PALAU TRADE AND INVESTMENT POLICY FRAMEWORK

Public-Private Partnership for a Self-Sufficient Palau

2017 - 2020

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Forward Message

Trade and investment have been the mainstay of our economy since time immemorial. Through trade, our people have been able to access goods and services that they cannot produce themselves, national value chains have been established between Islands and States, and new opportunities are open to us. Through our exports, we have fed people of the world with our unique and sensational food, and exposed millions of our visitors to our intact culture and traditions. However, our efforts to integrate ourselves into the global trading economy have been met with significant challenges. As a small Island Economy, our isolation from key markets, a small domestic market, and the threat of natural disasters and climate change continue to present challenges to our development. For example, the 2016 drought affected immensely our communities and the tourism industry in particular. It is my belief that this first ever trade and investment policy framework provides ways forward as to how these challenges can be overcome.

The title of this Trade and Investment Policy Framework "Public-Private partnership for a self-sufficient Palau" reflects not only the importance we attach to trade and investment for the development of Palau we want, but also the importance of working together. The title underpins our commitment to build synergies for the development of the private sectors, including Micro and Small Enterprises. Our understanding is that, whereas it's the women and men in the private sectors that labor hard to trade and invest on a daily basis, it is the mandate of our government to establish inclusive trade and investment policies (including ones called for in this framework). This framework has clearly outlined the direction we should all take for trade and investment to contribute to national development. As a living document, and one that will contribute to the implementation of other national policies, this trade and investment policy framework shall be fully mainstreamed (in the context of three key pillars: policy, institutional and development of trade mainstreaming) into our overall National Development Plans and Strategies, and all stakeholders shall be engaged in the implementation of this policy.

Now that 2017 has brought to us this trade and investment policy framework, delivery on our commitments lacks nothing!

His Excellence, Tommy E. Remengesau, Jr.
President of the Republic of Palau.

EXECUTIVE SUMMARY

Trade, Investment and National Development

The potential of trade and investment to foster national development is well acknowledged and reflected in global practices. History indicates that no developed economy has ever achieved national development without substantial trade and investment. Starting with England, during the Industrial revolution, to the recently emerging Asian economies (including China, South Korea and Singapore), all major economies have undertaken substantial trade and investment. Palau would like to adopt this development path. However, this must be done in a way that is appropriate to Palau's unique national operating systems and values. This approach means undertaking a paradigm shift towards trade and investment policies that will ensure inclusive and sustainable economic growth. It is in this regard that this Trade and Investment Policy Framework (TIPF) has been prepared.

Situational Analysis

The margin between Palau's imports and exports is huge, in favor of imports. Between 2010 and 2014, Palau experienced a total trade deficit of US$ 261,742,876. On the other hand, the inflow of foreign direct investments (FDI) is yet to improve. These challenges have contributed to consistent (though declining) current account deficits. Palau's current account deficit (as percentage of GDP) declined from 25 percent in 2005, to less than 5 percent in 2015 (IMF, 2016). The current account deficit is projected to remain below 10 percent of GDP until 2021 (IMF, 2016). The trend for FDI plus capital grants has been gradually declining since 2005 as well, but it has remained high enough to cover current accounts deficits. For a sense of scale, FDI and capital grants (as percentage of GDP) declined from over 30 percent in 2005, to closer to 10 percent in 2015 (IMF, 2016). It should be noted that capital grants outweigh FDI significantly. Nonetheless, the IMF notes that FDI plus capital grants are projected to stay above 10 percent of GDP till 2021, hence covering fully current account deficits. However, in light of the desired sustainable development momentum and the government's ambition to become a self-sufficient economy, current account deficits have to be narrowed even further. FDI as percentage of GDP should increase significantly, and the business operating environment needs fundamental reforms. In particular, further financial adjustments are needed to increase domestic financing. Some of the immediate adjustments suggested in the framework include: migration from GRT tax to VAT; strengthening tax compliance and easing tax payment processes and procedures; and improving the business operating environment so as to support private sector investments and development.

Scope of the Policy and Institutional Arrangement

This Framework is centered on seven key sectors. That is: Tourism, Agriculture, Manufacturing, International Trade, Investment Promotion, Private Sector Development, and selected key trade related issues-compounded in one chapter. Each chapter provides a synopsis of key challenges that pose threats to Palau's trade agenda, investment climate and private sector development. In this regard, policy recommendations are provided to address the identified challenges. In addition, case studies and best practices from other economies of the world are provided in some sections of this framework. These best practices provide good lessons and practices that Palau may learn from during the implementation of this policy framework. The scope of trade and investment is understood to be complex, which makes governance and coordination of trade and investment policies challenging. Hence, a comprehensive and inclusive institutional arrangement (the National Trade and Investment Development Council) is established to govern and coordinate the implementation of this policy framework. The National Trade and Investment Development Council encompasses all stakeholders handling trade, investment and other trade related issues. It also recognizes the role of State Governors, and intends to engage them in the development and implementation of trade and investment policies. This approach reflects the national government's ambition to mainstream trade and investment across National and State development plans. In addition, this framework recognizes the important role of the private sector (including Micro and Small enterprises) to contribute to Palau's socio-economic development. In this regard, this framework has precisely and concisely laid principles that will guide the formulation, implementation, and governance of trade and investment policies.

1. INTRODUCTION

Palau is an independent State located in the Micronesian region in the north Pacific. Palau is in a free association relationship with the United States of America (US). Since 1994 it has enjoyed strong diplomatic and trade relations with the US. Moreover, Palau is a member of the Pacific Islands Forum at the regional level and Micronesia Trade and Economic Community (MTEC) at the sub-regional level. Its membership of those two institutions offers opportunities around trade integration, including potential reduction in customs duties on Palau's exports to regional partners' markets and a platform to negotiate trade deals. At the time of writing, Palau was yet to accede to any trade agreement (such as the Pacific Island Countries Trade Agreement [PICTA]) involving other Forum Island Countries (FICs). Palau's reservation in joining any reciprocal trade agreement(s) can be attributed to its small export base. Except for significant fisheries exports, Palau's exports in other products are yet to increase and penetrate international markets. This limits Palau's efforts to join trade agreements and exploit trade integration benefits. Nonetheless, despite low exports, Palau's economy has been relatively buoyant reaching a record eight (8) percent annual GDP growth in 2014 (World Bank, undated). The GDP growth, which exceeded the previously estimated 6.9 percent (ADB, 2015), reflects the stability of the Palau economy. Compared to other FICs, Palau's economic development has been outstanding. Palau has the highest GDP per capita among the 14 FICs. In 2014, Palau's GDP per capita reached US$11,879 (World Bank, undated); the highest recorded in Palau's history. Ensuring equity in income distribution remains the main task facing the Palau Government.

1.2. Tourism Growth: Both a Challenge and an Opportunity

The tourism sector has been at the center of Palau's economic development for decades. 2015 alone saw a sudden increase in tourist arrivals by 34 percent (IMF, 2016). China dominated 2015 tourist arrivals by 54 percent, Japan followed with 9 percent, and Taiwan accounted for only 9 percent (IMF, 2016). The surge in tourist arrivals triggered spectacular growth in the entire tourism sector and the associated sectors (communication, wholesale and retail trade), which cemented the 8 percent (ADB, 2015) economic growth recorded in 2014. In general, Palau has recorded significant tourism growth for over a decade. Between 2001 and 2015, Palau experienced high growth in the tourism and tourism related activities (IMF, 2016), compared to other Pacific Island Countries. On a positive note, growth in the tourism sector in the last decade has strengthened Palau's economic growth, and contributed to the outstanding 2015 financial year GDP per capita of US$ 16,070 (IMF, 2016). This is different from other Pacific Smaller Island Economies (such as Tuvalu) where GDP growth relies on revenues from fishing licensing fees generated from the popular VDS scheme. However, Palau's economic growth is based on unbalanced terms of trade as exports continue to shrink compared to imports. In addition, over reliance on the tourism sector exposes the economy to external market volatilities, and unsustainable use of environmental resources. The surge in tourist arrivals (especially between 2014 and 2015) has gone beyond Palau's infrastructure capacity. The immediate result has been a sudden hike in accommodation costs (including for lower grade hotels), increase in low budget tourists especially from China, and threats to the sustainability of ecosystems and environmental resources. The pressure of high tourist arrivals has been felt predominately in Koror and onto tourist attraction amenities therein, especially the iconic jelly Fish Lake. Any further increase in tourist arrivals is likely to hinder the attainment of sustainable development objectives, affect the quality of services delivery, and tarnish the image of

Palau as a pristine (and a potential luxurious) tourist destination. Hence, addressing mass tourism and the associated challenges is a matter of urgency now than any other time in Palau's history.

1.3. Trade Performance and Challenges

Palau is relatively open to trade with the rest of the world. For instance, over 80% of imports attract between 0 and 3% tariffs. A few products attract slightly higher or other specific tariff rates. Traditionally, Palau is a net importer of most products, especially food and fuel products. This is the main factor behind the persistent Palau trade balance deficits. Most often, trade deficits are off-set by development aid and grants, just like many other Smaller Island States. In 2015, thanks to the appreciation of the US Dollar (the currency used in Palau) and fall in the commodity prices, Palau's import bill dropped by 14.4 percent and inflation rate declined to 2.2 percent as well (ADB, 2015). Palau's trade performance (and the economy at large) depends on a thriving tourism sector, which currently contributes between 60 and 70 percent to the GDP (ADB, 2015).

1.3.1. Challenges

Overdependence on the tourism sector exposes Palau to external shocks and market volatilities emanating from economic hardships in tourist source markets. This situation happened in 2008/2009 during the global financial recession. The recession affected incomes in tourist source markets (especially the US and Europe) which in turn affected tourists from these markets to Palau. As a result, Palau's economic growth rate declined to negative five (5) percent in 2008, and negative nine (9) percent in 2009 (World Bank, undated). Since 2010, the economy has returned to a stable economic development path mainly supported by a thriving tourism industry and huge increase in tourists from PRC. But mass tourism is threatening the sustainability of natural resources and eco-systems. For instance, in the last decade the number of tourist arrivals per year has been increasing exponentially, making Palau the leading tourist destination among the Pacific Island Countries in terms of tourist arrivals per capita. This facilitates trade and private sector development, but adverse effects onto ecosystems cannot be ignored. More so, like many other Smaller Island Countries, Palau's trade potential is constrained by a number of natural constraints. Some of the key challenges include remoteness from key markets and the associated high transport costs, a small domestic market, and exposure to natural disasters (such as Typhoon Haiyan in 2013, and the 2016 severe drought). Compared to other Pacific Island Countries, Palau has recorded the lowest average number of disasters in the period between 1970 and 2014 (IMF, 2016). However a single disaster of any moderate magnitude harbors significant negative shocks on trade and investments especially in the tourism sector. For instance, the drought that occurred between March and May 2016 is said to have caused a decline in tourist arrivals by 21 percent in the second half of 2016 (Pacific Island report, 2016). The drought that lasted for a few months left the Ngerimel Dam, which provides 80 percent of consumption water, shut down (IMF, 2016). The shortage of water resulted in water rationing for three times a day, and affected service delivery to tourists. These challenges constrain Palau's potential to attract appropriate Foreign Direct Investment and maximize gains from the booming tourism sector. On a strategic note, the recent drought revealed the importance of building disaster and climate change resilient infrastructure to support the booming tourism sector and other related sectors.

1.4. Outward-Looking Reforms

Palau's economic growth has been phenomenal in the last few years. But outward looking reforms are needed to maintain the current growth rate pace. The economy is still undiversified, business policies (such as Gross Revenue Tax [GRT]) do not match modern economy requirements, and integration of

ICT into businesses is very low. For instance, business registration can only be done manually, and game changing policy initiatives like E-procurement systems are yet to be welcomed. Broadly, the entire doing business environment and investment climate needs more attention, so as to support the development of the private sectors. The establishment of outward looking trade policies and active participation in regional integration could potentially expand Palau's small domestic market. Active participation in regional and sub-regional trade agreements is a conduit to Palau's fuller participation in the increasingly liberalized global economy. Trade integration and deregulation will come with competition, and savvy innovation from outsiders will spur investments in under developed sectors and enhance service delivery.

1.5. Trade Policies

Palau's trade policies are relatively favorable to international and domestic trade. Despite Palau being a non-WTO member, it has a relatively flexible tariff structure. Over 80% of all product lines attract duties between 0 and 3 per cent. In addition, Palau enjoys preferential access to the huge U.S market under the Compact Agreement. Benefitting from regional trade policies is central to the government's strategic trade policy agenda. As such, Palau is actively involved in the PACER-Plus trade negotiations and continues to foster sub-regional economic integration in the Micronesian region. The Micronesia trade policy integration agenda is in its infancy stages. But the grouping could establish the trade cooperation in the Pacific in the near future. The forthcoming PACER-Plus agreement (once it comes into force) will establish a Free Trade Area involving many Forum Island Countries, including the two developed economies in the Oceania - Australia and New Zealand. Among other benefits, once the PACER-plus enters into force and with proper transport links, Palau products will benefit from preferential access to a market of over 27 million people. This will break the current small domestic market constraint. Until March 2015, when EPA trade negotiations were suspended, Palau was actively engaged in the Pacific ACP-EU EPA negotiations. Palau's involvement in the EPA negotiations was under the PACP umbrella, and part of its long term vision to diversify its trading partners. Regarding regional trade among the Pacific Island Countries, Palau is still considering signing and acceding to the PICTA and its trade in services (TIS) protocol. The PICTA involves only 14 Pacific Island Countries.

1.6. Opportunities

Despite the natural constraints that Palau faces, its geographical location is a crucial asset in terms of trade development and attracting FDI. For instance, in addition to direct access to the US market, Palau's geographical proximity to the emerging and developing Asian economies offers a natural opportunity to be exploited. Thus, efforts to enhance value chains and connectivity to Asian economies (Philippines and Taiwan) are necessary and should be exploited. Likewise, Palau's strategic location and free access to the US market offers investment opportunities for multinational corporations that would wish to easily access the massive US market. In addition, the current technological advancements offer many benefits for innovative businesses to exploit through e-commerce. The ongoing efforts to connect Palau to the submarine fiber optic cable is likely to cut the costs related to internet access, which should facilitate easy access to market information. The internet has the potential to connect Palau producers to distant markets and consumers and facilitate e-commerce. Hence, the adoption of modern technology has the potential to create trade opportunities, encourage innovation, diversify exports, increase value addition and support the development of the private sector. The private sector should be savvy and exploit the existing opportunities. At the same time, e-commerce policies should be put in place.

2. Formulation of this Trade and Investment Policy Framework (TIPF)

The Ministry of Public Infrastructure, Industries and Commerce administers trade matters and contributes to investment and private sector development. The Ministry has played a lead role in the formulation of this TIPF. In order to formulate a comprehensive and inclusive policy framework, all relevant agencies were thoroughly consulted. Hence, the Ministry is confident that this TIPF reflects the views of public agencies, private businesses and non-state actors. As a result, this Framework is established to guide and ensure coherency in the implementation of trade and investment policies. Moreover, this TIPF intends to address trade policy-related issues and guide the process towards a coherent approach to the formulation and implementation of trade and investment policies. Also, the Framework will aid the mainstreaming of trade into national development plans, enhance the investment climate and streamline investment processes and procedures, and broadly improve the doing business environment. Furthermore, the TIPF builds upon and feeds into other national development strategies, such as the Medium-Term Development Strategy (MTDS) and the 2020 National Development Master Plan. Broadly, the Framework consolidates Palau's trade policies already contained in existing national development strategies and plans into a coherent policy document. Trade and investment, private sector development and other trade-related issues stipulated in this Framework will be mainstreamed into national development plans and strategies to ensure proper governance of the trade policy agenda.

2.1 Rationale for a Coherent TIPF

In the absence of a coherent TIPF, it is challenging to administer a diverse suite of legal and regulatory protocols that have direct or indirect bearing on trade, investment and private sector development. These diverse policies (as they currently exist in myriad of policy documents) may create conflicts during allocation of resources. In addition, absence of a proper and inclusive coordination, their implementation processes may result in duplication of effort and wastage of resources. This TIPF intends to consolidate existing policies in a coherent framework. Hence, it will ease the governance and development of trade and investments. It will also encourage strategic partnerships among NGOs, development partners and public institutions.

2.2. Objectives

Broadly, the objectives of this Framework are to:

1. Contribute to sustainable development (social, economic and environmental);
2. Facilitate private sector development, including micro-, small and medium enterprises (MSMEs);
3. Enhance the investment climate and doing business environment; and
4. Foster Palau's participation in regional integration so as to benefit from liberalized global market economy.

2.3. Vision

The Vision of this Framework is to "Reposition Palau as a trade competitive economy; create a conducive investment climate; and support the development of the private sector."

2.4. Mission

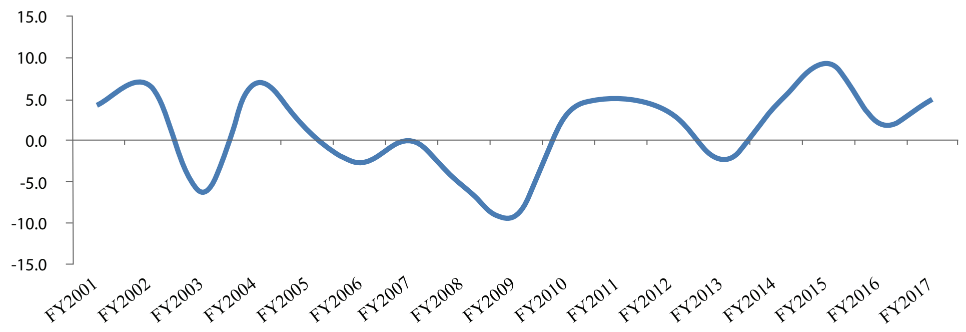
The Mission of this Framework is to "mainstream trade and investment into national development plans and build a resilient and diversified economy."
To achieve the TIPF's broader mission, the following specific objectives will be prioritized:

i. diversify the economy to avoid risks associated with over-reliance on the tourism sector;
ii. enhance productive capacities and value addition;
iii. attract appropriate FDI as well as support domestic investors;
iv. ensure sustainable development (economic, social, and environmental);
v. enhance the business operating environment; and
vi. Effectively coordinate and engage all Aid for Trade (AfT) partners, NGOs, private sector and public agencies handling trade and trade-related issues.

