



## **Executive Summary**

Palau's economy is dominated by tourism, subsistence agriculture, and fishing. The government is the country's largest employer. The Compact of Free Association with the United States governs the relationship between the U.S. and Palau. Palau's per capita income is over \$10,500 per year.

The Foreign Investment Act provides the approval-process guidance for foreign investment, and the Foreign Investment Regulations reserves some businesses to Palauan citizens, including wholesale or retail sale of goods, all land and water transportation, travel and tour agencies, and commercial fishing. Other sectors are semi-restricted, requiring a Palauan partner, though no fixed percent of ownership is required.

Palau's economy uses the U.S. dollar. Palau has a strong banking sector with three FDIC-insured U.S. banks.

Palau's judicial system is viewed by Transparency International and other observers as professional and fair. Regulatory and accounting systems are generally transparent and consistent with international norms.

Foreigners cannot own land in Palau, but they can lease land and own buildings on leased land. Establishing secure land title may be complicated due to the complexity of the traditional land ownership system and occasional over-lapping claims.

Palau is not a member of the World Intellectual Property Organization, the WTO, or any other organization or convention protecting intellectual property rights.

Palau has no bilateral investment protection agreements, and is not a member of any free trade associations. Foreign labor comprises a large proportion of Palau's labor force.

U.S. citizens are exempt from the Palau's normal resident visa requirements. A visa is not required for U.S. citizens visiting Palau for one year or less, provided the visitor otherwise complies with applicable regulations.

### **1. Openness to, and Restrictions Upon, Foreign Investment**

Palau's economy is dominated by tourism, subsistence agriculture, and fishing. The government is the country's largest employer. The Compact of Free Association with the United States, entered into after the end of the UN trusteeship on 1 October 1994, provided Palau with up to \$700 million in U.S. aid for the following 15 years. Foreign assistance grants comprise approximately 20 percent of GDP and finance roughly 50 percent of government spending. Palau's per capita income is over \$10,500 per year.

Palau's economy contracted in 2008 and 2009, due to the global economic crisis, and its effect on tourism spending and other outside investment into Palau. The number of tourist visitors rebounded in 2010, and hit new records in 2011 and 2012, though the number of arrivals fell slightly in 2013. New markets, such as Russia, have barely been tapped, and offer great potential. However, Palau's present hotel and other infrastructure limit its ability to absorb potential major increases in tourist numbers.

A 15-year renewal of grants for the U.S. Compact of Free Association is currently under review in the U.S. Congress. However, Palau must prepare for the eventual conclusion of Compact Grant funds. With Palau's current deficit, the Asian Development Bank estimates that an appropriate fiscal policy would require Palau to reduce its current deficit by 1½ percent of current GDP each year for the next 10 years. A 2012 IMF review applauded Palau's deficit-reduction efforts, but noted the need for reduced government employment and revenue reforms.

The 1991 Foreign Investment Act provides the approval-process guidance for foreign investment. In late 2010 the Government of Palau revised its implementing regulations, changing several key requirements in a bid to encourage more foreign investment. A broader reform of the investment law stalled in Palau's bicameral National Congress, or Olbiil Era Kelulau (OEK). The new "Regulations Implementing the Foreign Investment Act, 28 Pnc Section 101 *et seq.*," were signed by President Johnson Toribiong on August 1, 2010, and went into effect on November 1, 2010.

The 2011 Foreign Investment Regulations detail the significant number of restricted and semi-restricted sectors. There are no specific financial incentives extended to foreign investors.

According to Palauan law, the following businesses are solely reserved for Palauan citizens:

"(i) wholesale or retail sale of goods; (ii) all land transportation including bus services, taxi services and car rentals; (iii) tour guides, fishing guides, diving guides and any other form of water transportation services; (iv) travel and tour agencies; and (v) commercial fishing for other than highly migratory species"

While all of the businesses above are officially closed to foreign investment, there is a prevalent use of partnership companies in several categories, in which the foreign investor owns less than fifty percent. The retail sector, as well as travel- and tour-related businesses, currently has numerous foreign investors via such partnership companies.

