

Republic of Palau

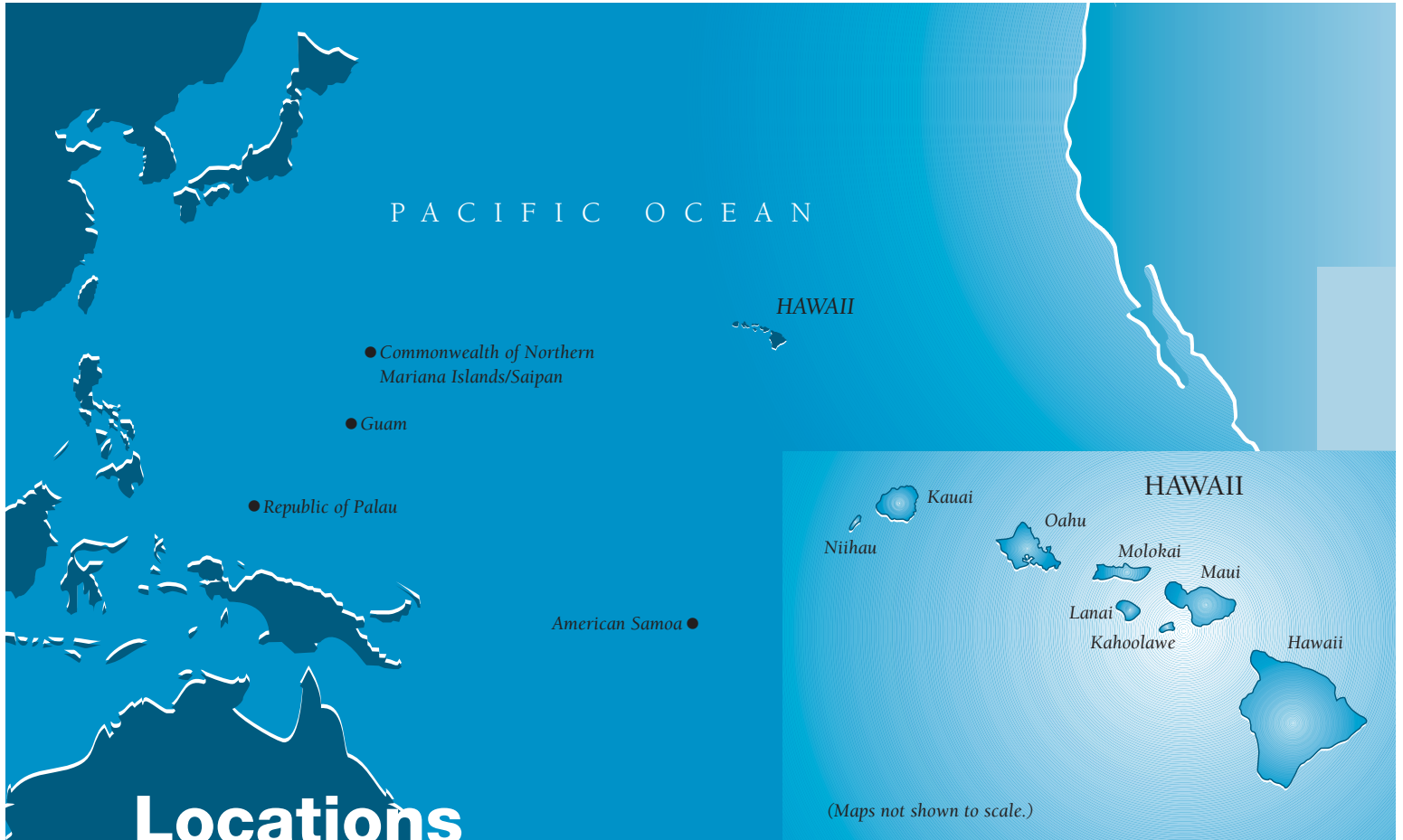
ECONOMIC REPORT

APRIL 2003



EAST-WEST CENTER





BANK OF HAWAII BRANCHES & IN-STORE BRANCHES
(as of December 31, 2002)

Hawaii	76
American Samoa	3
Commonwealth of Northern Mariana Islands/Saipan	2
Guam	9
Republic of Palau	1
Total	91

ABOUT BANK OF HAWAII

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Bank of Hawaii Corporation and its subsidiaries offer a wide range of financial products and services, including: deposit and lending services, investments, trust services, private banking, leasing, mortgage, insurance, cash management, employee benefits and retirement plan services.

The Bank provides convenient access to financial services through its network of branches, in-store branches and ATMs, and its 24-hour telephone and Internet banking services.

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TO OUR READERS:

We are pleased to present this 2003 edition of the Republic of Palau Economic Report, which was written and produced under a new regional research and study partnership between Bank of Hawaii and the East-West Center.

Palau is one of the West Pacific markets that Bank of Hawaii serves, and the bank's presence here dates back to 1961. Palau is also a part of the domain of the East-West Center's Pacific Islands Development Program (PIDP), which works with island leaders on major issues and fosters a better understanding of the island region in the United States and the rest of Asia-Pacific. The Center was created by the U.S. Congress in 1960, and PIDP was founded in 1981. Given Bank of Hawaii's and the East-West Center's long histories in the region, we have combined resources to reach a wider audience that may benefit from current economic information on these markets.

This report provides an analysis of the prevailing economic forces in Palau, the Western Pacific and surrounding regions. While industrial East Asia largely recovered from the 1997-98 financial crisis, the prolonged Japanese economic stagnation and the September 11, 2001 terrorist attacks on New York and Washington D.C. have had unfavorable effects on Palau and the rest of the region. With travel in the Asian markets returning to normal levels, and barring any further incidents of air traffic disruption, the region's economy, including that of Palau, should begin to improve over the next two years.

We anticipate publishing future reports on the economies of Guam and the Commonwealth of the Northern Mariana Islands—two other markets that Bank of Hawaii and the East-West Center serve. Additional information on the Pacific is available via Bank of Hawaii's Internet website, at www.boh.com, and the East-West Center's website, at www.EastWestCenter.org. Inquires may be directed to PIDP at e-mail pidp@EastWestCenter.org.

Aloha,



Michael E. O'Neill

Michael E. O'Neill
Chairman of the Board,
CEO and President
Bank of Hawaii



Charles E. Morrison

Charles E. Morrison
President
East-West Center

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Cover Photos

Scenic: *Palau Visitors Authority*

New Capital Building: *Black Micro Corporation, Koror*

REPUBLIC OF PALAU

Land Area

Number of Islands: more than 200
 Islands inhabited: 9
 Total land area: 170.4 square miles
 Largest Island: Babeldaob (136 square miles)

Population

1990 Census: 15,122
 1995 Census: 17,225
 2000 Census: 19,129
 1980-2000 Growth Rate: 2.3 percent

Political Status

Sovereign nation since 1994
 Compact of Free Association with the United States for 50 years (1994-2044)
 16 states
 Bicameral legislature
 American-style democracy with three branches of government

Economy

Currency: US dollar
 Income sources: Compact payments, tourism, services, trade, subsistence fishing and agriculture
 2002 GDP: \$109.5 million
 2002 per capita GDP: \$5,482
 2000 GDP: \$117.2 million
 2000 per capita GDP: \$6,128
 2000 visitor arrivals: 57,732
 2001 visitor arrivals: 54,111
 2002 visitor arrivals: 58,560

Government Finances

2000 revenues: \$75.0 million
 2000 spending: \$84.5 million
 2001 revenues: \$61.5 million
 2001 spending: \$77.2 million
 2002 revenues: \$70.1 million
 2002 spending: \$79.7 million

Distance from:

Honolulu: 4,500 miles
 California: 7,000 miles
 Australia: 2,500 miles
 Japan: 2,500 miles
 The Philippines: 550
 Papua New Guinea: 410



Source: U.S. Geological Survey, 1986

I. General Characteristics

I.1 Introduction

The Republic of Palau (Palau) comprises the western end of the Caroline archipelago in the northwestern Pacific, southwest of Guam.

Although a small and isolated country with a total landmass of only 170.4 square miles and a population of just under 20,000, Palau is recognized as being a part of the community of nations. Following independence in 1994, Palau joined the United Nations, the International Monetary Fund (IMF) and other global and regional entities. It also maintains diplomatic missions in Washington, Tokyo, Taipei and other capitals.

Palau is freely associated with the United States through a unique political and economic treaty, the Compact of Free Association. Palau's neighbors to the east, the Federated States of Micronesia and the Republic of the Marshall Islands, are other Western Pacific nations in free association with the United States through similar treaties. As members of the former Trust Territory of the Pacific Islands that the United States administered on behalf of the United Nations for half a century after the end of World War II, these states adopted the US dollar as their currency. They continued to use it as their currency even after independence, and thus, as part of the US monetary system, their economies were shielded from foreign exchange risks arising from currency fluctuations.

The Palauan archipelago comprises more than 200 islands and islets, but only nine are inhabited. The nearest landmasses are Papua New Guinea (410 miles to the south), the Philippines (550 miles to the west) and Guam (815 miles to the northeast). Regular and chartered flights connect Koror (Oreor), Palau's capital, to Guam, Tokyo, Taipei and Manila.

Seventy-eight percent of Palau's total land area is on its largest island, Babeldaob. Twenty miles long and 10 miles wide, Babeldaob is the region's second largest island after Guam. Most of Babeldaob, where a quarter of the population resides, is uninhabited. This is likely to change in 2005, when a 54-mile, two-lane highway is finished, connecting the villages around the island with Koror, Palau's commercial center. Known as the Compact Road, it is funded by a specifically designated grant in the Compact treaty.

Palau's international airport is located on the edge of Babeldaob facing Koror. In September 1996, a concrete bridge that had connected the two islands for decades suddenly collapsed, disrupting not only the traffic between the capital and the airport, but also the country's economic life. Emergency ferry service filled the gap until a temporary bridge could be installed. While this made commute between Koror and Babeldaob possible, complete normalcy was restored

only after the new permanent bridge opened in 2002. Funded and constructed by a goodwill grant from Japan at a cost of roughly \$25-30 million, it was named the Palau-Japan Friendship Bridge. This, along with the Compact Road soon to be completed, gives Palau the beginnings of a modernized infrastructure that will have a defining role in its future economic progress.

Babeldaob's importance to the country's economic and commercial future will be further enhanced by the new national capital now under construction. Funded by a \$23 million "soft loan" from the Republic of China (Taiwan) with which Palau has diplomatic relations, the capital is located roughly in the middle of the island near the eastern coast. It is to be ready for occupancy in 2004. Designed by a Hawaii architectural firm noted for its designs of other capitals and public buildings in the region, and built by a construction firm also from Hawaii with long roots in the islands, the new capital will be a totally modern complex of buildings and facilities. Each of the three branches of the national government—the executive, legislative and judiciary branches—will have its own building, all in close proximity. It is too early to tell how the capital's move will affect Koror, but anticipation of its positive impact seems to outweigh any negative effects.

The new capital is more than a group of modern buildings. It is a symbol of Palau's progress and emergence as a modern and independent nation that has carefully blended US-inspired democratic institutions with the local traditional system. The political, economic and financial stability that results from such an embodiment of democratic institutions and local cultures is the enduring legacy of US involvement in the region.

Among the critical lessons every Asia-Pacific economy learned from the 1997-98 Asian financial crisis was that stable and predictable political institutions are necessary to attract capital for economic growth and development. Following a period of political instability at its beginning with a republican system, Palau has since become predictably stable, both in its government and as a market. The president who led Palau to independence and presided over the Compact negotiations completed two consecutive peaceful and prosperous terms in 2000. His vice president succeeded him in a competitive democratic race. Palau's current vice president is the highest-ranking elected woman leader in Micronesia.

