,842
Gross domestic product	95,237	108,204	113,212	117,320	113,485	118,206	122,459
Nominal GDP (fiscal year)	92,309	104,962	111,960	116,293	114,444	117,026	121,396
Memorandum items:							
Nominal GDP growth	0	14	5	4	-3	4	4
Real GDP growth 3/	-8	10	2	2	-5	1	1
GDP deflator	3	3	2	2	2	3	3
	(Percentage change)						
Agriculture	-18.0	-22.0	6.6	6.5	-2.8	1.0	2.0
Fisheries	-19.4	-24.1	-30.8	-0.9	54.5	4.5	3.0
Mining and quarrying	-32.2	-47.6	-12.4	27.7	23.6	5.0	7.0
Manufacturing	20.7	17.1	40.7	21.3	-5.5	6.0	6.0
Electricity, gas, and water	-50.6	-102.5	5,002.0	-707.6	43.8	6.4	7.0
Construction	53.5	15.6	3.4	17.6	-20.6	8.0	8.0
Finance and insurance	34.6	25.7	24.2	-13.2	-24.7	6.0	6.0
Real estate and business services	26.4	20.9	-16.8	4.1	-29.7	6.0	4.5
Public administration	0.9	15.6	9.6	-3.2	3.2	3.4	1.5
Other services	4.4	51.3	-6.1	7.6	-2.2	3.8	2.0
Subtotal							
Less: Imputed bank service charge	25.7	20.5	0.0	25.6	-9.7	-47.6	...
Plus: Import duties	6.8	6.4	16.5	26.7	2.1	-22.7	...
Nominal GDP (fiscal year)	13.1	13.7	6.7	3.9	-1.6	2.3	3.7
ROP deflator	2.8	2.9	2.3	1.6	2.2	3.0	2.6

Sources: Data provided by Corporate Registrar, Social Security, and Government Audit Reports.

1/ Data for 1995 have been estimated using indicators for tourism, trade, and public administration between 1993 and 1996 benchmarks.

2/ Data for 1996 to 2001 have been estimated by a UNDP statistics specialist.

3/ U.S. CPI is used as GDP deflator for 1995 to 1999. Palau began compiling CPI from June 2000, therefore, GDP deflator for year 2000 is the average of the U.S. and Palau CPI. For 2001, Palau CPI is used as deflator.

Table 5. Republic of Palau: Visitor Arrivals by Purpose and by Country of Residency, 1996-2001

	1996	1997	FY 1998	FY 1999	FY 2000	FY 2001
Tourism 1/						
Visitor arrivals by purpose						
Tourist	58,022	63,601	59,780	45,462	42,470	46,684
Business	2,697	2,840	3,876	3,708	3,462	3,047
Employment	3,347	3,425	3,926	3,746	5,064	5,590
Other 2/	5,264	3,853	1,346	3,944	5,506	274
Total arrivals by country of residency						
Taiwan Province of China	22,523	30,497	24,123	12,754	14,390	14,077
Japan	21,410	19,519	21,567	22,651	21,140	23,303
United States	8,878	9,400	12,255	11,807	8,072	8,456
Korea	1,907	1,640	697	610	592	451
Australia and New Zealand	1,212	500	602	550	402	390
Philippines	854	879	3,130	2,863	3,819	4,164
Other	12,546	11,284	6,554	5,231	8,087	4,754
Total arrivals	69,330	73,719	68,928	56,466	56,502	55,595

Source: Data provided by the Palau Visitors Authority.

1/ On a calendar year basis up to 1997.

2/ Other includes returning residents, fishermen, crews, students, transits, and dependents.

Table 6. Republic of Palau: Employed Persons by Industry, 1990, 1995, 1999, and 2000

	1990 Census	1995 Census	1999 SSO	2000 Census
Agriculture, fisheries, and mining	446	724	287	215
Construction	861	1,087	946	1,112
Manufacturing	93	78	26	345
Transport, storage, communication, and other public utilities	477	435	766	765
Wholesale, retail, restaurants, and hotels	800	1,448	2,495	2,619
Finance, insurance, and real estate	119	122	119	116
Services 1/	687	1,573	1,147	1,246
Public administration	2,116	2,292	3,048	3,203
Total employed population	5,599	7,759	8,834	9,621

Sources: Office of Planning and Statistics, *1994 and 1999 Statistical Yearbook*; *1995 and 2000 Census of Population and Housing*, and Social Security Office (SSO) for 1999.

1/ Includes business, repair, personal, community, entertainment, recreation, health, education, and other social services.