Regulatory changes that occurred in 2010 created a new category of "semi-restricted" sectors. These sectors had been closed to foreign investors from the passage of the 1991 Foreign Investment Act through October 2010. Now, these formerly-restricted businesses can include foreign ownership, as long as a Palauan citizen also has an ownership interest. There are no minimum or maximum requirements for percentage ownership for the foreign investor, as long as the monetary and/or Palauan-employment

minimums for all foreign investments are met (as discussed below). These semi-restricted businesses are as follows:

- (i) handicraft and gift shops;
- (ii) bakeries;
- (iii) bar services;
- (iv) operations [selling] products being produced by wholly Palauan-owned manufacturing enterprise;
- (v) equipment rentals for both land and water within the Republic, including equipment for purpose of tourism; and
- (vi) any such other businesses, as the Foreign Investment Board may determine

Sectors not listed as either closed or semi-restricted are presumed to be open for foreign investment. The Foreign Investment Board may, however, amend the semi-restricted sector list for “*any such other businesses as the Board may determine.*”

Measure	Year	Rank or value
TI Corruption Perceptions index	2013	N/A
Heritage Foundation’s Economic Freedom index	2013	N/A
World Bank’s Doing Business Report “Ease of Doing Business”	2014	100 of 189
Global Innovation Index	2013	N/A
World Bank GNI per capita	2012	USD 9,860

## 2. Conversion and Transfer Policies

Other than best practices to review suspicious money transfers (e.g. money laundering), there are no restrictions on converting or transferring funds associated with an investment. Palau’s economy uses the U.S. dollar, so there are no issues in obtaining U.S. currency.

## 3. Expropriation and Compensation

The government of Palau has not demonstrated property-expropriation actions. The Palauan constitution provides for the right of the government to condemn land for national interest (“*eminent domain*”). There are no reported notable property-expropriation cases.

## 4. Dispute Settlement

There are no ongoing investment disputes involving the Government of Palau and foreign investors. There is currently no official “dispute resolution” procedure, apart from civil suits and other legal action. However, trained and licensed arbitrators exist, and the establishment of a privately-supported dispute arbitration system is underway. Palau’s judicial system is viewed by Transparency International and other observers as professional and fair.

There is no Uniform Commercial Code (UCC). The lack of a UCC complicates the business environment, as it difficult to obtain trustworthy information on existing titles and liens, and the scope of lender and investor rights and protections in the event of disputes can be unclear. A draft UCC is pending in the Palau legislature, but has been bottled up in committee for three years. The Asian Development Bank (ADB) has recommended adoption of UCC elements to improve Palau’s incomplete commercial legal system. Palau also has no bankruptcy law.

Palau is not a member of the Party to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID).

## **5. Performance Requirements/Incentives**

The Government of Palau does not apply performance requirements or incentives to domestic or foreign investors. Businesses in Palau must pay a straight 3% duty on all imported items, with no exemptions; duties are higher for alcohol and tobacco. There are no taxes on exports. Apart from two small Free Trade Zones located outside Koror, there are no “tax holidays” or other incentives offered to investors; however, taxes are low.

Per the reciprocity arrangements of the Compact of Free Association, U.S. citizens are exempt from the Government of Palau’s normal resident visa requirements. A visa is not required for U.S. citizens visiting Palau for one year or less, provided the visitor otherwise complies with applicable regulations, for example, on employment.

Palau does not offer citizenship by marriage to a Palauan, parental relationship to a Palauan, or through an established length of time as a legal resident in Palau. This prohibition on Palauan naturalization applies to all foreigners, including U.S. citizens. A foreign investor living in Palau needs to adhere to the procedures and regulations of the Foreign Investment Board.

Palau is not a member of the World Trade Organization (WTO).

## **6. Right to Private Ownership and Establishment**

Other than the foreign-ownership restrictions for certain business sectors, there are no restrictions on private entities to engage in all forms of remunerative activity. However, establishing secure land title may be complicated due to the complexity of the traditional land ownership system and occasional over-lapping claims.

