

## 8. The Republic of Palau

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**Population:** 19,129 (2001)

**Land Area:** 497 square kilometres

**Exclusive Economic Zone:** 629,000 square kilometres

**Political Status:** independent republic in free association with the United States since 1994

**GNP:** US\$133.6 million (1999)

**Major Industries:** agriculture, tourism, subsistence fishing

**Merchandise Exports (FOB):** US\$11 million (1998)

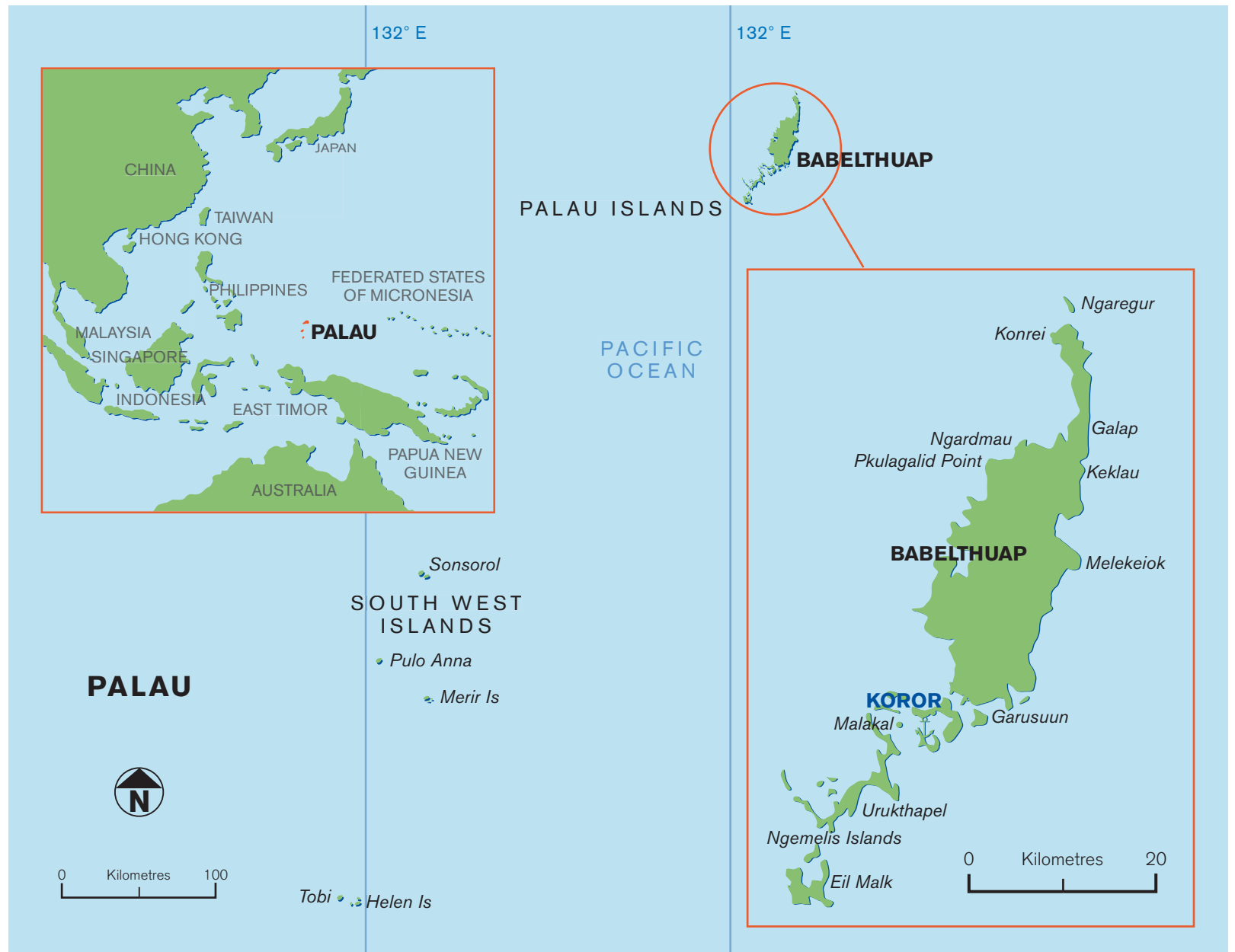
**Major Exports:** handicrafts; agricultural goods; taros and coconuts

**Merchandise Imports (CIF):** US\$79 million (1998)

**Major Imports:** mineral fuels; manufactured goods; machinery; food

**Currency:** United States Dollar





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## Location

The Republic of Palau is located at the western end of the Caroline Archipelago in the Western Pacific. The country is comprised of more than 200 islands of which only nine are inhabited. The nearest landmass is Papua New Guinea (660 kilometres to the south), the Philippines (880 kilometres to the west) and Guam (1,300 kilometres to the northeast). Japan, South East Asia and Australia (via Cairns and Guam) are all within five hours' flying time of Palau.