3. THE MACRO-ECONOMIC OPERATING ENVIRONMENT

Palau's economy grew at an average rate of 2.7 percent between Financial Year 2010-14. However, in the decade before that, it had contracted by 0.5 percent (Figure 1)[11]. One of the major compounding factors for the economic contraction was the 2008 Global Financial Crises (GFC) which suppressed global demand. Traditionally, growth was buoyed by the construction sector and the tourism industry. However, with the completion of most large-scale projects, including the multi-million dollar Compact Road Project, growth momentum also slowed down. The dampening global prospects led to lower visitor arrivals, which reduced the contribution of the accommodation and food services as well as the wholesale and retail trade sectors. Lower FDI inflow led to loss of financing for many externally-owned firms.

Figure 1: Palau GDP Growth (2001-2017)



Source: International Monetary Fund

During Financial Year 2010, the negative effects of the GFC waned with many industries (wholesale and retail trade; accommodation and food service; construction and transportation and storage) showing good progress, supported by healthy growth in visitor arrivals and robust infrastructure spending. Economic growth during the following two years (2011 & 2012) was strong, registering a 5.0 percent and 3.2 percent growth, respectively. This growth was underpinned by strong performance in the accommodation and food services sectors.

In financial year 2013, a 2.4 percent decline was registered owing to the decline in construction and tourism related activities (delayed capital grants and lower capital spending during the change in administration in early Financial Year 2013; cessation of some commercial flights from Asia; and the appreciation of the US dollar which impacted Palau's exports). In the Financial Year 2014/15, the economy recovered and is expected to maintain a steady growth trajectory in financial year 2016/2017.

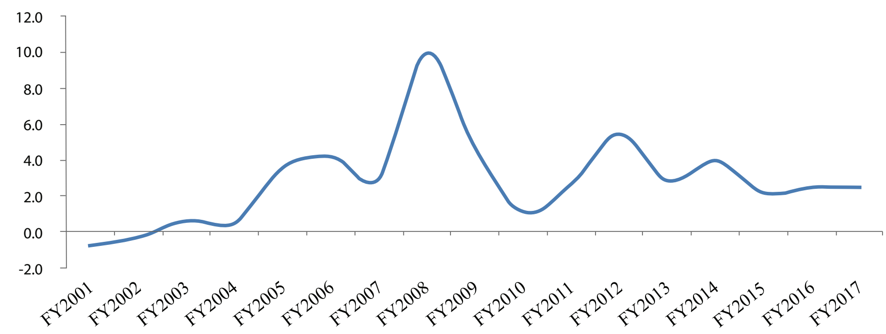
1 Looking at sectoral contributions, the primary sector including agriculture, fishing and mining industries is relatively small in Palau. The sector contracted by 1.9 percent on average between Financial Year 2010-14; and contributed negligibly towards growth. The secondary sector also posted a similar decline, in large due to the cyclical performance of the construction industry. The major driving impetus comes from the tertiary sector; which accounts for visitor arrivals

The rebound and positive outlook are based on recovery in the construction industry with some infrastructure projects coming on line, strong visitor arrivals and increased absorption capacity.

3.1. Inflation

Inflation averaged around 3.2 percent during financial year 2010- 14 (Figure 2), and decreased in financial year 2015 due to lower international food and fuel prices. Inflation is expected at 2.5 percent in financial year 2016 and financial 2017.

Figure 2: Palau Inflation (2001-2017)

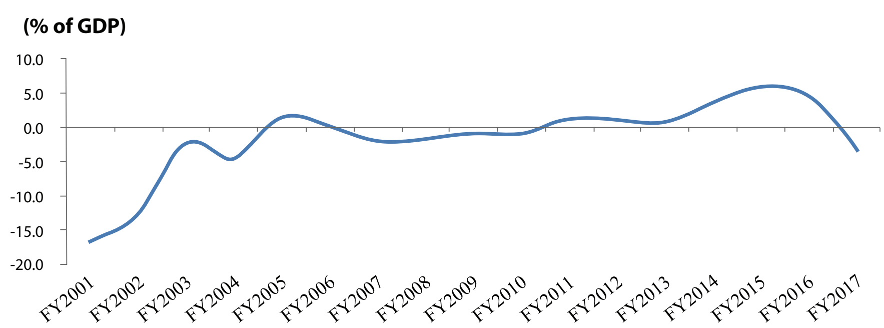


Source: International Monetary Fund

3.2. Fiscal Sector

Palau's fiscal performance in the recent past has been strong with prudent fiscal rules in place. During financial year 2010-14, the overall fiscal balance averaged at 1.1 percent of GDP. In financial year 2015, it was estimated at 6.0 percent of GDP due to continued fiscal consolidation while in financial year 2016 it is expected to reduce to 4.5 percent of GDP and deteriorate to a deficit of 3.3 percent of GDP in financial year 2017 (Figure 3).

Figure 3: Palau Fiscal Balance (2001-2017)



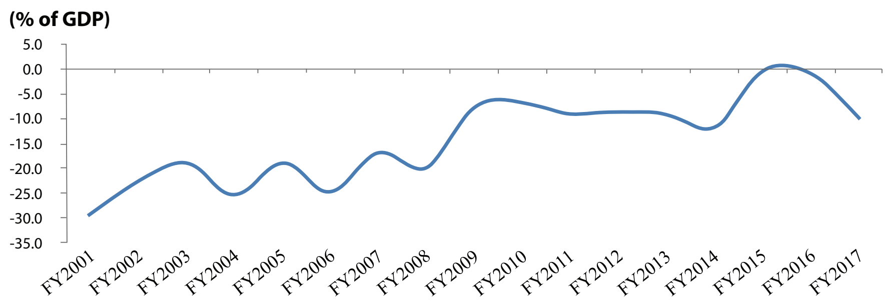
Source: International Monetary Fund

Palau is dependent on external grants, especially Compact grants, to finance fiscal spending. These grants are scheduled to end in financial year 2024. After which, all financing will be sourced from domestic revenue streams and withdrawals from the Compact Trust Fund (CTF). The CTF withdrawals are

3.4. External Sector

The current account deficit averaged around 9 percent of GDP during Financial Year 2010-14 and improved to 0.5 percent of GDP in Financial Year 2015 due to the recovery in the tourism industry and lower international food and fuel prices. In Financial Year 2016 and Financial Year 2017, the external sector balance is expected to deteriorate further due to higher infrastructure-related imports (Figure4).

Figure 4: Palau Current Account Balance (2001-2017)



Source: International Monetary Fund

3.5. Macroeconomic Challenges

Palau relies heavily on tourism receipts, external grants and food and fuel imports. This poses downside risks to its growth prospects and development. The financial market volatility and recessionary conditions in Asia, the US dollar and natural disasters (and disasters relating to climate change) can potentially undermine economic progress already made and weaken the external and fiscal positions. Reliance on food and fuel imports also makes Palau more susceptible to commodity price volatility.

In the absence of monetary and exchange rate policies, Palau will need to effectively use fiscal tools and structural reforms to address downside risks. Successful fiscal consolidation is needed to build adequate fiscal buffers and ensure long-term fiscal sustainability and external stability. In this respect, Palau needs to aggressively pursue reforms, particularly those relating to ICT and also in the area of tax. Improving investment and business climate would help diversify the economy, reduce economic vulnerability and support long-run growth. To address the bottlenecks in the tourism industry, the Government imposed a reduction in charter flights of 50 percent to limit market disruptions and address environmental concerns. However, slow progress thus far has not achieved the desired results. Additional rooms are being constructed to increase accommodation capacity. Palau has also pursued a policy to attract Free Independent Travelers (FITs). This notwithstanding, the expansion of hotels in recent times has catered for the package tour segment resulting in a misalignment of demand with supply. It would be useful for policy makers to adopt policies that will encourage investments in certain sectors of the tourist market through the extension of incentives to designated sectors.

4. TRADE POLICY BY KEY SELECTED SECTORS

4.1. Tourism

Palau is a services-driven economy. For many years, the tourism sector has remained the mainstay of the Palau economy. In 2014, the tourism industry contributed between 60 and 70 percent to the GDP (ADB, 2015). The tourist diving industry alone fetches over US$80 million annually (Food and Environment Reporting Network, undated). In terms of employment, the sector employs over 40 percent of the total labor force with spill-over benefits in other sectors of the economy (transport, wholesale trade, construction, etc.). As the tourism industry continues to expand, there have been labor shortages. To address labor shortages, foreign workers are sourced from neighboring Asian countries, mainly from the Philippines. However, of recent, some countries are known to be reviewing their policies towards limiting the mobility of certain labor categories, especially unskilled and semi-skilled workers. This unilateral policy is likely to affect availability of foreign workers that contribute to the performance of the tourism sector. Thus, Palau should consider establishing sustainable labor mobility programs with other FICs in particular.

4.1.1. Tourist Attraction Facilities

In terms of tourism resources, Palau has a tourism resource base of 1,706 square km of reefs, lagoons and mangroves, and at least 70 marine lakes (Palau Medium-Term Development Strategy). Palau's marine ecosystems have the highest diversity of reef fish species within Micronesia. This is in addition to the high culturally-significant terrestrial habitats which are yet to be fully explored and utilized. Palau's unique pristine natural beauty and diverse marine life continues to attract many tourists from various developed and emerging economies. Globally, Palau is usually ranked among the top three best diving destinations in the world. These resources continue to attract large numbers of tourists, mainly from the Asian economies (Japan, China and Taiwan). This has increased Palau's share of the tourism industry among the PICs. Compared to other PICs, Palau comes second to Fiji in terms of tourist arrivals per year. Overall, Palau takes the lead in terms of tourist arrivals per capita, among the 14 Forum Island Countries.

4.1.2. Palau in the Regional Tourism Industry

In 2015, the number of tourists to Palau increased to 166,136 tourists, a growth of 35.2 percent, doubling 2010 tourist arrivals (ADB, 2015). This increase pushed Palau to the second position on the list of tourist arrivals among the 14 PICs, after Fiji. Thus, surpassing the large and resource rich Papua New Guinea (PNG) in terms of tourist arrivals per year. This spectacular increase was attributed to the influx of many visitors from the People's Republic of China (PRC), which accounted for 54 percent of all tourism arrivals in 2015. Since then, the PRC replaced Japan as the main tourist source market for Palau. Before the emergence of PRC tourists, Palau's tourism industry relied on Japan and Taiwan. For instance, between August 2013 and August 2014, Japan dominated Palau's tourist arrivals basket with 4,367 arrivals. Other markets followed in the following order: Taiwan (3,433 arrivals), and North America (536 arrivals). Europe (including Russia) contributed the least, with only 298 tourists.

4.1.3. Ascendency of the People's Republic of China (PRC)

The increase in tourists from the PRC to Palau has been phenomenal in the last three years. Since 2013, the PRC has maintained its top score as Palau's top tourist source market, hence altering the pattern of traditional tourist source markets which Japan had dominated for many years. The number of tourist arrivals from the PRC increased from 942 arrivals (in August 2013) to 3,312 arrivals (in August 2014), according to the Palau Visitors Authority (PVA, 2014). This represents a significant increase in tourist arrivals equivalent to 2,370, or 251.9 percent in a 12-month period. By 2015, tourists from the PRC represented 54 percent of all tourists that visited Palau (ADB, 2015). However, PRC tourists are largely dominated by package tourists who are associated with less on-shore spending. In the approaching two to three years, tourist arrival projections suggest that Palau will receive around 214,000 visitors in 2016 and 360,000 visitors in 2018 (ADB, 2015) from all tourist destinations, including the PRC. Differences between regional and national data should be noted, however. For instance, the PVA projected total arrivals to reach 150,000 visitors in 2016, which is different from the ADB projection of 214,000 visitors. Nevertheless, Palau remains the second most highly-visited country among the 14 PICs.

4.1.4. Increase in Package Tourists

Most tourists to Palau are dominated by young and low spending package tourists especially from PRC. For instance, Chinese tourists' spending on accommodation rotates between US$ 80 and 100 per night, whereas their peers from Japan and Taiwan spend approximately between US$ 110 and 160 on accommodation per night (IMF, 2016). Low spending associated with Chinese tourists has resulted in a general perception that increase in tourist arrivals from PRC is crowding out high spending tourists from other tourist market sources, such as Japan and Taiwan. Tourists from PRC have surged the Palau tourism market in the last five years. However, the link between increase in tourist arrivals from PRC and a decline in tourist arrivals from EU, US and Japan is somewhat narrow or may not be present at all. It is worth noting that tourist arrivals from U.S, EU and Japan have been plummeting in other tourist destinations where China is not the leading tourist source market. Short period data indicate that tourist arrivals from U.S, Japan and EU to other Pacific Island Countries declined in 2016. For instance, in Fiji, tourist arrivals (for March 2016) from the US declined by 4.3 percent, South Korea declined by 20 percent, United Kingdom declined by 6.9 percent, Japan declined by 15 percent, and continental Europe declined by 2.3 percent (Fiji Bureau of Statistics, 2016). It should be noted that Fiji tourism market is dominated by tourists from New Zealand and Australia. China and the rest of Asia follow suit. The short term data above cautions any abrupt conclusion, and too much focus on attracting high-end tourists from the US, EU, Japan and other markets. Therefore, rigorous analysis of all factors behind the fall in the tourist arrivals from the usual traditional markets should be undertaken. On the other hand, the increase in tourists from the PRC has reduced risk and volatilities associated with continued decline in tourists from Palau's traditional tourist source markets. Moreover, given China's recent economic development and its huge middle class, its domestic market has varying income segments that can afford high-spending and luxurious tourism. Thus, more effort should be dedicated to attracting high spending tourists from PRC. Attracting high-end PRC tourists needs strategic marketing skills, savvy market segmentation and targeting techniques. Thus, the PVA and BoT should be facilitated to undertake proper market segmentation of the PRC market, enhance accommodation standards, and service delivery.

4.1.5. Transport Connectivity

Air transport is the most widely used mode of transport to Palau by all visitors. Despite some challenges in air connectivity, all tourists to Palau come by air. Flights to Palau (mainly from the Asia) are dominated by chartered flights. Palau records at least 30 chartered flights per month. Unlike Fiji, its strong competitor located in the South Pacific in terms of tourist arrivals, tourist cruise ships are yet to dock at any of Palau's ports for a number of days. Cruise ship tourism seems to offer a solution to the current accommodation crisis, without limiting the number of tourist arrivals. Despite disembarking to do shopping, tourists who come by cruise ships sleep on board, hence no need for accommodation onshore. Given accommodation constraints, cruise ship tourism should be explored. This would increase tourist arrivals without necessarily increasing demand for accommodation facilities.

4.1.6. Accommodation Constraints

Accommodation and the related services are part of a long value chain of any tourism industry. In this regard, any increase in tourist arrivals, similar to what has been recorded in recent years, should be accompanied by proportional increase in accommodation facilities and other related services. This has not been the case for Palau. At the time of writing, there were less than 1,800 hotel rooms. The shortage of accommodation facilities limits the potential of the entire tourism sector and other sectors (such as transport, retail and wholesale business) that depend on tourism. In recent years, the number of tourist arrivals has significantly outpaced accommodation capacity. As a result, hotels are at maximum capacity year round. As earlier stated, in 2015 tourist arrivals increased by 35.2 percent (ADB, 2015). The sudden increase in tourist arrivals has contributed to a hike in accommodation rates and strained the accommodation capacity even further.

4.1.7. Opportunities for Investors

With a staggering number of tourist visitors to Palau, finding accommodation in Koror has become more challenging in recent years. This affects tourists, business travelers and other people travelling to Palau for different reasons. Accommodation facilities are insufficient. At the time of writing, only 1,790 hotel rooms were reported to be operational (PVA, 2016). This is quite a small number of hotel rooms for a country that leads other Pacific Island Countries in terms of tourist arrivals per capita. However, investors have realized that the lack of accommodation facilities is more a business opportunity than a problem. Growth in the tourism industry is opening up more opportunities for investors to tap into. This is supported by recent staggering investments in the tourism industry - construction in particular. Due to the increase in tourist arrivals and growing demand for accommodation facilities, Green Field Investments are already committed (or in the pipeline) to construct additional 1,500 hotel rooms (according to national consultations). These investments intend to double the current hotels rooms by 2019. This will address the current hotel accommodation constraints and improve the delivery of services. However, construction of high-end accommodation hotels is still desirable. More so, processes and procedures to access construction permits and utilities should be streamlined to facilitate investment in the booming tourism sector.

4.1.8. Less on-shore Spending, and Harm to Eco-systems

The growth in tourist arrivals earlier noted has not been proportionately accompanied by significant on-shore spending. This is largely due to the bulge of package tours which has turned Palau into a mass tourist market. Less on-shore spending continues to limit economic returns to investors in the tourism sector, despite a surge in tourist arrivals. Currently, the daily on-shore expenditure per tourist is relatively low. Existing data puts on-shore nominal spending between US$1,000–US$1,200 per tourist per year (PVA, 2014). Unfortunately, over the past decade, the already low per person expenditure in real terms has fallen, and the significant increase in tourist arrivals continues to place pressure on natural resources and ecosystems. For instance, of all tourists that visit Palau annually, over 50 percent of tourists visit the Jelly Fish Lake or the iconic Rock Island. The trend in the number of visitors to Jellyfish Lake has not decreased, despite the increase in access fees from USD 50 to 100 per person. Congestion at Jelly Fish Lake and the related decline in the jelly fish population is said to have contributed to the decline in tourist arrivals in the second half of 2016 (Pacific Report, 2016). This reveals the impact of mass tourism on sustainability of ecosystems.

