

Republic of Palau: Selected Issues and Statistical Appendix

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REPUBLIC OF PALAU

Selected Issues and Statistical Appendix

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Approved by the Asia and Pacific Department

April 11, 2008

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I. TOWARD A SUSTAINABLE FISCAL POLICY¹

1. **Since independence, Palau has received a steady stream of grants averaging some 42 percent of GDP per year.** Early in fiscal year 2010 (FY10), a sizable portion of these grants is scheduled to end, reducing total annual grants to about 30 percent of GDP.² While Palau has saved in anticipation of the steep fall-off in grants by building up a trust fund with assistance from the United States (Box 1), it is unclear whether the accumulated net financial wealth is sufficient to maintain present welfare levels after these grants expire.
2. **This chapter assesses, under various assumptions, whether Palau can maintain current welfare levels after Compact grants end and, if not, the size of the required fiscal adjustment.** The analytical framework is based on the government's intertemporal budget constraint, and has been most widely applied to countries with aging societies and exhaustible natural resources, which like Palau face a pronounced drop in government revenues down the road.³
3. **Section A presents the framework, followed by the main findings in Section B.** Given the current level of net financial assets, not only is the current fiscal policy not sustainable, the required adjustment under all scenarios is formidable and unlikely to be achieved immediately. The paper proceeds by estimating the required cumulative adjustment and level of public service provision in the case that consolidation occurs over a period of 15 years. Section C concludes by summarizing the main results and highlighting some broader policy implications of the employed framework.

A. Framework, Assumptions, and Data

4. **At the core of the current framework is the government's intertemporal budget constraint,** which requires that the net present value of future expenditure streams equals the net present value of future revenue streams plus the government's financial net wealth.⁴ In the Palauan context, this budget constraint can be written as follows:

¹ Prepared by Erik Lueth.

² The fiscal year runs from October 1 through September 30.

³ See Kotlikoff and Raffelhüschen (1999) and Lundvig, Lueth, and Raffelhüschen (1999) for work on aging, and Barnett and Ossowski (2003) and Olters (2007) for work on exhaustible resources.

⁴ Readers unfamiliar with this framework are referred to Annex I, especially the first and last sections.

$$W+T+G=C+K, \quad (1)$$

where W denotes the government's net financial wealth, and T , G , C , and K denote the net present value of domestic revenue, grants, current spending, and capital spending, respectively.

Box 1: The Compact Trust Fund

The Compact of Free Association was ratified in 1994, seven years later than the other Compact countries, following a long domestic debate surrounding its compatibility with the new constitution. The Compact provides \$600 million of grant assistance over 15 years and defense protection in exchange for the right to maintain U.S. military facilities on one-third of the territory, if needed, for 50 years.

Out of the total Compact grants, \$70 million were provided to establish the Compact Trust Fund (\$66 million in FY95 and \$4 million in FY97). The stated purpose of the fund is to provide a steady stream of income that would replace grants after FY09. By assuming an average annual return of 12½ percent, the trust fund was expected to allow inflation-adjusted annual withdrawals of \$5 million between FY00 and FY09, and \$15 million thereafter. Preserving and increasing the trust fund in real terms was seen as consistent with such withdrawals to 2044.

At 10 percent the actual nominal return since inception has been lower than expected. Although the authorities started withdrawals only in FY02 and abstained from inflation adjustments, the trust fund is projected to fall short of the initially envisaged level in FY10 by \$76 million (40 percent of GDP).

5. **Equation (1) contains both variables that are exogenous to most fiscal policy decisions and those that can be influenced by policy makers.** The government's net wealth is inherited from previous administrations and is a given for current policymakers. Similarly, the level of grants is to a large extent determined by development partners and, hence, not at the discretion of Palauan policymakers. The level of capital spending is, in principle, at the discretion of Palauan policymakers, but should be maintained at a level that ensures growth. This leaves current spending net of domestic revenue—or the current deficit—as the policy variable for balancing the intertemporal budget constraint:

$$C-T=W+G-K. \quad (2)$$

6. **The present exercise solves for the current deficit that is constant over time (in percent of GDP) and satisfies Equation (2).**⁵ The prior is that such a sustainable current deficit is superior to all other deficit paths, because it leaves no generation worse off by imposing higher taxes or providing lower public services.

Assumptions and data

7. **To calculate the net present values in Equation (2) one needs to make assumptions about future expenditure and revenue streams, as well as about the interest rate for discounting future streams to the present.** The current deficit and capital spending are assumed to grow with nominal GDP, requiring an estimate for real growth and inflation. For the projections a growth rate of 3 percent—close to the average over the last 5 years—and an inflation rate of 2 percent is assumed. The rate of return on the trust fund serves as the discount rate. The real rate of return on the government's net financial wealth is set at 6 percent, which based on data for 1970 to 2005 corresponds to an investment strategy of 50 percent large U.S. stocks and 50 percent international stocks (GAO, 2007).

8. **In terms of grants, the exercise considers two distinct scenarios.** The first one assumes that Compact grants expire in FY10. However, there is a Compact review scheduled for FY09 and the authorities are actively pursuing a possible extension of Compact grants and a topping up of the trust fund to levels initially envisaged. Therefore, a second scenario assumes additional Compact grant assistance of a similar level through FY24 and a topping up of the trust fund.

9. **The exogenous variables on the right hand side of Equation (2) have been specified as follows:**

- *Net worth (W)*: The government's net worth consists of three main aggregates, namely the Compact Trust Fund, government deposits, and the government's external debt. At the beginning of FY08—the base period—the trust fund amounted to 107 percent of GDP, government deposits amounted to 6 percent of GDP, and government debt amounted to 14 percent of GDP, bringing the government's net financial wealth close to 100 percent of GDP.

⁵ Note that there are many current deficit paths that satisfy Equation (2), but only one where the current deficit is constant over time, that is sustainable.

- *Grants (G)*: Since independence in FY95, annual foreign grants have averaged some 42 percent of GDP, of which 15 percent of GDP have been received off-budget.⁶ These grants can be broken down in 5 broad categories: U.S. Compact grants (12 percent of GDP), U.S. non-Compact grants (9 percent of GDP), grants from other countries (6 percent of GDP), U.S. off-budget grants (8 percent of GDP) and Japanese off-budget grants (7 percent of GDP). For the current exercise it is projected that non-Compact grants which are on-budget remain at historical relative to GDP, while future off-budget grants are set to zero for simplicity.⁷ Under the scenario of no Compact renewal, Compact grants are assumed to fall to zero in FY10. Under the scenario of Compact renewal, it is assumed that U.S. Compact grants-to-GDP remain at historical levels until FY24 and fall to zero thereafter. In addition, it is assumed that the United States will top up the trust fund in FY10 to levels envisaged at the outset of the Compact, implying a capital injection of some 40 percent of GDP.
- *Capital spending (K)*: Budgetary capital spending since independence has averaged 12½ percent of GDP. Going forward, capital spending-to-GDP is assumed to remain at this level.

B. Findings

10. **This section will first discuss the needed fiscal adjustment under the no Compact renewal and Compact renewal scenarios, respectively.** Given that these adjustments are relatively large, it will subsequently discuss the implications of a more gradual adjustment to a sustainable fiscal policy.

Immediate Adjustment without Compact Renewal (bold solid line)

To achieve fiscal sustainability in the absence of Compact renewal, the current deficit would have to improve from 20½ percent of GDP in FY07 to 5 percent of GDP in FY08 and thereafter (Figure 1). In FY08 and FY09, grants would continue after the adjustment had taken place, therefore, Palau would run budget surpluses (Figure 2) and the Compact Trust Fund (CTF) would increase (Figure 3). After FY09 budget deficits would be financed from CTF returns and the CTF would remain constant at about 100 percent of GDP.

⁶ This excludes FY95 when grants were unusually high due to the establishment of the trust fund.

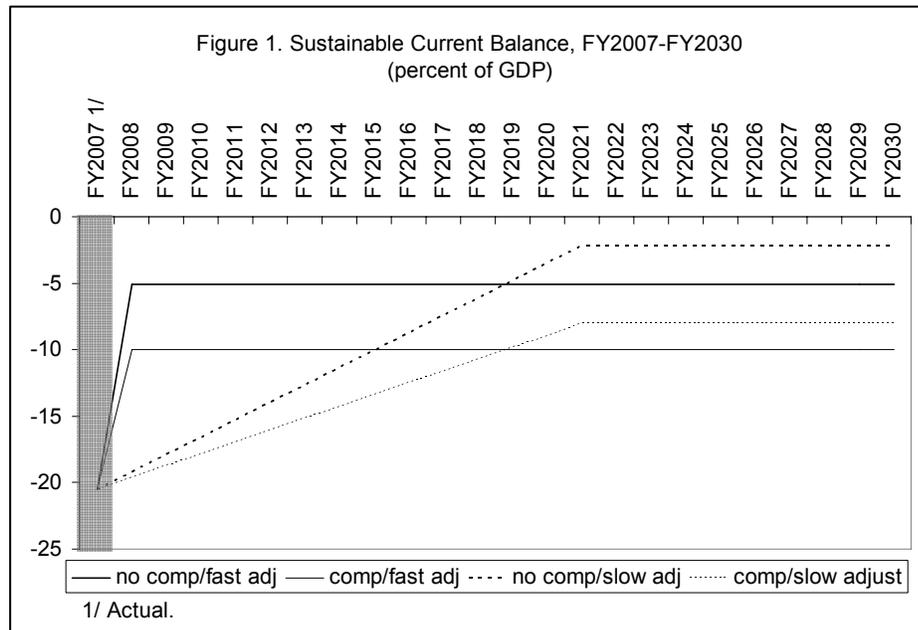
⁷ By the same token, future off-budget capital expenditure is set to zero.

Immediate Adjustment with Compact Renewal (solid line)

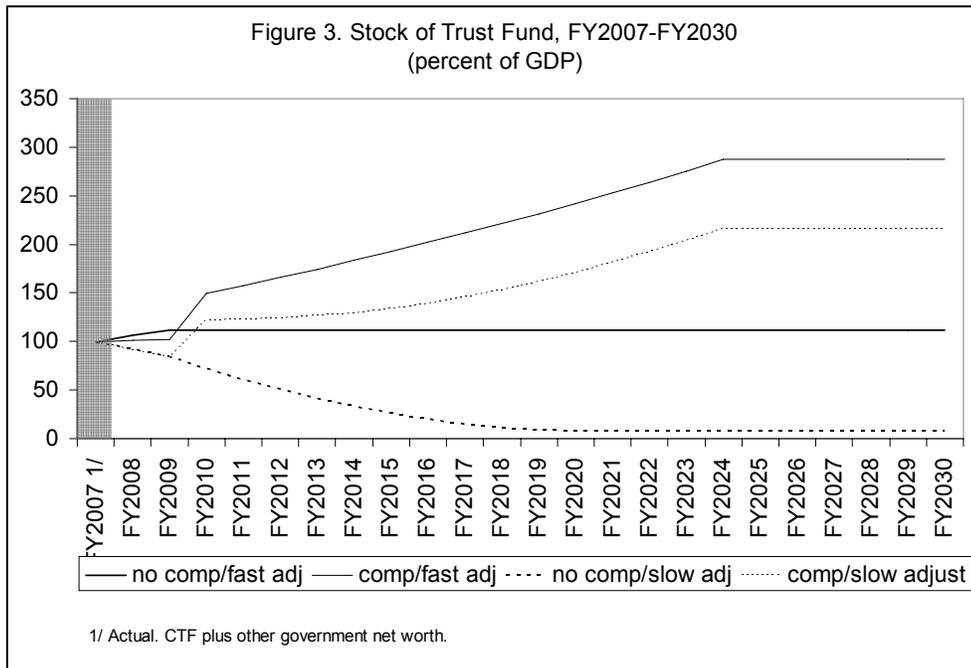
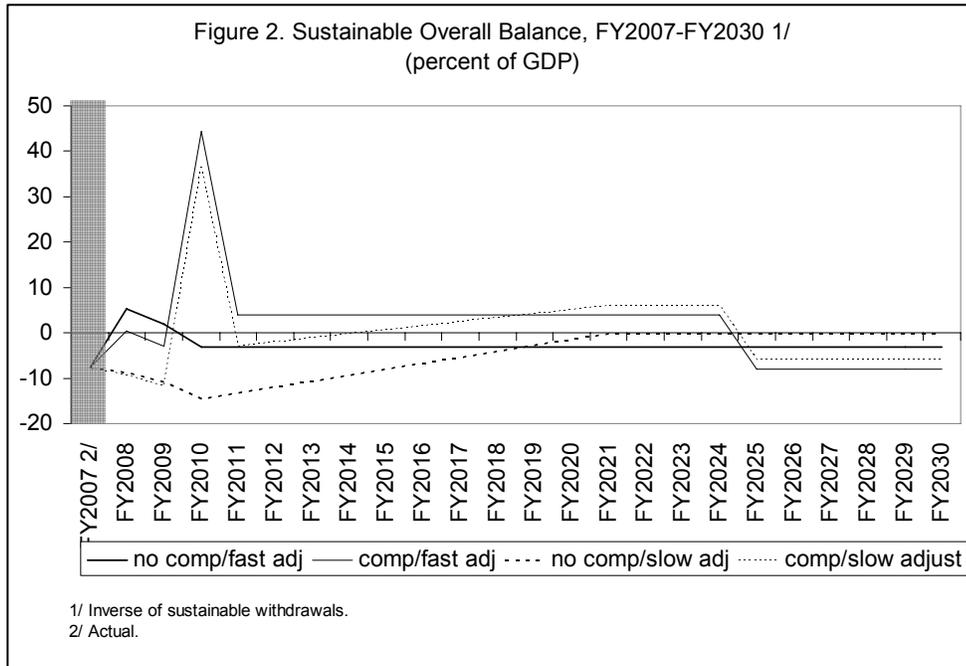
With an assumed Compact extension until FY24, adjustment to a sustainable current balance would be smaller than in the previous scenario (10½ percentage points of GDP). Overall budget balances would be much higher in the years of additional grant assistance. With a more uneven time path of grants, more would have to be saved for future Palauans and the trust fund would accordingly be much higher than under the previous scenario (290 percent of GDP).