A new airport terminal being built on Babeldaob will contribute to Palau's growth. A separate \$14-million grant from Japan funds this project. When it is finished later this year, it will be yet another addition to the new infrastructure that will make Babeldaob the focal point of Palau's economic and commercial future.

The westernmost islands of Palau, many of them small, are closer to Indonesia than to Koror, the largest urban area in Palau. Koror represents only 4.2 percent

of the country's total land area but is home to more than 70 percent of the total population.

Lying a few miles south of Koror is a group of 80-plus islands, some resembling giant mushrooms, known as the Rock Islands. None of the islands is inhabited and all remain relatively untouched, except for limited access by tourists, especially divers. Some of the region's cleanest, most beautiful beaches can be found here. The Rock Islands ranks as one of the world's unique aquatic ecosystems, and its preservation will ensure that the site remains an invaluable aesthetic resource and tourist attraction for Palau.

As in the rest of the tropical Western Pacific, Palau's climate changes little seasonally. Temperature averages from a high of 87.5 degrees to a low of 77.5 degrees. Heavy rainfall occurs from May to January and is heaviest in June and July. A slightly drier period extends from February to April. Short periods of torrential rains result in more than 150 inches of rainfall a year. Most of the islands have lush green vegetation throughout the year, with some areas covered by rain forests and many varieties of tropical trees, shrubs and other vegetation.

Palau's economic development level can best be described as that of a hybrid economy with attributes of both developed and developing economies. Palau's current financial and communication systems, as well as services such as medical and retail are quite advanced, especially in Koror. According to the Ministry of Health, Palau's population-to-physician ratio of 494 almost matches that of US's 500, but is higher than Guam's 484. Life expectancy is 64.5 years for males and 70.8 years for females, averaging 67 years for both sexes. Spending on health as a share of gross domestic product (GDP) is 11.2 percent, closer to US's 14.0 percent than to Britain's 8.7 percent.

By these measurements, Palau is a more developed economy than its Asia-Pacific neighbors such as Indonesia, the Philippines and Papua New Guinea. A more objective criterion that takes Palau out of the realm of the developing economy category is its per capita income. At an estimated \$5,482 in 2002, a year in which the economy was in a rather severe recession, Palau's economy is at a middle-income level. Palau's per capita income, though higher than that of some of its neighbors, is nowhere near that of industrial or developed economies. Still, Palau enjoys an adequate standard of living as measured by its per capita income and non-monetary quality of life indicators.

The essence of Palau's economy is services, mainly tourism and retail, with the public sector funded in part by the United States under a provision of the Compact. This financial package that is helping Palau build its public infrastructure while sustaining its current consumption, took effect in 1994 and ends in 2009. A review at the end of this 15-year period will determine the degree of continued economic assistance necessary from the United States to enable Palau to become more

self-sufficient.

Subsistence agriculture and fishing are critical to domestic food supply, especially in outlying villages. There is a small commercial fishing industry with potential for growth. At present, it consists primarily of foreign boats catching fish, mainly tuna, in the country's exclusive economic zone for sale elsewhere. Some foreign fishing firms have local facilities for fleet service, but no processing as yet takes place in Palau.

The total quantity of migratory fish export in 2001, the latest year for which information is available, was 2.031 million kilograms, down from both 2000 and 1999 but up from 1998. The market value of fish exports was \$700,000 in 2002, down 79.2 percent from the previous year when the total value was \$3.4 million. Fluctuations in fish exports reflect the effects of many factors, including fish prices in world markets.

Aside from fish exports, relatively small quantities of garment exports earned Palau a little over \$9 million in 2001. A garment-making factory has operated for several years in Koror and two others were recently licensed. However, the soft US economy and subsequent weaker demand for garments have discouraged the new factories from opening. The demand for garments is likely to increase as the US market gains in strength in the months and years ahead.

In 2001, Palau's export goods totaled roughly \$12 million, as compared to its total imports of \$95.7 million, down from \$123.7 million in 2000 and \$104.1 million in 1999. If Palau were a developing economy with a currency subject to world market swings, this type of commodity trade imbalance would be difficult to sustain for very long. Erasing such a large trade imbalance under those circumstances would require increasing both exports and their prices or reducing imports, all of which could adversely affect demand and standards of living. However, Palau's trade imbalance is adequately covered by grants from the United States and other countries, plus receipts from tourism and other exports, all denominated in US dollars.

As with CNMI and other US-affiliated Pacific markets, Palau can sell manufactured goods in the United States duty-free. This is one advantage of being an integral part of the US market. However, aside from garments, handicrafts, local food processing and furniture making for domestic markets, there is no manufacturing in Palau. While the government encourages increasing production activities such as garment making, expansion is unlikely to happen soon, as it requires foreign capital. Palau would do well to study successful garment- and other light manufacturing facilities elsewhere in considering expansion possibilities for its garment industry.

Apart from duty-free sale of products in the United States, Palau's main comparative economic advantage lies in developing specialty tourism, in particular that which its spectacular scenery could easily attract without causing irreversible harm to the fragile

ecosystem. As with all other small-island economies, Palau must balance its need for economic progress with that of preserving its limited resources. Climatic and environmental changes attributed to the depletion of ozone layers in earth's atmosphere already present challenges to Palau in maintaining the integrity of its ecosystem. Further, if the theory that degradation of environmental and climatic conditions lead to rising sea levels is true, Palau is highly vulnerable because its small parcels of coastal flat lands are the only areas available for livestock and the production of other essential foods.

I.2 Population Evolution

The original settlers of Palau are believed to have arrived as drift voyagers from Indonesia, possibly as early as 2500 BC. By the time of Captain Henry Wilson's shipwreck in 1783, Palau had a well-developed social system with an extensive village network. The population is estimated to have been 45,000. With the arrival of Europeans came contagious diseases, against which the Palauans had no immunity, and thus, population declined. At the beginning of the 20th century, the Germans estimated the number of Palauans at 3,700.

Population grew rapidly again during Japanese dominance because of Japanese immigration: in 1935 the Japanese civilian population in Palau was 25,760, four times the number of indigenous people. In 1957, the indigenous population was 7,726, increasing to 11,365 by 1967, and 12,473 in 1973. Growth slowed to 1.25 percent a year thereafter, as Palauans emigrated in search of work and education. In 1990, total population was 15,122.

A special mid-decade census, funded and conducted by the Palauan government in 1995, revealed total population of 17,225. The 1995 census also noted there were 9,213 males and 8,012 females, or 115 males for every 100 females. The median age was 28.1 years, up from 26.5 years in 1990, and only 5.7 percent of the population were 65 years old or older.

A US census in 2000 that covered Palau showed that total population had risen to 19,129. Males accounted for 10,450 and females 8,679, or 120 males for every 100 females. Annual growth rate in 2000 was 2.1 percent, down from 2.6 percent in 1995. Reflecting regional demographic changes such as delayed marriages and aging populations, the median age in Palau increased to 30.8 in 2000 from 28.1 in 1995 and 18.8 in 1980. Indigenous Palauans numbered 13,364 in 2000 or 70 percent, and foreigners, the single largest group of which is from the Philippines, made up the remaining 30 percent or 5,765. Almost 70 percent of the population in the 2000 census were classified as urban, compared to 62.6 percent in 1980.

Though Palau's population grew moderately in the 1990s, it was still at the rate of a developing economy. A rapid population growth rate may or may not accelerates economic growth, depending on a number of factors, but it increases the pressure on a fragile ecosystem. While Palau has yet to fully exploit its natural resources, preserving its pristine ecosystem in the midst of continued population growth in the years ahead will be just as challenging as keeping the economy growing.

II. The Compact of Free Association

The Compact of Free Association is a 50-year political, strategic and economic treaty between Palau and the United States. Under the Compact, Palau conducts its own domestic and foreign affairs as it chooses, while the United States retains control of defense and security matters for which it has exclusive access to Palau's waterways. For this exclusivity, the United States agreed to pay Palau a specified sum of money in the first 15 years of the Compact. The treaty took effect on October 1, 1994, the same date that Palau became a sovereign nation in free association with the United States.

Palau secured this pact with the United States just before the Cold War ended. US funds and technical aid will enable Palau to work toward greater economic self-sufficiency that may someday match its neighbors to the north, the Western Pacific's more prosperous economies of Guam and Commonwealth of the Northern Mariana Islands (CNMI). The Compact payments are a mix of rent and aid which, over 15 years ending in 2009, amount to a total of about \$630 million. Most of this amount has already been paid.

The main goal of the Compact funds was to put an infrastructure in place that would enable Palau to become a more self-sustaining economy, and maintain a certain level of living standard. The specific uses of the Compact funds, whether for current consumption or infrastructure and capital formation, are spelled out in detail.

Among the conditions for the Compact's approval by the US Congress was the formal adoption by the government of Palau of an economic development plan (EDP) which outlined how the Compact funds would be used to achieve specific goals. The policies and strategies outlined in detail in the original EDP have since been amended according to changing needs.

Within the broad framework of EDP, Compact funds are designated for three general uses:

(1) To fund government operations to maintain a certain level of public service (employment) while the economy moves toward greater reliance on markets.

(2) To build basic infrastructure such as roads, communication and water facilities with which Palau

can develop an increasingly self-supporting economy.

(3) To create a trust fund (initially about \$70 million) that would accumulate enough cash reserve in the first 15 years of the Compact to generate interest income that will replace the budgetary aid provided by the United States.

The government of Palau also agreed to submit annual reports with expenses detailed by use, type of funds and the impact on the affected areas as well as the economy as a whole. The latest report, for fiscal year 2001 (October 1, 2000 to September 30, 2001), is the seventh of its kind. It covers a whole range of issues - from a recap of economic activity and public finances during the year to specific applications of Compact funds and capital improvement programs and EDP amendments.

III. Macroeconomic Review and Forecast

III.1 Palau GDP: A Longer Horizon

The earliest gross domestic product (GDP) estimates for Palau go back to the 1970s, but methodologies used were not detailed, and no updates followed. Thus, these GDP estimates can only be viewed as rough measures of the economy. The United Nation's Economic and Social Commission for Asia and the Pacific attempted the first complete macroeconomic accounting of Palau in 1990-92. This accounting and the earlier GDP estimates were not necessarily based on the same data or methodologies. Nonetheless, these were the only GDP estimates available until recently when the International Monetary Fund (IMF) produced more detailed macroeconomic numbers. The first IMF estimates of Palau GDP became available in 1996 after its team

visited Koror in connection with the country's membership consideration in the global financial body. Revised, in part drastically, in 1999 by the United Nations Development Program (UNDP), they represent Palau's most complete and current GDP data.

Palau's GDP was an estimated \$14.5 million in 1975, \$17.4 million in 1977 and \$31.0 million in 1983. By these estimates, Palau's economy grew 9.5 percent annually in 1975-77 and 10.1 percent in 1977-83. GDP was an estimated \$76.9 million in 1990, \$83.9 million in 1991, \$82.5 million in 1992 and \$75.9 million in 1993. By this account, GDP grew 13.9 percent a year in 1983-90 and another 9.1 percent in 1991, before it contracted 1.7 percent in 1992 and another 8.0 percent in 1993. Based on these figures, all in current (actual) dollars, Palau was in a severe recession in 1992-93, caused mainly by a soft visitor market and government spending cuts necessitated by revenue shortfalls.