4.1.9. The Unprecedented Tourist Arrivals

Since 2006, Palau has dominated the list of 14 PICs in terms of tourist arrivals per capita (Table 1). In the last decade, no other Pacific Smaller Island State (SIS) has held this position. Moreover, among the PICs, Palau comes second to Fiji in terms of tourist arrivals per year; a position it took over from PNG. Given its small population (less than 20,000 people), Palau records the highest tourism intensity (number of annual total tourist arrivals divided by the entire population) compared to other PICs. Between 2006 and 2013, the ratio of tourist arrivals per capita rotates between 4 and 5 visitors per one Palauan (Table 1). The number of tourist arrivals declined in 2008 and 2009, largely due to the GFC. Despite this, Palau remained above all other PICs in terms of tourist arrivals per capita (Table 1). On the other hand, national data estimates put tourist per capita ratios even higher. During national consultations, some agencies believed that the ratio of tourists per capita is closer to 10 tourists to 1 local resident. The table below presents in detail, tourist arrivals per capita in the 12 PICs (only World Bank Group member countries).

Table 1: Tourism Intensity in the Pacific Island Countries (2006-2013)

	2006	2007	2008	2009	2010	2011	2012	2013
Fiji	0.66	0.65	0.69	0.64	0.73	0.78	0.76	0.75
Kiribati	0.05	0.05	0.04	0.04	0.05	0.05	0.05	0.05
Marhshall Islands	0.12	0.13	0.11	0.10	0.09	0.09	0.09	..
Micronesia, Fed Sts.	0.18	0.20	0.25	0.46	0.43	0.34	0.37	0.40
Palau	**4.10**	**4.37**	**3.91**	**3.54**	**4.20**	**5.29**	**5.73**	**5.02**
Papua New Guinea	0.01	0.02	0.02	0.02	0.02	0.02	0.02	0.02
Samoa	0.61	0.64	0.64	0.66	0.66	0.65	0.67	0.61
Solomon Islands	0.02	0.03	0.03	0.04	0.04	0.04	0.04	0.04
Tonga	0.38	0.45	0.49	0.44	0.45	0.44	0.46	0.43
Tuvalu	0.11	0.11	0.17	0.16	0.17	0.12	..	..
Vanuatu	0.32	0.37	0.40	0.44	0.41	0.39	0.44	0.43
Niue	1.96	2.23	2.84	2.47	2.82	3.05	3.12	4.41

Source: World Bank Data and Draft Niue TPF, 2016.

4.1.10. Measures to Reduce Mass Tourism

A few countries have managed to attract mass tourists without investing too much in marketing and promotions, like Palau. Ideally, high tourist arrivals play a significant role in the development of the tourism industry and the domestic economy at large. This happens mainly through the creation of employment opportunities and establishing value chains for other sectors (such as agriculture and transport) that are linked to the tourism industry. Sustainable exploitation of these opportunities can only happen when natural resources and ecosystems are used in a responsible manner. However, it is hard for Palau to realize this objective given that the current mass tourists has exceeded Palau's holding capacity. As such, a proper balance between sustainability of natural resources and tourism growth is now needed. In this regard, the Government has undertaken appropriate measures to curb the unexpected increase in tourist arrivals and the associated stress on environmental resources. In April 2015, the Government reduced the number of chartered flights from 48 to 32 per month (ADB, 2015). This resulted in a slight decline in tourist arrivals in the months of July - Sept 2015. However, the number of tourist arrivals is still staggering. Moreover, the airlines industry is likely to challenge the current policy by bringing aircraft with larger seating configuration. This will still maintain or increase tourist arrivals despite downsizing the number of chartered flights per month.

4.1.11. Policy Recommendations

i. Diversify the tourism services being provided, and strengthen national value chains between the tourism sector and other key sectors (agriculture sector, urbanization, transport, education, etc.);

ii. Enhance the suite of tourist products targeting FITs and experience-seeking tourists. This should include advancing eco-tourism, establishing cultural sites, beautification of urban environments and historical sites.

iii. Identify and promote other non-traditional tourism services such as marina development and mega-yacht services. It is recommended that a study be conducted to evaluate the potential and need for tourist cruise visits and visiting private vessels.

iv. Support existing sports tourism activities and explore the demand and potential of other non-traditional sports tourism activities (such as water sports). This may include establishing regattas/a sailing week, Ironman, power boating and jet skis. Identified priority segments are sport fishing, endurance category, bird watching and romance destination.

v. In consultation with the private sector, introduce other fiscal measures to scale down mass tourism. Development of a national aviation policy should be established as a matter of priority.

vi. Promote quality and up-scale accommodation facilities, in particular boutique hotels and villas. This can be encouraged and/or facilitated through attracting new international branded hotels with policy space for joint venture and co-management;

vii. Scale-up investment in public utilities and infrastructure to support the tourism industry and strengthen linkages to other key sector industries;

viii. Fast track and prioritize the implementation of the existing Tourism Action Plan and, where needed, review the Action Plan in time to match with the current development dynamics;

ix. Invest in data collection, analyses of markets and tourist preferences, and build strong tourist market intelligence to guide future policy direction with respect to further development of the tourism industry;

x. Promote entrepreneurship, particularly among local residents;

xi. Enhance product development through value addition and product differentiation. This may be achieved in three ways (identified in the MTDS 2009-2014): The existing Bai rating concept (an industry standards program) should be reintroduced and widely promoted and a program of annual tourism industry awards should be introduced.

xii. Revive the dormant Alii Host Program. Noting the weakness of the existing Alii Host Program, this initiative should be remodeled to adapt to Palau's needs and capacity. In addition, special attention shall be given to initiatives that foster skills transfer and encourage Palauan, especially the Youth, participation in the tourism industry. Strategic initiatives should include vocational training, showcasing and improving Palauan-style of hospitality. Best practices that Palau may learn from include the Hawaii and Indonesia model of vocational training and Canada's Super host Program. The Canadian Program has been replicated by other top tourist destinations such as: New Zealand (Kiwi Host), Australia (Aussie Host), Northern Ireland (Welcome host) and Singapore (Super Host Singapore).

xiii. Support the newly-established Bureau of Tourism through appropriate resources and its relevant policy instruments (including medium-term Corporate and Strategic Plan).

xiv. Assist States formulate their tourism development plans.

4.2. Agriculture

4.2.1. The Nature and Importance of the Agricultural Sector

For the last few decades, Palau's economy has evolved from being an agricultural-based economy towards a services driven (mainly tourism) economy. Nevertheless, Palau's agricultural sector retains considerable space for further development. The sector's potential to substitute some imported food items (where Palau has a comparative advantage) is considerable, thereby reducing food insecurity and creating spill-over benefits to other sectors - especially tourism. Given the growing tourism industry and local population, there is an abundant market (both tourists and residents) for food producers and processors to benefit from. Replacing some food imports has many benefits. Immediate benefits include: strengthening national value chains between sectors, hence spreading gains from agriculture to other sectors; and stabilizing Palau's Balance of Payments. However, in general, the development of the entire agricultural sector (except fisheries) needs more than the current level of attention given to it. At the time of writing, the sector received minimal financial support from the Government. Most of the operational financial support comes from development partners. In addition, Palauans' participation in both agribusiness and subsistence farming is very minimal. As a result, local food production is falling against increasing domestic demand from tourists and the growing local population. In effect, Palau has turned out to be a consistent importer of most food stuffs especially from the USA and other neighboring Asian economies, hence contributing to the existing balance of trade deficits.

4.2.2. Overview of Current Trade Policies

Palau's trade policies result in low or no customs duties on imported agricultural products, especially processed agricultural products. While this policy approach reduces food prices on the domestic market, it makes importation of cheap agricultural products more lucrative than farming the same products in Palau. In essence, it punishes farmers for taking the risk of farming rather than importing. Using tourist intensity figures earlier stated, it can be rightly argued that any customs duties lost on food imports goes to at least 10 tourists against one local. Therefore, the Government is subsidizing food costs for more tourists than locals. Moreover, trade policies intertwined with the current tax policies (such as the GRT) are reducing Government revenues, which would be used in the importation of capital goods and intermediate products necessary for the development of the manufacturing sector. In order to transform Palau into a self-sufficient economy (in terms of food) and increase economic returns from the thriving tourism industry, the existing trade and domestic tax policies ought to be reviewed.

4.2.3. The Staggering Food Bill and Declining Performance of the Agricultural Sector

Between 2011 and 2014, Palau's food import bill as a percentage of merchandise imports ranged between 20 and 23 percent of all merchandise imports (World Bank, undated). In 2015, due to the appreciation of the US dollar and substantial fall in the commodity prices, the total imports bill declined by 14.4 percent except for vehicles (ADB, 2015). Nevertheless, the imports bill is still high and the agricultural sector contribution to GDP is very weak and deteriorating. For instance, the agricultural sector contributed 3.2 percent to GDP in 2015, falling from 76 percent in 1992.

4.2.4. Employment Opportunities and Transfer of Skills

The agricultural sector is not the preferred choice for the youth and men when seeking employment. However, the sector creates livelihoods for a sizeable share of the population. Indirectly and directly, at least about 20 percent of the labor force is employed in the agricultural sector (Palau Economy, 2016). Non-nationals (both as investors and laborers) continue to supplement local residents' participation in farming activities, especially in the production of high-value fresh vegetables. Foreigners' participation in the agricultural sector has contributed to the recent slight increase in the supply of locally-produced and high-value vegetables. Moreover, the participation of foreigners into farming is facilitating the transfer of farming skills from experienced foreign farmers to locals.

4.2.5. Farming Practices and Women in Farming

Palauan farmers mix both traditional and modern farming practices. The former is predominant in production of root crops, tapioca, betel nut and pepper leaf. In large measure, in the subsistence farming sector, farming activities remain the work of the elderly, women and as a last resort career for the young Palauans who typically prefer the modern services economy. Men continue to prefer generating employment from the fisheries sector. On the other hand, modern and commercial farming practices are slowly emerging. These practices are commonly used in the production of high-value crops such as cucumber, green onion, Chinese cabbage, green peppers, beans, kangkung and eggplant. Broadly, commercial farming still commands a relatively small share of the entire commercial agricultural sector.

Both subsistence and commercial farming systems rely on a mixture of organic and in-organic inputs. However, the application and utilization of in-organic farming inputs is on a small scale compared to the use of organic inputs. There are conflicting tensions between commercialization (using inorganic inputs to increase productivity) and conservation (using organic inputs to reduce the impact on natural resources and minimize health issues associated with inorganic food).

4.2.6. Farming and Social Obligations

The current low productivity in the subsistence agricultural sector and official statistics hide the social and economic value small holder farmers attach to subsistence farming. On a daily basis, small holder farmers exchange locally-grown food items during special ceremonies (such as funerals, weddings, etc.). Moreover, food produce is used in the settlement of financial debts as well as other social obligations. Thus, despite such importance being hardly reflected in any official statistics, its relevance and impact should not be underestimated. Therefore, any agricultural developmental policy should deploy a double-pronged approach to assist small holder farmers produce agricultural products for both commercial purposes and settlement of any other social obligations.

4.2.7. The Promising Agribusiness, and Constraints

In recent years, the market for both staple foods and high-value agricultural products, including organic agricultural products, are lucrative. In some countries, high-value agricultural imports/exports have surpassed cash crops imports/exports. Disaggregated data for Palau imports of agricultural products is not available. However, its imports of consumable products (including agricultural products) reached 65% of total imports in 2014 (Figure 6). These trends in favor of high-value agricultural products and staple foods are driven by rising household incomes, changing food diets and growing healthy eating concerns. This revolution reveals latent business opportunities that Palauan small holder farmers should exploit. However, Palau remains a net importer of staple foods, high-value agricultural products and cash crops. Domestic production of agricultural products does not even satisfy the ever-growing Palau market, let alone producing for external markets. This is largely due to low productive capacities, poor product quality, infrastructure challenges, Palauans unwillingness to participate in farming activities and other natural factors (such as soil quality, pests and diseases, etc.). The mixture of these factors, inter alia, holds back the performance of the sector. Hence, addressing these challenges should form part of any strategic policy.

4.2.8. Strategies to Enhance Agricultural Production whilst Contributing to Poverty Reduction.

As earlier noted, agricultural production in Palau is insufficient. By a large measure, Palau depends on imported agricultural products. This situation exposes Palau to possible food insecurity in case of poor harvests in external markets or hike in food prices, which will increase food imports bill as a share of GDP (as earlier noted) that was experienced before the fall of commodity prices and appreciation of the US Dollar. High food imports bills reduces economic gains from the tourism industry as hotels and other recreational facilities spend large sums of their incomes importing food from abroad. These challenges must be addressed to ensure sustainable economic development and increase gains from the tourism industry. To address those challenges, access to markets and value chain development should be enhanced. In particular, livestock farming should be explored given that most of Palauan soils are non-cultivatable. Moreover, partnership links should be established between livestock farmers (i.e. Piggery Association), organic agriculture product growers (i.e. Palau Organic Growers Association) and sources of cut grass (i.e. Bureau of Public Works' road and Ground) to produce sizeable yield of organic fertilizers from dry litter systems for use by famers. Although potential for agriculture to contribute to poverty reduction and economic development is undoubtable, countless challenges face farmers. However, some countries have been successful in this sector and offer lessons that Palau might learnt from. Below is a summary of best practices from other economies that Palau might learn from. Best practices summarized below provide case scenarios where Public-Private-NGO partnerships have contributed to poverty reduction and economic development through farming. The same partnership is suitable for Palau as well.

1. Best practices for Livestock production

"In Bangladesh, Helen Keller International's Improved Poultry Program integrates asset protection and proper poultry-rearing practices. More so, the ultra-poor (landless) are empowered to participate in poultry-keeping, as vaccinators. This initiative promotes local poultry-rearing with improved management and feeding practices, including creep feeding (to increase egg production), appropriate housing and proper vaccination. This approach presents its uniqueness in integrating nutrition education and asset protection training as essential components of poultry-rearing. Further, this intervention benefits both landowners and the landless. The landless ultra-poor people work as community-based vaccinators. Results from program areas show increased egg production, household income and egg consumption among children under five years of age and women of reproductive age."

For details see Inter ACTION via: https://www.interaction.org/bpi-round-1-full

2. Best practices for Access to Markets and Value Chain Development

"In Nepal, Kyrgyzstan, Central African Republic, Somalia and Zimbabwe, Mercy Corps' has achieved phenomenal success through building partnerships among stakeholders. In these countries, smallholder farmers, Agribusinesses and Financial Institutions use a combined approach of improving high impact agricultural value chains and expanding access to agricultural financial services. The intention is to increase farmer productivity and incomes of over 80,000 beneficiaries in deep rural areas and transitional country contexts. The approach successfully integrates extensive market research, farmer and agribusiness development, and commercial development of financial services, such as village savings and loan associations, revolving funds, multilateral financial institutions or banks. Cumulative results show an increase in sales of 30 percent and an increase in profit margin of 35 percent for smallholder farmers." For details see Inter Action, accessible via: https://www.interaction.org/bpi-round-1-full

4.2.9. Policy Recommendations

i. Prioritise and fast track the implementation of the Agricultural and Forestry Action Plan;

ii. Reduce customs duties on farm-inputs, fertilizers and animal feeds, especially for those products that are or may potentially be produced in Palau;

iii. Encourage contract farming especially between food stores, wholesalers and smallholder farmers as a means of boosting commodity value chains and commercial farming;

iv. Encourage research and development in animal feed and the use of modern farming techniques in production of niche market agricultural products such as taro and other cash crops;

v. diversify and explore mechanisms to establish commercial operation and cultivation of native and exotic tropical flowers horticulture farming to take advantage of seasonal variations and growth demand for horticulture products in emerging Asian markets;

vi. Provide adequate financial support to the Bureau of Agriculture to implement sector policies;

vii. Integrate ICT into agriculture (especially initiatives that facilitate access to market information) to reduce transaction costs. Successful e-market platforms such as E-Soko may be explored and modelled to adapt to Palau's needs; and

viii. Encourage livestock farming (pig rearing; poultry keeping; and bee keeping).

4.3. Fisheries

4.3.1. The importance and Nature of the Fisheries Sector

At a household level, fish is an integral part of daily meal for Palauans. For instance, fish consumption per capita is estimated to be 85 kg per year (Preston, 2000). The fisheries sector is important and holds ample force to steer Palau's economic development towards the desired direction. With its EEZ as big as entire France, Palau is well endowed with rich marine resources that contribute significantly to Palau's GDP. Between 2010 and 2014, the fisheries sector alone contributed the average of 2.5 percent to Palau's GDP (Gillette, 2016). The lowest contribution was 2.2 percent in 2014, and the highest contribution was 2.8 percent recorded in 2012. Generally, fishing licensing fees comprise the largest component of fisheries revenues to the Government. Between 2010 and 2014, Palau received approximately US$ 12.7 million in total, from access fees only (Gillett 2016). Offshore fisheries sector owns a big share of Palau's total fisheries production in terms of volume and value per year. In 2014, both locally and foreign based off-shore industry produced approximately 8000mt of fisheries products (Gillett, 2016). That is approximately closer to US$50 million. In the same year, both commercial and subsistence coastal fisheries sectors harvested less than 2000mt of fisheries products (Gillett, 2016). In monetary values, Gillett (2016) estimates that off-shore locally based sector alone earned approximately US$31 million in 2014. He further estimates that the off-shore foreign based sector earned closer to US$20 million, while subsistence and commercial coastal sectors earned less than US$5 million. In terms of exports, fisheries products dominate Palau's export basket, especially to Japan. In 2014, Palau exported fish products worth US$11.4 million (World Bank undated, cited in Gillett 2016). Exports of fisheries products declined between 2012 and 2014. Export of tuna, billfish, and loins declined from 53,155 pieces in 2012 to 37,151 pieces in 2014 (Gillett, 2016). However, it is important to ensure sustainability of the marine resources especially for the vulnerable grouper species. Recent studies indicate a decline in fish population and catches for specific fish grouper species (SCRFA, undated). Stakeholders consulted during the formulation of this policy expressed concerns about over fishing of reef fish in particular, and the astonishing harvest volumes of tuna fisheries. Tuna fishing in Palau's EEZ is dominated by the locally-based foreign longline fleet of Republic of China and the offshore-based longline, pole and line and purse seine fleets from Japan (WCPFC, 2015). Harvests of tuna have increased in the recent years, mainly targeting big eye, yellow fin, and albacore tuna. In 2014, 4,181 metric tons of longline catches were in Palau waters (WCPFC 2015 report). The catch volumes increased from 1,845 mt in 2012 to 2,333 mt in 2013 (WCPFC, 2015). The concerns raised by stakeholders and current fisheries harvest statistics illustrate the need to strengthen the implementation of existing laws and regulations (including the Marine Sanctuary) governing the fisheries sector.