Gradual Adjustment without Compact Renewal (bold broken line)

The required adjustments are too large to be implemented in a single year. Hence, this scenario assumes an adjustment of 1.3 percentage points of GDP each year, to achieve sustainability by FY21. As in the first scenario, Compact grants are assumed to end in FY09. With the adjustment drawn out over 15 years, the cumulative adjustment will be greater (18.3 percentage points of GDP) and future Palauans will experience lower welfare levels, compared to a scenario with immediate adjustment. There would be no saving for the sake of future Palauans, the trust fund would be depleted by FY21, and as a result vulnerability to external shocks would increase.⁸



⁸ The maximum allowable withdrawal from the trust fund under the compact (\$15 million) is not binding under this scenario.



Gradual Adjustment with Compact Renewal (broken line)

To achieve fiscal sustainability by FY21 under the assumption of Compact renewal, the current deficit would need to improve by 0.9 percentage points of GDP each year. Again, the delay in the adjustment will come at the detriment of future Palauans who will experience a cut in public services (or an increase in taxes) on the order of 2 percentage points of GDP compared to a scenario with immediate adjustment. Under this scenario, the government would pay into the trust fund in most years until FY24, by which time the trust fund stabilizes at around 215 percent of GDP.

Sensitivity Test

The results are fairly robust to varying parameter assumptions. The following table shows the adjustment needed to achieve immediate sustainability for various combinations of real growth rates and real rates of return on the trust fund under the no Compact renewal assumption. The higher real growth rates, the higher are future generations' claims on the trust fund (which grow in line with GDP), and the higher is the needed adjustment. The higher the rate of return on the trust fund, the less saving is needed to meet future generations' claims on the trust fund, and the lower is the needed adjustment. The bottom line is that reasonable variations in the parameters have a fairly small impact on the outcome and do not change the assessment that a sizeable adjustment is required. However, results of the Compact renewal scenario are somewhat more sensitive than the no renewal scenario given the larger stock of wealth.

Adjustment under Varying Assumptions 1/
(percentage points of GDP)

		Real growth rate		
		2	3	4
Real rate of return	5	15.4	16.5	17.5
	6	14.3	15.4	16.5
	7	13.3	14.3	15.4

1/ No compact renewal scenario.

Adjustment under Varying Assumptions 1/
(percentage points of GDP)

		Real growth rate		
		2	3	4
Real rate of return	5	10.4	13.0	15.8
	6	8.2	10.5	13.0
	7	6.1	8.2	10.6

1/ Compact renewal scenario.

C. Conclusion

11. **Using an intertemporal government budget constraint, we find that current fiscal policy in Palau is not sustainable.** Even under a best case scenario that Compact grants continue for another 15 years after FY09, current spending would need to decline by at least 10 percentage points of GDP. If Compact grants end in FY09 or if, as is likely, the adjustment takes place over a period of years, the required adjustment is higher. To the extent that additional revenues can be raised, expenditure cuts would be smaller.

12. **The adjustment is not a policy choice and will eventually occur, unless additional resources can be mobilized to relax the government's intertemporal budget constraint.** However, the manner in which the adjustment occurs is very much in the hands of Palauans and their policymakers. They can determine whether to bring about the adjustment through lower public services or higher taxes, and they can determine the speed of the adjustment—with implications for the burden sharing among current and future Palauans. The speed of the adjustment also affects the size of government wealth or debt and, hence, Palau's vulnerability to external shocks.

13. **Broader lessons fall out of the framework employed here.** First, policy makers facing drops in revenue or increases in expenditures over the medium-term need to think beyond the current budget and election cycle. Second, welfare analysis should start with the appropriate level of taxes and public services and from there derive the appropriate level for the trust fund. Attempts to determine an optimal trust fund level and from there derive taxes and public spending remain arbitrary. Third, when assessing sustainability, accounts that exist for monitoring and political economy reasons need to be consolidated (e.g., the trust fund needs to be consolidated with government deposits and external debt), to provide a clear picture of the government's financial position.

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Annex: Achieving Fiscal Sustainability—A Stylized Example

This Annex presents the analytical framework described in Section A in a stylized manner to facilitate an intuitive understanding of the fiscal policies discussed in Section B.

Deriving a Sustainable Spending Level

An imaginary country exists for four periods. It is assumed that government revenue equals 10 currency units in the first two periods and zero in the last two periods. It is also assumed that the interest rate is zero. The aim is to find a level of public spending that is sustainable. In the following example the initial level of public spending is not sustainable:

Example 1: Spending is not sustainable					
	Period 1	Period 2	Period 3	Period 4	Sum
Revenue	10	10	0	0	20
Spending	10	10	0	0	20
Budget balance	0	0	0	0	

People fortunate enough to live in the first two periods enjoy public services equivalent to 10 currency units, while people who live in the last two periods enjoy no public services at all. What forces public spending to zero in period 3 is the government's intertemporal budget constraint, which requires that the sum (or net present value) of all expenditure streams (last column) equals the sum of all revenue streams.

In the following example, the initial level of public spending is sustainable. Spending remains constant over time, conveying the same level of welfare to all generations, and satisfies the government's intertemporal budget constraint (last column).

Example 2: Spending is sustainable					
	Period 1	Period 2	Period 3	Period 4	Sum
Revenue	10	10	0	0	20
Spending	5	5	5	5	20
Budget balance	5	5	-5	-5	
Trust fund (stock)	5	10	5	0	

Maintaining the same level of public services in the face of steeply falling revenues requires that the government saves some revenue in periods 1 and 2. The government would run budget surpluses in the first two periods, accumulate a trust fund (value shown at the end of the period), and finance budget deficits out of the trust fund in the last two periods.

In the next sections some of the simplifying assumptions are relaxed, including the zero interest rate assumption and the finite horizon assumption.

Allowing for a positive interest rate

Assessing whether the government's intertemporal budget constraint is satisfied becomes more complicated when the interest rate is positive. Instead of just adding money received or spent at different points in time the compounded interest on revenue and expenditure streams needs to be taken into account. This is shown in the memorandum items assuming an interest rate of 100 percent for simplicity: The 10 currency units received in period 1 will double with each subsequent period and be worth 80 currency units in period 4. The 10 currency units received in period 2 will double with each subsequent period and be worth 40 currency units in period 4. In sum, revenues will amount to 120 currency units in period 4 (last column).

Example 3: Intertemporal budget constraint with accrued interest					
	Period 1	Period 2	Period 3	Period 4	Sum
Revenue	10	10	0	0	
Spending	8	8	8	8	
Budget balance	2	2	-8	-8	
Trust fund (stock)	2	6	4	0	
<i>Memorandum Items (Values in Period 4):</i>					
Revenue	80	40	0	0	120
Spending	64	32	16	8	120

This revenue can finance spending of 8 currency units in each of the four periods, as shown in the memorandum items. The 8 currency units spent in period 1 are worth 64 currency units in period 4, the 8 currency units spent in period 2 are worth 32 currency units in period 4, and so on. In sum, expenditures are worth 120 currency units in period 4, or equal to the value of revenues in period 4.

The period for comparing total revenue and expenditure streams is arbitrary. In the above example all revenue and expenditure streams were compounded to period 4 (by doubling amounts with each subsequent period). However, revenue and expenditure streams can also be discounted to period 1 (by cutting in half amounts with each preceding period). This is shown in the following table.

Example 4: Intertemporal budget constraint in net present values					
	Period 1	Period 2	Period 3	Period 4	Sum
Revenue	10	10	0	0	
Spending	8	8	8	8	
Budget balance	2	2	-8	-8	
Trust fund (stock)	2	6	4	0	
<i>Memorandum Items (Values in Period 1):</i>					
Revenue	10	5	0	0	15
Spending	8	4	2	1	15

The 10 currency units received in period 1 are worth 10 currency units in period 1. The 10 currency units received in period 2 are worth half that amount in period 1. In sum, revenues are worth 15 currency units in period 1 (i.e., the net present value of revenues is 15). Similarly, the 8 currency units spent in period 1, are worth 8 currency unit in period 1, the 8 currency units spent in period 2 are worth 4 currency units in period 1, and so on. In sum, expenditures are worth 15 currency units in period 1, or equal to the value of revenues in period 1. Hence, the intertemporal budget constraint of the government is satisfied. In practice, discounting to the present is more common than compounding to some date in the future, because in real world problems the time horizon is infinite. Before turning to this extension in the next section, note that the level of sustainable spending is higher when the interest rate is positive (8 currency units versus 5 currency units).

Allowing for an infinite time horizon

If the time horizon of the government is infinite initial revenues need to be distributed over a larger (in fact, infinite) number of people. Hence, the sustainable expenditure level will be lower than in the previous example, and equal 7.5 currency units. To confirm that this spending level does indeed satisfy the government's intertemporal budget constraint, all revenue and expenditure streams are once again discounted to period 1 and added up (see memorandum items). The problem has a solution despite the infinite time horizon, because spending expressed in period-1-values becomes smaller the further in the future it occurs. Adding up these diminishing values yields a finite number, in this case 15.⁹

Example 5: Intertemporal budget constraint with infinite horizon									
	Period 1	Period 2	Period 3	Period 4	Period 5	Period 6	...	Period ∞	Sum
Revenue	10	10	0	0	0	0	...	0	
Spending	7.5	7.5	7.5	7.5	7.5	7.5	...	7.5	
Budget balance	2.5	2.5	-7.5	-7.5	-7.5	-7.5	...	-7.5	
Trust fund (stock)	2.5	7.5	7.5	7.5	7.5	7.5	...	7.5	
<i>Memorandum Items (Values in Period 1):</i>									
Revenue	10	5	0	0	0	0	...	0	15
Spending	7.5	3.8	1.9	0.9	0.5	0.2	...	0	15

As in the simpler examples, the government runs budget surpluses in the first two periods and accumulates a trust fund out of which to finance future budget deficits. In contrast to the

⁹ Adding up spending in period-1-values for the 6 periods shown in the table yields 14.8, or close to 15. Hence, limiting the calculations to 6 periods would have given already a good approximation of sustainable spending levels. However, with lower interest rates longer time horizons are needed for good approximations.

simpler examples, however, the trust fund does not get depleted. Instead, budget deficits are financed from interest earned on the fund.