Table 7. Republic of Palau: National Government Budgetary Operations, 1994/95-2001/02

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/2000	2000/01 Estimated	2001/02 Budget As passed 1/	2001/02 Budget Proposed 2/
(In thousands of U.S. dollars)									
Total revenue and grants	165,086	66,538	58,036	71,306	51,017	74,984	61,493	70,058	75,233
Domestic revenue	22,069	29,087	24,864	41,325	29,024	42,922	40,186	35,422	40,597
Tax revenue	13,351	15,637	16,829	19,037	18,925	22,879	25,762	25,195	30,370
Salaries and wages	3,822	4,096	4,620	4,720	5,152	5,480	6,315	6,827	6,827
Import tax	3,136	3,298	3,850	4,410	4,973	6,433	6,473	6,138	10,338
Gross revenue tax	4,774	6,068	6,260	6,260	5,615	6,184	7,145	6,617	6,617
Other	1,619	2,175	2,099	3,647	3,185	4,782	5,829	5,613	6,588
Nontax revenue	8,719	13,450	8,036	22,288	10,099	20,042	14,424	10,227	10,227
Fishing rights income	230	210	130	120	137	39	76	134	134
Interest income	56	79	68	81	69	253	1,875	879	879
Fees and charges	1,247	1,195	1,158	1,440	2,950	2,113	2,573	2,984	2,984
Other	1,043	1,713	2,088	15,288	1,361	1,876	1,383	1,410	1,410
Local trust funds	1,082	1,574	1,786	2,696	2,377	1,856	1,806	1,120	1,120
Investment income	5,061	8,679	2,806	2,663	3,205	13,906	6,711	3,700	3,700
Grants	143,017	37,452	33,172	29,981	21,993	32,062	21,307	34,636	34,636
Current grants	72,843	26,161	26,098	26,435	18,624	19,298	19,128	20,342	20,342
U.S. Compact	62,107	18,623	18,856	19,220	11,570	11,640	11,701	11,827	11,827
U.S. non-Compact	10,431	7,239	7,012	6,626	6,420	6,829	6,748	7,302	7,302
Other country	305	299	230	589	634	829	679	1,213	1,213
Capital grants	70,174	11,291	7,074	3,546	3,369	12,764	2,179	14,294	14,294
U.S. Compact	64,360	4,900	3,000	2,000	2,000	2,000	2,000	2,000	2,000
U.S. non-Compact	5,814	6,391	3,574	1,546	1,369	569	179	3,894	3,894
Other country	0	0	0	0	0	10,195	0	8,400	8,400
Total expenditure	65,251	75,148	76,542	64,617	71,678	84,493	77,202	79,691	79,691
Current expenditure	56,722	58,145	58,252	54,761	63,889	71,767	63,080	59,417	59,417
Wages and salaries	23,203	25,820	27,777	27,355	28,381	29,275	29,863	30,358	30,358
Purchases of goods and services	23,627	19,896	25,298	22,982	27,256	30,414	25,360	24,327	24,327
Interest payments	83	0	0	0	0	0	700	700	700
Subsidies and other current transfers	9,809	12,429	5,177	4,424	8,052	12,078	7,157	4,032	4,032
Public enterprises	5,543	7,889	3,037	1,964	1,337	3,149	3,287	1,662	1,662
Other	4,266	4,540	2,140	2,460	6,715	8,929	3,870	2,370	2,370
Capital expenditure	8,529	17,003	18,290	9,856	7,989	12,726	14,122	20,274	20,274
Errors and omissions 3/	-2,560	1,993	2,220	-4,252	3,875	4,843	-2,770	0	0
Overall balance	97,276	-6,616	-16,285	2,437	-16,786	-4,667	-18,479	-9,633	-4,458
Financing	-97,276	6,616	16,285	-2,437	16,786	4,667	18,479	9,633	4,458
Net long-term borrowing	-4,500	-3,000	-3,400	-3,600	-4,067	18,566	0	0	0
New borrowing	0	0	0	0	0	20,000	0	0	0
Principal repayments	4,500	3,000	3,400	3,600	4,067	1,434	0	0	0
Privatization receipts	0	0	3,052	0	0	0	0	0	0
Contingency Reserve Fund	0	0	0	0	0	0	0	0	-1,696
Other (-) equal increasing assets 4/	-92,776	9,616	16,633	1,163	20,853	-13,899	18,479	9,633	6,154
(As a percent of fiscal year GDP)									
Total revenue and grants	178.8	63.4	51.8	61.3	44.6	64.1	50.7	54.6	58.7
Domestic revenue	23.9	27.7	22.2	35.5	25.4	36.7	33.1	27.6	31.7
Tax revenue	14.5	14.9	15.0	16.4	16.5	19.6	21.2	19.7	23.7
Nontax revenue	9.4	12.8	7.2	19.2	8.8	17.1	11.9	8.0	8.0
Of which: Investment income	5.5	8.3	2.5	2.3	2.8	11.9	5.5	2.9	2.9
Grants	154.9	35.7	29.6	25.8	19.2	27.4	17.6	27.0	27.0
Current grants	78.9	24.9	23.3	22.7	16.3	16.5	15.8	15.9	15.9
Capital grants	76.0	10.8	6.3	3.0	2.9	10.9	1.8	11.1	11.1
Total expenditure	70.7	71.6	68.4	55.6	62.6	72.2	63.6	62.2	62.2
Current expenditure	61.4	55.4	52.0	47.1	55.7	61.3	52.0	46.3	46.3
Capital expenditure	9.2	16.2	16.3	8.5	7.0	10.9	11.6	15.8	15.8
Overall balance	105.4	-6.3	-14.5	2.1	-14.7	-4.0	-15.2	-7.5	-3.5
Overall balance, excluding grants	-49.6	-42.0	-44.2	-23.7	-33.9	-31.4	-32.8	-34.5	-30.5
Memorandum items:									
GDP (fiscal year) 5/	92,309	104,962	111,960	116,293	114,444	117,026	121,396	128,203	128,203
Direct financed projects not included above									
Compact road project 6/	...	...	...	...	5,000	20,000	28,571	28,571	28,571
Koror-Babeldaob (KB) bridge 6/	...	...	...	...	...	9,269	12,359	3,090	3,090
New Airport Project 6/	...	...	...	...	...	...	...	2,333	2,333