4.3.2. Sustainable Management of Fisheries Sector

In 2014, Palau strengthened its policy approach to protection of marine resources. In addition to other policies, a Marine Sanctuary was introduced to ensure the sustainability and proper management of fisheries sector. The government's intervention is in-line with its long term strategic goal of increasing economic returns from fisheries resources, address food insecurity, and support the transformation of the tourism sector from a mass tourist destination to a high-end and luxurious market destination. The government's interventions followed prolonged sentiments that the fisheries is unproductively exploited and unsustainably managed. Moreover, it is widely acknowledged that the off-shore fishing industry has not benefited Palauans and the tourists as expected, especially in terms of food security. For instance, locals and tourists can hardly eat grade "A" tuna fish on the islands, even when they are willing to pay premium prices. On the other hand, the establishment of large scale on-shore fish processing operations and canneries seem to be uneconomical. Energy costs, labor costs and negative externalities (especially on the environment) associated with fish processing canneries are likely to limit the competitiveness and sustainability of any on-shore canneries that may be established in Palau.

4.3.3. Regional Co-operation in the Fisheries Sector, and National Policies

Increasing economic returns from the off-shore fisheries sector is now a regional priority for the 14 PICs, including Palau. In 2015, Forum Leaders adopted five priority areas (including fisheries sector) under the Framework for Pacific Regionalism (FPR). At the time of writing this policy, a regional implementation plan to increase economic returns from fisheries was being formulated by the Fisheries Task Force. At the national level, Palau has put in place a number of policy instruments to ensure the sustainability of marine resources. These include the 2009 Shark Sanctuary and the Palau National Marine Sanctuary (enacted in 2015). The latter creates a non-commercial fishing zone of 500,000 square kilometers (80% of Palau's EEZ). The remaining 20% of Palau's EEZ is reserved for domestic market and local fishermen (PNA, undated). The 2015 Marine Sanctuary shall enter into force in 2021, following a five-year transitional period. Over that period, commercial fishing activities in the EEZ will gradually fall in the following order: 20% (2014), 20 percent (2015), 10 percent (2016), 10 percent (2017), 10 per cent (2018), 10 percent (2019) and 0 percent (2020). Ending commercial fishing in Palau's EEZ will contribute to conservation of fisheries resources and guarantee the sustainability of fisheries. However, illegal fishing in Palau's EEZ is likely to downplay the Government's efforts to ensure sustainability of marine resources. Illegal fishing hotspots are predominant in Palau's EEZ, which is adjacent to some Asian economies in the Pacific Ocean. To counter this challenge, the Government has established a Monitoring, Control and Surveillance (MCS) plan (PNA, undated). In addition, laws have been reviewed to strengthen punitive measures and transferring the burden of proof from the Government to the suspected vessels.

4.3.4. Coastal Fisheries

Coastal fisheries sector is another important component of Palau's fishing sector. This sector has the potential to provide food security and job opportunities for Palauans. A broad range of fishing activities (subsistence, artisanal and commercial fishing) continue to characterize this sector. For a sense of scale, in 2014, subsistence catches in coastal areas only is estimated to have earned US$3.3 million to fishermen (Gillett, 2016). However, in recent years the sector has experienced significant challenges. These include environmental degradation, over-exploitation of natural resources and non-compliance with the relevant legislation, which are effectively contributing to the steady declining stock of resources in this sector (MTDS 2009-2014). This has triggered allied efforts involving the National and State Governments, non-governmental organizations (NGOs), community groups and the private sector to revamp the sustainability and development of the inshore resources. Such efforts resulted in initiatives that incorporated a wide range of activities, including marine management and conservation areas and species-specific management plans. These initiatives are supported by legislation and enforcement measures. The prominent ones are the "Protected Area Network (PAN) and the Micronesian Challenge which involve the Micronesian States. The latter sets aside 30 percent of the total inshore reef areas of each country to be allocated to conservation and the PAN Act. Generally, the importance of a healthy functioning inshore marine ecosystem and its strong nexus with the tourism industry cannot be understated. Thus, careful monitoring of these fishing practices (artisanal and subsistence) and strict compliancy with regulations should be strengthened.

4.3.5. Aquaculture

Over the last three decades, Palau has embarked on the development of the aquaculture sub-sector. The sub-sector has the potential to supplement marine fishing resources (possibly reduce pressure on off-shore marine resources), contribute to food security, improve nutritional benefits and generate sustainable livelihoods to Palauans. The need to develop the sector is supported by the recent (domestic and international) changes in the food patterns in preference for seafood and the growth of the tourism sector. Given the growing demand of seafood in both national and international markets, aquaculture has the potential to reshape Palau's terms of trade. For instance, in 2013, approximately 19,173 live giant clams were exported from Palau (Gillett, 2016). Gillett (2016) estimates aquaculture production in 2014 to have earned approximately US$285,000. Palau's main aquaculture farming and production is confined to mollusk species - clams [Anadara, bear paw]; giant clam [Crocus, elongate, fluted, and smooth] and Finfish species such as milkfish. Palau's giant clams have penetrated global markets, including the United States, EU, Japan and Hong Kong. However, export of these products to international markets faces significant challenges relating to stringent product quality, quantity and various CITES requirements. Moreover, the development of the aquaculture industry in Palau is limited by the lack of a management plan. Without a management plan, policy interventions are misguided and reactive rather than strategic, hindering the proper approach to the development of the sub-sector.

4.3.5.1. Giant Clam Incubator

The Palau Mari-culture Demonstration Center (PMDC-the former Micronesian Mari-culture Demonstration Centre) established in 1972 is a key institution in the fisheries industry. The Center supports the development of the aquaculture sub-sector through provision of extension services to local farmers, linking buyers and sellers and provides packing and shipping services. The facility is the largest producer of giant clams in the Micronesia region. Currently, the center supplies more than 150,000 giant clam 'seedlings' per year to nearly 50 individual farmers throughout Palau.

4.3.6. Key Players in Coastal Fisheries

The Government and specific development partners remain at the center of the aquaculture industry development. Through this partnership, various programs focusing on biological issues, research and development have been facilitated. This partnership has seen the development of techniques required to farm aquaculture species, identify potential markets (both domestic and international) and their economic benefits. In addition, extension services and provision of information to the private sector has been facilitated.

4.3.7. Support to Aquaculture

The Bureau of Marine Resources (BMR) is the overall sectoral agency responsible for the sustainable development of fisheries resources through implementing and managing policies and regulatory frameworks. Given the broad nature of BMR's mandate, the agency faces significant challenges relating to specific human resource capacities needed to advance the development of the sector. Thus, to better support the goal of sustainable development of Palau's fisheries resources, BMR needs to further develop its function as a manager and facilitator and reduce its involvement in commercial production. This will include continuing its efforts to further improve linkages and synergies with other Government agencies, educational institutions, NGOs and the private sector (MTDS 2009-2014). The strategy also recommends streamlining of legal and institutional policies and processes to support the nation's public agencies whilst encouraging private sector partnerships (local and foreign) and investment. In terms of Government incentives to off-shore fishing vessels, the policy allows transfer of catch from one fishing vessels to a returning vessel, thereby reducing transport costs.

4.3.8. Regional and International Institutions

Palau is party to various regional and international arrangements relating to fisheries management. These arrangements regulate Palau's tuna fishery industry and involve a number of bilateral fishing arrangements primarily utilizing longline fishing techniques targeting species of tuna. For instance, under the PNA[3] and the related PNA Vessel Day Scheme, registered fishing vessels are allowed access to Palau waters. Upon payment of fishing access fees, Palau grants registered fishing vessels access to its waters. Palau is also party to other international conventions that incorporate provisions relating to conservation and sustainable management of fisheries resources. These include the United Nations Fish Stocks Agreement (UNFSA), United Nations Convention on the Law of the Sea (UNCLOS) and the Convention on the Conservation and Management of Highly Migratory Fish Stocks in the Western and Central Pacific Ocean (WCPFC). Palau is also a member of the Forum Fisheries Agency (FFA) and Western and Central Pacific Fisheries Commission (WCPFC). As a member, Palau receives technical assistance on fisheries-related issues. Other policy instruments that guide fishing activities include the Marine Protection Act (1994), Marine Sanctuary Act (2015) and the Shark Sanctuary Act (2009). However, despite the various Government efforts to protect marine fishing and boost aquaculture, there is cut-throat competition from other key giant clam suppliers (especially in South East Asia and other FICs). The lack of technical expertise, financial resources, modern infrastructure and cost-effective marketing techniques are some of the factors constraining the growth of the aquaculture sub-sector.

4.3.9. National Policies and Government Intervention

Generally, sectoral policies, regulations and development plans associated with fisheries resources have undergone rigorous amendments. Moreover, they are well founded and provide a good basis for sustainable development and management of the nation's marine resources (MTDS 2009-2014). Therefore, the key issue is the need for action and substantial resources to implement those policies. The MTDS 2009-2014 summarizes specific objectives and strategies to steer the fisheries sector towards the desired development direction. These include: (i) sustainable economic development of the industry; (ii) increased participation of nationals in all sectors of the industry; (iii) providing an enabling environment

3 Solomon Islands, Tuvalu, Kiribati, Marshall Islands, Papua New Guinea, Nauru, Federated States of Micronesia and Palau.

for sustainable development; (iv) managing and protecting the resources for all users; and (v) ensuring food security. Palau is strongly committed to develop and implement policies that facilitate sustainable use of its marine resources. This is reflected in the recent policies, including the 2015 Marine Sanctuary. The MCS Plan is the key instrument guiding the implementation of the Marine Sanctuary. The Plan details a five-year strategy to combat illegal activity and manage emergency responses in its ocean waters. In the next five years, the Government plans to enhance its capacity towards deterrence, detection, interdiction and prosecutions of Illegal, Unreported, Unregulated (IUU) fishing, and cut down illegal drug and human trafficking in Palau's EEZ. The Marine Sanctuary and the related MCS Plan seek to address issues identified in the MTDS 2009-2014. These are: (i) the development of a single concise piece of legislation; (ii) greatly improved management and enforcement in the fisheries sector; and (iii) the development and implementation of a nation-wide quarantine strategy and development plan.

4.3.10 Policy Recommendation

i. Allocate funds to the implementation of the Aquaculture and Fisheries Action Plan;
ii. Undertake a study on the current stock levels of coral reef fish. There are worries that the reef fish stocks are currently being overfished;
iii. Explore the need to introduce limits on fish exports in personal luggage. It was noted that most people are carrying excessive kilograms of fish abroad as part of personal luggage tagged as non-commercial export;
iv. Establish a comprehensive fisheries policy and implement the National Aquaculture Development Plan (NADP);
v. Enhance technical skills, research & development, especially in the aquaculture sector;
vi. Endorse an Aquaculture Management Plan;
vii. Continuously control, monitor and deter illegal fishing and implement the MCS at the fullest, including building partnerships with key development partners; and
viii. Introduce transparent measures that will facilitate the ease of domestication of foreign vessels.

4.4 Manufacturing Sector

Palau's manufacturing sector is relatively small. It is mainly concentrated in the production of niche hand-crafts, food stuff (bakeries) and other local products. However, the manufacturing sector retains significant potential to contribute to Palau's economic development.

4.4.1. Manufacturing and National Development

Different economies around the world have adopted different paths for their national development. However, two paths are common to most countries and involve establishing a fit-for-purpose manufacturing sector. The two common paths are export-oriented strategies and import substitution through industrialization. Both approaches start with analysis of sectors of comparative advantage the country has compared to interests of targeted export destination markets. For Palau, import substitution in light-manufacturing and eco-manufacturing in a few sectors where Palau can build and benefit from strong national, regional and global value chains, is appropriate and a fit-for-purpose development approach. This approach is feasible due to its potential to increase economic returns from the thriving tourism industry and build national value chains. Palau's tourism sector is robust. However, economic returns from the sector to other sectors of the economy are limited. On the other hand, linkages to the outside markets are huge. A large measure of revenue received from the tourism industry is spent on imports to meet the growing demand in the tourism industry. For instance, between 2011 and 2014, food imports as a share of all merchandise imports always fluctuated between 20 and 23 percent (World Bank, undated). This has not only worsened Palau's Balance of Payments, but has also weakened the potential for development of national value chains to support national development. Given Palau's high tourist intensity, domestic manufacturers can benefit from the growing domestic market without laboring too much to penetrate international markets. In other words, the domestic market is abundant. It should be understood that import substitution requires the adoption of a multi-engine development strategy encompassing agriculture and manufacturing as primary sectors while also ensuring that the development of the manufacturing sector is eco-friendly. The development of these sectors should aim at strategically supporting the booming tourism industry. This approach has the potential to broaden the scope of the economy from a single sector (Tourism) driven economy towards a more diversified and resilient economy.

4.4.2. Performance of Palau's Manufacturing Sector

Over the last decade, similar to the agricultural sector, the performance of the manufacturing sector has declined compared to pre-2000. In 2000, Palau's manufacturing and industry sectors performed relatively well and contributed 21 percent to Palau's GDP (World Bank, undated). Post-2000, the performance of both manufacturing and industry sectors gradually declined. Industry Sector's contribution to Palau's GDP has declined from 18% (in 2000) to 9% (in 2014). At the same time, the manufacturing sector has followed suit with contribution to GDP falling from 3% in 2000 to 1% in 2014 (World Bank, undated). Value addition on products processed at the domestic market has not improved either. For instance, in 2014, unprocessed raw materials accounted for 49 percent of Palau's exports. In particular, exports of unprocessed animal products (fisheries products) accounted for 46 percent of Palau's exports (WITS, undated). Moreover, consumer goods dominated Palau's 2014 imports by 64 percent. These trends need to be reversed to better serve the tourism industry. For this to be realized, investments in the manufacturing sector should focus on a few niche products in which Palau has a competitive advantage and where there is abundant domestic market. Some sectors where Palau has a niche advantage would be processing of or adding value to livestock products (eggs, pork and the related products), high-value agricultural products (fruits and vegetables) and niche health products (such as coconut soap). The demand for these products on the domestic market is growing. This can be manifested by the growing imports of these products. However, growth in the manufacturing sector is usually associated with increase in the carbon footprint that is harmful to the environment. In this case, this policy calls for establishment of eco-manufacturing sector which will not conflict with the Government's vision as set out in other policies, including the Palau Climate Change Policy. Given this desire, below is a summary of best practices on establishment of eco-manufacturing sector from which Palau might gain valuable lessons.

4.4.3. Best Practice in Attracting Investments in Eco-manufacturing

The Government of Palau is keen to attract investors to establish model eco-friendly industries. However, attracting investments into the eco-manufacturing sector is a challenge. In reality, not many countries have achieved a robust manufacturing sector whilst maintaining a low carbon footprint. The Republic of Korea is among a few countries that have managed to lead investors into a business model for going green. Thus, despite the difference in capacity, Korea's success in this area provides insights for Palau in pursuit to establish an eco-friendly manufacturing sector.

Republic of Korea's Ulsan Eco-Industrial Park Center

The Ulsan Industrial District is Korea's largest industrial center, with 15 industrial parks. Each park accommodates many companies and their employees. For a sense of scale, just two of these parks, Ulsan Mipo and Onsan, accommodate about 1,200 companies and more than 120,000 employees. They host a blend of domestic and foreign companies. However, few of the companies operating in Ulsan are engaged in green industries as their primary business lines. With this level of economic activity in such a concentrated area, the environmental impact must be carefully planned and monitored to manage waste and limit pollution. So in 2005, the Ministry of Trade, Industry and Energy introduced the EIP Initiative for the transition of industrial complexes into eco-industrial parks. This led to the establishment of the Ulsan EIP Center. The Center acts as a business development agency to identify and make the case for investment in green production processes with a reduced carbon footprint impact. The agency integrates carbon footprint mitigation measures with efficiency in production. This involves waste recycling, which cascades the use of energy and water in a way that optimizes efficiency and creates new value through industrial symbiosis.

How the Ulsan EIP Center promotes green investment

The Ulsan EIP Center explored symbiotic relationships and shared facilities among individual companies that would contribute to clusters achieving collective efficiencies that cut costs and increase eco-friendliness. Potential project identification started with mapping the companies in a park, their inputs and their waste products. The Center then identified a series of potential projects for steam recycling. Potential projects were shared with stakeholders and the R&D center, which together investigated project feasibility and produced a final report of projects and their business cases. Then the EIP Center started to run a few well selected pilot projects to show the feasibility of the green concept. With several sound business cases established for the sale and distribution of waste steam generated by a number of companies in the district, the Center worked with those companies to undertake the permitting, financing and construction needed for implementation. In the first phase, steam networks were established between two pairs of companies, which showed very positive results. For example, Sungam Municipal Waste Incinerator Facility and Hyosung Company together invested US$5 million in the network but accrued over US$7 million per year in cost savings. Steam replaced enough fossil fuels to reduce carbon dioxide emissions by 55,500 tons per year, and Hyosung generated so much excess steam that it made sense to expand its production facilities, employing additional 150 people. With demonstrated success, several more projects came online quickly, and the rationale for larger scale public-private investments in the infrastructure for a "steam highway" became evident. Eventually, US$26 million in public investment established a six-kilometer steam pipeline with multiple entrances and exits, allowing companies that invested in the infrastructure to connect their facilities to the highway. This is expected to reduce greenhouse gas emissions by 100,000 tons per year while creating US$20 million in energy supply and cost savings. At every step the Ulsan EIP Center was the lead coordinator, articulating the vision for park-level symbiosis, making the business case, and negotiating commitments and prices with participants who had to find a way to share the costs and benefits of these joint projects. Company due diligence typically took about a year, while negotiations lasted anywhere from three months to more than four years.