In the absence of an appropriate price deflator with which to correct current (actual) GDP data for price inflation, there is no easy way to determine the "real" adjusted numbers. There are also no reliable data on the labor market and its employment rates, which can sometimes indicate, even roughly, changes in national income and output levels. Still, it appears that Palau's economy grew relatively rapidly from the late 1970s through most of 1980-90.

III.2 Recent GDP Data: Economic Performance Assessment

In 1999, UNDP revised the IMF GDP data downward, showing Palau's 1998 per capita GDP at \$8,800. That figure would place Palau near economies such as Korea, which are much more capital-intensive and productive. UNDP further revised Palau's per capita GDP down to \$6,399 from an earlier figure of

PALAU'S MAJOR INDICATORS

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Population	15,122	15,521	15,931	16,352	16,783	17,225	17,587	17,956	18,333	18,718	19,129	19,531	19,976
Annual Growth Rate (%)	2.4	2.6	2.6	2.6	2.6	2.6	2.1	2.1	2.1	2.1	2.2	2.1	2.3
Foreign Workers	—	—	—	—	—	3,481	4,369	5,256	5,383	5,401	5,491	5,402	4,827
Nominal GDP (\$M)	76.9	83.9	82.5	75.9	84.6	95.2	108.2	113.2	117.3	113.5	117.2	120.8	109.5
Per Capita GDP (\$)	5,085	5,403	5,175	4,639	5,043	5,529	6,152	6,305	6,399	6,063	6,128	6,187	5,482
Visitor Arrivals	23,498	32,700	36,117	40,497	44,073	53,229	69,330	73,719	64,194	55,493	57,732	54,111	58,560
Visitor Spending (\$M)	—	12.5	15.3	17.7	27.5	47.6	67.9	73.7	64.2	55.5	63.5	61.1	66.1
Per Capita Spending (\$)	—	382	424	437	624	894	979	1,000	1,000	1,000	1,100	1,129	1,129
Public Revenues (\$M)	—	43.4	47.5	49.4	49.6	165.1	66.5	58.0	71.3	51.0	75.0	61.5	70.1
Public Spending (\$M)	—	47.0	50.5	46.6	50.4	65.3	75.1	76.5	64.7	71.7	84.5	77.2	79.7
Exports (\$M)	—	17.1	26.9	17.7	12.6	13.9	13.9	11.8	11.1	11.7	12.2	9.0	9.0
Imports (\$M)	—	32.3	38.1	42.2	44.2	60.4	72.4	69.3	65.9	104.1	123.7	95.7	86.2

Sources: Bureau of Planning & Budget, Palau Visitors Authority, Social Security Administration and other Palau public agencies.

\$6,987 for 1998. It is not entirely clear why UNDP revised the GDP data so substantially and questions regarding methodologies remain unanswered. However, even at a \$6,000 per capita gross income level, Palau enjoys a much higher standard of living than any of its neighbors, except for Guam and CNMI.

The latest estimates of Palau's GDP were made by UNDP in August 2002. These reveal a rather large, somewhat abrupt decline in total output, despite a robust building industry that has been busy constructing the country's largest projects. Other smaller building projects could also be spotted throughout Koror in late 2002. At the end of 2001, IMF had forecast a GDP of \$128.0 million for 2002. Instead, the latest GDP estimate of \$109.5 million for 2002 shows it was down 9.4 percent from 2001.

The latest UNDP figure indicates that Palau's

economy had dropped to the level of about 1996 when the national output was valued at \$108.2 million. Per capita GDP in 2002, based on the latest update, was \$5,482, roughly where it was in 1995. Losses were reported in 10 of the 13 production and distribution components of GDP in 2002.

The largest decrease in 2002 occurred in the value of fisheries, which was down 79.2 percent from 2001, followed by a 59.1 percent loss in finance and insurance, a 57.1 percent drop in agriculture, and a 54.9 percent loss in manufacturing, presumably garments.

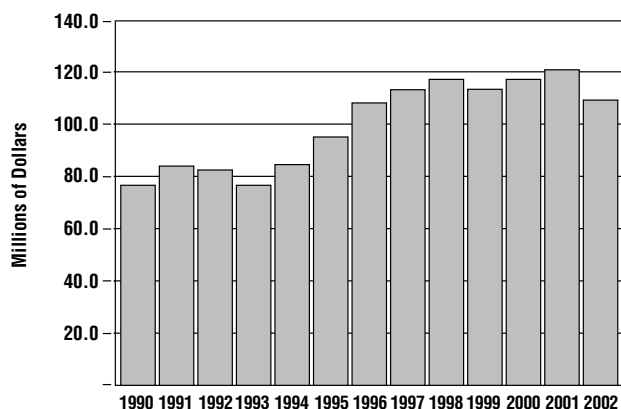
Three components of GDP that registered gains in 2002 over 2001 were construction (up 42.7 percent), trade (up 7.2 percent) and public administration (up 3.4 percent). The increase in trade may be due to import fees on materials for the various construction projects and other wholesale goods, rather than gains in exports.

PALAU GROSS DOMESTIC PRODUCT (GDP)

	1995	1996	1997	1998	1999	2000	2001	2002	2001/2002 Change (Percent)
Economic Activity (\$000)									
Agriculture	1,579	1,231	1,312	1,398	1,358	1,372	1,399	600	-57.1
Fisheries	3,918	2,973	2,057	2,038	3,148	3,274	3,372	700	-79.2
Mining & Quarrying	301	158	138	176	218	229	240	1,800	650.0
Manufacturing	851	997	1,403	1,702	1,609	1,690	1,774	800	-54.9
Electricity, Gas and Water	303	(8)	(388)	2,360	3,393	3,563	3,741	3,300	-11.8
Construction	7,395	8,545	8,834	10,389	8,249	8,661	9,181	13,100	42.7
Trade	18,238	20,995	23,913	24,837	23,165	23,860	24,337	26,100	7.2
Hotels and Restaurants	12,794	15,360	13,986	12,370	11,938	12,057	12,419	7,100	-42.8
Transport and Communication	8,345	7,270	8,734	9,191	9,846	10,338	10,855	5,500	-49.3
Finance & Insurance	4,210	5,294	6,573	5,706	4,297	4,511	4,647	1,900	-59.1
Real Estate & Business Services	6,262	7,570	6,298	6,555	4,611	4,842	5,036	5,000	-0.7
Public Administration	23,203	26,813	29,401	28,462	29,374	30,255	30,860	31,900	3.4
Other Services	6,480	9,807	9,211	9,907	9,691	9,982	10,381	7,500	-27.8
Sub-total	93,879	107,005	111,472	115,091	110,897	114,634	118,242	105,300	-10.9
Less: Imputed Bank Service Charge	1,743	2,100	2,100	2,640	2,384	1,250	1,250	1,250	0.0
Plus: Import Duties	3,101	3,298	3,842	4,869	4,972	3,842	3,842	5,455	42.0
Gross Domestic Product (GDP)	95,237	108,203	113,214	117,320	113,485	117,226	120,834	109,505	-9.4
Percent Shares									
Agriculture	1.7	1.1	1.2	1.2	1.2	1.2	1.2	0.5	
Fisheries	4.1	2.7	1.8	1.7	2.8	2.8	2.8	0.6	
Mining & Quarrying	0.3	0.1	0.1	0.2	0.2	0.2	0.2	1.6	
Manufacturing	0.9	0.9	1.2	1.5	1.4	1.4	1.5	0.7	
Electricity, Gas and Water	0.3	(0.0)	(0.3)	2.0	3.0	3.0	3.1	3.0	
Construction	7.8	7.9	7.8	8.9	7.3	7.4	7.6	12.0	
Trade	19.2	19.4	21.1	21.2	20.4	20.4	20.1	23.8	
Hotels and Restaurants	13.4	14.2	12.4	10.5	10.5	10.3	10.3	6.5	
Transport and Communication	8.8	6.7	7.7	7.8	8.7	8.8	9.0	5.0	
Finance & Insurance	4.4	4.9	5.8	4.9	3.8	3.8	3.8	1.7	
Real Estate & Business Services	6.6	7.0	5.6	5.6	4.1	4.1	4.2	4.6	
Public Administration	24.4	24.8	26.0	24.3	25.9	25.8	25.5	29.1	
Other Services	6.8	9.1	8.1	8.4	8.5	8.5	8.6	6.8	
Sub-total	98.6	98.9	98.5	98.1	97.7	97.8	97.9	96.2	
Less: Imputed Bank Service Charge	(1.8)	(2.2)	(2.2)	(2.8)	(2.5)	(1.3)	(1.3)	(1.3)	
Plus: Import Duties	3.3	3.0	3.4	4.2	4.4	3.3	3.2	5.0	
Gross Domestic Product (GDP)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	

Source: United Nations Development Program (UNDP) Public Sector Development Project, and Bureau of Budget and Planning.

PALAU'S GROSS DOMESTIC PRODUCT (GDP)



In the meantime, public finance data, which were not as complete and current in late 2002 as the GDP data, indicates that the government's gross revenues from business, including trade, were down from 2001. Such discrepancies between GDP data and government's financial data make any interpretation of the signals of economic and financial change less credible. In this instance, anecdotal evidence from local retailers in Koror corroborated the government's revenue shortfall from weaker tax collections as retail sales had reportedly dropped 6-7 percent in 2002 from 2001. Still, there is room for other explanations for the discrepancy.

The 3.4 percent gain in public spending in 2002 was relatively small, given the amount of public work underway. It was also too small to suggest a deliberate change in the direction of public spending to offset the weakness in the private sector. However, conventional theory holds that governments generally increase spending during periods of weak private sector activity. The increase in public administration as a share of GDP in 2002 appears to corroborate that theory, but one year does not constitute a trend in economic analysis. Government's share of GDP was relatively stable at 24-26 percent in 1995-2001, but increased to 29.1 percent in 2002, presumably because of the public construction projects underway. It is possible that the government purposely increased discretionary spending to offset the weakness in the private sector, but there is no concrete evidence to substantiate this. Such measures are generally unpopular, unless there are national emergencies.

There were no notable shifts in the composition of GDP. Public administration and trade remained the two dominant components. Construction rose to a double-digit share of GDP for the first time in 2002, but that does not necessarily suggest a trend. Once the major construction projects are completed, the industry will likely go back to its normal share of 7-9 percent of

GDP. One change for which there was no clear explanation was a significant loss in finance and insurance, which fell from 3-5 percent share of GDP to 1.7 percent in 2002.

III.3 Forecast

The stage was set at the end of the last decade for what was expected to be a period of rapid growth for Palau, lasting several years. With a haphazard recovery occurring in industrial East Asia, fueling growth in the rest of the Western Pacific, Palau's growth was to be driven by a unique combination of private and public projects that might never occur again. As discussed earlier, the public projects involved building Palau's new infrastructure consisting of the Compact Road, the national capital and the airport terminal, all funded primarily by the Compact and special grants from other countries. Private projects included one or two major-brand hotels that were expected to be under construction by 2001-02, plus some new retail space.

While the growth scenario more or less held, it was at a modest rate and lasted only two years from 2000 to 2001. In 2000, GDP grew 3.3 percent, followed by a weaker 3.1 percent rise in 2001. Large private projects such as brand-name hotels never materialized. In fact, only the steel skeleton remains of one abandoned project that was to be a hotel and high-end condominium complex near the port in Malakal. It is unlikely that construction on it will resume any time soon. While public projects generated increased total output, it was sufficient only to post a modest overall growth rate in short duration.