Sources: Reports on the Audit of Financial Statements and data provided by the Palauan authorities. Fiscal year runs from October to September.

1/ At the time the budget was passed, Congress also, separately, reduced "sin taxes", reducing revenue by \$1.2 million.

2/ Includes reduction in GRT relating to the impact of the events of September 11 and changes to import tax regime and introducing excise duties.

3/ Represents monies to be reimbursed (from reimbursable grants), changes in accounts payable/receivable, and other unidentified items.

4/ This is the change in government assets (NTFA).

5/ Calculated using simple quarterly interpolation.

6/ The road is estimated to cost around \$125 million, the bridge \$24.7 million, and the airport \$14 million; estimates of the expenditures by year are reported.

Table 8. Republic of Palau: U.S. Grants, 1994/95–2008/09

(In thousands of U.S. dollars; end of the period)

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Total Compact aid	246,807	25,013	123,996	23,010	15,510	15,730	15,941	16,217	16,523	16,828	15,554	15,772	15,990	16,207	16,425
<i>Of which:</i>															
Total direct payments	192,467	23,523	26,356	21,220	13,570	13,640	13,701	13,827	13,983	14,138	12,714	12,782	12,850	12,917	12,985
Operations	14,948	12,781	12,781	12,781	7,781	7,851	7,781	7,781	7,781	7,781	6,781	6,781	6,781	6,781	6,781
Inflation adjustment	6,279	5,842	6,075	6,439	3,789	3,789	3,920	4,046	4,202	4,357	3,933	4,001	4,069	4,136	4,204
Energy, Section 211(b)	28,000	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Inflation adjustment	12,880	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Trust Fund, Section 211(f)	66,000	...	4,000	...	...	...	...	...	...	...	...	...	...	...	...
Capital improvements	36,000	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Inflation adjustment	16,560	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Military options	5,500	...	...	...	...	...	...	...	...	...	...	...	...	...	...
Special program assistance	6,300	4,900	3,500	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Total federal services	54,340	1,490	97,640	1,790	1,940	2,090	2,240	2,390	2,540	2,690	2,840	2,990	3,140	3,290	3,440
Road system construction (in-kind)	53,000	...	96,000	...	...	...	...	...	...	...	...	...	...	...	...
Weather, postal, aviation services	1,340	1,490	1,640	1,790	1,940	2,090	2,240	2,390	2,540	2,690	2,840	2,990	3,140	3,290	3,440
Other U.S. assistance 1/	16,245	13,630	10,586	8,172	7,789	7,398	6,927	11,196	8,575	8,575	8,575	8,575	8,575	8,575	8,575
Total U.S. grants	263,052	38,643	134,582	31,182	23,299	23,128	22,868	27,413	25,098	25,403	24,129	24,347	24,565	24,782	25,000

Sources: Independent Auditor's Report on financial statements; and data provided by the Bureau of Program, Budget, and Management, Ministry of Administration.

1/ Other U.S. assistance is based on the proposals submitted to each grantor agency. Based on the Compact agreement, various programs were to be phased out beginning fiscal year 1996. Scheduled phasing out is 25 percent reduction of grant authorization for each fiscal year. However, there are old and new programs for which the Republic of Palau is eligible—accordingly, other U.S. assistance is forecast to continue, but at a reduced level from 2002/03.

Table 9. Republic of Palau: National Government Expenditure
by Budget Category, 1994/95–1999/00

(In thousands of U.S. dollars)