Economic Impact

By the end of 2014, eight years after Ulsan EIP's first symbiosis was established, projects involving 31 companies were all operational. These generated annual cost savings of US$74 million, new revenue of US$45 million.

Environmental benefits, reductions per year

- 487,626 tons of carbon dioxide
- 196,102 tons of energy
- 79,007 tons of wastewater
- 38,544 tons of industrial by-products
- 4,052 tons of air pollutants.

Today, Ulsan EIP enjoys a global reputation that brings new investments from companies for whom the symbiotic aspect is a driving factor. However, it should be noted that the initiative succeeded not only because of strong public-private partnership, but because the Government took the lead.

Source: UNCTAD, 2014.

4.4.4. Policy Recommendations

i. Encourage value addition, product differentiation and innovation especially for niche products;

ii. Facilitate investment in eco-friendly manufacturing activities such as furniture, textile, stationery and value addition in agricultural products;

iii. Formulate a manufacturing sector development strategy or action plan;

iv. Support capacity-building initiatives in product branding, labelling and packaging. This will include developing a national branding strategy to promote and raise the profile of Palauan made products;

v. Establish trade policies that facilitate importation of raw materials and capital goods; and

vi. Temporarily protect infant factories/industries against external competition. In this case, Palau should ensure that all trade agreements being negotiated contain provisions on protection of infant industries to retain enough policy space to use trade policies to promote investments in new/infant industries.

5. PALAU'S INTERNATIONAL TRADE

International trade is central to Palau's economic development. It is the source of revenue in the form of exports and the only way to access goods and services that can hardly be produced in Palau, such as fuel, some food products, capital goods, and etc. In 2014, imports of goods and services accounted for 88% of Palau's GDP. On the other hand, exports of goods and services accounted for 63% of Palau's GDP (World Bank, undated). In particular, merchandise trade accounted for 74.2% of Palau's GDP for the period 2011-2015 (World Bank, undated). Annually, Palau experiences a widening gap between imports and exports. The ratio of imports to exports is swelling as tourist arrivals continue to rise. The country is a net importer of most products. In 2014, merchandise trade in particular was significant in consumables (64.89%); fuels (29.20%), capital goods (18.59%), mechanical and electrical equipment (13.38%) and food products (11.89%) accounted for the highest share of total imports (WITS, undated). A breakdown of Palau's exports and imports by stages of processing reveals its weak manufacturing power. That is, almost half of Palau's exports are dominated by unprocessed raw-materials (49.33% in 2014); whereas, consumer goods dominate its imports (64.89% in 2014). This reveals the desire and latent opportunities for investors in the manufacturing sector.

5.1. Key Trading Partners

Japan is the leading Palau trading partner for both imports and exports. In 2013, the list of Palau's major export market destinations was led by Japan, which accounted for exports worth US$3m. Guam follows with less than US$1.5M exports value (2013). Other markets that account for less than US$1m of Palau exports by value are RMI, FSM, Korea, Australia, Austria and others. On the other hand, Palau's major import sources include Japan, accounting for US$ 29m (2013); the US, accounting for US$20m (2013); and Guam, accounting for US$16m (2013). Clearly, Palau's trading partners are few. Increasing trading partners is essential to avoid any trade disruptions.

5.2. Palau's Tariff Structure

Palau has a very flexible trade policy regime. Despite being a non-WTO member, Palau has the lowest tariff rate structure. For instance, approximately 50 percent (5,357) of the total tariff lines attract low MFN tariff rates, and 12.34% of all tariff lines are duty free. The most liberalized products include animal products (85.08% of the tariff lines are duty free), food products (68.27% of the tariff lines are duty free), raw materials (47.66 % of the tariff lines are duty free) and consumer goods (13.58% of the tariff lines are duty free). Generally, 16.66% of all 11,063 tariff lines are duty free, and most of other product lines attract 3% duty rates (WITS, undated).

5.3. Trading Across Borders

Palau's trade with the rest of the world is somewhat costly due to its isolation from key markets. Hence, Palau's high trading costs are more location-induced than due to policy inefficiency. The World Bank's Doing Business Report provides a synopsis to compare countries' performance based on a number of indicators, including trading across borders. On this measure, in 2016, Palau ranked 155th out of 189 reported countries and scored 46.22% (the closer to 100 the better) on Distance to Frontier (World

Bank, 2016). Despite the poor ranking, exporting a container from Palau is relatively cheap compared to average of East Asia and Pacific economies. That is, exporting a container from Palau requires approximately US$720, requires 5 documents and takes 26 days. Whereas importing a container to Palau costs US$ 680, requires 9 documents and takes 30 days (World Bank, 2014). This is relatively cheap compared to East Asia & Pacific, where exporting a container takes on average 18-19 days, requires 6 documents and costs US$ 901 (World Bank, 2014). This reveals that Palau's poor ranking is somewhat not due to policy inefficiency, but rather natural factors such as remoteness, its small domestic market size, etc.

5.4. Constraints to Palau's Export Potential

In general, the Government of Palau has tried to enhance the business operating environment and will continue to do so. However, Palau's export base is still small and undiversified. Exports are confined to mainly fisheries products. Other issues that seem to hold back Palau's export potential include existence of non-tariff measures (NTMs) in the destination markets (especially sanitary and phytosanitary standards (SPS) and technical barriers to trade (TBT)), the country's remoteness, low productive capacities, poor infrastructure, continued erosion of tariff preferences (especially in the US market) and failure to meet product standards in international markets.

5.5. Policy Recommendations

i. Enhance market access and product penetration through regional integration, especially in the Micronesian region;

ii. Engage the Pacific Trade & Invest Offices in key markets (Japan, China) to promote Palau exports in these markets, and well as lure Investors from these economies to Palau;

iii. Closely monitor the rise and advocate for the elimination of NTBs;

iv. Support export diversification, value addition and product differentiation;

v. Encourage investment in the production of niche products (Handi-crafts, etc.);

vi. Further streamline customs procedures;

vii. Collate trade statistics;

viii. Enhance infrastructure, including rehabilitation of Malakal Port and operationalization of the Special Economic Zone;

ix. Improve product quality to meet international standards; and

x. Facilitate trade missions to key markets (Japan, Guam, USA and within the Micronesian region)

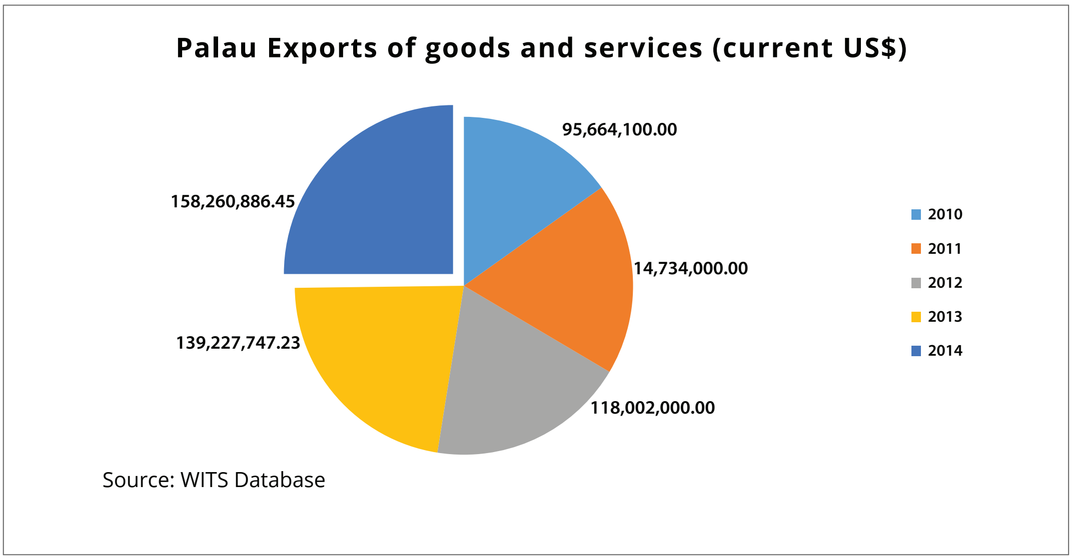
5.6 Trade Direction and Composition

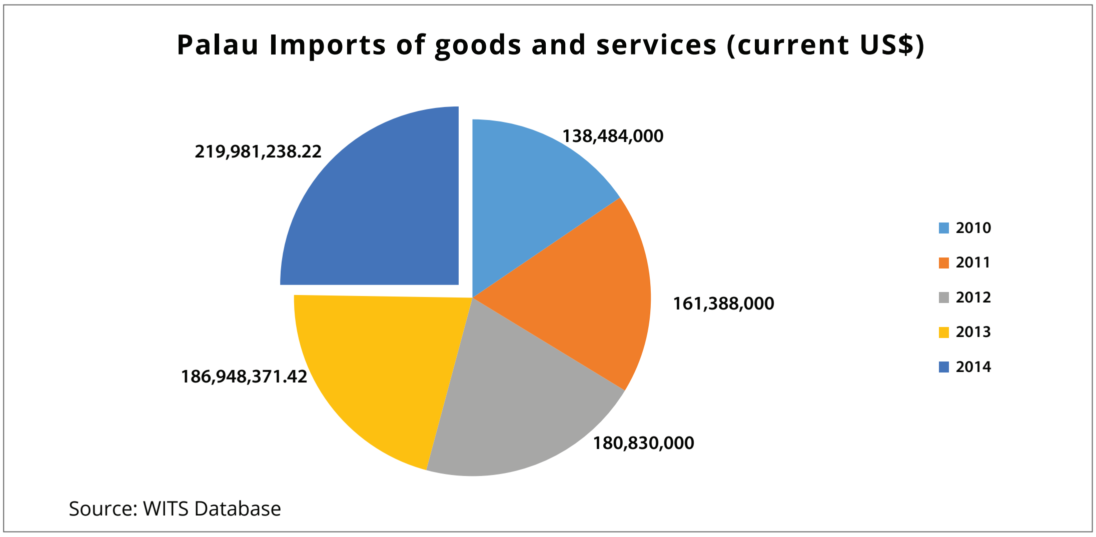
This section looks into Palau's trade direction and composition for the last five years (2010-2014). Using diagrams, Palau's exports and imports are analyzed by evolution, key market destinations and sources and product processing category.

5.6.1. Evolution of Trade

Palau's trade (both imports and exports) flows have increased with time (Figure 5), but imports continue to exceed exports throughout. In summary, Palau's exports have evolved from US$95,664,100 M (2010) to US$158,260,886M (2014). In the same period, imports have increased from US$138,484,000M (2010) to US$219,981,238M (2014). Overall, there has been a significant trade deficit of US$ 261,742,876M throughout five years (Figure 5).

Figure 5: Palau Imports and Exports by Value (2010-2014)

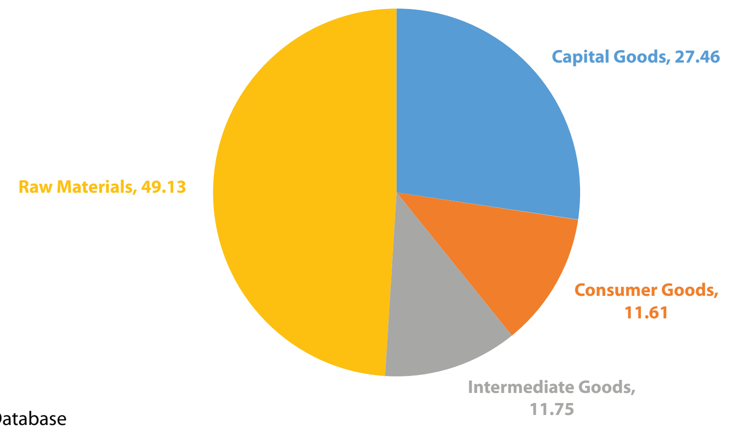




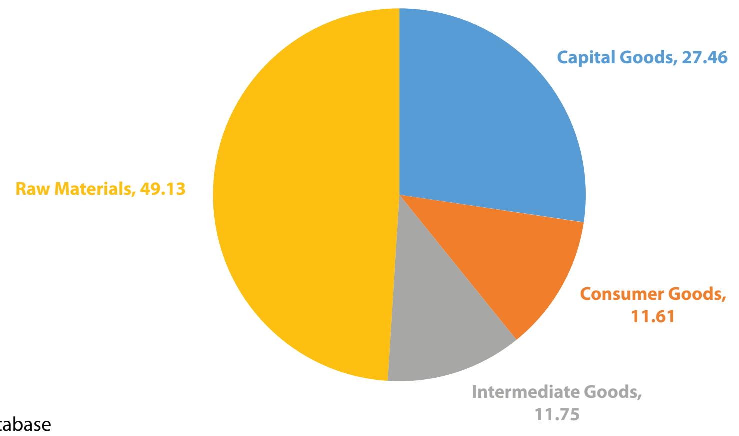
5.6.2. Trade Composition

Figure 6 below provides Palau exports and imports grouped into four categories (consumer, intermediate, capital and raw materials) for the year 2014. Consumer goods dominated Palau's import basket by 65%, followed by capital goods (19%). On the other hand, raw materials (49%) continue to dominate Palau's export basket, followed by capital goods with 27%.

Figure 6: Palau Imports & Exports by Stage of Processing (in 2014)



Source: WITS Database

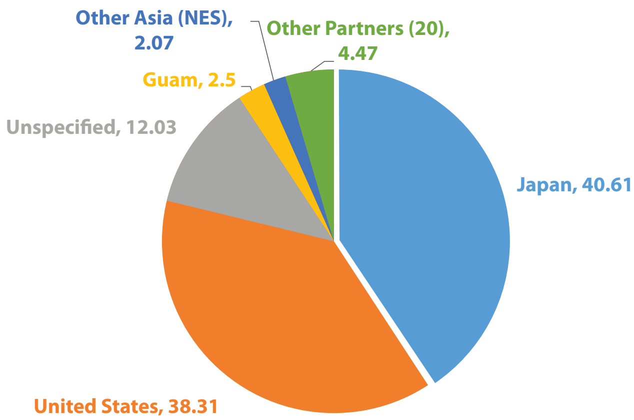


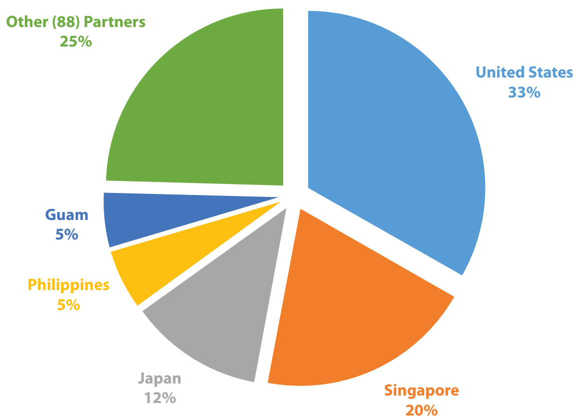
Source: WITS Database

5.6.3. Trade Direction

Figure 7 below provides a list of Palau's top preferred export destination markets and import sources in 2014. Japan is the preferred market destination (accounting for 40% of all Palau's exports), followed by the United States (attracting 38% of all Palau exports). On the other hand, in 2014, 33% of all Palau's imports came from US, followed by Singapore with 20% and Japan 12%. Overall, the Unites States and Japan are Palau's key trading partners. Once again, this presents that Palau's trading is undiversified. Thus, efforts should be made to tap into other markets, especially the neighboring Island Countries and emerging Asia economies.

Figure 7: Palau Trade Direction with Key Partners (with a percentage share) in 2014.





Source: WITS Database

5.7. Trade Integration

The Importance of Regional Trade Agreements

Among other benefits, key benefits of any Free Trade Area agreement include allowing exporters from small domestic market to access large markets, harmonize trade policies among member countries and increase both consumer and producer surpluses. In this regard, Palau sees binding trade arrangements as a conduit to enlarge its small market base and integrate itself into the global trading economy. As a small economy with a total population of 17,661 people, preferential trade arrangements have the potential to create guaranteed access to international markets and attract investment flows, hence supporting the Government's trade policy agenda to diversify the economy from a few traditional trading partners.

5.7.1 Palau's Participation in Trade Agreements

At the regional level, by 2016 Palau was yet to accede to any Regional Trade Agreement (RTA). At the time of writing this policy, the Government was still considering its readiness to ratify the PICTA TIS (Trade in Services Protocol). The PICTA is a preferential trade arrangement set to govern trade relations between PICs. By 2016, 7 out of 14 PICs were trading under the PICTA and 4 countries had ratified the PICTA TIS. Any PIC (including Palau) is permitted to join (at any time) and trade under PICTA / PICTA TIS. Concurrently, Palau is involved in the on-going PACER-Plus trade negotiations. Those negotiations bring together 16 Forum member countries and are set to be concluded in 2017. They will govern trade and investment relations between PICs, Australia and New Zealand. Once concluded, the Agreement shall establish the biggest FTA in the Oceania region, with a total population of 37 million people, and the only trade arrangement involving PICs that contain investment and labor mobility provisions. But, given Palau's little (or no) trade flows with most of the PACER-Plus parties and its geographical location, early benefits anticipated to ensue from this arrangement may be confined to labor mobility, development co-operation and FDI. Thus, strategic plans to exploit the PACER-Plus arrangement should prioritize these sectors, and development assistance should prioritize building productive capacities so as to benefit from the large market that will be created under PACER-Plus.

5.7.2. Palau in Sub-Regional Integration

At sub-regional level, Palau has signed the treaty establishing the MTEC (Micronesian Trade and Economic Community). The MTEC treaty (involving RMI, FSM and Palau) intends to foster economic cooperation in the Micronesia region. Parties to the treaty envisage deepening sub-regional cooperation amongst themselves (RMI, FSM and Palau). Palau's trade with RMI and FSM has the potential to increase in the near future. In 2013, Palau exported goods worth US$50,000 (FOB value) to both FSM and RMI. Palau is better positioned to take advantage of deep sub-regional integration in the Micronesia region due to its geographical proximity to both RMI and FSM. Deeper regional integration among the MTEC Member States will offer trade opportunities to Palau.