Allowing for domestic revenue and safeguarding capital spending

The budget in Palau is more complicated than in the stylized examples above and looks more like the upper part of the following table:

Example 6: Allowing for domestic revenue and safeguarding capital spending				
	Period 1	Period 2	Period 3	Period 4
Domestic revenue	20	20	20	20
Grants	20	20	10	10
Current spending	25	25	25	25
Capital spending	10	10	10	10
Balance	5	5	-5	-5
	↓		↓	
Grants minus capital spending	10	10	0	0
Current spending minus domestic revenue	5	5	5	5
Balance	5	5	-5	-5

Grants and capital spending have in common that they are exogenous to most fiscal policy decisions. The level of grants is to a large extent determined by development partners and, hence, not at the full discretion of Palauan policy makers. The level of capital spending is, in principle, at the discretion of Palauan policymakers, but should be maintained at a level that ensures growth. This leaves current spending and domestic revenue as the policy variables for achieving sustainability. In the lower part of the table grants and capital spending have been combined to one exogenous variable, while current spending and domestic revenue have been combined to one policy variable. The numbers are chosen such that the parallels to Example 2 are immediately obvious. The policy variable—current spending net of domestic revenue—is a good measure for net public services and should be kept constant over time to ensure generational equity (just as spending in the earlier examples). It is noteworthy that current spending net of domestic revenue corresponds to the current deficit which, indeed, is the authorities' declared policy variable.

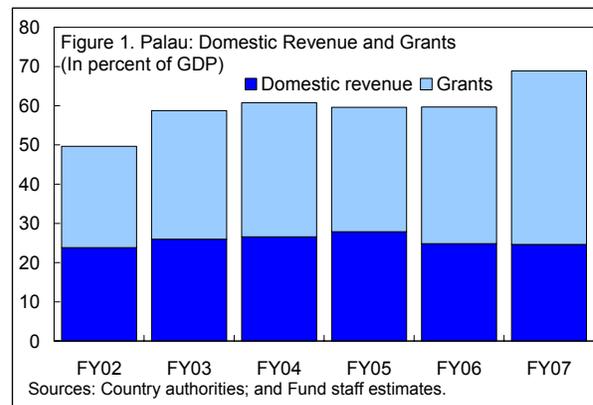
II. PALAU: MEASURES TO IMPROVE REVENUE PERFORMANCE¹⁰

Budget grants are scheduled to decline by about 10 percentage points of GDP in 2010, with the expiration of Compact grants in late 2009.¹¹ It has long been recognized that the current fiscal stance is unsustainable. More recently, weak revenue performance has undermined the government's expenditure cutting efforts. In order to achieve sustainability and protect public service provision, revenue must be increased. A comprehensive reform of the tax system is required. A second best approach could entail changes to the current tax regime aimed at near-term revenue generation followed by tax reform over the medium term.

A. Introduction

14. Like other small Pacific island economies, Palau is facing the overarching challenge of achieving fiscal sustainability.

Since independence in 1994, it has relied heavily on sizable grants from the United States, Japan and increasingly Taiwan Province of China, which on average have accounted for more than 55 percent of total government revenue.¹² These are set to decline abruptly when Compact grants, which have accounted for some 10 percent of



GDP over the past decade, expire in late 2009.¹³ While the Compact Agreement allows for withdrawals from the Compact Trust Fund (CTF) of up to \$15 million per year (9¼ percent of FY07 GDP) to supplement budget revenues, withdrawals of this magnitude would simply delay the fiscal adjustment and expose Palau to external shocks as the CTF is depleted.

15. A formidable fiscal consolidation is required. The staff estimates that an immediate reduction in expenditure of about 15 percentage points of GDP would be required to achieve

¹⁰ Prepared by Jie Yang.

¹¹ Under a 1994 Compact of Free Association (CFA) with the United States, Palau is to receive \$450 million in grants over 15 years and an upfront \$70 million to be set aside in a trust fund for use after Compact grants cease in late 2009. The CFA expires in 2044.

¹² Average of FY02–FY07.

¹³ A review of the Compact is scheduled for 2009. The Palauan authorities are aiming to renew or renegotiate the Compact with the United States government, seeking a continuation of Compact grants and a topping up of the CTF to levels originally envisioned.

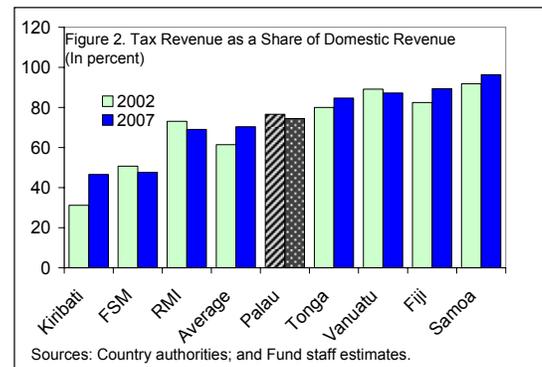
sustainability.^{14,15} Under an indicative scenario in which the Compact is renewed on similar terms and the CTF is topped up to the level originally envisioned in the CFA, an immediate reduction in expenditure of about 10 percentage points of GDP would be required. Adjustments of such a magnitude can rarely be carried out immediately. The more gradual the consolidation, the larger the required adjustment down the road and the higher the likelihood that the CTF will be depleted.

16. **In so far as additional revenue can be raised, the required reduction in expenditure would be lower.** The staff estimates that about one-third of the adjustment (5–6 percentage points of GDP) could come from the revenue side. Front-loading, with a smaller but sustained revenue effort thereafter, would be desirable. This could take the form of measures aimed mainly at revenue generation in the short run, with a major tax reform aimed at addressing distortions and inefficiencies over the medium term.

17. **This paper is organized as follows: we first describe Palau’s tax structure and recent revenue performance, including through comparisons with other small island economies (SIEs).** Subsequently, a series of reforms which would contribute to strengthening revenue performance in the near-term is presented, followed by key elements of a medium-term reform package. The final section concludes.

B. Tax Structure in Palau and other SIEs

18. **In most SIEs taxes are the main source of domestic revenue (Table 1 and Figure 2).** In six of the eight island nations compared, taxes account for 70 percent or more of total domestic revenue (2007)—only the Federated States of Micronesia (FSM) and Kiribati have a significant share of nontax domestic revenue.¹⁶ Palau falls near the average, relying more heavily on nontax revenue than Tonga, Vanuatu, Fiji and Samoa. Nontax revenues in Palau comprise mostly airport use and water charges, and the foreign labor fee.

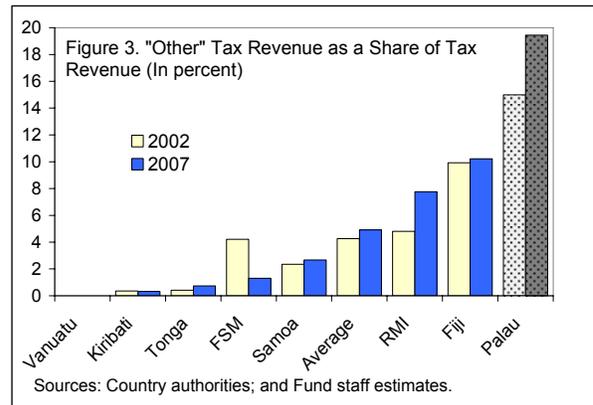


¹⁴ See accompanying selected issues paper “Toward a Sustainable Fiscal Policy.”

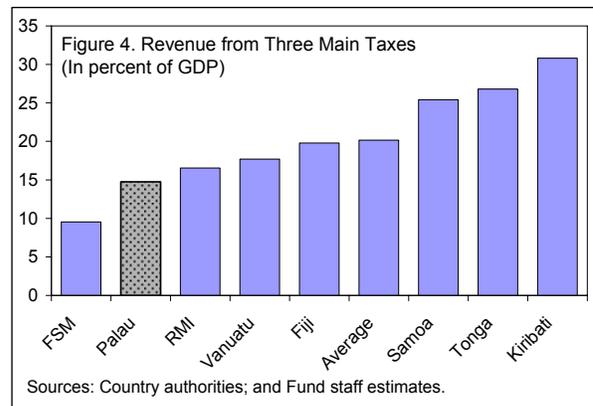
¹⁵ Analyses which take into account fiscal arrears and the large actuarial deficit of the Civil Service Pension Fund estimate a required adjustment of near 20 percentage points of GDP.

¹⁶ Comparator countries include the Federated States of Micronesia (FSM), Fiji, Kiribati, Palau, Republic of the Marshall Islands (RMI), Samoa, Tonga and Vanuatu. Data for FY06 is used for FSM, Kiribati, Tonga and Vanuatu as FY07 data is not yet available.

19. **Palau’s tax system is by some measures less efficient than regional comparators.** Only about 80 percent of tax revenue in Palau—versus 95 percent for comparators—comes from three major taxes: (i) personal income tax, (ii) taxes on goods and services, and (iii) taxes on trade.¹⁷ There is no corporate income tax, which has been adopted widely through the region, or value added tax. In the same vein, the revenue raised from “other” taxes in Palau is high at 20 percent of tax revenue (5 percent for comparators); this is indicative of a tax regime which relies heavily on nuisance taxes and is difficult to administer. Moreover, the regime is inequitable, with distortions resulting from the “cascading” of the turnover tax negatively affecting low value added producers.



20. **Palau’s are relatively less taxed than regional comparators.** Revenue from the three main taxes amounted to 14½ percent of GDP in FY07, significantly below the average for SIEs (20 percent of GDP). Revenue collection is lower across the board, with all three taxes yielding a smaller percentage of GDP. Palau’s highly open trade regime, which imposes a tariff of 3 percent on most imports of commercial goods, accounts for only a fraction of the difference.¹⁸ Rather, the personal income tax is less progressive and is charged at a lower rate relative to other SIEs, which also have more broad based excise taxes.¹⁹



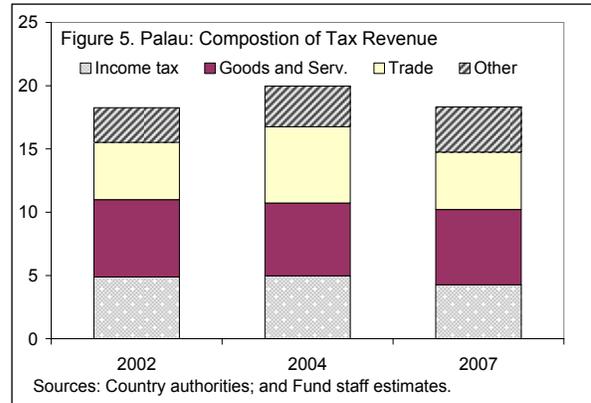
¹⁷ In Palau, the personal income tax comprises a wage and salaries tax; the tax on goods and services is a gross revenue (turnover) tax; and trade taxes capture import taxes and the fish export tax.

¹⁸ Comparisons of trade tax revenue excludes Kiribati, which levies a high import tax in lieu of a tax on goods and services. Tariff rates in SIEs average more than 10 percent, although countries such as Samoa and Tonga have begun cutting rates as trade liberalization progresses.

¹⁹ In Palau, only tobacco and alcohol are subject to excise taxes.

C. Revenue Performance in Palau and other SIEs

21. **Palau’s revenue performance has deteriorated since the last Article IV consultation (Figure 5), with revenue from the three main taxes falling by 2 percentage points of GDP since FY04. The decline has been strongest in the fish export tax and income taxes, which were partially offset by gains in “other” tax revenue. Given that economic growth was positive, imports buoyant, fish export volumes constant or rising and tax rates unchanged, the decline in revenue points to weakness in tax administration.**



22. **Compared with other SIEs, Palau’s revenue performance has gone from “average” in 2004 to somewhat “below average” in 2007.** This is the result of two things: first, the deterioration in Palau’s tax performance, and second, a significant improvement in revenue collection over the same period for other SIEs. Much of this improvement is the result of tax reform measures.²⁰ For example, Tonga’s 2002 tax reform helped boost revenues from 23.2 to 27 percent of GDP. Samoa, which *inter alia* raised the rate of its value added tax on goods and services, saw an equally impressive increase in tax collection from 22.4 percent to 26.2 percent of GDP. The effectiveness of these reforms in strengthening revenue collection suggests that some front-loading of the required adjustment in Palau is possible.

D. Revenue Enhancing Measures

23. **Increasing tax revenue will be key to successfully carrying out fiscal adjustment, and is an important complement to progress made to date on expenditure reduction.**²¹ A comprehensive reform of the tax system is called for; however, political will appears to be lacking.²² In light of the impending expiry of Compact grants and the magnitude of the required adjustment, a second best option could entail implementing measures which can be put in place quickly aimed at revenue generation, followed by broader reforms aimed at reducing distortions and improving administrative capacity over the medium term.