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Office of the President	1,251	985	1,408	1,645	1,879	1,942
Office of the Vice-President	390	410	437	507	442	450
Ministries						
State	1,627	1,846	1,731	1,859	2,244	2,440
Administration	1,618	2,204	1,953	1,911	2,587	2,661
Health	7,608	8,030	9,704	9,147	9,536	10,193
Education	11,204	8,844	9,173	8,833	9,710	9,055
Community and Cultural Affairs	1,010	726	654	815	748	785
Social Services	...	...	...	...	...	...
Justice	2,308	2,458	2,973	2,970	3,870	4,366
Resources and Development	4,736	3,931	4,830	5,534	7,719	9,161
Commerce and Trade	810	914	1,559	1,753	1,386	1,475
Natural Resources	...	...	...	...	...	...
Boards, Comm & Authorities	1,208	835	791	454	335	564
Office of the Public Auditor	391	527	608	566	779	689
Office of the Special Prosecutor	136	188	117	62	213	227
Olbiil Era Kelulau (Congress)	3,470	3,261	3,651	3,384	3,394	3,606
Grants to State Governments	3,268	1,747	4,682	4,612	4,514	4,850
Judiciary	1,618	1,793	1,915	2,045	2,206	2,259
Other 1/	4,260	7,018	6,890	5,204	4,074	4,966
Capital expenditures	8,529	17,003	18,290	9,856	7,988	12,726
Interest payments	...	...	...	...	...	...
Operating transfers 2/	9,809	12,429	5,176	3,460	8,052	12,078
Public enterprises	5,543	7,889	3,036	1,000	1,337	3,149
Other 3/	4,266	4,540	2,140	2,460	6,715	8,929
Total	65,251	75,148	76,542	64,617	71,678	84,493

Sources: Reports on the Audit of Financial Statements for fiscal years 1992/93–1997/98 (1997/98 data are preliminary); and data provided by the Bureau of Program, Budget, and Management, MOA.

1/ Other expenditures include other programs from General Fund expenditures, Special Revenue Fund expenditures, CIP management fees, and prior year appropriations.

2/ Includes subsidies and other transfers for current operations.

3/ Other major public entities receiving transfers are: Palau Community College PCC Board of Trustees, COM Board of Regents, Civil Service Pension Plan, and National Development Bank.

Table 10. Republic of Palau: Operating Accounts of the State Governments, 1992/93–1998/99

(In thousands of U.S. dollars; end of period)

	1992/93	1993/94	1994/95	1995/96	1996/97 1/	1997/98 2/	1998/99 3/
Revenues							
National government grant	2,704	2,612	1,303	4,960	3,092	1,346	1,546
Fishing right fees	669	885	346	847	373	166	112
Interest income	3	2	5	27	73	12	96
Other	481	333	114	853	273	12	133
Total revenues	3,856	3,832	1,768	6,688	3,811	1,535	1,791
Expenditures							
Salaries and wages	650	654	334	1,451	1,312	455	552
Capital expenditure	637	1,023	399	2,815	2,005	645	778
Other	2,263	2,395	1,097	1,623	1,320	880	596
Total expenditures	3,550	4,071	1,830	5,889	4,637	1,980	1,926
Net collection (deficit)	306	-239	-62	799	-826	-445	-135
Account receivables /loan repayment	...	232	...	-53	-15	...	...
Fund balance (beginning of year)	384	690	683	622	1,368	526	82
Fund balance (end of year)	690	683	622	1,368	526	82	-53

Source: Data provided by the Office of the Public Auditor.

1/ A total of 2 States' Operations are not yet included in FY 1997.

2/ A total of 11 States' Operations are not yet included in FY 1998.

3/ A total of 12 States' Operations and the Fund balances are not yet included in FY 1999.

Table 11. Republic of Palau: Financial Position of the Compact
Section 211(f) Trust Fund, 1994/95-2000/01

(In thousands of U.S. dollars; end of period)

	1994/95	1995/96 1/	1996/97 2/	1997/98 3/	1998/99	1999/00	2000/01
Total receipts	71,034	6,961	28,862	17,600	19,621	21,472	-25,811
Compact grants 4/	66,000	...	4,000	...	...	...	...
Investment gains and							
Interest income	5,034	6,961	24,862	17,600	19,621	21,472	-4,975
Investment gains (losses)	5,034	...	14,917	10,559	11,368	...	...
Investment interest income	...	6,961	9,944	7,040	7,579	...	...
Total expenditures	255	564	502	773	845	778	963
Investment fees	255	564	502	773	845	778	963
Overall balance	70,779	6,397	28,360	16,826	18,776	20,694	-26,774
Fund balance at year end	70,779	77,176	105,536	122,362	141,139	161,832	135,039

Sources: Independent Auditor's Report on Financial Statement; and data provided by the Office of President and Ministry of Administration.

1/ Investment income for FY 1996 excluding unrealized losses \$731,594.

2/ For FY1997, investment income includes restatement of investments at fair value is \$11,019,473.

3/ For FY1998, investment income includes restatement of investments at fair value is \$8,779,741.

4/ Covers operations of the Compact Section 211(f) Trust Fund, starting in 1994/95.

Table 12. Republic of Palau: Financial Position of the Social Security Fund, 1993/94–2000/01

(In thousands of U.S. dollars)

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Revenues	3,349	5,727	4,930	8,280	6,791	10,276	13,469	-1,342
Contributions	3,383	3,615	4,014	5,310	5,487	5,587	6,362	7,379
Government	1,853	1,948	2,011	2,681	2,644	2,748	2,780	3,675
Private	1,517	1,649	1,983	2,599	2,805	2,838	3,403	3,664
Penalties and interest	13	18	20	30	38	1	179	40
Investment and other income	-34	2,112	916	2,970	1,304	4,689	7,107	-8,720
Expenditures	2,539	2,625	2,871	3,105	3,354	3,713	4,215	4,295
Total benefit payout 1/	2,192	2,304	2,420	2,616	2,780	2,990	3,551	3,908
Administrative fees 2/	347	321	451	489	574	723	664	387
Net collection (deficit)	810	3,102	2,059	5,175	3,437	6,563	9,254	-5,636
Fund balance (end-year)	9,477	12,579	14,638	19,813	23,250	29,813	39,067	33,431

Sources: Annual audit reports; and data provided by the Palauan Social Security Office.