Hotels and other large private projects never took off mainly because of the continuing economic and financial woes in industrial East Asia, especially in Japan and Taiwan. Japan led the East Asian economic boom for decades before the asset market bubble burst in 1991-92. Ever since, Japan has struggled to maintain the early 1990s level of national output and standard of living. With both its asset prices and income levels falling for several years, Japan's ability to lead the region has eroded. Similarly, Taiwan's economic and financial strength has been compromised by a variety of factors, including political disagreement with the People's Republic of China, which considers Taiwan a province. Meanwhile, China has been growing rapidly, and is gaining momentum to become East Asia's new leading economic power.

Economic and financial difficulties in Japan and Taiwan and subsequent erosion of their purchasing power have adversely affected the entire Pacific. The West Pacific primarily depends on Japan and to a lesser degree on Taiwan, for both capital and tourist dollars. These weaknesses became even more severe following the September 11, 2001 terrorist attacks on New York and Washington. Japanese tourist traffic to

the West Pacific, especially Guam and CNMI, dropped by as much as 50-70 percent after the attacks. It has yet to regain its strength, even now, more than a year since the attacks with no further disruption to traffic flows in and out of the United States.

Unlike Guam, CNMI and Hawaii, Palau does not depend heavily on Japanese tourists, and therefore did not suffer as much in the aftermath of the September 11, 2001 terrorist attacks. Palau's tourists are mainly divers and other specialty tourists less affected by mass-market changes. Tourist traffic to Palau in 2001 was down only 6.3 percent and the number of Japanese tourists actually went up from 2000.

Without the construction of public projects, Palau's economy would have been much weaker since other primary income sources such as exports, including tourism services, have remained at low levels for some time. Palau's strong construction activity has had little visible ripple effect (or multiplier impact) on total output, especially on domestic production, which suffered lower retail sales. One of the reasons for this is that construction workers, who are mostly temporary foreign workers, send their salaries home to their own countries. Despite its negative economic impact, there is no alternative to using temporary foreign labor because Palau does not have the required manpower for large construction projects.

It is clear that Palau's economy never gained the anticipated momentum it needed at the end of the 1990s. With the economy now in recession and construction expected to fall off next year, Palau appears to be headed for a period of economic stagnation and decline in 2003 and beyond.

IV. Population, Labor Force and the Labor Market

IV.1 The 2000 Census Data

The 2000 census provides the most current and complete data set on population, labor force and the labor market. Key indicators in the population and demographic profile over the 20-year period, 1980-2000, provide some insight into the changes that

POPULATION BY AGE GROUPS

	1980	1986	1990	1995	2000	80-00 Change
0-4 years	1,401	1,576	1,513	1,762	1,308	-6.6
5-9 years	1,701	1,546	1,529	1,551	1,700	-0.1
10-14 years	1,732	1,727	1,534	1,527	1,555	-10.2
15-19 years	1,565	1,523	1,464	1,282	1,382	-11.7
Sub-total	6,399	6,372	6,040	6,122	5,945	-7.1
As % of Total	52.8	45.9	39.9	35.5	31.1	-41.2
20-24 years	1,081	1,429	1,340	1,427	1,342	24.1
25-29 years	826	1,158	1,403	1,741	1,910	131.2
30-34 years	694	1,015	1,338	1,717	2,169	212.5
35-39 years	503	831	1,243	1,583	1,891	275.9
40-44 years	494	637	873	1,261	1,651	234.2
45-49 years	396	524	666	943	1,272	221.2
50-54 years	384	394	513	603	886	130.7
55-60 years	408	415	403	488	563	38.0
61-64 years	287	349	387	361	463	61.3
Sub-total	5,073	6,752	8,166	10,124	12,147	139.4
As % of Total	41.9	48.7	54.0	58.8	63.5	51.7
65-69 years	284	303	332	328	318	12.0
70-74 years	130	179	249	278	274	110.8
75-plus years	230	267	335	373	445	93.5
Sub-total	644	749	916	979	1,037	61.0
As % of Total	5.3	5.4	6.1	5.7	5.4	2.0
Total Population	12,116	13,873	15,122	17,225	19,129	57.9
% Change from Previous Period	—	14.5	9.0	13.9	11.1	—
1980-2000 Annual Growth Rate (%)	—	—	—	—	—	2.3
Median age	18.8	22.0	25.6	28.1	30.8	

Source: Bureau of Budget & Planning, Ministry of Administration, *Republic of Palau 2001 Statistical Yearbook*, p. 9.

occurred during that period and the likely trends in population and demographics. This period included the first six years of independence during which the government received the largest Compact fund deposits to assist current spending as well as establish a trust fund. These deposits may have inadvertently caused distortions in the economy by stimulating unusually rapid growth in some segments of the economy that in turn affected the population and labor market data.

It may not be possible to isolate the initial distortions in the economy caused by the Compact disbursement. However, it is important to at least estimate when the distortions may have worked themselves out of the system. While there is no precise way to do this, evidence based on government finances suggests there were minimal Compact-related distortions by the end of the 1990s. In 2000, Palau appeared well adjusted to the post-Compact flows of income and levels of economic activity. Presuming that the beginning of the 21st century was also the start of a normal economy in Palau, the 2000 census should provide reliable signals of change in the country's demographic profile and the labor market, which have

both immediate and long-term implications ultimately on its living standards.

The most significant changes have to do with Palau's demographic profile and its implications for the labor force (those actively seeking work for pay) as well as the labor market (those potentially able to join the labor force). In 1980-2000, the youngest population of ages 0-19, decreased. This was the only segment of the population to decrease in both number and as a share of the total. The number of persons in this segment dropped 7.1 percent, from 6,399 in 1980 to 5,945 in 2000. As a share of total population, it dropped from 52.8 percent in 1980 to 31.1 percent in 2000.

This is an important change, signaling a shift toward a more chronologically mature but still rapidly growing population since the total increased 57.9 percent in 1980-2000, or 2.3 percent annually. This high rate of growth has important implications for the labor market and the economy's capacity to create jobs for a rapidly growing labor force.

The core of Palau's labor market (those aged 20-64) increased a remarkable 139.4 percent, from 5,073 in 1980 to 12,147 in 2000. The largest gain occurred in those aged 30-49 who are customarily persons with experience, knowledge and skills. These attributes make this segment potentially the most productive component of the labor force as it can contribute proportionately more to total labor income. Those 20-64 years of age also increased as a share of total population, rising from 41.9 percent in 1980 to 51.7 percent in 2000.

Persons aged 65 and over increased 61.0 percent in 1980-2000. But as a share of total population, they increased only slightly, from 5.3 percent in 1980 to 5.4 percent in 2000.

The median age for the entire population increased from 18.8 years in 1980 to 30.8 years in 2000.

The 2000 census also revealed some important favorable developments, especially in the 1990s. In 1990, labor force was 40.2 percent of the population, lower than that in developed economies but not out of line with many developing economies. By 2000, the ratio was up to 50.2 percent, close to mature economies such as the United States. The more important ratio, however, is that of employment to population, which tells how many persons in the economy each worker has to support. This ratio in Palau increased even more, rising from 37.0 percent in 1990 to 49.1 percent in 2000. This suggests that as more people entered the labor market, they were able to find work for pay. Palau's challenge is to maintain that ratio, or at the very least, prevent it from falling.

Generally, these are signs that both the labor market and the labor force are rapidly expanding, thus creating a steady demand for jobs. These trends are typical of developing economies and have both

favorable and unfavorable implications, depending on market realities.

If adequate private and public capital stocks exist, and the economy has the institutional structure to attract more capital and skills while creating jobs for those in the labor market at prevailing wage, it can meet the demands of a growing labor force. This results in a higher rate of employment that contributes to increases in both national income and output levels, and ultimately a higher standard of living for the entire economy.

If, on the other hand, the economy cannot create enough jobs to keep pace with its growing labor force, a condition of excess labor supply results. Such a condition contributes to high unemployment and financial losses as well as social problems, especially among youth.

Ideally, those who work and those they support through family, social security or other support systems would grow in tandem, maintaining a stable employment-population ratio. Economic and financial difficulties, especially in economies with population growth rates higher than the labor market can absorb gainfully, reduce the employment-population ratio, which means losses to the total wage bill (or labor income). Ultimately, the entire economy suffers from the consequences of excess labor supply and fewer jobs.

Small economies that depend heavily on overseas capital, skills and income flow (such as from tourist arrivals and spending) tend to be stagnant. Their labor markets become even less vibrant when the large markets on which they depend themselves become stagnant. The islands of the Western Pacific can attest to this as many suffered tremendous economic and financial ills when Japan, their primary source of capital, skills and income flows, stalled in the early 1990s. Because small economies like Palau can exert little pressure on large economies, implementing economic policies to diversify sources of capital, skill and income flows would help maintain flexibility. While this may take some effort and considerable resources to accomplish, economic and financial stability is not only a worthwhile endeavor, but also a necessity.

IV.2 The Labor Market and Foreign Labor

According to US labor market accounting rules, all persons 16 years of age and older (also known as the non-institutional population) are counted because it is as of age 16 that it is legal to work for pay. Within this all-encompassing total are two main categories: the labor force, which is made up of both the employed and the unemployed, and those not in the labor force. The unemployed may include discouraged workers, transient workers and others who are temporarily out of work. For all practical purposes, those who study the

LABOR FORCE PARTICIPATION BY BIRTHPLACE AND SEX

	1980				1990				2000			
	Born in Palau	Born Elsewhere	Total	Born Elsewhere As % of Total	Born in Palau	Born Elsewhere	Total	Born Elsewhere As % of Total	Born in Palau	Born Elsewhere	Total	Born Elsewhere As % of Total
Total of 16-Years & Over	6,387	579	6,966	8.3	7,874	2,364	10,238	23.1	8,680	5,561	14,241	39.0
In the Labor Force	2,494	402	2,896	13.9	4,161	1,911	6,072	31.5	4,583	5,024	9,607	52.3
Employed	2,372	373	2,745	13.6	3,713	1,888	5,601	33.7	4,393	4,990	9,383	53.2
Unemployed	122	21	143	14.7	448	23	471	4.9	190	34	224	15.2
Not in Labor Force	3,893	177	4,070	4.3	3,713	453	4,166	10.9	4,097	537	4,634	11.6
Males, 16-Years & Over	3,215	407	3,622	11.2	4,045	1,570	5,615	28.0	4,398	3,540	7,938	44.6
In the Labor Force	1,582	322	1,904	16.9	2,503	1,330	3,833	34.7	2,616	3,332	5,948	56.0
Employed	1,510	300	1,810	16.6	2,228	1,316	3,544	37.1	2,513	3,314	5,827	56.9
Unemployed	72	20	92	21.7	275	14	289	4.8	103	18	121	14.9
Not in Labor Force	1,633	85	1,718	4.9	1,542	240	1,782	13.5	1,782	208	1,990	10.5
Females, 16-Years & Over	3,172	172	3,344	5.1	3,829	794	4,623	17.2	4,282	2,021	6,303	32.1
In the Labor Force	912	80	992	8.1	1,658	581	2,239	25.9	1,967	1,692	3,659	46.2
Employed	862	73	935	7.8	1,485	572	2,057	27.8	1,880	1,676	3,556	47.1
Unemployed	50	1	51	2.0	173	9	182	4.9	87	16	103	15.5
Not in Labor Force	2,260	92	2,352	3.9	2,171	213	2,384	8.9	2,315	329	2,644	12.4

Source: Bureau Budget and Planning, Ministry of Administration

various economic impact of the labor market primarily focus on the labor force and its two components.

Palau’s labor force data from the 1980, 1990 and 2000 censuses provide a clear and consistent perspective on the changes in Palau’s labor market. There was a steady rise in the labor force participation rate among Palauans, as well as the integration of temporary foreign workers into the domestic labor market. The precise number of foreign workers varies somewhat from source to source since some count work (and entry) permits while others count persons. However, it is clear that they represent an important source of labor for Palau.