The largest island, Babeldaob (78% of the country's total land area), where Palau's international airport is located, is linked to the capital of Koror by a bridge.

Koror is the largest urban area in Palau and is home to more than 70% of the population. Koror is the seat of Palau's national government and the civic and commercial centre.

English and Palauan are the official languages in Palau's 16 states, with the exception of Sonsoral (Sonsorolese and English are official), Tobi (Tobi and English are official), and Angaur (Angaur, Japanese and English are official).

## Government

In July 1980, Palau adopted its own constitution and its first president took office in 1981. Palau entered into a Compact of Free Association with the United States in 1994.

Executive authority is vested in the President, who is elected by the people for a four-year term, as is the vice-president.

Palau's National Congress is known as the Olbiil Era Kelulau (OEK), which means 'Meeting Place of Whispers'. The OEK is composed of a House of Delegates (sixteen elected members) and a Senate (14 elected members).

In addition, the Constitution of Palau provides for a 'council of chiefs' composed of traditional chiefs from each of the 16 states that make up Palau. The 'council of chiefs' advises the President on matters concerning traditional laws, customs and their relationship to the Constitution and laws of Palau.

The judicial branch is comprised of a Supreme Court, a National Court and a Lower Court of Common Pleas, members of which are appointed for life.

## Economic Profile and Performance

Palau is a small developing economy, generating a total GDP of US\$133.6 million in 1999. Despite the fact that it is a remote country, it enjoys a relatively high standard of living which, in the main, is a result of support funds drawn down annually from the Compact of Free Association with the United States.

Under the Compact, the United States government agreed to pay Palau US\$447 million over the first 15 years (1994–2009) of the 50-year Compact. There is also provision for major infrastructure projects, including the construction of a road around Babeldaob and the continuation of some United States federal programmes. Palau also receives preferential trade access to the United States under the Compact.

The Compact obliges the United States to defend Palau. It also commits the United States to continue to provide, at no cost to Palau, many services including air safety, weather prediction, health services and assistance in the event of a natural disaster.

Tourism, the main source of income in Palau, has recovered from a decline in 1998 and the first six months of 1999, effected by the Asian economic downturn. Palau's tourism is focused on high-income, small-volume tourism, in order to achieve a balance between maintaining its pristine environment and tourism infrastructure development.

Major infrastructure development projects, including the United States-funded Babeldaob road and the Japan-funded replacement bridge between Koror and Babeldaob will assist Palau's economy over the next two to five years. The government is also building a new complex on Babeldaob which should ease the pressure on the heavily congested tourist areas.

Small-scale agriculture is experiencing an increase in demand, and fishing is also important to Palau. Japan is a major importer of Palau's tuna and Mackerel, and Chinese and Taiwanese long-line fishing fleets also fish in Palau's Exclusive Economic Zone (EEZ).

## Industry Sectors

**Agriculture:** There is limited agricultural production beyond the subsistence farming of taro, cassava and sweet potato. With a small area of land to cultivate and a small domestic market, large-scale commercial agriculture is not viable.

**Fisheries:** Beyond subsistence fishing and a small local market, including restaurants, Palau's main source of income from this sector is generated through the sale of licences to foreign fishing vessels from Japan and Taiwan that are involved in catching tuna in its extensive EEZ.

**Tourism:** Tourism is Palau's main source of income. Palau has been identified as one of the world's leading diving sites. Its pristine lagoons and coral reefs offer diving and snorkelling in some of the most tranquil waters in the northern Pacific. Tourism infrastructure is well advanced, with accommodation facilities ranging from fully integrated resorts to small guest houses.

Palau is expanding its hotels, transportation and communication systems and public utilities to accommodate an expected growth in tourism over the ensuing years.

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**Manufacturing:** Palau has a small manufacturing sector, which is mainly involved with producing handicrafts and garments for the local market and for tourists.

**Wholesale and Retail:** There are a large number of retail and wholesale operations in Koror and these companies handle mainly imported products.

**Construction:** There are a number of small local construction companies undertaking maintenance of existing infrastructure. For larger projects, international companies compete under a tendering process.