1/ Total benefit payout includes retirements, survivors, disability, and lump sum payments.

2/ Including administrative and investment management expenses and fees.

Table 13. Republic of Palau: Financial Position of the
Civil Service Pension Fund, 1992/93–2000/01

(In thousands of U.S. dollars; end of period)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01 June
Revenues	4,202	2,715	7,221	5,688	7,069	5,108	12,183	14,115	7,073
Contributions									
Government employees	2,228	2,708	2,851	3,125	3,285	3,309	3,438	3,596	1,040
Investment gains (losses)	992	-359	1,827	653	3,306	1,201	3,880	6,288	1,554
Investment interest income	159	164	227	290	346	456	455	554	28
Other income	672	52	86	120	132	142	110	177	76
Transfers from national government	150	150	2,230	1,500			4,300	3,500	4,375
Expenditures	2,032	1,840	2,305	2,536	3,025	3,116	3,488	4,328	1,299
Total benefit payout 1/	1,416	1,557	1,980	2,078	2,545	2,703	3,008	3,819	1,252
Administrative fees 2/	616	283	325	458	480	413	480	509	46
Net collection (deficit)	2,170	875	4,915	3,152	4,044	1,991	8,695	9,787	5,774
Fund balance (end-year)	7,422	8,297	13,212	16,364	20,408	22,399	31,094	40,881	46,655

Sources: Independent Auditor's Report on financial statements; and data provided by the Palau Civil Service Pension Plan Authority.

1/ Including lump sum benefits, refunds, and disability benefits.

2/ Including investment management expenses and fees.

Table 14. Republic of Palau: Operating Accounts of the Major Public Corporations, 1994/95–1999/00

(In thousands of U. S. dollars; end of period)

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Palau Utility Corporation						
Operating revenues	4,508	5,712	6,170	8,055	7,797	9,248
Operating expenses	6,240	7,369	9,379	9,761	8,378	11,400
Gross operating profit (loss)	-1,732	-1,657	-3,209	-1,706	-581	-2,152
Non-operating revenues (expenses)						
Subsidies from government and foreign grants	5,744	4,355	2,239	1,566	706	1,990
Net total profit (loss)	4,012	2,698	-970	-140	125	-162
Palau Housing Authority						
Operating revenues:	239	474	389	270	201	115
Operating expenditures	191	441	398	258	227	139
Change in equity during the year	48	59	23	41	-26	-24
Fund equity, beginning of year	0	-326	-268	-245	-245	-231
Fund equity, end of year	-326	-268	-245	-205	-231	-281
Palau National Communications Corporation						
Operating revenues	4,668	5,458	5,835	6,390	6,412	6,656
Operating expenses	2,784	3,131	4,496	5,632	6,206	5,594
Other income (expenses)	249	151	-1	-1	-1,911	-1,337
Change in equity during the year	2,132	2,478	828	0	-1,705	-275
Fund equity, beginning of year	8,500	10,633	13,111	13,939	13,536	11,831
Fund equity, end of year	10,633	13,111	13,939	13,536	11,831	11,556

Sources: Independent Auditor's Report on Financial Statements; and data provided by the Palau Public Utilities Corporation, Paluan Housing Authority, and Palau National Communications Corporation.

Table 15. Republic of Palau: Summary of Tax Structure

Type of Tax	Nature of Tax	Exemptions and Deductions	Rate Structure
Wages and salaries tax.	<p>The wages and salaries tax is payable on the gross income from wages and salaries of all individuals who work in the Republic of Palau. This includes Palauans, U.S. citizens, and other expatriates who work under contracts.</p> <p>The wages and salaries tax is payable to the National Treasury within 30 days after making disbursement of wages and salaries to the employee.</p> <p>This is applicable to all citizens and noncitizens. U.S. embassy personnel are not subject to the tax.</p>	There is an annual exemption of \$2,000.	<p>6 percent (\$0-\$8,000). 12 percent over \$8,000.</p>
Gross revenue tax.	<p>Business taxes are payable on gross receipts and are applicable to sole ownerships, partnerships, and corporations.</p> <p>The gross revenue tax is payable on or before the 30th day following the close of each quarter.</p>	100 percent of wages and salaries of citizens and 50 percent of wages and salaries of noncitizens are allowable deductions.	4 percent on the total after allowable deductions.
Net income tax.	Financial institutions.	<p>100 percent of wages and salaries of citizens and 50 percent of wages and salaries of noncitizens, interests or discounts paid, ordinary operating expenses such as supplies, utility services, insurance premiums, other than life insurance, provided that any deductible insurance expenses shall be allowable only to the extent that such a premium is applicable to the tax period against which it is claimed; loans or obligations charged against reserves then in existence; losses other than loan losses, such as those occasioned by fire or other casualty, theft, embezzlement, and the like, but only to the extent not covered by proceeds collected; transfers from earnings to reserve for bad debts or other contingencies provided for; miscellaneous direct expenses such as legal, advertising, auditing, and the like; loss on property sold and depreciation on property owned.</p>	4 percent net income.