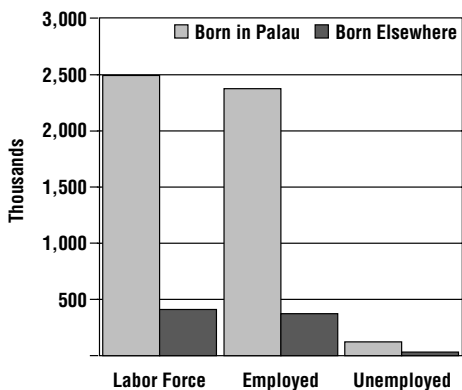
In 1980, the total of those 16 years of age and

older numbered 6,966, of whom 579 (8.3 percent) were born elsewhere. Of these foreign-born persons, 402 (13.9 percent) were in the labor force and 177 (4.3 percent) were not. Of those in the labor force, 373 (13.6 percent) were employed. Those born in Palau aged 16 years and over numbered 6,387 and fewer than half (2,494 or 39.0 percent) were in the labor force and still fewer, 2,372, were employed.

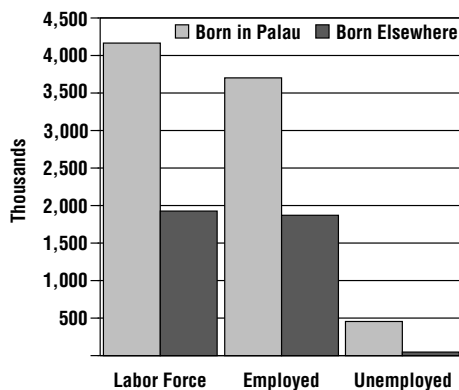
In 1990, those 16 and older not born in Palau were 2,364 (23.1 percent), of whom 1,911 (31.5 percent) were in the labor force and 1,888 (33.7 percent) were employed. Those not in the labor force rose to 453 (10.9 percent).

By 2000, foreign-born people aged 16 years and

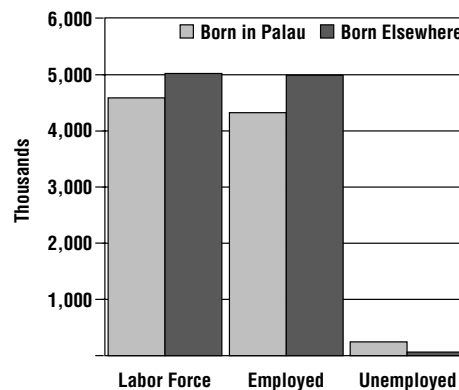
PALAU LABOR FORCE IN 1980



PALAU LABOR FORCE IN 1990



PALAU LABOR FORCE IN 2000



AVERAGE GROSS WAGES BY OCCUPATION (DOLLARS PER YEAR)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Agriculture	4,777	1,815	3,552	3,171	3,335	2,809	2,908	3,042	3,070	2,969	2,817	2,465
Fishing	3,562	5,085	5,583	5,540	5,460	4,805	4,117	4,621	4,974	4,911	4,680	3,846
Construction	4,076	3,834	4,470	4,793	4,131	4,860	5,033	5,056	5,088	5,232	5,466	6,036
Manufacturing	4,248	3,459	3,718	4,015	4,827	3,303	1,942	4,580	4,357	4,028	3,541	3,547
Land Transportation	5,586	5,024	5,158	5,469	6,193	5,487	5,394	5,436	5,700	5,871	6,022	6,611
Water Transportation	8,218	8,061	8,791	7,910	6,643	6,482	6,794	7,834	8,437	8,913	9,566	9,479
Air Transportation	10,377	8,119	9,237	10,656	9,254	10,164	9,839	10,879	11,546	12,062	12,644	13,047
Tourist Services	6,114	5,977	3,656	6,121	7,143	7,685	6,903	6,901	7,478	8,255	8,177	7,784
Utilities	6,353	6,144	6,383	5,479	6,679	4,797	5,022	9,367	9,209	9,445	9,567	10,034
Wholesale Trade	4,875	5,571	6,018	6,037	6,628	6,710	7,357	10,796	8,630	6,539	7,505	8,532
General Merchandise Retail	4,491	4,847	5,177	5,256	5,587	5,411	5,465	5,628	6,049	6,529	6,577	6,708
Food Stores	3,982	2,780	3,196	3,730	3,812	3,898	3,850	4,033	4,424	4,590	5,002	4,945
Automotive & Service Stations	3,963	3,755	4,564	4,673	4,391	4,522	4,824	5,455	5,055	5,299	5,313	4,859
Eating and Drinking Places	3,395	2,257	3,884	4,119	5,145	4,343	4,079	4,530	4,568	4,584	4,354	4,412
Other Retail	5,387	6,666	6,746	5,236	3,508	4,641	5,192	4,878	4,710	4,733	3,982	4,127
Banking	10,459	10,684	11,523	12,805	13,564	13,727	13,640	14,205	15,053	16,370	18,195	16,286
Credit Unions, S&Ls, etc.	5,438	4,813	5,516	5,959	9,639	8,568	10,027	9,897	9,388	11,456	11,683	11,174
Insurance Agents	9,207	10,922	10,680	9,916	11,296	11,611	12,070	11,261	12,274	11,472	13,724	11,411
Hotels, Motels & Apartments	4,964	5,454	6,008	6,047	5,509	6,249	6,315	6,897	6,889	7,558	7,569	7,252
Legal Services	10,184	8,099	9,769	9,388	9,143	8,571	10,417	10,891	13,035	13,766	15,563	15,227
Religious Organizations	5,058	5,181	4,310	5,128	5,312	5,470	6,012	5,922	5,904	5,764	5,387	5,667
Private Households	2,533	1,596	1,906	1,930	1,412	1,361	1,456	1,680	1,651	1,574	1,676	1,760
Other Services	4,097	3,942	5,229	4,737	4,454	4,929	5,229	5,891	7,142	7,170	7,171	7,382
Public Administration	7,678	8,658	8,951	8,836	9,681	10,249	10,488	10,855	10,846	10,958	10,967	10,969
Non-Profit Organizations	3,592	3,253	3,320	3,790	4,881	5,003	5,403	4,942	5,759	5,681	5,078	5,978
Average	6,020	6,402	6,856	6,874	7,101	7,257	7,193	7,624	7,722	7,901	7,768	7,718
Average Number of Workers	—	—	—	—	—	—	—	8,768	8,838	9,039	9,958	10,578

Source: Palau Social Security Administration

older had increased to 5,561 (39.0 percent), those in the labor force 5,024 (52.3 percent) and those employed were 4,990 (53.2 percent). The numbers of those not in the labor force and unemployed were also higher to reflect the presence of a large body of foreign labor. The data show how critical foreign workers have become to Palau's labor supply.

According to social security data, temporary foreign workers in Palau numbered 5,402 (50.3 percent of total) in 2001. Of those, 3,323 (61.5 percent) were from the Philippines, 804 (14.9 percent) from China and the rest from more than two dozen countries, including 171 from the United States, 169 from Bangladesh, 133 from Japan, 124 from Indonesia, 70 from neighboring Yap, 64 from Korea and 45 from Taiwan.

In September 2002, the data showed that the total of foreign workers was down 10.6 percent to 4,827 from the previous year's average, reflecting Palau's weakened economy. Those from the Philippines accounted for 65.0 percent and those from China 19.8

percent. Combined, the Philippines and China supply about 85 percent of Palau's foreign labor, and because these two markets have labor surpluses, they are likely to continue to dominate its foreign labor force. The country's newest resort, funded by capital from Taiwan, opened late last year and added to the workers from both Taiwan and China. As in other Asia-Pacific markets, Taiwanese investors provide capital and management, but hire workers from China who are eager to go abroad and earn wages in foreign currencies, especially in US dollars. With exchange rate regimes remaining the way they are, workers from China may become just as important a source of foreign labor as that from the Philippines has become over the last 20 years.

Meeting the immediate demands of the labor market has obviously been the government's priority. However, a study of the future implications of a whole range of social, economic and demographic consequences of foreign labor is advisable. Foreign workers would have little social and demographic

impact if they left after finishing their work. However, not every worker who comes to work leaves. Those who stay to become a part of the community impose both costs and generate benefits to the local economy. While efforts to maintain such a steady labor force may be a good policy in the short term, policy makers must strive to determine its long-term socio-economic effects on small economies like Palau. Looking to the experience of other US-affiliated economies employing foreign labor may provide some insight.

IV.3 Wages, Per Capita Income and Standards of Living

Palau's social security administration, which follows the US system, keeps detailed data on wages and the number of workers subject to social security provisions. The detailed wage data are about a year

behind the calendar year for which they are tabulated and released. Thus, the last year for which Palau's wage data were available is 2001. In that year, the average annual wage rate for the entire labor force was \$7,718, only slightly lower than the previous year's rate of \$7,768, and even lower than the 1999 peak of \$7,901.

Price inflation, according to IMF, averaged 2.5 percent in 2001. Palau's inflation would be expected to be in line with that of the region, which has been low, so there should be little concern of price inflation. Given the possibility of military conflict between the United States and Iraq, the anticipated impact of disruptions in oil flows may already have contributed to energy price increases, but inflation should remain of little concern in the near future. As a result, the purchasing power of Palau's dollar wages in the near term will probably be unaffected by inflation. Dormant inflation in the region has mainly been the result of price deflation in Asia, notably Japan.

NATIONAL GOVERNMENT FINANCES (\$000)

	1995	1996	1997	1998	1999	2000	2001	2002
Total Revenues & Grants	165,087	66,539	58,039	71,306	51,017	74,984	61,493	70,058
Domestic Revenues	22,070	29,087	24,865	41,325	29,024	42,922	40,186	35,422
Taxes	13,351	15,637	16,829	19,037	18,925	22,879	25,762	25,195
Wage & Salary	3,822	4,096	4,620	4,720	5,752	5,480	6,315	6,827
Import tax	3,136	3,298	3,850	4,410	4,973	6,433	6,473	6,138
Gross Revenue Tax	4,774	6,068	6,260	6,260	5,615	6,184	7,145	6,617
Other	1,619	2,175	2,099	3,647	2,585	4,782	5,829	5,613
Non-Tax Revenues	8,719	13,450	8,036	22,288	10,099	20,043	14,424	10,227
Fishing Rights Income	230	210	130	120	137	39	76	134
Interest Income	56	79	68	81	69	253	1,875	879
Fees & Charges	1,247	1,195	1,158	1,440	2,950	2,113	2,573	2,984
Other	1,043	1,713	2,088	15,288	1,361	1,876	1,383	1,410
Local Trust Fund	1,082	1,574	1,786	2,696	2,377	1,856	1,806	1,120
Investment Income	5,061	8,679	2,806	2,663	3,205	13,906	6,711	3,700
Grants	143,017	37,452	33,174	29,981	21,993	32,062	21,307	34,636
Current Grants	72,843	26,161	26,100	26,435	18,624	19,298	19,128	20,342
US Compact	62,107	18,623	18,858	19,220	11,570	11,640	11,701	11,827
US Non-Compact	10,431	7,239	7,012	6,626	6,420	6,829	6,748	7,302
Other Country Grants	305	299	230	589	634	829	679	1,213
Capital Grants	70,174	11,291	7,074	3,546	3,369	12,764	2,179	14,294
US Compact	64,360	4,900	3,500	2,000	2,000	2,000	2,000	2,000
US Non-Compact Grants	5,814	6,391	3,574	1,546	1,369	569	179	3,894
Other Country Grants	—	—	—	—	—	10,195	—	8,400
Total Expenditures	65,251	75,148	76,542	64,597	71,678	84,483	77,202	79,691
Current Spending	56,722	58,145	58,252	54,761	63,689	71,767	63,080	59,417
Wages & Salaries	23,203	25,820	27,777	27,355	28,381	29,275	29,863	30,358
Purchase of Goods & Services	23,627	19,896	25,298	22,982	27,256	30,414	25,360	24,327
Interest Payments	83	—	—	—	—	—	700	700
Subsidies & Other Transfers	9,809	12,429	5,177	4,424	8,052	12,078	7,157	4,032
Public Enterprises	5,543	7,889	3,037	1,964	1,337	3,149	3,287	1,662
Other	4,266	4,540	2,140	2,460	6,715	8,929	3,870	2,370
Capital Spending	8,529	17,003	18,290	9,836	7,989	12,716	14,122	20,274
Errors & Omissions	(2,560)	1,993	2,220	(4,252)	3,875	4,843	(2,770)	—
Overall Balance	97,276	(6,616)	(16,283)	2,457	(16,786)	(4,656)	(18,479)	(9,633)