## 7. Protection of Property Rights

**Intellectual Property:** Palau is not a member of the World Intellectual Property Organization (WIPO), the WTO, or any other organization or convention protecting intellectual property rights. Pirated DVDs imported from off-island are readily available. According to Palau's Attorney General, Palau will extend copyright protection to any resident of Palau and any offshore individual or company that registers its products in Palau, and pays the related \$200 fee (see below). Palauan copyright law explicitly covers materials in which:

- (1) one or more of the authors is or was on the date of first publication a national or resident of the United Nations Trust Territory of the Pacific Islands, Palau District, or the Republic of Palau;
- (2) the work is or was initially published in the Republic of Palau;
- (3) the work is or was initially published in another country and also published in the Republic of Palau within 30 days thereafter, irrespective of the nationality or residence of the author;
- (4) the work is an audiovisual work, the author of which is a resident of Palau; or
- (5) the work is an architectural work erected in the Republic of Palau or is an artistic work incorporated into a building or other structure located in Palau.

Any copyright owner who is the bona fide owner of a copyright or the owner of a transferred copyright shall be subject to the same protections provided above, provided he or she registers the work or works with the Office of the Attorney General and pays the requisite fee. The Attorney General shall charge a fee of \$200.00 per work registered, or \$2,000.00 for ten or more works registered to the same owner. For persons or businesses registering 10 or more works, additional works may be added at no charge during the same calendar year.

**Land:** Foreigners cannot own land in Palau, but they can own buildings that they have legally erected on leased land (e.g., prefabricated structures). Foreigners are able to lease government-owned land for lease terms of up to 99 years. In addition, foreigners are able to lease private land for up to 50 years, with an option to renew for up to an additional 49 years. Condominiums may be leased for 99 years.

The Land Court of Palau issues Certificates of Title. Portions of Palau are still un-surveyed and lack Certificates of Title. Ownership of much land remains unclear, and overlapping and contesting Warrantee Deeds and Deeds of Transfer are common in Palau. Land owned by Palau's clans is communal property and negotiating the terms for land requires the cooperation and agreement of many individuals.

## 8. Transparency of the Regulatory System

Regulatory and accounting systems are generally transparent and consistent with international norms. Proposed new regulations must go through a period of public comment before being adopted. Businesspeople in Palau do not report specific regulatory discrimination against foreign investors.

**Regulations:** A foreign investor will commonly have to submit for approval to the Foreign Investment Board (FIB), the Environmental Quality and Protection Board (EQPB), and the Historical Review.

**Taxes and Fees:** Palau places a 4% Gross Revenue Tax (GRT) on businesses, and allows deductions only for hiring Palauan employees and for donations to non-profit organizations. Businesses are unable to write-off business expenses or depreciation.

There is an occupancy tax on hotel rooms. Hotels with 20 or more rooms pay 12 percent or \$12 per room, whichever is larger. For hotels with less than 20 rooms, the minimum tax is \$7 per room.

Except for food, Palau charges a flat 3 percent ad valorem duty on most imports; import duties for alcohol and tobacco are higher. Immediate personal property imports (such as furniture for use in the investor's private home) are exempt from import duty. Palau also charges a fuel import tax of five cents per gallon on all imported diesel and gasoline.

## **9. Efficient Capital Markets and Portfolio Investment**

Palau has a strong banking sector with three FDIC-insured U.S. banks as the foundation: the Bank of Hawaii, the Bank of the Pacific, and the Bank of Guam. The IMF has also praised Palau's healthy and efficient banking sector. Total assets of these banks exceed \$125 million. There is no stock exchange in Palau.

## **10. Competition from State-Owned Enterprises**

The state-owned enterprises in Palau include the utilities sector, telecommunications, and the national bank. As noted above, due to growing pressure on local infrastructure and encouragement from the Asian Development Bank (ADB) and others, some of these companies may be wholly or partially privatized in the future. There is a state-managed giant clam farming company, but this is not a barrier to private clam-farming initiatives.

## **11. Corporate Social Responsibility**

Many businesses provide corporate donations to environmental and social Non-Governmental Organizations (NGOs), and /or engage in environmental corporate social responsibility programs to preserve Palau's environment and wildlife. Most CSR activities are conducted via donation, partly attributable to the available tax deduction of up to 10 percent of a company's Gross Revenue for donations to non-profit organizations. Apart from this tax incentive, there are few laws or regulations pertaining to CSR.

## **12. Political Violence**

Palau experienced some political violence in the 1980's and early 1990's, but has become increasingly stable and peaceful since then. The World Bank placed Palau in the 98<sup>th</sup> percentile in its 2011 rating of country political stability.