5.7.3. Palau's Efforts to Diversify Trading Partners

5.7.3.1. Looking at Far Europe

In addition to regional and sub-regional groupings, Palau is a member of the ACP-EU grouping. The historical ACP-EU grouping involves 79 countries from Africa, Caribbean, Pacific and EU Member States. The grouping is founded on the Cotonou Partnership Agreement (CPA) signed in 2000 and its subsequent revisions and other preceding agreements between ACP States and EU and its Members States. Trade relations feature heavily in the CPA objectives, based on Article 36 of the CPA. For that reason, since 2004, Palau has been part of the Pacific ACP States (PACPS) group negotiating the comprehensive EPA with the EU. In March 2015, however, the negotiations were suspended for a period of three years. The EPA intended to govern Pacific ACP- EU Member States' preferential trade relations even after the expiry (2020) of the CPA.

5.7.3.2. Palau-EU Trade Relations without EPA

The absence of a comprehensive EPA involving all the 14 PACPS and the EU leaves the Interim EPA involving Fiji, PNG and the EU as the only trade agreement in force between some PACPS and the EU. Already the absence of a binding trade arrangement between Palau and the EU has started to signal some foreseeable challenges. For instance, in 2014, Palau graduated from LDCs category to upper middle-income category. Subsequently, its preferential access to the EU market under the Everything But Arms (EBA) arrangement applicable to only LDCs is no longer applicable. Therefore, Palau's exports (if any) can only enter the EU market on stringent GSP+ and MFN preferential rates applicable to all countries. Generally, by 2016 Palau's trade flows with all ACP-EU member states was still insignificant. Nevertheless, the importance of the EPA in Palau-EU relations cannot be completely ignored. In fact, the EPA could potentially be the only binding trade arrangement between ACP States and the EU post the Cotonou Partnership agreement expiry in 2020. Therefore, the absence of any binding EPA arrangement may pose significant negative impacts to non-EPA States, including Palau. In particular, Palau is likely to lose any benefits associated with the EPA and ACP-EU relations in the areas of development co-operation, trade development and intra-ACP private sector development programs.

5.7.3.3. Policy Recommendation

i. Palau should consider the benefits of joining the regional FTAs which are being negotiated (preferably PACER-Plus) so as to benefit from trade integration.
ii. Palau should consider requesting for observer status in the Trade Development Committee of the Interim EPA.

5.7.4. Looking at the Neighboring United States Market

The USA has been Palau's traditional trading partner for decades. Palau-US trade relations are governed by the Compact of Free Association). Through the Compact, the US grants Palauan exports preferential duty-free market access to its domestic market except for a few products. Palau products ineligible for US market duty-free access under the Compact include watches, clocks and timing apparatuses; finished or unfinished buttons; textile and apparel articles which are subject to textile agreements; footwear; handbags; luggage; flat goods; work gloves and leather wearing apparel. However, due to continued proliferation of RTAs (such as TPP, etc.), preferences offered to Palau under the Compact arrangement risk being eroded or offered to other fully-fledged industrialized and competitive economies.

5.7.5. Over all Government Strategy

The Government recognizes the potential of trade arrangements to expand Palau's small domestic market. For that purpose, the Government is keen to strengthen its trade diplomacy with traditional trading partners (including FSM and RMI) as well as to explore other potential markets especially with the proximate Asian economies. In principle, the Government will continuously advocate for aid for trade (inclusion of development co-operation provisions in trade agreements and arrangements its party to) to address supply side constraints.

6. POLICIES AND PROCEDURES GOVERNING TRADE IN MERCHANDISE

Palau's import and export procedures are governed by Customs Regulation (2006), the associated tariff schedule (HS 2012) and other sector policies. The enforcement of the Custom Regulation lies within the purview of the Bureau of Customs and Border Protection, Ministry of Finance. The Customs Regulation sets guidelines to conduct importation and exportation of goods to and from Palau. Essential guidelines are highlighted below.

6.1. Import Tariff Structure

Palau's merchandise trade can be categorized into six broad product groups. These are: (1) Animal products (46.80% of imports in 2014); (2) metals (12.59% of imports in 2014); (3) mechanical and electrical products (12.86% of imports in 2014); (4) transportation products (5.74% of imports in 2014); (5) wood products (5.25% of imports in 2014); and (6) other miscellaneous products (12.44 of imports in 2014) (WITS, undated). By 2016, Palau did not belong to any preferential trade agreement. Thus, it has no applicable preferential tariff rates. Also, Palau does not participate in the Generalized System of Preference (GSP) scheme and hence does not provide any preferential tariff treatment to any imports from developing and/or Least Developing Countries (LDCs). On the other hand, Palau's originating exports benefit from the US' GSP scheme. Moreover, in the event Palau falls back into the LDC category, its exports to the EU would benefit from the EU's EBA arrangement. At the moment, Palau is not eligible to benefit from EBA as it graduated from the LDC category. Palau has a flexible tariff structure. Over 80% of tariff lines attract between 0 and 3 % duty rates. Moreover, it has flexible duty rates, despite being a non-WTO member. For instance, 12.34% of Palau's tariff lines are duty free, 82.94% tariff lines attract non-specific duties and 0.56% tariff lines attract specific duties. Broadly, Palau's minimum tariff rate ranges between 0 and 3% (WITS, undated). Products on duty free rates include Animal products (85.08% tariff lines), vegetable products (70% tariff lines), raw materials (47.66% tariff lines), food products (68.27% tariff lines) and consumer goods (13.58 % tariff lines). In 2012, Palau imported products worth US$26 Million duty free, US$11 Million on non-specific duties and US$50 M on specific duty rates (WITS, undated). Mostly, fuel products fall in the latter category, accounting for approximately 12.24% tariff lines. In particular, products that attract specific tariffs include tobacco (excise duty of $200 per kg), fuel ($.0132086/liter), and motor vehicles (5% + US$ 250). Wines are spirits attract specific duties as well.

6.1.2. Policy Recommendation

i. Where needed, the Government shall periodically review its tariff structure.

6.2. Duty Exemptions and Waivers on Imports

Palau's Customs Regulation 2006 (Art 4.12) provides for duty exemptions. Duty exemptions are permitted for bona fide travelers, returning residents, diplomats, specific temporary imports, grant aid projects and duty-free shopping facilities at the Palau International Airport. Also, Palau offers duty exemptions for goods temporarily (6 months) imported into Palau for construction, installation or repair, subject to re-export after completion of the activities for which they were imported. However, the Government has the right to withdraw any granted duty exemptions. This is permitted in case, within one year of importing a product and receiving duty exemptions, the same exempted product or its major part is transferred to another person other than a family member living with the beneficiary.

6.2.1. Policy Recommendation

i. The Government should continuously monitor and review its duty exemption instruments in alignment with the current development dynamics.

6.3. Rules of Origin (RoO)

Rules of Origin form a key component of standard trade policies and instruments. Among others, Rules of Origin guide the determination of a product's origin for purposes of duty concessions. But where Rules of Origin are used wrongly, they might hinder business operations. By 2016, Palau was still considering establishing its own set of non-preferential Rules of Origin. Whilst its preferential Rules of Origin are contained in the US Compact arrangement, the Compact Rules of Origin are prescriptive in nature as they indicate value addition criteria, origin of raw materials and extended cumulation requirements. Specifically, the Compact arrangement Rules of Origin require 35% value addition on non-originating products and provide for 15% value tolerance for regional products, subject to US approval. Once these measures are met, Palau's eligible exports to the US are accorded preferential duty concessions. Palau envisages to have another set of preferential RoO once the PACER-Plus trade negotiations are concluded and Palau ratifies the Agreements. If theses RoO accord more preference to PACER-Plus parties, the same RoO must be accorded to the US.

6.3.1. Policy Recommendation

i. Establishing Palau's non-preferential RoO is not considered feasible; Hence, Palau should consider adopting any of the existing preferential RoO; and
ii. The Government shall continue to advocate for flexible preferential RoO in any trade agreement to which Palau is party.

6.4. Import Restrictions and Prohibitions

Authority to restrict or prohibit importation of any product is provided for under the Palau Customs Regulation (2006) and the Palau Biosecurity Act (2016). The Government has a right to restrict and/or prohibit importation of any product(s) from any country for various reasons, including health requirements, protection of the environment and natural resources, in the interest of public security and/or to fulfil Palau's international obligations. In particular, the Bureau of Customs and Border

Protection has the right to seize goods, articles or merchandise of prohibited and restricted imports. In case of the latter, this may subsequently lead to one-year suspension of the offender's business license. At the time of writing, Palau has restricted the importation of a few products (controlled substances and weapons). Importation of some meat products, such as Dugongs, is banned. However, where needed, restricted or prohibited products may be imported with permission from a competent Authority.

6.4.1. Policy Recommendation

i. A list of prohibited and restricted products should be identified and displayed in areas with proper visibility for exporters and importers.

6.5. Standards and Technical Regulations

Standards and technical regulations (SPS & other technical regulations) are major components of any modern trade policy. Usually, standards and technical regulations seek to protect human, plant and animal life. Nevertheless, where they are used wrongly, they may constitute another form of non-tariff barrier to commerce. Palau's legal instruments that establish standards and technical regulations for trade in plants and animals and their products include the Biosecurity Act (2016) and the Plant & Animal Quarantine Regulations (1999). The 2016 Biosecurity Act intends to prevent the entry of animal, plant pests and diseases and their spread/movement in Palau as well as to facilitate international cooperation in this area. Further, the Plant & Animal Quarantine Regulations (1999) seek to protect agricultural activities and general well-being of the people of Palau. The Bureau of Agriculture is the administrative agency for standards and other technical regulations. Where required, importation and exportation of products is subject to biosecurity clearance and inspection. Noting the current technical capacity requirements and importance of a fully-fledged quality infrastructure, the Government should continue to co-operate with other advanced economies, including the US, in this area so as to enhance the effectiveness of these measures and collaboration in the development of modern quality infrastructure.

6.5.1. Policy recommendation

i. Mobilize sufficient resources to implement the Biosecurity Act and strengthen SPS measures, taking due diligence to ensure SPS instruments do not unnecessarily disrupt commerce.
ii. Formulate a national Quality Infrastructure.

6.6. Valuation of Imports

Authority and modalities to value imports is provided for in the Palau Customs Regulation (2006). Goods imported into Palau's economic territory are valued Free on Board (FOB) and in US dollars (at the current exchange rate). In case FOB prices cannot be determined, an equivalent price of identical goods on sale in Palau may be adopted. Where a Customs Officer is certain that the value of declared items is lower than the actual transaction value contained in the Customs valuation data base, the consignee may be required to provide reasonable proof ascertaining non-malpractices.

6.6.1. Policy Recommendation

i. Cost, Insurance and Freight method of imports valuation should be introduced to replace the current FOB imports valuation method.

6.7. Export Taxes, Restrictions and Licensing

The Palau Customs Regulation (2006) permits imposition of export taxes on certain products. Where needed, appropriate export licenses are issued accordingly. The Biosecurity Act (2016) provides guidelines on exportation of plant and animal products. Usually, export taxes are instituted to ensure food security, provide raw materials to local industries, protect the environment and for fiscal reasons. The Director of Customs and Border Protection makes public information on all goods prohibited or restricted for export. Some products (animal and plants) require biosecurity export clearance issued by the authorized officer. Currently, export taxes are imposed only on fisheries products (US$0.35 per kg); whereas, exportation of copra is restricted and requires a license. Also, re-exportation or transshipment of any commodity imported from the US and its territories or possessions to any other country requires an export license.

6.7.1. Policy Recommendation

i. Where needed, the Government should continue to restrict exports so as to protect the environment, maintain fiscal stability and protect infant industries. These measures should be adopted on a temporary basis; and

ii. 2. The Government should exempt from export licensing requirements goods imported from US that have undergone substantial transformation in Palau.

6.8. Business Incentives

Incentives form an integral part of Palau's strategic trade policy agenda. This is reflected in the Export Incentives Act of 1986. The Act encourages diversification of Palau's exports and penetration of new markets. These measures are sought to, ultimately, improve living standards, create more jobs, increase foreign exchange earnings and build a self-sufficient economy. Under the Export Incentives Act, export producers and brokers (except for fish and copra products) are exempted from Gross Revenue/sales or profits taxes. Also, the Government provides tax incentives to all licensed industries that will be established in the Ngardmau Free Trade Zone. In particular, the 2003 & 2010 Acts establishing the Free Trade Zone exempt industries that will be established in the zone from import and export duties. Products exempted from duties upon importation into the zone are raw materials; capital goods and machinery, except consumable supplies; and food or items that might be utilized by businesses on a daily basis.

6.9. Overall Policy Recommendations

1) Deploy proper marketing strategies and destination market targeting to facilitate penetration of international and regional markets. Penetration of Asia and Pacific regions, including Guam, should be prioritized. This objective can be achieved through, among others, engaging the Pacific Trade and Invest Offices in potential markets, including Japan, Taiwan, R.O.C., etc.;

(2) Mobilize and allocate Aid for Trade resources to fully operationalize the Free Trade Zone, and build economic infrastructure to support trade development;

(3) Endorse the proposed Customs Management Bill;

(4) Enhance the collection of trade statistics. This includes recording of exports and requesting importers to report actual source of imports rather than transit countries;

(5) Facilitate the implementation of the existing policies, including the Biosecurity Act (2014);

(6) Enhance the capacity of the Bureau of Customs and Border Protection and Division of Economic Development.

7. Investment Promotion

7.1 Nexus between Trade and Investment

Trade and investment are by their nature inseparable. The two complement each other. For instance, trade-enabling policies will have positive effects on export-oriented investments. Also, favorable trade policies facilitate investments that ought to benefit from low cost imported raw materials. These complementarities build productive capacities, increase investments flows, enhance trade capabilities and foster greater integration into commodity value chains. Therefore, a conducive investment climate is a requisite for the development of the private sector and trade, and vice versa.

7.2. Investment Processes and Guidelines

Procedures and guidelines for foreigners to invest in Palau are stipulated in the Foreign Investment Act (1990), as amended (FIA). The FIA seeks to promote foreign investments that benefit Palau, protect businesses beneficial to citizens, promote employment for citizens and guide onshore investments. It should be noted that the landscape for which the FIA was enacted has significantly changed. By the time the FIA was enacted, Palau did not belong to any trade agreement incorporating investment protection provisions. However, at the time of formulating this policy, Palau was negotiating the PACER-Plus trade agreement that incorporates a comprehensive chapter on investment. These unprecedented changes have significant impacts on Palau's FIA in its current form and other institutions governing investment processes and procedures. The Foreign Investment Board (FIB), composed of seven appointed members, is the statutory body mandated to screen, approve and monitor foreign investments onshore and to provide advice to other executive arms of the Government. Investment procedures and processes (application and registration) are mainly undertaken manually as on-line investment application procedures are yet to be considered. Prior to establishment of a business entity, every foreign investor has to apply for and obtain a foreign investment approval certificate (FIAC) at a non-refundable cost of US$500. The FIAC is issued by the FIB and any decision on individual investment application proposals is made within 90 days. Depending on the type of investment, a foreign investor may be required to obtain other business licenses. The FIAC is granted to foreign investors on grounds that the proposed investment is no less than US$500,000 (minimal capital requirement) or at least 20 percent of the employees are Palau citizens. Further, any foreign investor intending to employ foreign workers is required to pay US$500 per year for each foreign worker employed.

7.3. Reserved Sectors

In the interest of citizens, the Government has exclusively reserved some sectors from foreign investment. The sectors reserved from foreign investment are wholesale and retail sale of goods; land transportation, including, but not limited to, bus services, taxi services, and car rentals; any form of water transportation services, including rentals of any water transportation vehicle; travel and tour agencies and land-based and water-based tour service providers, including, but not limited to, dive shops, chartered fishing operations and surfing businesses; and commercial fishing other than highly migratory species.

7.4. Existing Incentives for Investors

Granting incentives to promote quality investments (both domestic and foreign) is central to the Government's strategic objectives. As such, Palau provides tax exemptions to any business enterprises that construct high-end facilities in Palau. Tax exemption include a tax refund equivalent to the costs associated with off-site road construction and water, power or sewer infrastructure improvements accomplished to service the enterprise's facility. Annually, the tax refund is limited to 50% of the taxes paid by the enterprise. In addition, Palau provides import duty exemptions for enterprises to be established in Ngardmau Free Trade Zone. Moreover, Palau does not obligate any enterprise to use local materials (Trade-Related Investment Measures-TRIMs) in order to obtain any incentives.