Source: Department of Administration

PALAU VISITOR ACCOMMODATIONS

Name	Classification	Average Room Rate (\$)	Number of Rooms
1 Airai View Hotel	4-Star Full-Service Hotel	120-200	72
2 Carolines Resort, The	Deluxe Bungalows	150	7
3 Carp Island Resort	Resort/Dive Shop	65-140	25
4 Cocoro Hotel	Standard	70-120	16
5 Country Plaza Hotel	Economy	35+	NA
6 D. W. Motel	NA	35-55	NA
7 Guest Lodge Motel, The	Standard	45-55	12
8 H. K. Motel	Economy	30-55	11
9 Hotel Nikko Palau	Closed	NA	51
10 Island Villas Beach House (Angaur State)	NA	20-30	2
11 King's Motel	Economy	45-55	15
12 L & K Motel	Economy	NA	8
13 Lehns Motel & Apartments	NA	45-75	21
14 Malakal Central Hotel	Hotel & Restaurant	140	18
15 Mayumi's Inn (Peleliu State)	Guesthouse/Motel	22-55	10
16 New Koror Hotel	Economy	33.0-33.5	25
17 Ngaraard Traditional Resort	Eco-Tourism Cottages	45-55	3
18 Palasia Hotel Palau	Deluxe Hotel	200-780	165
19 Palau Hotel	Budget Hotel	50-60	30
20 Palau Marina Hotel	Standard	88	28
21 Palau Marine Clubhouse	Standard	25-120	10
22 Palau Pacific Resort	5-Star World-Class Hotel	225-575	160
23 Papago International Resort Palau	Resort	180-600	100
24 Peleliu Marine (Peleliu)	Guesthouse	60	4
25 Penthouse Hotel, The	Standard	79-95	12
26 Reiko's Inn (Peleliu State)	Guesthouse	25	5
27 Storyboard Beach Resort (Peleliu State)	Deluxe Bungalows	85	6
28 Sunrise Villa Hotel	Deluxe	130-295	21
29 Tree-D Motel & Apartments	Economy	NA	24
30 VIP Guest Hotel	Business Hotel	65-100	22
31 Waterfront Villa	Hotel & Condominium	63.25	22
32 Wenty's Sunset Inn (Peleliu State)	NA	15	4
33 West Plaza Coral Reef Hotel	Standard	70-100	14
34 West Plaza Desekele Hotel	NA	70-90	30
35 West Plaza Downtown Hotel	Standard	70	22
36 West Plaza Hotel by the Sea	Standard	70-120	34
37 West Plaza Hotel Malakal	Standard	70-100	27
38 Yuhi Motel	Motel & Apartments	72	13
Total			1,049

Source: Palau Visitors Authority

Since 2001 was a growth year for the economy as a whole, a drop in the average wage rate, no matter how small, is unusual. However, this finding is from wage data that are far more detailed than before, and also based on actual social security withholdings, so it is credible.

A closer look at the wage rates of the last five years, 1997-2001, shows only small variations from year to year. The average wage rate for the entire labor force exceeded the \$7,000 level for the first time in 1994, the same year the Compact took effect. It stayed in the \$7,100-7,200 range in 1995-96. It increased 6.0 percent to \$7,624 in 1997, peaked at \$7,901 in 1999,

then dropped to \$7,768 in 2000 and \$7,718 in 2001. It averaged \$7,747 in the entire five-year period, indicating a steadier level that is consistent with GDP data for the same period. If one takes the drop in the number of foreign labor in 2002 as a signal of diminished demand, it may suggest yet another drop in the national wage rate, but that is a forecast that must await corroboration by actual data.

The wage rates in 11 of the 25 wage categories dropped in 2001 from their 2000 levels, but increased in the other 14 categories. The lowest wage rate in Palau in 2001 was \$1,760 for private household workers and the highest was \$16,286 in banking. With a per capita GDP of about one-third of Guam and less than a quarter of Hawaii, Palau is a less affluent economy in terms of comparative dollar income and wages.

V. Economy by Sector

V.1 Agriculture and Fishing

Agriculture and fishing comprise a small share of the total national output and income. While there is potential for growth, especially in agriculture to meet more domestic demand for food and fiber from domestic production, the likelihood of growth in this

sector very soon is low. The reason for agriculture's limited role is Palau's small market, which cannot take advantage of economies of scale that make commercial agriculture financially successful.

As pointed out in the findings of a recent presidential task force on agricultural development, it costs less to import foods and fiber than to produce them in Palau.¹ While exceptions do exist, this situation of imports meeting more of the demands for food and

¹National Task Force on Agriculture Development, *Progress Report Submitted to the Office of the President, Republic of Palau*, October 1999, p. 4.

fiber is common to many Pacific Island economies where small markets and small landmasses prevent the establishment of large commercial agricultural enterprises.

In rural Palau, households earn a part of their livelihood from subsistence farming and fishing. Women grow crops and men catch fish. Rice has become an increasingly important staple food. Also, bread made of imported wheat flour has gained popularity as a staple mainly in urban Koror, where several bakeries operate.

Among the most pressing problems agriculture faces, especially in small economies, is the availability of adequate labor willing to work on farms, and capital to invest in both skills and facilities. As agriculture is always subject to natural uncertainties, and demand for food does not always go up with rising income, its earning potential is both limited and unpredictable. That is the main reason agriculture receives subsidies in most economies, usually from Europe, Japan and the United States. Since an adequate supply of food and fiber is always a priority, governments readily justify subsidies and other assistance programs to agriculture.

V.2 Government

Apart from the usual services government provides in the United States, government in Palau provides other

services such as utilities, communication and health and medical services. As a result, government is Palau's single largest employer and recently accounted for almost a third of the national income. While there is a clear desire in Palau to develop a strong and diversified private sector and improve the public sector's efficiency, such a transformation will neither be easy nor quick. Since Palau's economy is still considered to be in a state of flux, government's share may vary from time to time, depending on the projects it undertakes. Also, as privatization and market principles assume larger roles in Palau, it is likely to accelerate its move in that direction. Meanwhile, government is expected to remain a major provider of income, employment, services and infrastructure.

As government continues in its dominant economic role in the foreseeable future, how it manages the country's public financial resources may have an important impact on how the transition to a more private sector economy progresses. Perhaps Palau's government and business need to establish a stronger partnership and work together, especially in areas where privatization and divestment of public assets may advance both economic growth and efficiency in the public sector. Despite the continuing economic and financial challenges affecting the entire Asia-Pacific region, the government of Palau appears to have managed the country's financial resources well in recent years.

VISITOR ARRIVALS BY MARKET

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Japan	13,212	14,529	17,021	18,554	17,493	21,052	22,619	20,507	21,571	22,087	21,708	22,395	23,748
Taiwan	—	—	—	—	6,126	11,163	23,309	31,246	18,503	10,936	14,122	12,476	15,819
USA	6,440	6,411	8,032	7,861	9,700	9,846	9,955	10,481	11,055	11,181	11,035	8,340	8,503
Philippines	3,528	4,073	4,032	3,622	3,554	3,199	3,838	3,344	3,033	2,952	3,981	4,128	3,410
Europe	1,674	1,202	1,527	1,722	2,207	2,508	2,870	1,767	1,455	1,418	974	930	834
Korea	—	—	—	—	1,221	1,823	2,074	1,782	545	539	586	350	497
Others	7,992	6,485	5,505	8,738	3,772	3,638	4,665	4,592	8,032	6,380	5,326	5,492	5,749
Total	32,846	32,700	36,117	40,497	44,073	53,229	69,330	73,719	64,194	55,493	57,732	54,111	58,560
Percent Shares													
Japan	40.2	44.4	47.1	45.8	39.7	39.5	32.6	27.8	33.6	39.8	37.6	41.4	40.6
Taiwan	—	—	—	—	13.9	21.0	33.6	42.4	28.8	19.7	24.5	23.1	27.0
USA	19.6	19.6	22.2	19.4	22.0	18.5	14.4	14.2	17.2	20.1	19.1	15.4	14.5
Philippines	10.7	12.5	11.2	8.9	8.1	6.0	5.5	4.5	4.7	5.3	6.9	7.6	5.8
Europe	5.1	3.7	4.2	4.3	5.0	4.7	4.1	2.4	2.3	2.6	1.7	1.7	1.4
Korea	—	—	—	—	2.8	3.4	3.0	2.4	0.8	1.0	1.0	0.6	0.8
Others	24.3	19.8	15.2	21.6	8.6	6.8	6.7	6.2	12.5	11.5	9.2	10.1	9.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note:

1) Visitor arrivals from Taiwan and Korea and some other Asian markets were included in "Others" through 1993.

2) USA includes Guam.

Source: Palau Visitors Authority

VISITOR ARRIVALS BY MONTH

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
January	2,021	2,406	2,792	3,957	3,332	4,209	5,955	5,663	5,851	4,196	4,235	5,398	4,441
February	2,118	2,693	3,545	3,802	4,495	5,277	7,043	7,425	6,757	5,592	4,423	5,089	5,850
March	2,316	3,221	3,579	3,427	4,288	4,044	8,065	7,166	6,004	5,621	5,689	5,917	5,453
April	2,159	2,883	3,340	4,268	3,686	4,221	5,790	6,311	5,669	4,544	5,054	4,389	4,370
May	1,484	2,668	2,459	3,727	3,795	3,660	5,368	5,901	5,132	4,531	4,490	4,545	4,002
June	1,415	2,926	2,579	2,565	3,302	3,831	5,609	5,136	4,962	4,420	4,659	4,146	4,571
July	1,960	2,957	3,500	3,239	3,605	4,190	6,004	7,261	6,243	5,231	6,247	4,432	4,481
August	2,600	3,150	2,995	3,151	3,268	4,820	5,557	6,622	6,325	5,081	5,442	5,297	5,462
September	1,611	2,392	2,778	2,880	3,633	4,064	4,453	4,994	4,745	4,744	4,729	3,500	4,279
October	2,002	2,460	2,448	2,802	2,944	4,442	5,365	5,661	3,863	3,502	3,994	3,116	4,116
November	1,695	2,160	2,870	3,120	3,549	5,328	4,757	5,726	4,246	4,380	4,313	3,628	4,383
December	2,117	2,784	3,232	3,559	4,176	5,143	5,364	5,853	4,397	3,651	4,457	4,654	7,152
Total	23,498	32,700	36,117	40,497	44,073	53,229	69,330	73,719	64,194	55,493	57,732	54,111	58,560

Source: Palau Visitors Authority

V.3 Tourism

V.3.1 Tourism Plant

Tourism is Palau's leading private sector income source, with potential for further growth. Palau is one of the world's top diving destinations, and the Rock Islands is one of the most pristine marine ecosystems in the Pacific. Lagoons and coral reefs offering snorkeling in some of the most tranquil waters in the Pacific surround the islands. World War II wreckage sites that lie just south of the Rock Islands are becoming areas of interest to tourists, especially those from Japan. Recently, however, international metal processing and recycling companies have shown interest in lifting these sunken ships, planes and other war implements from the seabed to recycle the metals. The quantity of metal is apparently large enough to prompt thinking about its reuse, but only time will tell whether this stock can actually be brought back to the surface for recycling.