²⁰ Major tax reforms were passed in Samoa (1994 and 2002), Tonga (2002), and Vanuatu (2002).

²¹ Between FY03-FY06, current expenditures were reduced from 50 percent to 44.7 percent of GDP.

²² Proposals for a comprehensive reform of the tax system are beyond the scope of this paper.

24. **A piecemeal approach aimed mostly at revenue generation involves risks, but may be the only viable option in the current environment.** Implementing changes to the existing tax system may divert attention away from the more fundamental and necessary changes to the tax system itself, and lead to tax reform fatigue. Moreover, approval of some of the more politically difficult measures, such as removing exemptions or taxing nonwage compensation, may only be possible in the context of a broader reform package which could, for example, include reductions in some tax rates. Notwithstanding, the need for revenue generation and the current environment argue for consideration being given to a second best approach.

25. **Various tax reviews have been conducted, but the measures contained in the 1998 Tax Review Advisory Committee (TRAC) report remain valid.** Those recommendations form the basis of the measures presented below.²³

Near-term policy measures

1. Import tax

Weaknesses: exemptions and fob valuation

The current general import tax contains very broad exemptions from taxation, which include food and medicine, commodities imported for noncommercial purposes, governmental imports and exemptions imposed by international treaty. These open the door for significant evasion, reportedly estimated to be as large as 50 percent of total potential collection.

Commodity imports are currently valued on an FOB basis, and not the more common practice of using CIF. Changing to CIF would help generate revenue in two ways: 1) by raising the tax base; and 2) by reducing channels for undervaluing imports (i.e., over reporting of transport costs).

Recommended Measures:

- Abolish all the exemptions except those required under international treaties. This not only decreases channels for evasion, but also simplifies tax administration.

²³ In 2007 a Tax Review Task Force (TRTF) report was also produced. Some of its recommendations, such as eliminating many tax exemptions and changing import valuation methods from FOB to CIF, are in line with 1998 TRAC report. However, many other proposed measures would exacerbate weaknesses in the current tax system (i.e., advocating many new small taxes, which would contribute very little to total revenue collection, but create a heavy burden on tax administration).

- Move from FOB valuation to CIF.

2. **Wages and salaries tax**

Weaknesses: exemptions and refunds

The current wages and salaries tax does not apply to nonwage benefits. In addition, refund provisions for contributions to schools and non-profit organizations lead to significant evasion.

Recommended Measures:

- School fees should no longer be eligible for refund. This would eliminate mechanisms of evasion and simplify administration. If deemed necessary, the tax rate could be reduced in a revenue neutral way.
- Limits should be placed on deductions for contributions to non-profit organizations, and the list of eligible organizations could be reduced.
- The tax base should be extended to cover all forms of in-kind benefits received, including housing, value of motor vehicles, goods provided, bonuses, and the like, which comprise a large proportion of employee compensation.

3. **Hotel tax**

The hotel tax was recently changed. Previously, evasion of the ad valorem rate was prevalent through transfer pricing (i.e., the selling of tour packages with “complimentary” or very low stated room rates). It was recently increased: (i) for hotels with 20 rooms or less, it is the greater of 5 percent or \$5 per night; and (ii) for hotels with more than 20 rooms, it is the greater of 10 percent or \$10 per night.

Weaknesses: low rate and unclear definition of “accommodation”

The hotel room tax remains low in light of continued use of transfer pricing. Moreover, there is a need to clarify the types of accommodation and length of stay subject to the tax (i.e., hotels versus motels, apartments, guest houses; apartment rentals of short duration versus longer term stays).

Recommended Measures:

- Increase the flat per night rate to further reduce tax avoidance by package tour operators. This is also supported in the high end of the non-package tourism market, which is characterized by low price elasticity of demand for hotel rooms.

- Broaden the tax base by clarifying the definition of accommodation to include all hotel and motel rooms, apartments and other accommodation of a similar type used for short to medium term (three month) accommodation.

4. **Fish export tax**

The fish export tax was recently raised from \$0.25 per kilo to \$0.35 per kilo, despite a recommendation by the 2007 Tax Review Task Force to raise it to \$0.85 per kilo. The proposed hike was supported by developments in the industry—strong and growing world demand for tuna together with a recently placed cap on the annual regional tuna catch—which suggest that a higher tax could be charged.

Weaknesses: narrow tax base, low tax rate and prevalent evasion

The fish export tax only applies to tuna, the export of which is now capped. The rate locally based fishing companies are charged is very low at \$0.35 per kilo. Palau has very limited capacity to patrol its sizable waters, and evasion is prevalent. Stepped up efforts to track registered fishing vessels using GPS technology have fallen short of expectations.

Recommended Measures:

- Given rising global demand and fixed catches, there is scope to further increase the tax rate.
- Extend the fish export tax to other species.

5. **Foreign labor fee**

Weakness: tax avoidance

Currently, all employers in Palau are assessed annually \$150 for each skilled foreign worker and \$125 for each unskilled foreign worker employed. In addition, non-Palauan employers are assessed an additional \$500 per foreign worker. Evasion occurs through non-Palauan employers “renting” foreign workers from Palauan employers.

Recommended measure:

- Unification of the foreign labor fee to reduce tax evasion.

6. **Water and sewer charges**

Weaknesses: rates below cost recovery

Provision of water and sewer services imposes a large cost on the budget, as rates are below cost recovery. There is no charge for sewage, and water rates are very low at \$0.85 per 1000 gallons.

Recommended measures:

- Increase the currently nominal water charge to cost recovery levels.
- Place a flat rate sewage charge on all household's water bills.

Medium-term policy directions

26. **Over the medium term, a broader tax reform aimed at improving efficiency of the tax system should be considered.** Such a reform should address the distortions in the present system and aim at simplifying the tax system. Measures to strengthen administrative capacity would also be key. Introduction of nuisance taxes, which have high administrative costs but yield little revenue, should be avoided in favor of moving toward a modern tax system.

27. **Strong consideration should be given to replacing the gross revenue tax with a type of net profit tax.** The gross revenue tax is distortionary due to “cascading.”²⁴ It falls more heavily on high turnover, low profit margin businesses, as well as nascent businesses. It also creates inefficient incentives for businesses to integrate vertically. Moreover, it tends to be the most regressive of consumption taxes, since it shifts resource allocation away from high volume businesses which are typically patronized by lower income households. Moving to a net profit tax for business above a certain turnover threshold would remove these distortions.

28. **The authorities may also consider implementing a broad based VAT tax.** This, together with excises taxes, could take the place of the current import tax. Implementing a VAT would require a fairly lengthy preparation period (2+ years) given the need to significantly strengthen tax administration, train staff and educate the public. The experience of other SIEs has been positive, with proper implementation of the VAT leading to a strengthening of the tax system and significant revenue gains. Given the need to raise revenue over the near term, introducing a sales tax as an interim step toward a fully-fledged VAT could be considered.

²⁴ Because the tax is levied on the gross amount of all transactions, tax is charged on a base which includes taxes paid at other points in the production chain.

E. Conclusion

29. **Achieving fiscal sustainability requires a formidable fiscal adjustment.** Reversing declining tax revenue will be key to safeguarding necessary public service provision over the near term, and will complement progress to date on expenditure reduction. Further delays in passing needed tax measures will only heighten vulnerability to external shocks by increasing the likelihood that the Compact Trust Fund is depleted, and imply a stronger adjustment down the road.

30. **Cross country comparisons and analysis of current weaknesses suggest that a greater revenue effort is feasible.** Comparisons with other Small Island Economies reveal a higher dependence on nontax revenue in Palau and a lower tax burden. Moreover, falling tax revenue in the absence of declining tax rates indicates that there is likely scope to improve tax administration. A comprehensive tax reform, as successfully undertaken in some island nations, is the first best solution. However, the political environment and the urgent need to raise revenue point to a second best set of measures aimed at addressing current tax weaknesses, including through raising rates and eliminating conduits of tax evasion.

31. **Over the near term, tax measures should aim to raise tax revenue without increasing administrative burden.** Addressing tax avoidance and evasion will be key. Specifically, removing exemptions is likely the most effective measure, as it not only broadens the tax base, it decreases administrative cost and eliminates the conduits of tax avoidance. Increasing current tax rates and charges is also warranted in some cases, to reduce hotel-tax avoidance through transfer pricing and to bring prices up to cost recovery levels.

32. **Over the medium term, reforms should aim to remove distortions and make the tax system more efficient.** A key element of such a reform would be to replace the distortionary gross turnover tax with a net profit tax. A VAT-like consumption tax together with excises may also be considered as a replacement for import taxes. A significant effort will be required to improve low tax administration capacity, train staff and educate the public.

Table 1: Selected Pacific Island Countries: Structure of Domestic Revenue
(In percent of GDP)

	Income Tax	Tax on Goods and Services	Trade Taxes	Other Tax	Total Tax Revenue	Total Domestic Revenue
Palau						
FY2002	4.9	6.1	4.5	2.7	18.3	23.8
FY2004	5.0	5.8	6.0	3.2	20.0	26.6
FY2007	4.3	6.0	4.5	3.6	18.3	24.6
FSM						
FY2002	3.4	2.8	3.0	0.4	9.6	19.0
FY2004	3.6	2.7	3.0	0.0	9.2	23.5
FY2006	2.8	2.9	3.8	0.1	9.7	20.3
Vanuatu						
FY2002	0.2	10.5	6.4	0.0	17.1	19.2
FY2004	0.3	10.8	6.0	0.0	17.1	19.2
FY2006	0.5	11.5	5.7	0.0	17.7	20.3
Fiji						
FY2002	6.6	6.7	4.4	1.9	19.6	23.8
FY2004	6.4	8.6	4.6	2.4	21.9	24.9
FY2007	7.4	8.2	4.2	2.3	22.0	24.7
RMI						
FY2002	8.0	3.0	5.0	0.8	16.8	23.0
FY2004	8.1	3.1	4.7	1.3	17.2	25.5
FY2007	7.6	3.3	5.7	1.4	17.9	26.0
Samoa						
FY2002	4.5	12.3	3.9	0.5	21.2	23.1
FY2004	4.4	14.0	3.6	0.6	22.4	25.2
FY2007	4.5	17.0	3.9	0.7	26.2	27.2
Tonga						
FY2002	5.0	3.2	15.6	0.1	24.0	30.0
FY2004	4.4	3.2	15.4	0.1	23.2	28.5
FY2006	5.9	11.6	9.3	0.2	27.0	31.9
Kiribati						
FY2002	9.0	0.0	19.0	0.1	28.1	90.1
FY2004	12.5	0.0	19.7	0.1	32.3	71.1
FY2006	11.6	0.0	19.2	0.1	30.8	66.1
Mean						
FY2002	5.2	5.6	7.7	0.8	19.3	31.5
FY2004	5.6	6.0	7.9	1.0	20.4	30.6
FY06/07	5.6	7.6	7.0	1.0	21.2	30.1

Source: Country authorities; and Fund staff estimates.