Currently, 11 major infrastructure projects costing a total of more than US\$340 million over 1999–2003 are underway, including the circumferential road on Babeldaob, which will cost \$US113 million over four years. Other large public projects include the Koror/Babeldaob bridge and the proposed new national capital complex. Among notable private projects are three proposed tourist resorts.

**Finance and Insurance:** A large number of international banks have representation in Palau, most of which are offices of United States or Asian banking corporations. The country is well serviced by local and international insurance and accountancy firms.

Palau has only limited **forest reserves** and there are no plantations of introduced species. Apart from high-quality manganese in the seabed of Palau's EEZ, yet to be quantified, there are no other known **mineral resources**.

## Imports/Exports

Palau's merchandise exports totalled US\$11 million in 1998 and comprised handicrafts, agricultural goods, taros and coconuts. Over the same period it imported goods valued at US\$79 million, including mineral fuels, manufactured goods, machinery and food. Its principal import sources are the United States, Guam, Japan and Singapore.

## Labour and Human Resources

Palau has a population of approximately 19,129 people of whom approximately one third are active members of the work force.

Education in Palau is modelled on the United States curriculum. Free public elementary and secondary education is available (Grades 1–12) and there are two private primary schools and five private high schools. The Palau Community College provides two-year vocational and tertiary courses ranging from business studies, nursing and hospitality to carpentry and mechanics.

Overseas workers from the Philippines and Taiwan are critical to Palau's labour market and economy. Many employers recruit overseas workers from Taiwan and the Philippines. Foreign businesses are required to pay a fee of US\$500 a year for every foreign worker employed by the company.

Palau's statutory minimum wage for the private sector is US\$2.50 per hour and for the public sector a minimum wage of US\$2.74 an hour.

## Infrastructure

Relative to its size, Palau has a well-developed infrastructure base. There is an excellent and well-maintained road network connecting Koror with Palau's largest island, Babeldaob, and a number of major new road projects are currently underway.

Palau is serviced by three **international airlines**. Continental Micronesia has several 737 flights a week from Guam and the Philippines. Far Eastern Air Transport has a twice-weekly scheduled 757 service from Taiwan, and Japan Airlines runs a weekly charter flight directly from Osaka.

There is only one **domestic airline**, Belau Air, which has a daily six-seater service from Koror to Angaur and Peleliu.

The main **port** of Palau is located in Koror. It is capable of handling large container vessels and also has facilities for refrigerated cargo. **International shipping** is handled by Philippine, Micronesia, and Orient (PMO) Line with a twice-monthly service from the United States and Asia; the Kambara Line with a weekly service from Guam; and the Kyowa Line (Bali Hai) with monthly services from Hong Kong, the Republic of Korea and Japan.

Shipments to and from Australia and New Zealand are transshipped in Guam, as is freight being handled by the Matson Line from the west coast of the United States.

There is very little **domestic shipping**. The states of Peleliu and Angaur each own barges and/or small vessels, which have services three times a week from Koror.

**Electricity** is generated by imported petroleum products and is available throughout the country.

There are 16 different **banks** in Palau, which are mainly representative offices of United States or Asian banking corporations. The country is also well serviced by local and international insurance and accountancy firms. Global freight-forwarding companies (FEDEX and UPS) have offices in Koror.

Domestic and international telecommunications are well developed with International Direct Dial telephone, facsimile and internet services.

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## Investment Policy and Regulations

The government of Palau aims to maximise benefits for its people by developing and implementing policies that will stimulate the economy. The government recognises and encourages the value of foreign investment, provided the investment is compatible with the cultural and environmental heritage of the islands.

Foreign investment in Palau is regulated by the *Foreign Investment Act 1990*. All proposals from foreign investors seeking to engage in business in the Republic of Palau are required by the Act to apply for and obtain a licence known as a Foreign Investment Approval Certificate (FIAC).

A proposed business activity must involve a foreign investment of more than US\$500,000 or the workforce of the business must be at least 20% Palauan. Foreign investors are required under the Act to pay an annual fee of US\$500 for every foreign worker employed in the country.

Applications for foreign investment are submitted through the Foreign Investment Board for decisions. Its functions are to:

- review and evaluate proposals for foreign investment;
- grant or deny applications for FIACs;
- monitor and enforce compliance with the terms and conditions of any FIAC granted; and
- monitor and enforce compliance with the provision of the Act.

Applications are evaluated by the Board according to the following criteria:

- the economic need for the proposed activity in Palau;
- the extent of its current availability in Palau;
- the likely impact on same or similar activities currently being carried on by citizens;
- the overall benefit to the national economy;
- the bona fide financial capacity, experience and expertise of the applicant; and
- the technical and economic viability of the proposed project.