Table 15. Republic of Palau: Summary of Tax Structure

Type of Tax	Nature of Tax	Exemptions and Deductions	Rate Structure
	The net income tax is payable on or before the 30th day following the close of each quarter.		
Import tax.	Every person who imports products into the Republic of Palau for commercial purposes shall pay import taxes.	Medicines, medical supplies, foodstuff for human consumption, products for government and for personal use are exempt, except for vehicles.	
	Cigarettes.		\$0.50 per 20 sticks.
	Tobacco products, other than cigarettes.		150 percent ad valorem.
	Perfumery, cosmetics, including cologne and other toilet waters, articles of perfumery, and all preparations to the hair and skin, except soap, toothpaste, shampoo, and the like, lipsticks, pomades, powders, and other toilet preparations not having medicinal properties.		25 percent ad valorem.
	Carbonated soft drinks.		\$0.10 per 12 oz.
	Beer.		\$0.03 per oz.
	Liquor.		\$0.30 per oz.
	Wine.		\$0.20 per oz.
	Wine coolers.		\$0.05 per oz.
	Liquid fuel.		\$0.05 per gal.
	Vehicles.		5 percent ad valorem + \$250.00 per vehicle.
	All other imported products.		3 percent ad valorem.

Table 15. Republic of Palau: Summary of Tax Structure

Type of Tax	Nature of Tax	Exemptions and Deductions	Rate Structure
Hotel/Motel room tax.	Every hotel and motel business is required to collect room tax from guests and hold in trust and pay over to the National Treasury. The room tax is payable on or before the 15th of every month.		10 percent of net room charge.
Amusement device tax.	Every person who, at any time during the tax year, owns a coin-activated amusement device for business shall pay an amusement device tax. Tax is payable within 30 days of its purchase or on or before the 31st day of January.		\$200.00 per device.
Travelers head tax.	Every person departing from the Republic of Palau whether by aircraft or by vessel shall pay a departure tax.	Palauan students, children under the age of 3 and masters, pilots and other crewmembers of aircrafts or vessels are exempt.	\$20.00 per person.
Road use tax.	Every person who owns a motor vehicle shall pay an annual road use tax. Road use tax is based on motor vehicle weight. Tax is payable at time of registration.	National government and public corporations owned motor vehicles are exempt.	\$50.00 (0-2,000 lbs.) \$75.00 (2,000-4,000 lbs.) \$150.00 over 4,000 lbs.
Foreign water vessel tax.	Every nonresident-owned water vessel entering the Republic of Palau shall be assessed and levied a tax. A nonresident-owned water vessel present in the Republic of Palau for more than one year shall be assessed and levied an annual tax.	U.S. military and common carrier-owned vessels are exempt.	\$50.00 per entry. \$250.00 annual tax.
Fish export tax.	Every person exporting any species of tuna or billfish in any form for commercial purposes shall pay tax.		\$0.25 per kg.
Vessel cabin tax.	A tax levied against paying passengers taking overnight cabin accommodations on ships or water vessels owned or operated by persons or business entities licensed to do business in the Republic of Palau.		10 percent of cabin charge or \$10.00 per day or fraction thereof whichever is greater.

Source: Ministry of Administration

Table 16. Republic of Palau: Operating Accounts of the National Development Bank of Palau, 1992/93–2000/01

(In thousands of U. S. dollars; end of period)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1997/99	1999/00	2000/01 1/
Revenues	424	535	2,675	1,875	872	820	727	2,970	1,069
Interest	...	...	...	...	...	...	629	564	737
Loan fees	304	370	397	547	746	770	20	61	92
Others	11	20	58	52	126	50	78	195	240
Transfers from national government 2/	58	95	219	276	...	...	...	2,150	...
Contributions from other countries	50	50	2,000	1,000	...	...	...	...	...
Expenditures	255	435	493	570	602	256	571	572	645
Wages and salaries	103	117	107	138	136	123	148	158	210
Depreciation	11	13	23	19	16	13	15	35	33
Interest	32	33	36	17	...	5	...	...	...
Others	110	272	327	395	450	115	408	379	402
Net income (losses)	169	100	2,182	1,305	270	564	156	2,398	424
Fund equity, beginning of year 3/	836	1,004	1,104	4,401	6,176	6,446	6,572	6,728	9,904
Fund equity, end of year	1,005	1,104	3,286	5,706	6,446	7,010	6,728	9,126	10,328

Sources: Independent Auditor's Report on Financial Statements; and data provided by the Palau National Development Bank (PNDB).