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Statistical Appendix

Table 1. Republic of Palau: Gross Domestic Product, 2002–07 1/

	2002	2003	2004	2005	2006	2007 Est.
(In thousands of U.S. dollars, unless otherwise noted)						
Agriculture	1,427	1,470	1,544	1,891	1,918	2,097
Fisheries	2,529	2,630	2,788	3,124	3,383	3,500
Mining and quarrying	240	243	243	169	103	180
Manufacturing	1,774	532	540	695	780	822
Electricity, gas, and water	3,741	3,928	4,242	5,248	5,993	7,027
Construction	15,402	16,018	18,421	17,123	20,026	25,099
Trade	21,903	22,998	26,218	31,245	32,297	34,369
Hotels and restaurants	10,929	11,694	13,565	15,561	15,626	16,013
Transport and communication	10,095	10,600	11,660	13,186	13,240	12,655
Finance and insurance	4,368	4,499	4,769	5,100	5,925	6,188
Real estate and business services	4,985	5,185	5,600	7,325	8,437	7,149
Public administration	31,169	31,792	32,428	33,340	32,822	32,340
Other services	9,550	9,837	10,132	9,976	11,491	12,568
Subtotal	118,114	121,428	132,150	143,983	152,040	160,009
Less: Imputed bank service charge	2,681	2,600	2,820	2,890	2,913	3,087
Plus: Import duties	4,022	3,900	4,229	4,335	7,486	7,367
Nominal Gross domestic product (calendar year)	119,455	122,728	133,560	145,428	156,614	164,289
Nominal Gross domestic product (fiscal year)	120,755	121,909	130,852	142,461	153,818	162,370
(Percent change)						
Agriculture	2.0	3.0	5.0	22.5	1.4	9.4
Fisheries	-25.0	4.0	6.0	12.0	8.3	3.5
Mining and quarrying	0.0	1.3	0.0	-30.8	-39.0	75.4
Manufacturing	0.0	-70.0	1.4	28.7	12.2	5.4
Electricity, gas, and water	0.0	5.0	8.0	23.7	14.2	17.3
Construction	8.0	4.0	15.0	-7.0	17.0	25.3
Trade	-10.0	5.0	14.0	19.2	3.4	6.4
Hotels and restaurants	-12.0	7.0	16.0	14.7	0.4	2.5
Transport and communication	-7.0	5.0	10.0	13.1	0.4	-4.4
Finance and insurance	-6.0	3.0	6.0	6.9	16.2	4.4
Real estate and business services	-1.0	4.0	8.0	30.8	15.2	-15.3
Public administration	1.0	2.0	2.0	2.8	-1.6	-1.5
Other services	-8.0	3.0	3.0	-1.5	15.2	9.4
Subtotal	-4.2	4.2	8.8	9.0	5.6	5.2
Less: Imputed bank service charge	0.6	-3.0	8.4	2.5	0.8	6.0
Plus: Import duties	0.6	-3.0	8.4	2.5	72.7	-1.6
Nominal GDP (calendar year)	-4.2	2.7	8.8	8.9	7.7	4.9
Nominal GDP (fiscal year)	-2.2	1.0	7.3	8.9	8.0	5.6
CPI (fiscal year)	-1.2	-0.6	5.8	3.2	4.8	3.0
Real GDP growth (fiscal year)	-1.0	1.6	1.5	5.5	3.0	2.5

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

1/ Estimates, derived from partial source data.

Table 2. Republic of Palau: Employed Persons by Industry, 1990, 1995, and 1999–2007

	1990	1995	1999	2000	2000	2001	2002	2003	2004	2005	2006	2007
	Census	Census	Social Security	Census	Social Security	Social Security	Social Security	Social Security	Social Security	Social Security	Social Security	Social Security
Agriculture, fisheries, and mining	446	724	287	215	272	183	287	337	358	395	368	326
Construction	861	1,087	946	1,112	1,235	1,815	2,285	1,913	1,856	1,912	1,539	1,273
Manufacturing	93	78	26	345	619	...	...	178	200	282	244	268
Transport, storage, communication, and other public utilities	477	435	766	765	718	607	573	797	835	923	929	981
Wholesale, retail, restaurants, and hotels	800	1,448	2,495	2,619	2,914	2,364	2,291	2,910	2,975	3,360	3,487	3,516
Finance, insurance, and real estate	119	122	119	116	707	126	150	702	695	682	724	804
Services 1/	687	1,573	1,147	1,246	1,116	1,917	2,049	1,400	1,573	1,691	1,840	1,850
Public administration	2,116	2,292	3,048	3,203	2,775	4,087	3,997	2,862	2,876	2,967	2,940	3,005
Extra-territorial bodies	...	...	...	...	7	...	...	11	12	11	11	13
Total employed population	5,599	7,759	8,834	9,621	10,363	11,099	11,632	11,110	11,380	12,223	12,082	12,036

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

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

Table 3. Republic of Palau: Selected Social Indicators, 1995 and 2000–07 1/

	1995	2000	2001	2002	2003	2004	2005	2006	2007
	Census	Census	SS	SS	SS	SS	Census	SS	SS
GDP per capita (U.S. dollars)	5,529	6,179	6,352	5,980	6,045	6,480	6,925	7,284	8,412
Area (square miles)									
Land	188	188	188	188	188	188	188	188	188
Sea	237,850	237,850	237,850	237,850	237,850	237,850	237,850	237,850	237,850
Demographic indicators									
Total population	17,225	19,129	19,626	19,976	20,304	20,610	20,891	21,058	21,227
Population growth (percent per annum)									
1986–90	2.4	...	...	...	...	...	...	...	...
1990–95	2.6	...	...	...	...	...	...	...	...
1995–00	2.0	2.1	...	...	...	...	...	...	...
2001–05	1.8	...	...	...	...	...	1.0	...	...
Age-dependency ratio (dependents to working-age population)	51	...	...	...	...	...	...	...	...
Labor force	8,368	9,845	...	...	...	...	10,203	...	...
Employed 2/	7,780	9,621	11,099	11,632	11,110	11,380	9,777	12,082	12,036
Agriculture, fisheries, and mining	724	215	183	287	337	358	795	368	326
Construction	1,089	1,112	1,815	2,285	1,913	1,856	1,365	1,539	1,273
Manufacturing	78	345	...	...	178	200	225	244	268
Transport, storage, communication, and other public utilities	436	765	607	573	797	835	769	929	981
Wholesale, retail, restaurants, and hotels	1,455	2,619	2,364	2,291	2,910	2,975	1,947	3,487	3,516
Finance, insurance, and real estate	124	116	126	150	702	695	132	724	804
Other business, personal, community, and social services	1,120	1,246	1,917	2,049	1,411	1,585	2,701	1,851	1,863
Public administration	2,879	3,203	4,087	3,997	2,862	2,876	1,734	2,940	3,005
Unemployed	588	224	...	...	...	...	426	...	...
Age structure (in percent)									
0–14	28	24	...	...	...	...	24	28	...
15–64	66	71	...	...	...	...	70	66	...
65 and over	6	5	...	...	...	...	6	6	...
Public education									
Percent graduating									
Primary	97.0	97.0	118.0	119.0	...	119.1	115.4	...	...
Secondary	65.0	78.0	99.0	82.0	...	...	...	...	...
College student/teacher ratio	11.0	11.0	10.9	11.6	12.1	...	...	...	...
Health									
Crude birth rate (per 1,000)	13.4	14.5	15.3	13.0	13.7	14.0	13.0	12.0	...
Crude death rate (per 1,000)	7.0	6.5	7.0	6.7	6.7	7.0	7.0	6.6	...
Infant mortality (per 1,000)	20.0	10.8	16.7	23.2	16.7	16.0	10.3	7.7	...
Life expectancy at birth, female (years)	72.6	...	...	...	75.4	75.7	...	...	...
Life expectancy at birth, male (years)	65.7	...	...	...	67.5	67.8	...	...	...
Life expectancy at birth, total (years)	70.8	...	...	...	71.3	71.6	...	...	...
Hospital beds (per 1,000)	61.0	...	...	...	65.0	65.0	...	...	...

Sources: 1995, 2000 and 2005 Census of Population and Housing; Data provided by the Office of Planning and Statistics; Social Security Office and World Bank, *World Development Indicators*.

1/ Figures for 2001–07 are estimates based on partial data.

2/ Composition of employment figures for 2001–04 and 2006–07 are based on figures from social security records. Data for 1995, 2000, 2005 are from census.

Table 4. Republic of Palau: Consumer Price Index: Quarterly and Annual Average, June 2000–December 2007

(December 2004=100)

		All Groups	Food and beverage	Alcohol, tobacco, and betelnut	Clothing and footwear	Housing	Household operations	Transportation	Health, personal care, education, and services	Leisure and entertainment
2000	Average	94.7	92.5	79.0	113.3	106.5	102.0	92.0	92.0	97.5
	Jun.	93.6	91.1	79.8	112.5	105.5	100.5	91.5	90.2	95.8
	Sep.	95.4	94.1	78.7	114.2	106.3	102.5	91.8	92.8	98.4
	Dec.	95.0	92.1	78.6	113.4	107.8	103.1	92.8	93.0	98.3
2001	Average	95.1	93.1	78.6	115.3	111.3	100.1	92.9	93.3	98.0
	Mar.	95.6	93.8	77.2	115.4	112.3	101.3	93.4	93.0	99.4
	Jun.	95.5	93.8	79.1	115.2	112.7	100.7	92.7	92.7	97.8
	Sep.	95.0	92.4	79.8	115.5	111.9	100.3	92.6	93.9	97.3
	Dec.	94.2	92.5	78.2	115.0	108.3	98.0	92.9	93.4	97.4
2002	Average	93.9	91.9	76.0	110.0	105.9	100.1	92.1	94.7	98.4
	Mar.	94.2	93.4	77.4	114.9	108.9	97.6	92.1	93.1	97.1
	Jun.	94.1	93.0	77.6	110.6	108.9	97.5	92.5	94.0	98.1
	Sep.	94.0	91.1	76.7	108.6	102.8	102.7	92.1	95.8	98.6
	Dec.	93.1	90.1	72.3	106.0	103.2	102.5	91.9	95.9	99.0
2003	Average	94.7	92.6	78.0	106.1	102.5	102.0	93.3	98.5	98.5
	Mar.	93.4	90.0	70.9	104.8	102.3	104.0	93.4	96.1	98.7
	Jun.	93.7	92.2	70.0	105.9	102.0	101.8	93.2	97.7	98.2
	Sep.	93.9	92.0	71.7	107.1	103.0	101.5	92.8	100.5	97.9
	Dec.	97.9	95.9	99.5	106.7	102.5	100.9	93.6	99.7	99.3
2004	Average	99.4	99.2	99.4	102.2	100.6	100.3	97.6	99.6	100.1
	Mar.	98.4	97.0	99.7	104.4	100.6	100.7	95.1	99.6	100.3
	Jun.	99.0	98.4	98.7	104.4	100.0	100.6	97.0	99.5	100.0
	Sep.	100.3	101.4	99.1	100.0	102.0	100.1	98.4	99.5	100.0
	Dec.	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2005	Average	103.3	97.7	103.9	101.5	100.6	105.9	104.6	109.2	99.0
	Mar.	101.1	99.8	102.6	100.0	100.0	101.2	102.8	100.0	100.7
	Jun.	102.4	97.5	103.9	101.0	98.0	105.7	104.1	104.5	100.8
	Sep.	104.8	96.8	104.5	102.4	102.2	108.4	105.1	116.1	97.3
	Dec.	105.0	96.9	104.5	102.4	102.2	108.4	106.6	116.1	97.3
2006	Average	107.9	96.5	111.5	91.2	97.5	113.4	113.3	121.1	97.3
	Mar.	106.7	96.4	104.9	109.8	101.0	107.8	110.9	127.7	97.3
	Jun.	107.4	94.9	110.8	85.1	101.2	114.6	113.5	118.8	97.3
	Sep.	109.0	96.7	113.0	84.9	97.0	116.8	116.6	119.0	97.3
	Dec.	108.8	97.9	117.2	84.9	90.9	114.3	112.2	119.0	97.3
2007	Average	111.4	101.7	115.8	85.7	91.9	123.8	111.8	118.3	94.3
	Mar.	109.4	99.7	115.5	85.9	91.8	119.3	106.8	119.6	97.3
	Jun.	110.9	101.6	113.9	85.7	91.8	122.7	112.5	117.8	93.5
	Sep.	111.7	101.7	116.5	85.7	91.8	124.8	111.6	117.8	93.5
	Dec.	113.7	103.6	117.3	85.7	92.3	128.3	116.3	117.8	92.8

Source: Bureau of Budget and Planning.