There is a list of reserved investment areas in which new investments will be reserved for Palauan citizens or for enterprises partially or wholly owned by citizens. These areas include:

- handicraft and gift shops (except hotel or gift shops at the international airport);
- bakeries;
- bar services not associated with and contained within restaurants or hotels;
- operations manufacturing products being produced by wholly Palauan-owned manufacturing enterprises;
- equipment rentals for both land and water within the Republic, including equipment for tourism;

- commercial fishing for farm-raised fish or maricultured species; and
- any such businesses as the board may determine.

Palau also maintains Exclusive investment areas, which are reserved totally for Palauan citizens or for enterprises wholly owned by local citizens. These include:

- wholesale or retail sale of goods;
- all land transportation, including bus services, taxi services and car rental;
- tour guides, fishing guides, diving guides and any form of water-transportation services;
- travel and tour agencies; and
- commercial fishing for other than highly migratory species.

The Foreign Investment Board is required by law to issue a decision on application within 90 days of submission of a complete application. Moves are presently being made to expedite the review process and to issue decisions more quickly.

Following approval the Board will set the duration, scope and any conditions to be included in the FIAC. Foreign investors are required to submit period reports to the Board, enabling the Board to monitor investor compliance.

Any foreign investors wishing to do business in Palau will also need to obtain the necessary business licences from the Bureau of Revenue, Customs and Taxation, and if necessary from the state government where the business is to be located. In certain circumstances, specific permits from the Environmental Protection Board or the Maritime Authority may need to be obtained.

The primary incentive for investment in the Republic of Palau is its status as one of the lowest taxed business environments in the Asia Pacific region. There is no corporate tax, nor is there any taxation of income for business owners.

The Compact of Free Association also allows Palau free access to the United States markets.

Also any foreign investor who constructs a facility in Palau may be entitled to a refund of taxes paid equal to the costs of off-site roads, water, power or sewer infrastructure improvements accomplished to service such facility. The amount refunded in any single tax year shall not exceed 50% of the amount paid in that tax year by the foreign investor.

### Land

Foreigners cannot buy land in Palau. Only citizens of Palau and corporations wholly owned by citizens of Palau may acquire title to land or waters in Palau. However, foreigners may lease land from the Palauan owners for up to 50 years.

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Due to the complex history of Palau, including long periods of foreign control and management of the islands, the actual ownership and title to much of the land in Palau is only now in the process of being conclusively established. Foreign investors should be careful to ensure that the person or company that they intend to lease land from has acquired the right to alienate the specific parcel of land in question.

## Taxation and Other Regulations

A major incentive for foreign investors in Palau is its low tax structure. There is **no corporate tax** in Palau. There are three general types of taxes. These are:

- **Gross revenue tax:** All businesses operating in Palau are subject to a 4% gross revenue tax; however, no tax is payable where gross revenue is US\$2,000 or less. A recent amendment to the Unified Tax Act clarifies that a 100% deduction is permitted for income in the form of wages and salaries paid to Palauan employees, whereas a 50% reduction is permitted for income for foreign wages.
- **Wage and salary tax:** The current wage and salary tax rates are 6% on the first US\$8,000 and 12% on amounts over this level. No tax is payable where the annual wage and salary is US\$2,000 or less.
- **Import duties:** All imported products attract an import tax. The rates vary depending on the product. Most products are levied at 3% of their value.

Other taxes may be imposed by the government for specific business activities, including social security tax, export taxes, foreign vessel taxes and hotel room taxes.

## Investment Opportunities

Palau is at a critical stage of its development and, while the domestic market is limited, there are lucrative opportunities for foreign investors. These include:

**Tourism:** There is room for further 'upmarket' tourist resorts to cater for the growing number of tourists from Japan, Taiwan and the United States. New resorts could be totally integrated and incorporate restaurants, golf courses and diving and snorkelling activities.

**Fisheries:** A commercial fish-canning plant for processing the unlimited tuna stocks found in Palau's EEZ could be established.

**Garment Manufacture:** To take advantage of the preferential access to the United States market an export-orientated garment factory would contribute greatly to foreign exchange earnings. There is also potential for a viable project designed to specialize in the manufacture of resort wear to be sold to tourists in the domestic market.

**Agriculture:** There is potential for some specialised agricultural projects, including the production of medicinal plants such as noni, kava and sakua.

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## USEFUL CONTACTS

### BANK OF GUAM, PALAU

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### BANK OF HAWAII

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### BANKPACIFIC LTD

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