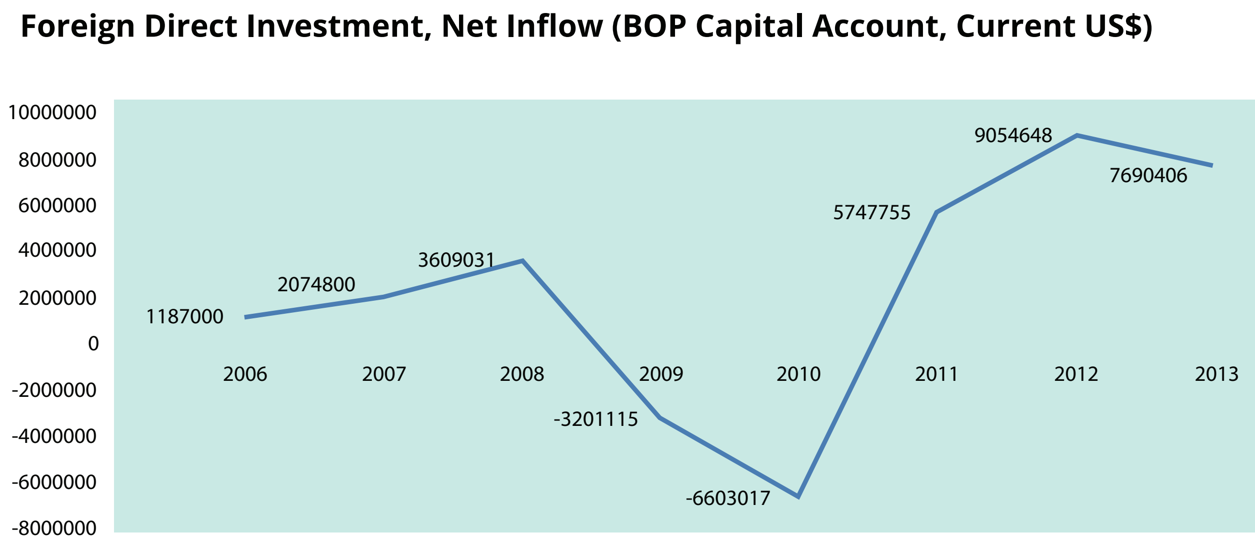
7.5. Needed Business Reforms

Despite the current incentives and other supportive policies, the entire investment climate needs further structural reforms to support trade and private sector growth. Reforms needed include establishing mechanisms to protect minority investors; ensuring transparent property, including land, rights; addressing insolvency-related issues; and easing construction processes, including access to construction permits. In terms of scale, Palau performs relatively low in the above mentioned areas. In 2016, Palau ranked 182nd/189 countries (scored Distance to the Frontier (DTF) 28.33%) on protecting minority investors; 46th/189 countries (scored DTF 74.28%) on registering property; 130th/189 countries (scored DTF 50.36%) on enforcing contracts; 166th/189 countries (scored DTF 16.28%) on resolving insolvency and 166th/189 countries (scored DTF 16.28%) on dealing with construction permits (World Bank, 2016). Based on the rankings highlighted and other issues, including proliferation of front businesses, weak capacity of FIB, and land issues, that emerged during stakeholder consultations, it is unquestionable that Palau's investment climate requires substantial enhancement.

7.6 Measures to Attract more Foreign Direct Investment (FDI)

FDI is crucial for Palau's economic development. Most FDI into Palau come from the neighboring Asian economies, especially Japan and Republic of China. Recently, there has been some investments from PRC in the accommodation sector. Among other benefits, FDI increases the amount of capital to employ labor, purchase modern technology and facilitate transfer of human skills. Unfortunately, in the last years, FDI inflows into Palau have been very volatile (Figure 8). To some extent, this reflects the need for considerable structural reform in order to improve the business operating environment. As a starting point, investment promotion activities should be undertaken in key markets periodically. At the national level, communication tools such as regular and up-to-date Palau investment profiles should be produced and published. An investment guide should established as well. The investment guide should reflect priority sectors for investment and be aligned to National and State development strategies.

Figure 8: Palau Foreign Direct Investment, 2006-2013



Source: World Bank, PIFS Calculations 2015

7.7. Aligning Investment Regimes to National and International Dynamics

Both domestic and foreign investment have the potential to expand the current financial resources and increase business skills and entrepreneurship. These are necessary for Palau's development. For this to be achieved, the current foreign investment regime (the FIA) needs to be aligned to NMDP 2020. More so, investment-related policies should be flexible enough to foster long-term growth and attract quality investments in essential sectors. Attracting and retaining investment requires a paradigm shift towards the current development dynamics, which have a bearing on the direction of FDI. As such, setting of investment policies should consider the impact of regional integration and multilateralism on FDI direction and composition. In this regard, the deepening regional integration among the Pacific Island Countries, the emergence of Asian economies and Palau's proximity to Asian economies provide many opportunities to attract high quality FDI into Palau.

7.8. Strategies to Facilitate Investments and Address Front Businesses

The existing investment policies have yielded two unwanted results. One, the existing policies have seen decade-long volatilities in FDI (Figure 8). Two, existing policies have failed to attract high-quality foreign investors. Instead, front businesses have multiplied in sectors reserved for nationals. In this regard, this policy framework offers two strategies (adopted from MTDS, 2009-2014) to remedy the situation. The proposed strategies are: first, liberalize the foreign investment regime; and secondly, simplify and enforce the foreign investment regime. Strategy one suggests setting uniform regulations for both domestic and foreign investors (no reserve list for Palauan nationals), except a performance bond for foreign investors. On the other hand, strategy two "would involve strategy one", plus a small list of businesses and occupations reserved for Palauans exclusively. A number of specific presumptions for determining if a business enterprise is effectively set up as a front business have been adopted through recent amendments to the FIA. In fact, penalties for front businesses and activities based on civil liability and improved enforcement capacity are core to strategy two. However, even though the two options reflected above are economically viable and have the potential to reduce the number of illegal investments front businesses, further efforts to enhance investment procedures and processes (application, registration, property rights, investment promotion and retention, and enhancing FIB capacity) are indispensable.

7.8.1. Best Practices in Attracting FDI

Attracting FDI is a concern for almost every country due to economic benefits that come with these investments. In that struggle, some countries, especially the resource rich, have attracted a big share of the world's FDI envelope. Some other countries have faced challenges in attracting investment. For Palau, inflows of FDI have been volatile, usually plummeting, in the last decade (Figure 8). Thus, countries, especially natural resource poor countries have successfully attracted the right investments offer good practices for Palau to learn from. On the other hand, countries that have failed to attract investment also provide insights on what should be avoided as well as the nature of Investment Promotion Agencies that are needed. Below is an example of a best practice from which Palau might learn.

Malaysia's approach to matching skills development and FDI, lessons for Palau.

Malaysia is among the countries that have successfully attracted significant FDI inflows. In 2015, Malaysia attracted FDI inflows worth 3.7 percent of its GDP - US$296.2 billion (World Bank, undated). InvestPenang, a State Investment promotion Agency (IPA), established in 2004, is part of this tremendous success. InvestPenang's approach to attracting investors intends to match human skills and investment inflows. This is done in partnership with the PENANG Skills Development Center (PSDC). At the center, established businesses and local academia partner to train more than 10,000 workers needed to meet corporate growth plans. When the IPA was established in 2004, it found its niche to enhance that partnership to benefit foreign direct investors. The approach was simple: "expand the training program to form a tripartite of elements of the skill equation". The three elements are (1) the pool of companies; (2) the pool of educational institutions; and (3) the pool of workers to be trained. In the process, PSDC retained its initial goal to build the skills of companies already operating in Penang. On the other hand, investPenang took an additional task to develop skills needed by high-value industries that the State intended to attract. InvestPenang facilitates skills development through analyzing FDI trends and feeds local institutions of higher learning, including PSDC, with information on the skills needed to be competitive among targeted potential investors. To supplement the capacity of the PSDC, investPenang has integrated attracting foreign universities into its work program so as to expand training capacity in the region. These efforts have resulted into the establishment of a number of universities and a satellite training campus. Key institutions established include a satellite campus of the United Kingdom of Great Britain Northern Ireland's Hull University and the Asian Women's Leadership University. These universities provide a range of training programs in engineering, finance and accounting. This has contributed to increasing a highly-skilled labor force in critical areas which are needed to grow the State's priority sectors. On the other hand, investPenang continues to expand its size by attracting highly-skilled individuals from abroad. InvestPenang supplements local labor pool by contacting foreign-based Malaysians, matching job seekers with employers and advocating measures that improve living conditions in Penang for locals and expatriates. Moreover, investPenang holds regular labor opportunity awareness events for Malaysian students at universities in Australia, Japan and the United Kingdom. Concurrently, the Penang Career Assistance and Talent Centre has been established, managed by investPenang. The Center connects job seekers and recruiters.

Source: UNCTAD, IPA Observer, 2014

7.9. Policy recommendations

i. Review the FIA;
ii. Migrate from general category of sector and services to the WTO Services Sectoral Classification List to allow greater clarity of reserved sectors;
iii. Strengthen the human and financial capacity of the FIB;
iv. develop an investment guide, adaptive to reforms at State level;
v. use a positive list approach whenever liberalizing the investment chapter in any trade agreement;
vi. streamline business application and registration processes and procedures related to construction permits;
vii. Improve and/or establish legal instruments relating to insolvency and enforcing contracts; and
viii. Establish a one-stop shop.

8. Private Sector Development

The contribution of the private sector to Palau's national development is unquestionable. The private sector is a reliable source of valuable expertise and a key partner in the supply of public goods. Furthermore, the private sector provides the suite of skills and capacity needed to find new solutions and fosters national development. Moreover, in light of the sustainable development goals, the private sector can play a leading role in addressing development challenges in various sectors, whether in educational and health needs or environmental challenges. In economic terms, the private sector has the potential to create more decent jobs, invest in the production of goods and services for both domestic consumption and export, and contribute to domestic financing, which is essential for socio-economic development. In addition, as Palau strengthens its pursuit towards a self-reliant economy, the private sector is looked at as the main source of domestic and external finance. For this to happen, the business operating environment needs to be enhanced and streamlined even further.

8.1. Nature of Palau's Private Sector

Operations of Palau's private sector are somewhat intertwined with and influenced by trade with the rest of the world. That involves both domestic and international trade policies. For instance, a few days delay of a single import consignment is likely to affect over 70% of domestic business lines, mainly hotels and other recreational facilities. The Palau business community is largely dominated by MSMEs. Most MSMEs are involved in the distribution, wholesale and retail of imported products. Nevertheless, the MSMEs sector is still an active engine for Palau's economic development. The sector creates job opportunities for both locals and foreigners. Approximately 90% of foreign workers are employed in the private sector. More so, MSMEs contribute significantly to domestic financing in the form of taxes.

8.2. Overview of Palau's doing Business Environment

The status of Palau's business regulatory environment can be analyzed through the World Bank's annual doing business reports. These reports provide a holistic analysis of business operating environment in 189 countries, including Palau, based on 11 indicators. The latest report indicate that between 2015 and 2016, Palau's business regulatory environment worsened, especially in the areas of starting a business, dealing with construction permits, getting credit and paying taxes (World Bank, 2016). In short, in 2016, Palau ranked 136/189 countries reported in the ease of doing business report, declining from 131/189 countries the year before (World Bank, 2015). Despite some weaknesses in international data, this trend ought to be reversed to facilitate the development of private businesses. In general, key challenges hindering the potential of the private sector which should be resolved include low investments in productive capacities, outdated investment policies that hinder both domestic and foreign direct investment, poor product quality, difficulty in accessing business finance, stringent tax policies (such as the GRT) and the less streamlined investment processes and procedures.

8.3. Challenges and Opportunities

Today, Palau's private sector operates in a business environment with more opportunities and challenges than any other time in the country's history. The thriving tourism industry, stable macro-economy, and globalism provide many opportunities for the private sector to tap into, whilst contributing to national development. However, those opportunities require a very dynamic business community that can easily adjust to new realities (such as climate change) and the myriad of impacts of global integration. Any success in trade and investment depends upon the ability of private businesses to navigate the abovementioned challenges along market chains to exploit market opportunities. For Palau, this is being done amidst structural and natural challenges such as small domestic markets, the country's isolation from key international markets, infrastructure bottlenecks and stiff competition from developed and emerging economies, among others. In terms of trade and investment, Palau's terms of trade is somewhat unbalanced as imports continue to outweigh exports, and the inflow of foreign investments is still below the required FDI. As a result, both Palau's current and capital accounts depend on foreign aid for stabilization. This has contributed to the persistent unbalanced terms of trade and weak investments in productive capacities. However, the increasing gap between imports and exports reveals opportunities that investors can tap into through undertaking import substitution production in sectors in which Palau has comparative advantages. In this case, increasing productive capacities and narrowing the current trade deficits is central to this TIPF. As such, measures and incentives to facilitate import substitution and integration of Palau into national, regional and global value chains in a few sectors, especially in the agriculture sector, in which Palau has a comparative advantage should be facilitated. The role of the private sector in building productive capacities to add value and produce products to replace some imports is widely acknowledged and called for.

8.4. Access to Finance

Easy access to finance is essential for businesses, especially the MSMEs. The World Bank Doing Business Report provides indicators on access to finance across 189 countries, including Palau. At the global level, Palau has performed relatively poor on ease of access to finance indicators. In 2016, Palau ranked 79th/189 countries, and scored 50% on Distance to Frontier on getting credit index (World Bank, 2016). A 50% score on Distance to Frontier measure indicates that Palau is a bit far from the best performers on this specific indicator. Areas that need improvement to enhance access to finance and where Palau performs relatively poor on doing business indicators are access to credit information (Palau scored 0/8, under World Bank 2016 doing business report) and presence of a credit registry coverage and credit bureau coverage (Palau scored 0/8) (World Bank, 2016).

8.5. Strategies to Enhance Access to Finance, Through Moveable Collateral

One of the challenges facing both borrowers and financial lenders in Palau is collateral security. Land cannot be used as collateral to access finance. Excluding land from assets that can be used as collateral security limits the number of assets that can be used as collateral to get financial credit to only movable assets. The usual problem with moveable assets is that their validity is questionable. In most cases, the bearer of the asset might not be the actual owner. Confirming actual ownership involves screening costs and other transaction costs in general. One strategy to reduce transaction costs and increase confidence in assets is to establish a collateral registry. Collateral registries are preferred because of their potential to provide all necessary information regarding collaterals and reduce asset screening costs.

8.5.1. Establishment of Collateral registry.

“Since land is hardly used as a collateral security in Palau, moveable assets remains the only option. However, before accepting collateral, creditors need an effective way to find out whether the potential borrower has already granted a security interest in the collateral somewhere else and, if so, what priority those rights have. This can best be done where there is a centralized collateral registry—one that is unified geographically and recording interests in all types of movable assets. If registries are not unified across States, a creditor will have no way of knowing whether a security interest in an asset has already been registered in another jurisdiction. A need to search multiple registries increases transactions costs. Where registries are unified and computerized, a creditor can immediately check all the registries in an economy from one location by searching the debtor’s name. Collateral registries therefore support the use of movable collateral to secure loans. Studies show that establishing a new collateral registry can have an economically significant impact. In economies undertaking such reforms, access to bank finance increases by about eight percentage points on average, while interest rates decline by about three percentage points and the terms of loans increase by about six months. The positive impact tends to be larger for smaller firms. The other option is to integrate ICT property management. One model practice is a notice-based registration and allowing online access to data. While traditional registries usually require a copy of the loan agreement or other documents, notice-based registries require no documentation other than a simple generic form that records the existence of a security interest, providing the names of the creditor and the debtor as well as a general description of the collateral asset and the obligation secured. This avoids the need for a specialist to review lengthy documents, which can be costly and time-consuming. It also improves the quality of registration. With less documentation, the potential for errors is minimized. Online systems allow users to perform searches and register security interests from anywhere and at any time. Unlike with paper-based systems, there is no need for users to appear before the registrar and wait their turn to enter information in the registry index. Online registration also transfers the burden of preventing errors to the interested party.”

Source: World Bank, Good practices.

8.6. Internal Taxes and Charges

In addition to customs duties, Palau has various types of internal taxes. These are the GRT (4%) and wages/salary tax (6%). For the latter, 6% is imposed on the first US$8,000 of salaries or wages earned and salaries and wages above US$8,000 attract 12% tax. Other forms of internal taxes include a hotel room tax (15%), amusement device tax (US$200), Environmental Impact Fee (US$100), road use tax, foreign water vessel tax, annual levy and vessel cabin tax (10%). Palau does not have a corporate tax, which is a great incentive to investors. Palau has yet to review its internal tax structure to match the current development dynamics. The World Bank indicates that, in 2016, Palau’s total tax rate (as a percentage of profit) was 75%. This is twice the average of East Asia and the Pacific, where tax rate as a percentage of profits total is 34% (World Bank, 2016).

8.7. Government support to private sector development

The Government of Palau is keen to facilitate the development of the private sector, including through public-private partnerships (PPPs), where needed. At the moment, the Government has facilitated the establishment of institutions to support the development of the private sector. Notable ones include the well-established and functioning National Chamber of Commerce. The Chamber acts as the representative and advocacy arm of private sector actors. The Government, in partnership with development partners, has also established and continues to support the Small Business Development Center (SBDC). The Center is fundamental to the growth of small businesses amidst its capacity constraints. Moreover, a joint public-private sector dialogue forum (Annual Economic Symposium) is fully operational. The Symposium brings together Government, private sector operators and regional and international experts on an annual basis to discuss issues pertinent to the development of Palau, including a re-look into favorable policies necessary for the development of private businesses.

8.8. Policy Recommendations

i. Consider the establishment of a business incubator.
ii. Define and categorise SMEs to facilitate the appropriate allocation of preferential finance.
iii. Enhance the capacity of the SBDC to provide technical assistance to MSMEs in access to finance. This should include conducting capacity-building workshops/seminars on preparation of business plans, project proposals, among others.
iv. Increase the ratio of credit given to private businesses.
v. Establish a taskforce (involving the National Development Bank and SBDC) to oversee credit allocation to MSMEs and provide advice on flexible modalities to access finance.
vi. Develop a private sector development strategy. The strategy should include a MSME development action plan. Where necessary, it is recommended that the implementation of the private sector development strategy report to the Office of the President.
vii. Review the current investment policies (FIA) and tax policies (moving from GRT to VAT).
viii. Streamline investment processes and procedures. This includes considering migrating to online business registration and application platforms and establishing a single/one-stop shop.
ix. Facilitate product development through value addition and product differentiation through awards and special recognition.

x. Enhance entrepreneurship skills through training and providing up-to-date business information.
xi. Enhance the capacity of the Bureau of Commercial Development.

9. TRADE-RELATED ISSUES

In this Chapter, key trade-related issues that have direct or indirect influence on trade, investment and private sector development are briefly highlighted.