Table 5. Republic of Palau: Balance of Payments, 2000/01–2006/07 1/

(In thousands of U.S. dollars)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Est.
Trade balance	-83,302	-76,367	-79,833	-101,398	-91,765	-101,690	-81,206
Exports, f.o.b.	16,567	20,345	8,411	5,882	13,414	13,594	10,081
Imports, f.o.b.	-99,869	-96,712	-88,244	-107,280	-105,179	-115,284	-91,287
Services account	47,889	46,005	68,239	87,698	86,539	79,594	87,262
Receipts	59,537	58,339	76,911	98,680	98,858	94,372	101,242
Travel	58,531	57,354	75,612	96,940	97,220	92,913	99,360
Other	1,006	986	1,300	1,739	1,638	1,459	1,882
Payments	-11,648	-12,334	-8,672	-10,982	-12,319	-14,778	-13,980
Transportation	-10,682	-11,129	-7,697	-9,457	-10,790	-13,184	-12,493
Passenger's service	-1,032	-1,302	-1,095	-1,761	-1,766	-1,656	-1,805
Freight and insurance	-9,650	-9,827	-6,602	-7,696	-9,024	-11,528	-10,688
Travel	-966	-1,205	-975	-1,525	-1,529	-1,594	-1,487
Income	5,985	5,450	4,458	6,019	4,292	2,157	2,215
Investment income	5,163	4,854	3,911	5,605	3,733	445	297
Pension Fund Investment Income	605	595	566	309	432	840	740
Social Security Investment Income	917	713	685	792	792	1,529	1,798
Income and interest payment	-700	-712	-704	-687	-665	-657	-620
Current transfers	3,837	3,679	1,124	892	-3,799	-892	1,532
Private	-17,576	-17,525	-20,366	-23,497	-25,869	-23,367	-22,864
Inflows	5,686	7,494	4,123	3,022	1,124	2,756	2,301
Outflows	-23,262	-25,019	-24,489	-26,519	-26,993	-26,123	-25,165
Official	21,413	21,204	21,490	24,389	22,070	22,475	24,396
Business licenses and fees	1,380	1,148	1,062	1,077	1,634	1,601	1,358
Budget grants	20,334	20,561	20,966	23,383	20,678	21,642	23,398
Other	-301	-505	-538	-71	-242	-768	-360
Current account (includes official grants)	-25,591	-21,233	-6,012	-6,789	-4,733	-20,831	9,804
Current account (excludes official grants)	-45,925	-41,794	-26,978	-30,172	-25,411	-42,473	-13,594
Capital and financial account	26,616	19,582	24,752	37,001	41,639	27,483	50,597
Public Sector	13,645	10,622	18,428	23,485	22,914	25,927	49,297
Capital grants	1,064	1,888	13,243	13,882	14,979	22,424	24,800
Off-budget capital grants	12,581	8,734	5,756	8,746	9,578	4,646	12,140
Gross borrowing 2/	0	0	0	2,000	0	0	13,500
Loan repayments	0	0	-571	-1,143	-1,643	-1,143	-1,143
Private Sector	12,972	8,960	6,324	13,516	18,725	1,556	1,300
Foreign direct investment	12,972	8,960	6,324	13,516	18,725	1,556	1,300
Other private flows/errors and omissions 3/	-11,554	-32,329	-23,670	-38,763	-41,689	-11,988	-65,737
Overall balance 4/	-10,528	-33,980	-4,931	-8,550	-4,783	-5,336	-5,336
Memorandum items:							
Current account as a percent of GDP							
Including official grants	-20.7	-17.6	-4.9	-5.2	-3.3	-13.5	6.0
Excluding official grants	-37.2	-34.6	-22.1	-23.1	-17.8	-27.6	-8.4
Service receipts as a percent of GDP	48.2	48.3	63.1	75.4	69.4	61.4	62.4
Return on the Compact Trust Fund	-26,794	-5,543	16,799	10,317	15,896	9,457	22,011

Sources: Data provided by the Ministry of Finance and Palau Visitors Authority; Banks, and Fund staff, and Ministry of Finance estimates.

1/ Fiscal year ending September 30.

2/ Gross borrowing in FY07 includes the \$7 million borrowings by Palau Public Utilities Corporation (PPUC).

3/ Private bank flows, profit repatriation of so-called front businesses, and errors and omissions.

4/ Increase in the government's gross foreign assets minus return on the Compact Trust Fund, which is not covered in the balance of payments.

Table 6. Republic of Palau: Imports by Product Category, 1999/00–2006/07 1/ 2/ 3/

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

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Food and live animals	7,393	8,373	7,886	7,086	8,861	8,868	8,849	8,608
Beverages and tobacco	16,444	15,317	14,658	12,988	13,564	14,688	14,256	13,625
Crude materials, inedible, except fuels	6,110	5,228	5,849	4,546	5,718	5,275	5,494	4,996
Mineral fuels, lubricant, and related minerals	36,495	23,029	21,453	20,359	28,402	37,227	49,507	34,252
Chemicals and related products	8,032	8,156	8,525	6,735	8,680	8,893	7,356	7,925
Manufactured goods	10,690	7,703	9,109	3,051	3,347	3,724	3,483	3,959
Machinery and transport equipment	32,359	23,337	20,140	18,541	21,316	23,636	20,900	16,107
Miscellaneous manufactured articles	9,424	8,436	9,604	7,073	5,886	5,773	5,434	1,815
Total	126,946	99,579	97,224	80,379	95,774	108,083	115,280	91,287

Source: Data provided by the Customs Office, Ministry of Administration.

1/ Fiscal year ending September 30.

2/ Total imports is different from imports in Tables 5 and 7 due to different statistical methods.

3/ Based on new classification provided by the authorities.

Table 7. Republic of Palau: Imports by Country or Territory of Origin, 1999/00–2006/07

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

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
United States	45,688	41,016	43,097	34,732	37,408	34,534	35,822	30,263
Singapore	12,231	8,578	7,435	8,931	17,451	23,671	31,192	22,630
Guam	13,648	10,938	9,675	10,979	10,652	12,461	12,468	10,226
Japan	21,931	9,779	8,722	7,661	7,575	10,645	11,159	8,791
Taiwan Province of China	8,896	5,229	6,505	3,835	5,783	8,250	6,897	5,429
Australia	1,922	1,051	1,744	982	1,399	3,162	1,062	849
Hong Kong SAR	3,793	3,459	3,897	848	884	587	1,991	780
The Philippines	4,418	4,004	3,451	4,078	6,289	7,266	5,848	6,960
Korea	6,938	6,217	7,803	4,679	4,900	3,994	3,320	1,502
Saipan	527	586	590	346	422	384	262	460
New Zealand	150	38	140	637	162	192	252	293
Federated State of Micronesia	118	385	74	240	13	76	11	40
People Republic of China	937	2,644	1,102	629	722	1,440	2,228	1,221
Malaysia	675	102	142	62	314	428	227	56
Indonesia	2,860	367	616	575	252	119	193	131
Thailand	148	155	256	220	264	266	218	419
Germany	87	3,281	32	2	326	65	17	9
Others	1,980	1,766	1,961	969	962	561	2,117	1,229
Total 1/	126,946	99,592	97,241	80,405	95,778	108,100	115,284	91,287

Source: Data provided by the Customs Office, Ministry of Finance.

1/ Total imports is different from imports in Tables 5 and 6 due to different statistical methods.

Table 8. Republic of Palau: Tourism and Business Arrivals, and Travel/Work Abroad by Residents, 1999/00--2006/07 1/

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Tourism								
Visitor arrivals by purpose								
Tourist	44,034	46,684	44,721	57,465	79,180	80,656	75,487	83,310
Business	3,323	3,047	3,436	3,269	4,271	4,348	4,233	3,832
Employment	5,076	5,590	4,590	4,392	5,233	5,374	4,719	4,659
Resident	9,730	10,311	335	430	642	534	10,455	10,706
Other	4,004	156	11,703	9,949	12,132	10,795	404	216
Total tourism and business arrivals	47,357	49,731	48,157	60,734	83,451	85,004	79,720	87,142
Total arrivals	66,167	65,788	64,785	75,505	101,458	101,707	95,298	102,723
Total arrivals by country of residency								
Taiwan Province of China	14,390	14,077	13,708	26,813	43,452	39,297	30,463	31,118
Japan	21,140	23,505	22,831	21,620	24,384	26,033	27,092	28,902
United States	8,072	9,652	10,098	9,449	10,296	10,250	9,654	8,435
Korea	592	451	439	466	2,952	5,062	8,562	14,330
Australia and New Zealand	402	391	395	547	1,241	1,050	715	660
The Philippines	3,819	4,162	3,666	3,409	3,938	3,575	3,227	4,445
Other 2/	17,752	13,550	13,648	13,201	15,195	16,440	15,585	14,833
Total arrivals by country of residency	66,167	65,788	64,785	75,505	101,459	101,707	95,298	102,723

Source: Data provided by the Palau Visitors Authority.

1/ On a fiscal year basis; fiscal year ending September 30.

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

Table 9. Republic of Palau: National Government Debt and Debt Service, 1999/00–2006/07

(In thousands of U.S. dollars)

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Prel.
Gross External Debt	20,000	20,000	20,000	19,429	20,286	18,643	17,500	22,857
ICBC Capital Relocation	20,000	20,000	20,000	19,429	18,286	17,143	16,000	14,857
ICBC PIA Upgrade	...	...	...	...	1,500	1,500	1,500	8,000
BOH FPA Support	...	...	...	...	500	...	...	...
Debt Service								
Principal	1,433	0	0	571	1,143	1,643	1,143	1,143
Interest	0	700	712	704	687	665	657	620

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

Table 10. Republic of Palau: National Government Budgetary Operations, 2001/02–2007/08 1/

(In thousands of U.S. dollars)

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Est.	2007/08 Budget
Total revenue and grants	51,225	65,866	70,819	75,352	82,239	86,222	80,943
Domestic revenue	28,776	31,657	34,764	39,695	38,173	38,024	41,782
Tax revenue	22,042	22,706	26,131	30,086	29,376	29,751	34,068
Salaries and wages	5,901	6,326	6,508	6,899	6,978	6,918	7,632
Import tax number	5,455	5,693	7,885	9,255	7,486	7,371	7,692
Gross revenue tax	7,380	7,120	7,536	9,015	9,541	9,676	11,217
Other	3,306	3,567	4,202	4,917	5,370	5,786	7,527
Nontax revenue	4,520	5,713	7,622	6,276	6,641	5,825	5,857
Fishing rights income	83	101	106	158	158	153	107
Interest income	257	315	2,097	217	415	465	0
Fees and charges	1,265	2,778	2,855	3,481	3,341	2,525	3,322
Licenses and permits	1,973	1,915	2,025	1,956	1,932	2,002	1,951
Other	941	604	539	463	795	680	477
Local Trust Funds	2,214	3,238	1,011	1,333	2,157	2,198	1,856
Capital revenue	...	...	...	2,000	...	250	...
Grants	22,449	34,209	36,055	35,657	44,066	48,198	39,161
Total expenditure	80,032	83,789	90,655	85,473	100,889	104,064	98,814
Current expenditure	58,994	68,444	70,628	71,837	78,161	81,215	76,467
Wages and salaries	29,020	30,118	31,237	31,687	32,760	33,662	34,032
Other purchases of goods and services	21,783	22,559	21,526	21,433	25,959	27,207	23,095
Interest payments	712	712	687	665	657	620	982
Investment fees	81	59	54	38	19	18	18
Subsidies, State government and other	7,398	7,498	8,562	9,007	9,383	9,854	9,170
Current transfers	7,398	7,498	8,562	9,007	9,383	9,854	9,170
Public enterprises	1,662	1,669	1,549	1,520	1,601	1,580	1,401
State block grants	3,266	3,484	4,573	4,491	4,711	4,811	4,811
Other	2,470	2,345	2,440	2,996	3,071	3,463	2,958
Capital expenditure	21,038	15,345	20,027	13,636	22,728	22,849	22,347
Errors and omissions,							
Accounts Payable/Receivables	-6,148	16,149	7,095	7,111	16,785	5,544	9,498
Current balance (excluding grants)	-30,218	-36,787	-35,864	-32,142	-39,987	-43,191	-34,685
Current balance (including grants)	-9,657	-15,821	-13,691	-11,464	-18,345	-19,793	-12,869
Overall balance	-34,955	-1,774	-12,741	-3,010	-1,865	-12,298	-8,373
Financing	34,955	1,774	12,741	3,010	1,865	12,298	8,373
Net long-term borrowing	0	-571	857	-1,643	-1,143	5,357	-2,000
New borrowing	0	0	2,000	0	0	6,500	0
Principal repayments	0	571	1,143	1,643	1,143	1,143	2,000
Change in NTF assets	29,955	-2,655	6,884	-347	-1,992	1,941	5,373
Withdrawals from Trust Fund	5,000	5,000	5,000	5,000	5,000	5,000	5,000

Source: Ministry of Finance.

1/ Fiscal year ends September 30.