## **13. Corruption**

Palau acceded to the United Nations Convention Against Corruption (UNCAC) in March, 2009. It has been a member of the Asian Pacific Group on Money Laundering (APGML) since 2002. Palau's legal system is based on common law (as understood and applied in the United States) and customary laws. Its criminal bribery offences have not been externally reviewed. The Code of Ethics Act spells out what is illegal for government officials, and the Public Auditor and the Special Prosecutor hold them accountable for failure to observe the law.

Palau is currently the only one of the Micronesian nations to employ a Special Prosecutor; however this position has been vacant since 2010. Prior to this vacancy, successive Special Prosecutors successfully prosecuted a large number of elected Federal and State officials, recovering substantial sums of money. Most corruption (proved and alleged) involves improper use of government funds or property, and/or fraudulent collaborations of various kinds. Even without a sitting special prosecutor, there have been several high profile prosecutions/resignations by public officials related to violations of Palau's government ethics law. None involved alleged abuse targeting foreign investors. Government extortion or semi-extortion of private companies is virtually unknown.

Local media often reports on alleged corruption cases, and serves as an informal watchdog. Palau does not appear in Transparency International's Index of Corruption (which includes ratings of 184 countries). However, in a 2004 country report, Transparency International praised the fairness and professionalism of Palau's judiciary. There are no formal anti-corruption NGOs or international watchdogs based in Palau.

Palau is not a member of the OECD Convention on Combating Bribery.

## **14. Bilateral Investment Agreements**

Palau has no bilateral investment protection agreements, and is not a member of any free trade associations. Palau is currently negotiating with both the Philippines on a bilateral cooperation agreement and the European Union on a free trade and economic agreement.

## **15. OPIC and Other Investment Programs**

The Overseas Private Investment Corporation (OPIC) has had an investment incentive agreement with Palau since March 15, 2002. Palau is a member of the Multilateral Investment Guarantee Agency of the World Bank Group.

## 16. Labor

With an estimated total of 14,000 Palauan nationals in country (including non-working individuals, such as children and elderly) and 4,000 estimated foreign workers, foreign labor comprises a large proportion of Palau's labor force. In July 2011, the U.S. Interior Department provided a grant to Palau for development of a comprehensive Labor Code.

In October 2013, Palau established the minimum wage for workers at USD \$2.75/hour with \$0.25 increases slated for future years until it reaches \$3.50/hour in 2016, though certain categories of workers are exempted from the minimum wage. Business owners must pay a tax of \$500 per foreign employee per year.

Palau is not a member of the International Labor Organization (ILO).

## 17. Foreign Trade Zones/Free Ports

The Free Trade Zone Act of 2003 established the Ngardmau Free Trade Zone Authority. Another "Tax Free Zone" has recently been established in the state of Melekeok, covering a one mile radius around the Federal capitol building. These zones, still largely undeveloped, offer potential investors tax and other incentives, but ownership and labor rules are the same as elsewhere in Palau.

## 18. Foreign Direct Investment Statistics

Foreign Direct Investment statistics are not readily available. Neither the Palau Bureau of Budget and Planning, nor the Foreign Investment Board track FDI after the initial FIAC is approved. There are currently 172 companies listed by the Foreign Investment Board as having FIACs.

	2012 Statistical Yearbook, Palau Ministry of Finance		CIA Factbook		USG or international Source of data
<b>Economic Data</b>	Year	Amount	Year	Amount	
Palau Gross Domestic Product (GDP) ( <i>Millions U.S. Dollars</i> )	2012	228.4	2011	221	CIA Factbook estimate

Foreign Direct Investment	Host Country Statistical source*		U.S. Department of Commerce, Bureau of Economic Analysis		
U.S. FDI in partner country ( <i>Millions U.S. Dollars, stock positions</i> )		N/A		2	<ul style="list-style-type: none"> <li>U.S. Direct Investment Position Abroad on a Historical-Cost Basis</li> </ul>
Host country's FDI in the United States ( <i>Millions U.S. Dollars, stock positions</i> )					Palau's data is not disaggregated from Other Asia Pacific
Total inbound stock of FDI as % host GDP ( <i>calculate</i> )					

**TABLE 3: Sources and Destination of FDI**

Palau does not appear on IMF web site.

**TABLE 4: Sources of Portfolio Investment**

Palau does not appear on IMF web site.

**19. Contact Point at Post for Public Inquiries**

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