Palau's tourism plant and activities are concentrated in Koror. Among the consequences of putting so much of the country's infrastructure and economic activity in such a small area is traffic congestion on narrow roads that were not designed for heavy traffic. In most instances Palau's city roads, such as the main road through Koror, cannot be widened without major disruptions to the infrastructure, businesses and the environment. Babeldaob offers an alternative to further expansion in Koror. With the new infrastructure there, Babeldaob can further strengthen its role in Palau's economic growth by enhancing its ability to develop tourism. The Palau Visitors Authority (PVA) has classified the visitor plant into three main

types: resorts, hotels and motels. Most establishments on the outer islands tend to be small all-purpose facilities. Offering a variety of accommodations makes it possible to attract a diverse combination of visitors.

Total hotel inventory has increased rapidly. It rose from 573 in 1993 to 709 in 1996 and 1,049 in 2002. Of this total, 425 rooms (40 percent) are considered world-class and regionally competitive. This inventory is contained in three hotels: Palau Pacific Resort with 160 rooms, Palasia Hotel with 165 and the new Papago International Resort with 100 rooms. As the pieces of a new infrastructure get built, they will add to Palau's competitive advantage as a unique destination. However, Palau's limited and fragile ecosystem is the ultimate constraint on how much tourism the country can accommodate. Given this challenge, Palau should determine specific types of visitors, as the focus of its development strategy.

V.3.2 Tourism Statistics

PVA has made a concerted effort over the past few years to generate up to date and detailed tourist data, which are now also available on its web site. According to PVA, Japanese and Taiwanese tourists make up the bulk of Palau's visitors. Visitors from the United States, (including those from Guam) who are mainly divers, other marine habitat enthusiasts and business and government travelers, make up a distant third largest group. There are also sizeable groups from the Philippines, CNMI and neighboring Micronesia. Small groups of Europeans also visit Palau, as do those from Hong Kong, Singapore and Australia. Unlike Guam and Saipan who now have direct flights to Korea, Palau has yet to make inroads into the Korean

market, which is growing rapidly. Of the markets most severely affected by the 1997-98 Asian financial crisis, Korea has made the most impressive recovery, and is becoming an important force in the industrial East Asian region as well as the Asia-Pacific tourist markets. If Palau is to develop that growing market, direct flights to Korea may be required.

The year 2002 ended with a significant improvement over 2001, especially in the last four months, suggesting that tourism markets in the West Pacific are returning to normal levels. Tourist arrivals to Palau increased 22.3 percent in September 2002 over September 2001. Similar or larger increases followed in October and November, and December's 53.7 percent gain helped the year's total to become the highest in four years. In 2002, total arrivals of 58,560 were up 8.2 percent over 2001. Though far smaller than the pre-Asian financial crisis record of 73,719 in 1997, it marked a turnaround from the previous year. Palau did not fare as badly as Guam, CNMI and Hawaii in 2001, but it still posted a decline of 6.3 percent in total arrivals, with American tourists dropping 24.4 percent and Taiwanese tourists decreasing 11.7 percent. Japanese tourists, on the other hand, rose 3.2 percent in 2001 from 2000.

The rise in Japanese tourists in 2001 may be taken as a counterintuitive signal because Japanese travel to the rest of the West Pacific declined in the aftermath of the September 11 tragedy, and the Japanese economy continued to decline in 2002. But it may be far more useful to interpret it as proof that specialized tourist markets such as Palau can successfully draw their visitors from targeted specialized groups in large markets unaffected by conditions of uncertainty. It should be noted, however, that since specialized markets tend to be small, their growth potentials are also limited.

Japanese visitors were up again in 2002 by 6.0 percent, surpassing the 1996 record of 22,619. Because some of the non-Japanese segments increased much more, Japanese visitors as a share of the total market declined slightly to 40.6 percent in 2002 from 41.4 percent in 2001. Still, the increase in 2002 of tourists from Japan is a sign that strong segments do exist within the weak Japanese economy. If so, any improvement in the Japanese economy can only mean further growth in visitors from Japan.

There were no notable changes in the tourist mix in 2002, as compared to the four preceding years. Given present air transport routes and conditions, this stability in market shares can be used as the basis from which to expand. Palau should maintain its major market mix of visitors from Japan, Taiwan and the US while adding other markets such as Korea to diversify. Reliance on 3-4 markets rather than one or two would reduce the risks of tourist traffic fluctuations.

V.3.3 Tourist Spending

Among the more notable steps PVA took toward a better understanding of the industry was to conduct a comprehensive exit survey in 2001, which produced a great deal of very useful data. Some findings simply verified what was known about Palau's visitors, while others offer insight that can be helpful to those in the industry as well as to policy makers.

The survey verified that nearly 70 percent of visitors to Palau are divers. Other leisure travelers accounted for 13.6 percent, and only 12 percent of all visitors were on business trips. A little over 54 percent of all visitors stayed 1-4 days, about a quarter stayed 5-6 days, a little over 17 percent 7-14 days and only 3.5 percent stayed even longer. Nearly three-quarters of all tourists to Palau were first-time visitors, a little less than 12 percent were second-time visitors and the remainder had visited three or more times.

The most telling numbers were those that have to do with tourist spending, which is the bottom line. Average expenditures per person per visit varied, as one would expect. There were no big surprises in the spending data, but it showed that Japanese travelers spend just as much (\$1,195 over four days) as their Taiwanese counterparts (\$1,148 over the same period), which implies something important about the state of the Japanese economy. Adjusted for purchasing power parity, Japanese per capita tourist spending has dropped to the level of Taiwan. Although these figures should be interpreted carefully, they suggest a shift in tourism markets in East Asia, as Japan is no longer the dominant economic powerhouse it was for the four decades after World War II.

Applying per capita spending data to the various markets yields a total spending of \$61.1 million for 2001, as compared to a total of \$66.1 million in 2002. These figures are consistent with previous data and market realities.

Despite unfavorable developments in some tourist countries, the stable per capita spending of Palau's visitors is reassuring. The negative aspect of steady spending is that providers of local services must meet constant demand, which makes market growth for a small economy like Palau a difficult proposition. The only way to overcome stagnation caused by steady state spending is to attract higher numbers of affluent tourists who are likely to spend more per visit.

V.3.4 Market Potential

The question remains as to how many tourists Palau needs or can accommodate without doing harm to the ecosystem. Not too long ago, informal long-term estimates ranged from 200,000 to 300,000 by the middle of this decade. As critical a policy issue as this appears to be, there is no consensus on the type of destination

Palau should be in the long run. In the short term, however, markets have defined Palau to be a limited specialty destination, primarily for divers.

Unlike its northern neighbors, Guam and CNMI, Palau does not have the capacity for mass markets. However, opening Babeldaob to mass tourism could eventually change that. For tourism to become an even greater source of income, there must be acceptance of its potential, an infusion of new capital and possibly labor. Given these constraints, Palau's comparative advantage lies in strengthening its position as a specialty market by attracting small masses of higher per capita spenders. This may not be easy to achieve, but it is the only realistic option for Palau.

VI. What Lies Ahead

As with other destinations in the Pacific, Palau has had to adjust to three major crises in less than a decade. First, there was the Asian financial crisis that caused a considerable amount of paper wealth to disappear overnight. The subsequent economic and financial difficulties eroded per capita income and spending in all of industrial East Asia. The second crisis was a shift in the world's economic powers, precipitated by the continued deterioration of the Japanese economy. Japan is no longer the world's second largest economy according to its current income levels after adjustment for purchasing power parity (PPP). China, after adjustment for PPP, has risen to third place, following the United States and the European Union (EU). The third crisis was the September 11, 2001 terrorist attacks on New York and Washington, which changed the geopolitical debate in a manner that was not anticipated when the Cold War ended.

These crises have had crippling effects on the small island economies that depend on both tourism and, more importantly, capital from industrial East Asia.

On a significantly positive note, there is evidence that these small markets have adjusted to the post-crisis environment, even though it meant cutbacks in all aspects of their economic lives. Furthermore, the 2002 tourist data for Palau include signs that the markets from which their visitors originate seem to have undergone similar adjustments. Recovery in some parts of East Asia, particularly Korea, Taiwan and China, is occurring rapidly. Economic recovery in the United States may take more time and require more effort than just tax cuts, as excess capacity left over from the booming 1990s still needs to be addressed.

Dictated by its natural comparative economic advantage, Palau is on track to becoming an even more diversified tourist market, staying within the limits of its human, natural and capital resources. Because travel is a qualitative experience rather than a tangible



good, elevating the quality of current visitors' experience is of critical importance in optimally targeting Palau's tourism development.

At the same time, tourism is a highly competitive business. Destinations are developing rapidly in and around the Pacific, all with the objective of attracting the most lucrative tourists. How would Palau achieve tourist spending growth objectives while maintaining local traditions? The trade-off is not as straightforward as it once appeared. Destinations cannot remain totally immune to adverse influences of tourists.

In addition to developing a specialized destination, Palau can also make use of its open space for other commercial activities such as fishing and raising other aquatic species. These activities can be designed in ways to complement the landscape and other characteristics of the destination. What lies ahead in Palau will most certainly be a challenge, but it will be rewarding if Palau successfully develops a diversified and self-sustaining economy that generates a reasonably high standard of living.

Achieving sustainable economic growth that meets the needs of both its labor market and its government will require a steady infusion of capital from outside sources since Palau does not generate enough from its own resources. To attract foreign capital, government must encourage capital formation, both from within and outside Palau. Land registration is a step in the right direction, but more needs to be done. Financial transactions should be secure, verifiable and free from suspicion. One of the important lessons of the Asian financial crisis, especially for Pacific Islands, is that open markets require open rules and a verifiable system of checks and balances. Today, no economy, no matter how small, is immune to the adverse effects of mismanagement. The best course of action is to anticipate where the world is headed and act accordingly.