Table 11. Republic of Palau: National Government Budgetary Operations, 2001/02–2007/08 1/

(In percent of GDP)

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Est.	2007/08 Budget
Total revenue and grants	42.4	54.0	54.1	52.9	53.5	53.1	47.7
Domestic revenue	23.8	26.0	26.6	27.9	24.8	23.4	24.6
Tax revenue	18.3	18.6	20.0	21.1	19.1	18.3	20.1
Nontax revenue	3.7	4.7	5.8	4.4	4.3	3.6	3.5
Local Trust Funds	1.8	2.7	0.8	0.9	1.4	1.4	1.1
Capital revenue	...	...	...	1.4	...	0.2	...
Grants	18.6	28.1	27.6	25.0	28.6	29.7	23.1
Total expenditure	66.3	62.6	62.7	53.7	59.5	58.0	52.8
Current expenditure	48.9	50.0	47.4	44.1	44.7	43.9	39.6
Wages and salaries	24.0	24.7	23.9	22.2	21.3	20.7	20.0
Other purchases of goods and services	18.0	18.5	16.5	15.0	16.9	16.8	13.6
Interest payments	0.6	0.6	0.5	0.5	0.4	0.4	0.6
Investment fees	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Subsidies, State government and other	6.1	6.2	6.5	6.3	6.1	6.1	5.4
Current transfers 2/	6.1	6.2	6.5	6.3	6.1	6.1	5.4
Public enterprises	1.4	1.4	1.2	1.1	1.0	1.0	0.8
State block grants	2.7	2.9	3.5	3.2	3.1	3.0	2.8
Other	2.0	1.9	1.9	2.1	2.0	2.1	1.7
Capital expenditure	17.4	12.6	15.3	9.6	14.8	14.1	13.2
Errors and Omissions,							
Accounts Payable/Receivables	-5.1	7.1	-1.1	-1.3	4.8	-2.7	0.2
Current balance (excluding grants)	-25.0	-24.0	-20.9	-16.2	-19.9	-20.5	-15.0
Current balance (including grants)	-8.0	-6.8	-3.9	-1.7	-5.8	-6.1	-2.2
Overall balance (excluding grants)	-47.5	-29.5	-37.3	-27.1	-29.9	-37.3	-28.0
Overall balance	-28.9	-1.5	-9.7	-2.1	-1.2	-7.6	-4.9
Memorandum Items:							
GDP (in thousand U.S. dollars)	120,755	121,909	130,852	142,461	153,818	162,370	169,758
Off-budget grants (percent of GDP) 2/	7.2	4.7	6.7	6.7	3.0	7.5	...

Source: Ministry of Finance.

1/ Fiscal year ending September 30.

2/ Spent off-budget on infrastructure projects.

Table 12. Republic of Palau: Revenue, 2001/02–2006/07

(In thousands of U.S. dollars)

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Est.
Domestic revenue	28,775	31,658	34,764	37,863	38,173	38,024
Tax revenue	22,041	22,707	26,130	30,086	29,376	29,750
Fish export tax	413	379	384	882	1,471	1,002
General import tax	4,626	5,269	6,887	7,960	6,644	6,598
Fuel excise tax	828	424	998	900	842	772
Road use tax	472	455	475	511	483	453
Salary and wage tax	5,901	6,326	6,508	6,899	6,978	6,918
Business gross revenue	7,380	7,120	7,536	9,015	9,541	9,676
Hotel occupancy tax	950	1,026	1,223	1,498	1,329	1,758
Traveler's head tax	1,156	1,310	1,732	1,749	1,734	1,774
Delinquent taxes, penalties and interest	249	346	338	221	333	775
All other taxes	66	50	49	452	20	23
Nontax revenue	4,520	5,713	7,623	6,444	6,641	6,076
Fishing rights income	83	101	106	158	158	153
Interest income	257	315	2,097	217	415	465
Fees and charges	1,265	2,778	2,855	3,481	3,355	2,525
Airport fees and rentals	0	1,186	1,397	1,875	1,747	1,136
Water utility charges	622	652	616	667	710	697
Postal service	398	411	435	453	381	372
Court and fines and fees	245	318	189	225	209	191
Seaport fees	0	113	133	141	146	111
Other	0	98	86	121	162	19
Licenses and permits	1,973	1,915	2,025	1,956	2,187	2,002
Foreign labor permits	1,082	1,302	1,406	1,107	1,082	944
Business licenses	166	157	162	169	366	225
Banking fees	0	0	0	0	0	10
Foreign investment permits and fees	414	168	140	234	205	201
Corporate filing fees	32	31	35	34	27	29
Other licenses and permits	279	257	282	413	506	302
Airport fuel taxes	...	...	...	...	...	140
FIC nonresident workers	...	...	...	...	...	29
Copyright registration fee	...	...	...	...	...	0
Palau passport fee	...	...	...	...	...	122
Other	941	604	540	631	526	931
Indirect cost recoveries	...	66	...	111	190	200
Service Mart sales	0	62	61	38	29	40
Belau Mariculture Demonstration Center	22	16	21	33	11	7
Other	920	460	458	449	296	683
Trust funds	2,214	3,238	1,011	1,333	2,157	2,198

Source: Ministry of Finance.

Table 13. Republic of Palau: Tax Structure Legislation History, 1998–2007

	1998 (RPPL 5-7)	2000 (RPPL 5-41)	2002 (RPPL 5-41)	2003 (RPPL 6-26)	2004 (RPPL 6-35)	2005 (RPPL 6-37)	2006	2007
Inclusion and authority to define "commercial purposes"								
Allowable deduction of salaries and wages paid from GRT for noncitizen				0%				
Tax refund for wages less than \$2,000 annual				No				\$0.35
Fish Export Tax - any species of tuna or billfish in any form per kilogram		\$0.25						
Travelers Head Tax								
Citizens [effective 11/01/97]	\$20.00							
Noncitizens [effective 11/01/97]	\$20.00							
Palauans and spouses		\$10.00						
Exemptions:								
Children less than 3 years								
Masters, pilots and crew members								
Palauan students	x							
Medical referral patients and escort			x					
Import Tax [effective 01/01/98]								
Cigarettes, per 20 cigarettes exemption 1 carton (10 packs containing 20 cigarettes)		\$0.50			\$2.00			
Tobacco products, other than cigarettes, ad valorem		150%	100%		x			
Beer, per oz.		\$0.03	\$0.015		\$0.03			
Liquor, per oz.		\$0.30						
Wine, per oz.		\$0.20	\$0.10		\$0.20			
Wine cooler, per oz.			\$0.03		\$0.05			
All other alcohol not fruit based					\$0.30			
Vehicles, ad valorem plus \$250 per vehicle		5%						
Perfume and cosmetics								
Carbonated soft drinks, per 12 fluid ounce								
Liquid fuel, per gallon								
Bottled water, except distilled water						25% ad valorem		
Elimination of Exemption of small businesses with gross revenues less than \$2,000								
Hotel Room Tax								
Elimination of Exemption of small businesses with gross revenues less than \$2,000	x							
Maximum of \$10 or 10% for hotels with 20 rooms and more								
Maximum of \$5 or 10% for hotels with 20 rooms less								
Road Use Tax [effective 01/01/98]								
Motor vehicles weighing 0–2,000 lbs.		\$50.00						
Motor vehicles weighing 2,000–4,000 lbs.		\$75.00						
Motor vehicles weighing over 4,000 lbs.		\$150.00						

Table 13. Republic of Palau: Tax Structure Legislation History, 1998–2007 (concluded)

	1998 (RPPL 5-7)	2000 (RPPL 5-8)	2002 (RPPL 5-41)	2003 (RPPL 6-26)	2004 (RPPL 6-35)	2005	2006	2007
Definitions								
Director - BRCT instead of BNT	x							
Bureau - BRCT instead of BNT	x							
Business...	x							
Motor vehicles...	x							
Powers and duties of the Director to enter in binding agreements for the liquidation of tax liability								
BRCT prohibited employment	x							
Fees for employment of nonresident workers [effective 11/01/97]								
Nonresident worker fee [after effective date of Act]	\$150.00							
Nonresident worker annual fee	\$100.00							
Nonresident worker dependent fee	\$500.00							
Licenses required; fees [effective 01/01/98]								
Taxicab operator	\$150.00							
Massage parlor	\$500.00							
Fees for Division of Labor								
Change status to employment	\$500.00							
Temporary permit	\$500.00							
Extension of permit	\$125.00							
Re-issue permit	\$75.00							
Transfer employment	\$150.00							
Change of employment status	\$125.00							
Citation	\$75.00							
Change of occupation	\$100.00							
Application fee	\$5.00							

Source: Ministry of Finance.

Table 14. Republic of Palau: National Government Expenditure, 2000/01–2006/07

(In thousands of U.S. dollars; by budget category)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Prel.
Office of the President	1,690	1,971	1,225	1,166	1,159	1,655	836
Office of the Vice-President	402	560	453	529	380	558	420
Ministries							
Health	10,391	10,053	10,604	12,527	12,145	13,255	12,119
Education	9,431	8,730	8,517	9,138	7,953	8,610	8,669
Resources and development	7,657	6,766	6,463	6,557	7,156	7,080	7,306
Finance	2,479	2,889	3,781	3,362	4,170	3,263	2,276
Justice	3,538	3,579	3,510	3,589	3,837	4,007	4,075
State	2,409	2,135	2,329	2,186	2,169	2,366	2,399
Commerce and Trade	1,503	1,290	1,518	1,603	1,654	1,654	1,424
Community and Cultural Affairs	768	808	1,175	1,348	1,478	969	963
Boards, Commissions and Authorities							
Boards, Commissions and Authorities	526	443	428	587	589	599	675
Legislative Branch							
Legislative Branch	3,312	3,368	3,372	3,396	3,432	3,572	3,842
State block grants							
State block grants	4,453	4,453	4,463	4,573	4,491	4,711	4,811
Judiciary							
Judiciary	2,268	2,342	2,124	2,255	2,170	2,240	2,250
Independent agencies							
Independent agencies	892	966	615	1,412	1,309	2,293	1,390
Other agencies and activities							
Other agencies and activities	...	...	5,658	2,529	1,157	1,453	1,047
Other							
Other	5,269	3,834	...	7	2,140	2,013	2,231
Capital Outlay:							
Capital expenditures	15,361	21,038	15,345	20,027	13,636	22,728	19,721
Interest payments							
Interest payments	700	712	712	687	665	657	620
Operating transfers							
Operating transfers	6,707	4,132	4,014	4,553	4,516	4,516	4,544
Public enterprises	2,837	1,662	1,669	1,549	1,520	1,485	1,566
Other	3,870	2,470	2,345	3,004	2,996	3,031	2,978
Total	79,756	80,068	76,307	82,030	76,206	88,199	81,618

Sources: Reports on the Audit of Financial Statements and data provided by the Bureau of Program, Budget, and Management, Ministry of Finance.

Table 15. Republic of Palau: Financial Holdings of the Central Government, 2000/01–2006/07

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

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Est.
Foreign assets 1/							
Deposits with foreign banks	39,785	10,805	10,874	7,324	7,541	8,248	7,912
<i>Change in Foreign Bank assets</i>	(5,528)	(28,980)	69	(3,550)	217	707	(336)
Change due to:							
Deposits	37,313	16,006	13,928	14,071	12,533	12,786	12,907
Interest income	171	55	48	2,079	188	328	398
Investment Gains/Losses	(8,928)	(768)	1,094	(1,675)	261	212	332
Investment fees	(185)	(81)	(62)	(54)	(40)	(21)	(20)
Withdrawals	(33,900)	(44,192)	(14,938)	(17,971)	(12,725)	(12,598)	(13,952)
<i>Total change</i>	(5,529)	(28,980)	70	(3,550)	217	707	(335)
Grant deposited/withdrawn from Bank of Guam	23,328	(23,329)	...	...	...	...	...
Domestic assets 2/							
Deposits with domestic banks	3,882	2,907	5,493	2,159	2,289	3,574	1,969
<i>Change in Domestic Bank assets</i>	(28,487)	(975)	2,586	(3,334)	130	3,574	(1,605)
Fiduciary funds 3/	135,039	124,496	136,295	141,613	152,509	156,966	173,977
Total financial holdings	178,706	138,208	152,662	151,096	162,339	168,788	183,858

Sources: Data provided by the Office of the President and Ministry of Finance.

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

2/ Deposits with local banks.

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

Table 16. Republic of Palau: Financial Position of the Compact Section 211 (f) Trust Fund, 2000/01–2006/07

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

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 1/ Prel.
Total receipts	(25,810)	(4,695)	19,518	11,312	16,783	10,391	22,961
Compact grants	...	...	...	...	...	...	...
Investment gains and							
Interest income	(25,810)	(4,695)	19,518	11,312	16,783	10,391	22,961
Investment gains (losses)	...	...	...	...	...	...	...
Investment interest income	...	...	...	...	...	...	...
Total expenditures	984	5,848	7,719	5,995	5,886	5,933	5,950
Investment fees	984	848	2,719	995	886	933	950
Withdrawals	...	5,000	5,000	5,000	5,000	5,000	5,000
Overall balance	(26,794)	(10,543)	11,799	5,317	10,896	4,457	17,011
Fund balance at year end	135,039	124,496	136,295	141,612	152,509	156,966	173,977

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

1/ Unaudited figures for FY07.