1/ Unaudited figures for FY2001.

2/ Capital transfers the amount of \$150,000 for Y2K upgrading project and \$2 million for the first-time home-owner program from the government.

3/ Adjustment of fund equity for FY2001.

Table 17. Republic of Palau: Assets and Liabilities of the National Development Bank of Palau, 1993/94–2000/01

(In thousands of U.S. dollars; end of period)

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01 1/
Assets								
Cash	707	1,775	1,146	33	113	919	3,583	448
Time certificates of deposit	100	500	600	606	1,339	1,413	1,084	4,313
Loans	2,487	2,721	4,356	5,728	5,049	4,181	4,007	5,397
Fixed assets	59	52	36	25	33	16	133	100
Other 2/	31	50	38	33	46	210	1,097	71
Total assets	3,384	5,098	6,176	6,425	6,580	6,739	9,904	10,329
Liabilities								
Accounts payable 3/	28	18	23	1	8	10	23	25
Bonds payable	253	...	...	...	...	...	...	...
Loans payable	885	680	407	407	...	...	...	...
Bank capital 4/	2,218	4,400	5,746	6,016	6,572	6,729	9,881	10,305
Total liabilities	3,384	5,098	6,176	6,424	6,580	6,739	9,904	10,330

Sources: Independent Auditor's Report on Financial Statement; and data provided by the Palau National Development Bank (PNDB).

1/ Figures from 1993/94-1999/00 are audited, 2000/01 figures are unaudited.

2/ Includes other receivables, inventory, prepaid expenses, and receivable from Republic of Palau.

3/ Includes accrued expenses.

4/ Includes contributed capital and retained earnings.

Table 18. Republic of Palau: Credit Allocation by the National Development Bank of Palau, 1993–2001

(In U.S. dollars)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Agriculture	23,377	47,346	54,586	65,000	45,000	7,000	...	15,000	15,000
Fisheries	270,936	239,374	201,608	359,000	164,000	16,000	...	...	16,882
Tourism	867,315	1,259,143	1,257,773	348,000	265,000	...	...	...	...
Forestry	181	...	...	...	...	...	...	...	...
Small business	1,763	1,739	...	48,271	...	...	...	...	...
Manufacturing	1,640,543	1,353,788	1,789,561	2,469,000	1,685,000	70,000	...	488,651	1,134,984
Commerce and construction	...	...	...	...	...	...	...	2,378,217	1,881,138
Housing	2,804,115	2,901,390	3,303,528	3,289,271	2,159,000	93,000	...	2,881,868	3,048,004
Total loans	2,804,115	2,901,390	3,303,528	3,289,271	2,159,000	93,000	...	5,763,736	6,096,008

Source: Data provided by the Palau National Development Bank (PNDB).

Table 19. Republic of Palau: Imports by Product Category, 1994–2001 1/

(In thousand of U.S. dollars; F.O.B.)

	1994	1995	1996	1997	1998	1999 2/	2000	FY00	FY01
Food and live animals	6,647	9,164	9,317	10,987	8,462	10,446	14,213	14,650	14,534
Beverages and tobacco	3,816	5,002	5,428	6,165	5,530	5,588	8,721	8,702	7,954
Crude materials, inedible except fuels	33	187	118	199	172	821	1,968	1,858	1,840
Mineral fuels, lubricant, and related minerals	19,882	15,057	20,886	8,341	14,761	11,036	16,428	20,093	9,930
Animal and vegetable oils, fats, and waxes	112	234	204	268	235	188	273	248	247
Chemicals and related products	1,147	2,306	1,949	2,818	2,396	5,165	7,838	7,187	7,134
Manufactured goods	3,546	4,765	4,930	5,713	5,090	14,490	24,989	25,223	18,203
Machinery and transport equipment	5,936	13,246	23,846	17,599	18,045	18,977	34,242	32,350	23,179
Miscellaneous manufactured articles	7,100	12,567	12,758	17,148	11,037	11,127	15,312	16,816	12,744
Commodities not classified elsewhere	363	191	199	51	147	...	...	...	...
Total	48,582	62,719	79,636	69,289	65,875	77,838	123,984	127,127	95,765
Memorandum items:									
Duty exempt imports 3/									
Aid projects	...	...	...	...	...	8,416	15,604	3,529	...
Diplomatic concession	...	...	...	...	...	322	14	29	...
Food stuff	...	...	...	...	...	1,215	122	613	...
Government use or for purpose of trade	...	...	...	...	...	16,865	17,419	8,567	...
Medicine/medical supplies	...	...	...	...	...	734	586	577	...
Personal baggage	...	...	...	...	...	617	422	675	...
Re-import of temporary export	...	...	...	...	...	203	560	94	...
Temporary import without transferral of ownership	...	...	...	...	...	24	3,225	94	...

Sources: Data provided by the Customs Office, Ministry of Administration, and Ministry of Commerce and Trade.

1/ On a calendar year basis until 2000.

2/ Data for 1999 are only for the last nine months due to adoption of Harmonized System in April 1999.