PACIFIC ISLANDS FACT SHEET

US DOLLAR-DENOMINATED ECONOMIES

	Population	Land Area (square miles)	Notable Geographic Characteristics	Capital/ Distance from (miles)	Currency	Major Languages
GUAM	159,547	212	One island. Major US naval base and regional trans-shipment center at Apra Harbor. In hurricane path.	Agana/ Honolulu 3,800 Tokyo 1,600	US dollar	English, Chamorro, also Tagalog, Japanese
COMMONWEALTH OF THE NORTHERN MARIANA ISLANDS (CNMI)	69,221	177	Saipan the largest island, Tinian and Rota next, 14 others in the chain. 125 miles north of Guam. US territory closest to Asia.	Garapan, Saipan/ Honolulu 3,700 Tokyo 1,500	US dollar	English, Chamorro, Carolinian
FEDERATED STATES OF MICRONESIA (FSM)	116,268	270	607 islands and atolls, Pohnpei 130 square miles, other major islands Kosrae, Yap and Chuuk. The 4 FSM states span 1,700 miles from east to west.	Kolonia, Pohnpei/ Honolulu 3,100 Hong Kong 3,100	US dollar	English, 8 major local languages
REPUBLIC OF PALAU	19,976	170	343 islands, the main group encircled by a hundred mile reef. Babeldaob 136 square miles. 8 other inhabited islands. Rock Islands.	Koror/ Honolulu 4,600 Tokyo 2,000 Hong Kong 1,700	US dollar	English, Palauan, Sonsorolese-Tobian
REPUBLIC OF THE MARSHALL ISLANDS (RMI)	52,671	70	34 coral islands, 870 reefs, highest elevation 33 feet above sea level, average elevation 7 feet.	Majuro/ Honolulu 2,300 Guam 1,800	US dollar	English, Marshallese dialects
AMERICAN SAMOA	58,900	76	5 islands, 2 atolls. Pago Pago Harbor. Home of newest US national park. In hurricane path.	Pago Pago, Tutuila/ Honolulu 2,600 Los Angeles 4,800	US dollar	English, Samoan
TOTAL/AVERAGE	476,583	975				

NON-DOLLAR ECONOMIES

FRENCH POLYNESIA	231,500	1,609	130 islands, mostly atolls in 5 archipelagoes. Tahiti the largest island, 400 miles square, maximum elevation 7,464 feet.	Papeete, Tahiti/ Honolulu 2,800 Los Angeles 4,100 Paris 10,400 Tokyo 5,900	French Pacific franc (F CFP)	French, Tahitian
NEW CALEDONIA	209,222	7,376	Main island, Grande Terre 250 miles by 30 miles (larger than the Hawaiian Islands together), mostly mountainous. Several small islands.	Noumea/ Honolulu 3,900 Paris 10,400 Brisbane 900	French Pacific franc	French, 30 Kanak dialects
WALLIS AND FUTUNA	14,800	106	2 main islands, highest elevation 2,493 feet.	Wallis Island/ Honolulu 2,700 Paris 10,000	French Pacific franc	French, East Uvean, East Futunan
PAPUA NEW GUINEA (PNG)	4,800,000	178,704	Eastern half of the island of New Guinea. Largest by far Pacific island-state land mass. Other main islands New Ireland, New Britain and Bougainville.	Port Moresby/ Honolulu 4,300 Cape York, Australia 300 Tokyo 3,100 Hong Kong 3,100	Kina	English, Tok Pigin, Hiri Motu, hundreds of vernaculars
COOK ISLANDS	19,600	92	15 widely dispersed islands including volcanic peaks and atolls. Rarotonga the largest island 26 miles square. In hurricane path.	Rarotonga/ Honolulu 3,000 Wellington 2,000	New Zealand dollar	English, Cook Islands Maori
SAMOA	168,000	1,158	4 inhabited islands, 5 uninhabited. Highest point 6,100 feet, Mt. Silisili on Savai'i. In hurricane path.	Apia/ Honolulu 2,600 Suva 700 Brisbane 2,500	Tala	English, Samoan

GDP/GNP (US\$ million current)	Per Capita GDP/GNP (US\$)	Major Income Sources	Political Status	Major Sources of External Investment	Major Sources of Future Income
2,218.3	13,904	Tourism, military, trade and services	US territory since 1898. Guam Organic Act of 1950 conferred U.S. citizenship.	US, Japan, Korea	Tourism, services
445.6	6,437	Tourism, garment manufacturing, trade and services	After WWI under Japanese mandate. In 1947 became part of UN Trust Territory of the Pacific. Since 1978 a Commonwealth of the US. Islanders are US citizens.	Japan, Korea, Hong Kong, US	Tourism, services
230.0	1,978	US payments, government services, fisheries, tourism	After WWI under Japanese mandate. In 1947 became part of UN Trust Territory. Became sovereign in 1979. In compact of free association with US as of 1986.	US, Japan	Compact status being renegotiated. Fisheries development, tourism
109.5	5,482	US Compact payments, tourism	After WWI under Japanese mandate. In 1947 became part of UN Trust Territory. Became sovereign in 1994, in compact of free association as of 1994. Compact ends 2044.	Japan, US	Compact money, tourism
95.9	1,821	US payments, Kwajalein Missile Range, government services, copra, fisheries	After WWI under Japanese mandate. In 1947 became part of UN Trust Territory. Became sovereign in 1979. In compact of free association since 1986.	US, Japan	US military. Compact being renegotiated. Fisheries.
253.0	4,295	Tuna canneries, government services, remittances from Samoans overseas	US territory since 1899. Samoans are US nationals.	US	Canneries, remittances, US entitlements
3,352.3	7,034				
3,929.2	16,973	Payments from Metropolitan France, tourism, Tahitian pearls	French controlled from the 19th century. Overseas territory of France since 1957. Active independence movement.	Metropolitan France	French transfers, tourism, pearls
3,058.0	14,616	Payments from Metropolitan France, nickel, agriculture and ranching, tourism, aquaculture	1853 became a French possession. Overseas territory of France since 1946.	Metropolitan France	French transfers, nickel, tourism, agriculture, aquaculture
28.7	1,939	French transfer payments, trochus shells	French controlled from the 19th century. Overseas territory of France since 1961.	Metropolitan France	French transfers
3,754.4	782	Minerals, oil and gas, forestry, agriculture, tourism	Under Australian & German control before WWI. Administered by Australia after WWII. Independent within the British Commonwealth since 1975. The Bougainville secessionist movement ended by a formal treaty in April 1998.	Australia, UK	Minerals, oil, timber, fisheries, tourism
76.1	3,882	Government aid, services, tourism	Self-governing since 1965 in association with New Zealand. Cook Islanders are citizens of both Cook Islands and New Zealand.	New Zealand	Tourism
199.0	1,185	Agriculture, remittances from abroad, tourism, manufacturing	Under German control before WWI, New Zealand after. New Zealand trusteeship after WWII. Independent since 1962.	New Zealand, Japan	Agriculture, tourism, light manufacturing

PACIFIC ISLANDS FACT SHEET *(continued)*

	Population	Land Area (square miles)	Notable Geographic Characteristics	Capital/ Distance from (miles)	Currency	Major Languages
FIJI	812,300	7,055	320 islands. Viti Levu 4,000 miles square, Vanua Levu 2,100 miles square. Major islands are mountainous and forested to windward.	Suva/ Honolulu 3,100 Sydney 2,000 Tokyo 4,500	Fiji dollar	English, Fijian, Hindi
KIRIBATI	83,976	266	33 islands scattered 2,400 miles east to west, 1,300 miles north to south. Almost entirely low-lying atolls, Christmas Island the largest.	Tarawa/ Honolulu 1,300 Tokyo 3,900	Australian dollar	English, Micronesian
SOLOMON ISLANDS	393,000	11,197	850 mile long double island chain. 6 mountainous main islands, Guadalcanal 2,080 miles square.	Honiara, Guadalcanal/ Honolulu 3,960 Port Moresby 900	Solomon Island dollar	English, Solomon Islands Pijin, more than 80 vernaculars
TONGA	97,800	386	Main islands volcanic, some 150 coral atolls, 36 permanently inhabited.	Nukualofa/ Honolulu 3,100 Brisbane 2,000	Pa'anga	Tongan
VANUATU	199,016	4,707	80 scattered islands, several active volcanoes. Largest island Espiritu Santo 1,500 miles square, highest point 6,158 feet.	Port Vila, Efate/ Honolulu 3,500 Tokyo 4,100	Vatu	French, English, Bislama
NAURU	11,200	8	A single island with a 100 foot high central plateau of now nearly exhausted phosphate-bearing rock.	Nauru/ Honolulu 2,800 Banaba, Kiribati 200	Australian dollar	English, Nauruan
NIUE	1,745	101	Coral island rising 65 feet from the ocean and another 130 feet to a central plateau.	Alofi/ Wellington 1,800 Suva 800	New Zealand dollar	English, Niuean
TOKELAU	1,507	4	3 atolls with islets 10 to 16 feet above sea level. In hurricane path.	Nukunonu/ Honolulu 2,300 Wellington 3,800	New Zealand dollar	English, Tokelauan
TUVALU	10,900	10	5 atolls, 4 coral islands, maximum elevation 16 feet above sea level.	Funafuti/ Suva 700 Sydney 2,500	Australian dollar	English, Tuvaluan
TOTAL/AVERAGE	7,054,566	212,779				
GRAND TOTAL/ AVERAGE	7,531,149	213,754				
HAWAII	1,244,898	6,423	4 main islands. Island of Hawaii 4,028 miles square, highest point of Mauna Kea 13,796 feet. Mauna Loa and Kilauea on Hawaii both active volcanoes. Maui 727 miles square, Oahu 597 (Waikiki), Kauai 552. In hurricane path.	Honolulu/ San Francisco 2,400 Los Angeles 2,600 Washington 4,800 Tokyo 2,500	US dollar	English

SOURCE: Pacific Islands Development Program (PIDP), East-West Center, Honolulu, Hawaii

GDP/GNP (US\$ million current)	Per Capita GDP/GNP (US\$)	Major Income Sources	Political Status	Major Sources of External Investment	Major Sources of Future Income
1,821.3	2,242	Sugar and other agriculture, tourism, forestry, fishing, mining, garment industry	Annexed by Great Britain in 1874. Became independent within the Commonwealth in 1970, rejoined the Commonwealth in 1997.	Australia, New Zealand, EU, Japan	Agriculture, tourism, mining, light manufacturing
76.0	905	Agriculture (copra), remittances, aid	Annexed by Britain in 1919. A republic within the British Commonwealth since 1979.	NA	Fisheries development
343.7	875	Agriculture, timber sales, fishing and fish canneries, aid	British protectorate as of 1873. Politically independent within the Commonwealth since 1978.	Australia, Japan	Agriculture, fisheries, tourism
177.0	1,810	Agriculture, tourism	British protectorate as of 1900. Independent monarchy within the Commonwealth.	NA	Tourism, agriculture
224.6	1,129	Agriculture and ranching, tourism, Offshore Finance Center, services	Anglo-French New Hebrides Condominium in 1906. Republic of Vanuatu within the British Commonwealth established in 1980.	Australia, Japan	Tourism, agriculture
368.0	32,857	Phosphates and investments from phosphates	From 1919 administered by Australia. Became an independent republic in 1968.	NA	Investments from phosphate
6.1	3,476	Subsistence activity, government aid	Self-governing since 1974 in free association with New Zealand.	NA	Tourism
1.2	796	Subsistence activity, government aid	Non-self-governing territory administered by New Zealand beginning 1925.	NA	Subsistence activities, government aid
9.0	826	Subsistence activity, government aid	Independent state within British Commonwealth since 1978.	NA	Subsistence activities, government aid
14,072.3	1,995				
17,424.6	2,314				
45,602.6	36,632	Tourism, services, trade, government	Annexed in 1898, became a US territory in 1900, became a state in 1959.	US, Japan, Australia	Tourism, defense, services, trade, government

For further information, contact Bank of Hawaii Senior Fellow for the Pacific Economies, Dr. Wali M. Osman, at 808-944-7229 (phone), 808-944-7670 (fax) or osmanw@EastWestCenter.org.

HEADQUARTERS

Bank of Hawaii
130 Merchant Street
Honolulu, Hawaii 96813
☎ 1 (888) 643-3888
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MAILING ADDRESS FOR GUAM BRANCHES, PACIFIC ISLANDS DIVISION, GUAM CORPORATE BANKING CENTER

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Fax: (671) 637-2760

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Fax: (671) 649-8552

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Pacific Islands Development Program
East-West Center
1601 East-West Road • Honolulu, HI 96848-1601
Phone: (808) 944-7778 • FAX: (808) 944-7670
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