Table 17. Republic of Palau: Financial Position of the Social Security Fund, 2000/01–2006/07

(In thousands of U.S. dollars)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 Prel. 1/
Revenues	-221	5,402	13,137	10,311	16,819	12,486	18,448
Contributions	6,891	8,166	7,882	7,828	8,580	8,509	9,097
Government	2,885	3,381	3,545	3,688	4,054	3,715	4,010
Private	3,925	4,521	4,320	4,059	4,447	4,501	4,691
Penalties and interest	81	264	17	81	79	293	396
Investment and other income	-7,112	-2,764	5,256	2,482	8,239	3,977	9,351
Investment with trust company	-7,130	-2,787	5,228	2,396	8,140	3,769	9,154
Other income (local)	18	23	27	87	99	208	197
Expenditures	4,721	5,195	5,720	5,848	6,150	6,574	7,353
Total benefit payout 2/	3,968	4,252	4,566	4,950	5,286	5,629	6,263
Administrative fees 3/	753	943	1,154	898	864	945	1,090
Net collection (deficit)	-4,942	207	7,417	4,463	10,669	5,912	11,095
Fund balance (end-year)	34,129	34,336	41,753	46,216	56,885	62,797	73,892

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

1/ Unaudited figure for FY07.

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

3/ Including administrative and investment management expenses and fees.

Table 18. Republic of Palau: Financial Position of the Civil Service Pension Fund, 2000/01–2006/07

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

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 1/ Prel.
Revenues	(1,329)	2,951	10,100	6,466	11,414	7,781	12,062
Contributions							
Government employees	3,926	4,096	4,214	4,328	4,861	4,715	4,832
Investment gains (losses)	(7,653)	(2,097)	5,101	1,493	5,734	1,829	5,332
Investment interest income	605	595	566	309	432	840	740
Other income	268	232	219	336	387	397	758
Transfers from national government	1,525	125	...	...	...	...	400
Expenditures	5,318	5,219	5,548	5,794	6,368	6,446	6,650
Total benefit payout 2/	4,752	4,740	5,069	5,284	5,876	5,950	6,035
Administrative fees 3/	566	479	479	510	492	496	615
Net collection (deficit)	(6,647)	(2,268)	4,552	672	5,046	975	5,412
Fund balance (end-year)	33,964	31,696	36,248	36,920	41,966	42,941	48,353

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

1/ Unaudited figures for FY07.

2/ Including lumpsum benefits, refunds, and disability benefits.

3/ Including investment management expenses and fees.

Table 19. Republic of Palau: Operating Accounts of the Major Public Corporations, 2000/01–2006/07

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

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07 1/ Prel.
Palau Utility Corporation							
Operating revenues	11,528	10,422	11,071	12,553	15,777	17,718	20,016
Operating expenses	12,263	11,576	12,137	14,725	19,652	22,404	22,617
Gross operating profit (loss)	(735)	(1,154)	(1,066)	(2,172)	(3,875)	(4,686)	(2,601)
Nonoperating revenues (expenses)	...	...	1,038	...	884	673	943
Subsidies from government and foreign grants	1,198	552	535	571	393	...	145
Net total profit (loss)	463	(602)	506	(1,601)	(2,598)	(4,013)	(1,513)
Palau Housing Authority							
Operating revenues	209	403	201	258	152	141	193
Operating expenditures	120	94	149	133	114	117	119
Change in equity during the year	89	309	52	125	38	24	74
Fund equity, beginning of year	(255)	(166)	143	195	320	358	382
Fund equity, end of year	(166)	143	195	320	358	382	456
Palau National Communications Corporation							
Operating revenues	6,059	8,812	8,812	8,629	8,245	8,745	9,234
Operating expenses	6,166	8,438	8,523	9,760	7,585	7,882	7,974
Other income (expenses)	(1,496)	1,686	1,686	1,579	1,348	(945)	(1,154)
Change in equity during the year	(1,603)	2,060	1,975	448	2,008	(82)	106
Fund equity, beginning of year	12,041	10,438	10,783	5,715	737	48	(33)
Fund equity, end of year	10,438	9,126	8,516	3,002	48	(33)	74

Sources: Independent auditor's report on financial statements; and data provided by the Palau Utilities Corporation, Palau Housing Authority; and Palau National Communications Corporation.

1/ Unaudited figures for FY07.

Table 20. Republic of Palau: Assets and Liabilities of the National Development Bank of Palau, 2000/01–2006/07

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

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Assets							
Cash	3,589	482	1,169	1,800	3,836	2,994	2,158
Time certificates of deposit	1,149	2,219	1,241	896	1,363	1,460	1,536
Loans	5,966	8,653	10,315	11,337	13,100	14,802	17,014
Fixed assets	100	109	88	54	60	34	34
Investments	...	...	...	5,007	1,000	1,000	1,000
Other 1/	95	109	97	278	704	434	586
Total assets	10,899	11,572	12,911	19,373	20,063	20,724	22,328
Liabilities							
Accounts payable 2/	25	32	19	110	104	457	285
Bonds payable	...	...	...	...	...	...	...
Loans payable	...	...	500	6,000	6,300	6,434	7,696
Bank capital 3/	10,874	11,540	12,392	13,262	13,659	13,833	14,347
Total liabilities	10,899	11,572	12,911	19,373	20,063	20,724	22,328

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

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

2/ Includes accrued expenses.

3/ Includes contributed capital and retained earnings.

Table 21. Republic of Palau: Operating Accounts of the National Development Bank of Palau, 2000/01–2006/07

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

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Revenues	1,068	1,106	1,283	1,374	1,552	1,344	1,894
Interest	737	904	1,137	1,211	1,244	1,046	1,621
Loan fees	84	89	81	100	149	101	106
Others	247	114	65	63	158	197	167
Transfers from national government 1/	...	...	...	...	...	...	...
Contributions from other countries	...	...	...	...	...	...	...
Net provision for allowance for loan losses	320	15	...	8	-441	-439	-448
Expenditures:	395	455	431	512	715	735	939
Wages and salaries	203	250	224	230	266	273	295
Depreciation	33	38	45	51	37	36	36
Interest	0	0	2	83	245	257	365
Others	159	167	160	148	166	169	243
Net income (losses)	992	666	852	870	397	174	514
Fund equity, beginning of year	9,882	10,874	11,540	12,392	13,262	13,659	13,831
Fund equity, end of year	10,874	11,540	12,392	13,262	13,659	13,831	14,347

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

1/ Capital transfers include amount of \$149,916 for Y2K upgrading project and \$2 million for the first time home-owner program from the government.

Table 22. Republic of Palau: Bank Credit Allocation by the National Development Bank of Palau, 1990–2007

	Agriculture	Fisheries	Tourism	Forestry	Manufacturing	Commerce and		Housing	Total Loans
						Construction	Construction		
1990	55,009	191,552	755,995	14,858	86,140	574,674	...	...	1,678,228
1991	65,905	253,118	917,419	11,565	150,837	882,035	...	...	2,280,879
1992	56,934	237,764	910,211	4,357	91,543	1,411,854	...	...	2,712,663
1993	23,377	270,936	867,315	181	1,763	1,640,543	...	...	2,804,115
1994	47,346	239,374	1,259,143	...	1,739	1,353,788	...	...	2,901,390
1995	54,586	201,608	1,257,773	...	...	1,789,561	...	...	3,303,528
1996	65,000	359,000	348,000	...	48,271	2,469,000	...	...	3,289,271
1997	45,000	164,000	265,000	...	...	1,685,000	...	...	2,159,000
1998	7,000	16,000	...	...	...	70,000	...	...	93,000
1999	...	...	...	...	...	...	...	...	...
2000	15,000	...	...	...	488,651	2,378,217	...	2,881,868	5,763,736
2001	15,000	16,882	...	...	1,134,984	1,881,138	...	3,048,004	6,096,008
2002	...	25,449	...	...	...	1,671,583	...	2,736,012	4,433,044
2003	189,539	76,086	669,825	...	...	3,820,427	...	6,677,830	11,433,707
2004	180,186	90,938	763,772	...	...	3,804,231	...	7,603,875	12,443,002
2005	194,092	90,060	1,400,570	...	...	4,900,703	...	8,483,768	15,069,193
2006	117,297	41,421	287,578	...	...	4,783,504	...	8,736,414	13,966,214
2007	128,430	22,892	420,587	...	29,437	7,281,608	...	9,288,936	17,171,890

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

Table 23. Republic of Palau: Structure of Interest Rates, 2002/07

(In percent)

	May 2002	May 2003	May 2004	May 2005	May 2006	May 2007
<u>National Development Bank of Palau 1/</u>						
Lending rates						
Consumer loans	...	...	...	...	...	...
Commercial loans (one year)	10.00-12.00	10.00-12.00	10.00	11.00	8.00-10.00	8.00-10.00
Residential housing loans						
30-year, fixed (maximum 20 year)	8.00-12.00	8.00-12.00	8.00-10.00	8.00-10.00	8.00-10.00	8.00-10.00
15-year, fixed	12.00	12.00	10.00	10.00	8.00-10.00	8.00-10.00
Government-directed scheme 2/	8.00	8.00	8.00	8.00	8.00	8.00
Normal loan scheme	12.00	12.00	10.00	10.00	10.00	10.00
Microfinance: Commercial and Housing	...	...	...	...	...	6.00
<u>Bank of Hawaii-Palau Branch</u>						
Deposit rates						
Checking account (with minimum balance)	...	...	N/A	0.0-0.08	0.05-0.25	0.05-0.25
Savings account	0.25-2.05	0.25-1.00	0.30-0.85	0.05-1.45	0.10-1.69	0.10-2.48
Time savings account						
30 days	1.00-1.51	0.30	...	...	0.20-1.25	0.20-1.25
One year	1.20-1.75	N/A	...	...	1.65-3.15	1.65
Certificates of deposit						
Six months	1.00-1.51	0.45	0.45	0.35-1.10	0.20-1.25	1.25
One year	1.20-1.75	0.50	0.50	1.40-1.50	1.65	1.65
Two years	1.90-2.60	1.30	1.50	2.90	2.90	2.90
Three years	3.00-3.25	2.00	2.50	3.05	3.05	3.05
Five years	...	3.00	3.00	3.15	3.15	3.15
Lending rates						
Consumer loans	10.00-15.00	10.00-16.00	10.00-16.00	10.00-16.50	3.25-16.00	3.25-16.00
Commercial loans (one year) 1/ 3/	P + 0.75-4.00	P + 0.50-4.00	P + 0.50 - 4.0	P + 0.50-4.00	...	...
Residential housing loans						
30-year, fixed	...	...	...	...	...	...
15-year, fixed	...	...	...	...	...	...
<u>Bank of Guam-Palau Branch</u>						
Deposit rates						
Checking account (with minimum balance)	1.25	0.25-0.50	0.25	0.25	0.25	0.25
Savings account	1.50	0.50-1.00	0.50-0.75	0.75	2.00	2.00
Time savings account						
30 days	0.88	0.88	0.73	0.77	...	...
One year	0.88	0.88	0.73	1.34	...	...
Certificates of deposit						
Six months	1.16	0.56-0.67	0.77-0.89	1.21	2.33-3.19	2.60-3.04
One year	1.21	0.94-1.00	1.25	1.34	2.60-3.01	2.96-3.21
Two years	1.44	1.18-1.36	2.00	1.84	2.58-3.33	3.17-3.54
Three years	1.44	1.28-1.36	2.50	2.11	2.81-3.38	3.22-3.54
Lending rates						
Consumer loans	15.00	15.00	15.00	15.00	15.00	15.00
Commercial loans (one year)	7.50-13.50	7.50-13.84	7.50-13.50	8.25	15.00	15.00
Residential housing loans						
30-year, fixed	N/A	N/A	N/A	N/A	N/A	N/A
15-year, fixed	N/A	N/A	N/A	N/A	N/A	N/A

Source: Office of Planning and Statistics.

1/ NDBP is not a deposit taking institution.

2/ Under a government-directed loan scheme, loans are provided to Palauans who have never owned a house.

3/ P denotes the Prime rate as quoted by the Wall Street Journal.