3/ Duty exempt imports are in calendar years for 1999, 2000, and 2001.

Table 20. Republic of Palau: Imports by Country or Territory of Origin, 1996–2001 1/

(In thousands of U.S. dollars, f.o.b.)

	1996	1997	1999 2/ 3/	2000	FY 1999/00	FY 2000/01
United States	27,010	27,872	28,690	40,704	41,552	37,611
Singapore	23,412	9,047	11,948	8,727	12,195	7,343
Guam	12,473	12,223	8,381	17,472	17,033	13,379
Japan	9,051	9,348	11,949	19,104	21,996	9,814
Taiwan Province of China	2,391	3,465	5,370	8,012	8,751	5,091
Australia	1,463	994	1,094	1,739	2,005	1,047
Hong Kong SAR	1,070	1,245	634	5,585	4,434	3,484
Philippines	1,053	1,221	2,297	3,374	4,215	2,617
Korea	570	517	2,021	8,626	6,852	6,155
Saipan	440	690	...	...	...	...
New Zealand	238	590	49	145	141	38
Micronesia, Federated States of	189	...	79	110	118	389
China	42	1,685	892	887	824	2,546
Malaysia	37	...	576	135	648	90
Indonesia	9	...	786	2,231	2,850	367
Thailand	...	...	1,296	200	177	151
Pakistan	...	...	1,143	198	198	...
Other countries and territories:	188	391	633	6,735	3,137	5,644
Total	79,636	69,289	77,838	123,984	127,127	95,765

Sources: Data provided by the Customs Office, Ministry of Administration, and Ministry of Commerce and Trade.

1/ On a calendar year basis until 2000.

2/ Data not available in 1998.

3/ Data for 1999 are only for the last nine months due to the introduction of new customs system in April 1999.

Table 21. Republic of Palau: National Government Debt and Debt Service, 1992/93–2000/01

(In thousands of U.S. dollars)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Gross external debt	67,429 1/	20,000 1/	15,500	12,500	9,100	5,500	1,433	20,000	20,000
ICBC debt service									
Debt service									
Principal 2/	0	0	4,500	3,000	3,400	3,600	4,067	1,433	...
Interest 2/	0	0	0	0	0	0	0	0	700

Sources: Independent Auditor's Report on Financial Statements; and data provided by the Ministry of Administration.

1/ Total external debt outstanding (related to the construction of IPSECO power plant), including payments arrears.

2/ In June 1993, an agreement was reached with the guarantor banks for the settlement of the outstanding IPSECO debt, by which there would be a debt relief and only \$20 million would be paid to the guarantor banks over the period 1994/95–1999/2000 without any interest payment.

Table 22. Republic of Palau: Financial Holdings of the Central Government, 1992/93–2000/01

(In thousands of U.S. dollars; end of period)

	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Foreign assets 1/									
Deposits with foreign banks	...	...	96,173	83,953	76,086	64,241	64,628	45,313	40,102
Domestic assets 2/									
Deposits with domestic banks	854	474	622	2,300	4,715	17,580	2,377	32,369	3,882
Fiduciary funds 3/	...	...	70,779	77,176	105,536	122,362	141,139	161,832	135,039
Total financial holdings	854	474	167,574	163,429	186,337	204,183	208,144	239,514	179,023

Source: Data provided by the Palauan authorities.

1/ Deposits with all foreign banks, including those in the United States.

2/ Deposits with local banks.

3/ Refer only to Compact Section 211(f) Trust Fund, excluding the Civil Service Pension Trust and Social Security Retirement Fund.

Table 23. Republic of Palau: Selected Social Indicators, 1995 and 2000

	1995	2000
GDP per capita (U.S. dollars)	5,527	6,179
Area (sq. miles)		
Land	188	188
Sea	237,850	237,850
Demographic indicators (2000)		
Total population	17,225	19,129
Population growth (percent per annum)		
1986-90	2.4	...
1990-95	2.6	...
2000		2.1
Crude birth rate (per 1,000)	13.4	14.5
Crude death rate (per 1,000)	7.0	6.5
Infant mortality (per 1,000)	20.0	10.8
Labor force	8,368	9,845
Employed	7,780	9,621
Agriculture, fisheries, and mining	724	215
Construction	1,089	1,112
Manufacturing	78	345
Transport, storage, communication, and other public utilities	436	765
Wholesale, retail, restaurants, and hotels	1,455	2,619
Finance, insurance, and real estate	124	116
Other business, personal, community, and social services	1,120	1,246
Public administration	2,879	3,203
Unemployed	588	224
Age structure (in percent)		
0-14	28.1	23.9
15-64	66.2	70.7
65 and over	5.7	5.4
Public health and education		
Education		
Percent graduating		
Primary	97.0	97.0
Secondary	65.0	78.0
College	12.2	10.0
Student/teacher ratio (1998 and 2000)	10.7	10.6
Health		
Number of encounters at dispensary	115	48

Sources: 1995 and 2000 Census of Population and Housing from the Office of Planning and Statistics; and Social Security Office.