9.1. Competition and Consumer Protection

For a small economy like Palau, uncompetitive business practices may hurt both consumers and producers. This includes both low income households and MSMEs. As such, the Government has established a raft on measures to deter any uncompetitive business practices. The existing policy instruments that ensure competitive business practices include the unfair business regulations (11 PNC Ch. 1); the Consumer Protection Act (11 PNC Ch. 2) and anti-price gouging regulations (11 PNC Ch. 15). The Unfair business practices regulation prohibits the use of capital, skills or other acts to restrict trade or commerce, limit/reduce production of a commodity, set product price, undertake price discrimination, and deter competition and contractual arrangements. In addition, the Consumer Protection Act declares 13 unlawful methods of competition, deceptive acts or practices in the conduct of trade or commerce and sets exemptions to and restraint of such prohibited acts. The anti-price gouging regulation prohibits the sale or offer for sale of vital goods or services necessary for health, safety, and consumers' welfare at excessive price(s) following an abnormal market disruption. By 2016, there were no reported disputes related to uncompetitive business practices. However, even though there are many policy-guiding instruments relating to consumer protection and competition, their implementation is slack and some regulations are outdated.

9.1.2 Policy recommendations

i. Expedite the enforcement of the unfair business regulations, the Consumer Protection Act and Anti-Price Gouging regulations;
ii. Review the Unfair Business Regulations to explicitly include mergers and acquisitions;
iii. Undertake periodic market surveillance missions to verify measurement instruments.

9.2 Government Procurement

9.2.1 Public Sector Market

The public sector accounts for a big component of Palau's domestic market, mainly the labor market. The Government employs approximately 60 per cent of citizens and close to 10 percent of foreign workers. The Government also provides essential services to the general public through full or partly State-owned enterprises. The provision of these services involves purchasing goods and services from private businesses. Due to the importance and size of this market, government procurement has gained traction in preferential trade agreements, mainly between developed economies. At the time of writing this policy, Palau had not yet joined any trade agreement containing government procurement provisions.

9.2.2. Spending on Government Procurement and Policies

Globally, in 2013, governments on average spent 29% of their total expenditure on public procurement (OECD, undated). For Palau, public procurement consumes a significant share of domestic finances, usually between 40 and 43% of its GDP. Much of Palau's public spending goes to salaries, wages and infrastructure. Due to the size of public spending, the public procurement process is a potential hotspot for corruption and other malpractices if not properly managed. As such, the Government has undertaken various legal reforms in its procurement processes and procedures to ensure value for money, limit corruption and deter other malpractices in government procurement processes. Key policy instruments promulgated to ensure clear government procurement procedures include the Public Auditing Act, the Special Prosecutor Act, the Code of Ethics, the Money Laundering and Proceeds of Crime Act and the Government Procurement Act (OECD, undated). The latter stipulates procurement guidelines and modalities to execute any public procurement. Palau has a centralized public procurement system. The Ministry of Finance processes all public procurements for the Executive Branch. Congress, the Judiciary and some semi-autonomous agencies can procure their good and services up to a certain expenditure level. The same policies shall be used in procuring services and goods relating to the implementation of the TIPF.

9.2.3. Procurement Processes and Procedures

The Government Procurement Act stipulates methods and procedures to be followed whilst conducting procurement processes. Public procurement may be undertaken through three modalities. One is through a competitive bidding process. This applies to any procurement of at least US$10,000. Second is through a restricted tendering process. This applies to procurements between US$5,000 and 10,000. Third is through single sourcing. The latter modality applies to procurement of less than US$10,000 and when there is only one reliable supplier. Lastly, emergency procurement is provided for as may be determined by the existing situation. However, some gaps still exist in the procurement policy itself. For instance, some terminologies are not defined and only the Procurement Officer has sole rights to interpret unclear terminologies. Moreover, the participation of small businesses in public procurement is still low. Reasons for low participation of small businesses in public tenders is two-fold. One is that micro- and small businesses hardly receive information in time. Secondly is that their capital is small, limiting their ability to compete for high public procurement. Even when they can raise the capital, they do not have enough technical skills to prepare competitive tender proposals.

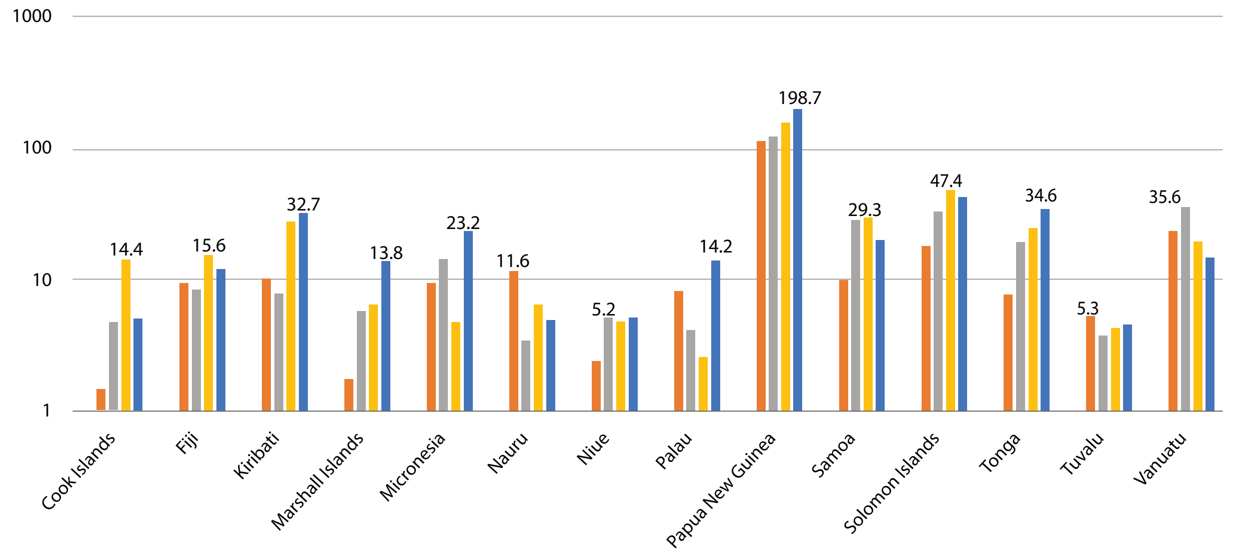
9.2.4. Policy recommendations

i. Adopt a Public-Private Partnership Act or establish a built-in mechanism to guide and allow PPP for big projects, especially infrastructure projects;
ii. undertake periodic capacity-building training for procurement officers, especially on integrity, audit, project analysis and management among others;
iii. Encourage (where appropriate) SMEs to participate in government procurement;
iv. Establish a procurement manual guide with clear definitions of all relevant terminologies (currently, interpretation of terminologies is at the discretion of the procurement officer); and
v. Conduct a thorough cost-benefit analysis before joining any trade agreement containing government procurement provisions.

9.3. Aid for Trade (AfT)

All kinds of aid from various development partners have had a fundamental contribution to Palau's national development. AfT is a decade-old initiative that was born during the 2005 WTO Hong Kong Ministerial Conference. This gave birth to a new category of Official Development Assistance (ODA), which pays special focus on trade capacities and addressing supply side constraints. The initiative was introduced by WTO Members, and has benefited Palau in different ways. Broadly, disbursement of AfT resources targets mainly trade-related technical assistance and capacity-building, addressing supply-side constraints (trade-related infrastructure and building productive capacities) and trade-related adjustments. Reducing trading costs is among the goals of the AfT initiative. With AfT resources, Palau has been able to address some of the supply-side constraints, paving the way for its integration into the global trading economy. For instance, the number of days required to export has declined from approximately 28 days (in 2006) to 25 days (in 2015), while the cost to export a container has fallen from approximately US$1,200 (in 2006) to approximately US$800 (in 2015). However, much remains to be done in the area of building national productive capacities (especially niche Palau products with potential to penetrate regional and international markets) and private sector development in general. The distribution of AfT resources among the Pacific Island Countries is uneven. This is in favour of the big economies (Figure 10, below). Hence, the implementation of this TIPF intends to enhance Palau's access to AfT resources as well as ensure proper management and allocation of AfT resources to priority areas identified in this Framework.

Figure 9: Aid for Trade Disbursement to PICs (in US$ Million), 2013.



Source: OECD/WTO 2015,A4T at Glance.

From Figure 10 above, the largest quantum of AfT resources thus far received by Palau is US$14.2M. This is much less compared to what other large Pacific Island Countries, such as Vanuatu, Solomon Islands, and PNG have received. By sector analysis, over the last five years the energy sector has consumed over 78% of Palau's AfT resources, followed by the fisheries sector (9.6%) and communications (5.7%). Trade policies and regulations accounted for less than 2%. In general, the disbursement of AfT resources to Palau has been uneven. With variations between US$1.4M (2011) and US$14.3M (2013). These variations need to be narrowed and AfT resources increased on average to ensure the effective implementation of this TIPF.

Table 2: Palau Aid for Trade Disbursements (Current prices, US$ M) by Sector

Sectors	2010	2011	2012	2013	2014	% Average AfT
II.1. Transport & Storage, Total	0.1		0.0	0.0	0.2	1.0
II.2. Communications, Total	0.3	0.4	1.0	0.1	0.1	5.7
II.3. Energy, Total	7.0	0.5	0.7	12.9	3.3	78.8
II.4. Banking & Financial Services, Total			0.4	0.0		1.3
II.5. Business & Other Services, Total				0.1		0.3
III.1.a. Agriculture, Total	0.1	0.0		0.1	0.0	0.9
III.1.b. Forestry, Total			0.0			0.1
III.1.c. Fishing, Total	0.6	0.3	0.6	0.9	0.6	9.6
III.2.a. Industry, Total		0.0				0.0
III.3.a Trade Policies & Regulations, Total	0.0	0.1	0.2	0.2	0.1	1.9
III.3.b. Tourism, Total	0.0	0.0		0.0	0.0	0.4
Total	**8.0**	**1.4**	**2.9**	**14.3**	**4.3**	**100**

Source: OECD, 2016

9.3.1. Policy Recommendations

i. Ensure that trade agreements negotiated contain provisions on development co-operation/ assistance to facilitate the implementation of the same agreements. In this case and where possible, the Government shall develop a number of development projects (indicating the required soft and hard infrastructure with clear milestones and required resources related to each trade agreement signed between Palau and a developed economy.

ii. Prioritize allocation of AfT resources to the implementation of recommendations highlighted in this TIPF, most especially support for the development of productive capacities, niche products and the private sector;

iii. In partnership with development partners, train private sector, trade and investment officials on the preparation of good technical project proposals to access third party AfT resources; and

iv. Formulate a national AfT strategy or action plan. The strategy or action plan should identify sectors where AfT resources should be allocated to best address supply-side constraints.

9.4 Land

Development of trade and investment depends upon the availability of land. Similar to most Pacific Island Countries, land is a scarce economic resource in Palau. Moreover, availability of arable land is limited and unevenly distributed. Most of the arable land is located on Babeldaob Island. Land scarcity has resulted in poor settlement patterns and informal land markets. There is also the issue of unclear property rights. In fact, land is not properly demarcated in all States. This has resulted in regular land disputes, between both people and some States. This affects many sectors of the economy, mainly potential investors in the tourism sector. It also contributes to the current shortage in tourist accommodation highlighted in this TIPF. Broadly, land issues in many ways have affected the entire Palau business environment. In 2016, Palau is ranked 136/190 countries in ease of doing business (World Bank, undated). The business environment is affected by a confluence of factors, with access to construction permits playing a big role. In 2016, Palau ranked 94/189 countries reported on dealing with construction permits. In 2017, it will move to 98/190 countries (four places down) on the same indicator (World Bank, 2016). This decline in the area of construction permits is a result of lengthy procedures and delays involved in seeking a construction permit. For instance, in 2016, obtaining a mere clearance to construct on a given piece of land took seven days (World Bank, 2016). This is almost 10% of the entire duration (72 days in 2016) it takes to get a construction permit. This situation has to be reversed in order to facilitate the development of trade and investment.

9.4.1 Strategies to Enhance Trade and Investment

The construction process involves a number of procedures. Some of these are related to access to land for construction while others are policy-related. This process involves a number of agencies, each providing technical oversight and stamping its approval. In Palau, getting a construction permit involves 19 procedures. The whole process takes 72 days. On average, getting a construction permit in East Asia and the Pacific involves only 15 procedures (World Bank, 2016). Given the size of the Palau economy, those procedures are many and streamlining some is possible. Below is a summary of some strategies that may be adopted to facilitate trade and investment in the construction sector and the related tourism industry in particular.

Strategy One: Establish one-stop shop to provide coordination of construction process.

One way to simplify the current lengthy construction process is by establishing a one-stop shop to handle construction processes and procedures. One-stop shops have proved successful in many countries. For instance, Taiwan, R.O.C., established its first one-stop shop for construction permits in 2011. By 2012, the number of procedures required to process permit applications had fallen from 25 to 10 and the processing time reduced from 125 days to 94. Also one-stop shops are preferred for their potential to increase efficiency in service delivery whilst cutting costs for businesses. This was the case for Burkina Faso. In 2006, Burkina Faso was among the 10 economies with the most complex requirements in the world. In 2008, Burkina Faso opened a one-stop shop for construction permits. A new regulation was introduced that merged 32 procedures into 15. This reduced the time required to process a construction permit from 226 days to 122, and cut the cost by 40%. However, it should be noted that the efficiency and success of one-stop shops depends on good coordination among all agencies involved in the processes. So, establishing overarching legislation to provide for information-sharing and oversight mechanisms to minimize cases of non-compliance is required.

Strategy two: Differentiate investment projects by risk

The fact that all construction projects go through the same approval process does not mean that risks associated with each project are the same. Different construction projects have varying cultural, economic or environmental risks. For instance, risks associated with the construction of a chemical industry near a water reservoir are not similar to ones associated with constructing a hospital or skyscraper. Worldwide, the main criteria used to classify a construction project by its potential risk are based on the building's use, location and size. Efficiency-seeking governments have implemented rigorous yet differentiated construction permitting processes to treat buildings according to their risk level and location. For instance, in 2012, Ukraine adopted a risk-based approval system. This system classifies construction projects into 5 categories based on their complexity, with categories 1–3 being simpler buildings. This has simplified the process and streamlined the procedures needed to obtain construction permits for less complex buildings like warehouses, which fall into category 3. For warehouses the requirement to obtain a construction permit was replaced with a requirement to

provide notification that construction works had commenced.
Strategy three involves ensuring proper zoning, reducing costs associated with land registry, establishing building codes and undertaking land appraisal in strategic locations.

Source: summarized from World Bank Good practices

9.4.2. Policy Recommendations

i. Establish land-use plans, zoning laws and regulations, and enhance the required institutional capacity to implement land-related policies;
ii. Establish a regular forum for national-state cooperation on zoning, land-use planning and other policies affecting land use;
iii. Consolidate the formal registrar of titles to a single, efficient and reliable source;
iv. Conduct community awareness of the value of land;
v. Establish clear land expropriation policies;
vi. Work with and assist States establish building codes and land-use master plans; and
vii. Locate, and develop land for potential investors in selected sectors, starting with the Free Trade Zone

Annex I

10. Institutional Arrangement for the Implementation of Palau's Trade and Investment Policy Framework

The scope of trade and investment policies is complex, involving private sector actors, public institutions, development partners and Non-State actors. This implies that the implementation of this policy will require the intervention of various agencies. In this regard, an inclusive institutional arrangement is necessary to ensure that all stakeholders engage seamlessly and in a coordinated manner.

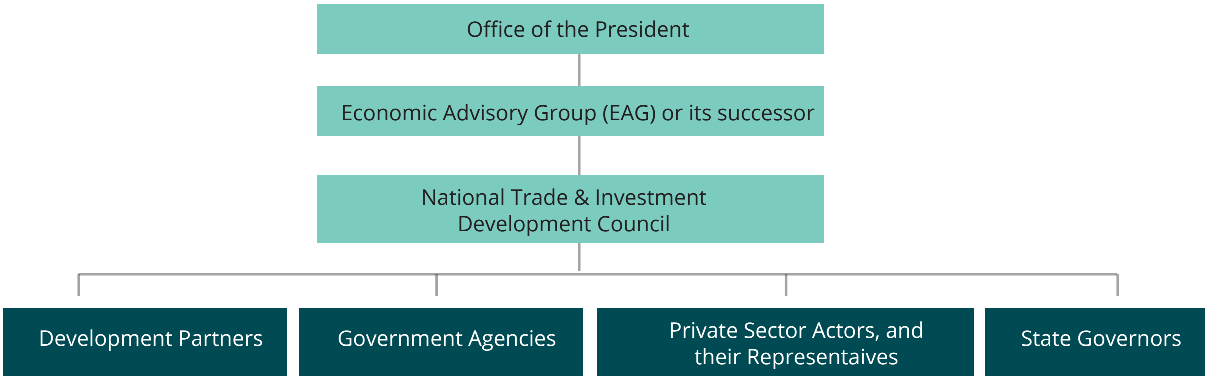
10.1 Establishment of the National Trade and Investment Development Council

For a specific mandate, the National Trade Facilitation Committee was established to facilitate trade negotiations that Palau is engaged in. The Committee is still in existence; however, the enlargement of Palau's trade and investment policy agenda requires the mandate of the Committee to be reviewed so as to strengthen its capacity and broaden its scope to implement this Policy Framework. In addition, consultation with stakeholders revealed the need to rename the "National Trade Facilitation Committee" as "National Trade and Investment Development Council" (NTIDC). This suggestion reflects a shift in Government's vision from mere 'trade facilitation' to 'trade and Investment development' which covers the development of the private sector and building productive capacities. In addition to the National Trade Facilitation Committee, the Economic Advisory Group (EAG) was established and is fully operational. The membership and mandate of the EAG is quite broad, encompassing the private sector and public agencies. Consultations with stakeholders suggested maintaining the EAG or its successor as the top body responsible for the implementation of this TIPF. As such, the National Trade Facilitation Committee (to be renamed) should report directly to the EAG or its successor. On the other hand, the EAG or its successor will periodically report to the Office of the President regarding the implementation of this TIPF. In addition, the EAG or its successor will ensure that the implementation process is inclusive, secure funds (from the regular national budget and development partners) and guide allocation of resources to implement recommendations of this TIPF. The EAG shall further set targets, oversee and synchronize the activities of all the different institutions that contribute to the implementation of this Policy Framework.

10.2. Establishment of Institutional Framework

In recognition of the above, a structured institutional arrangement to coordinate and oversee the implementation of this TIPF is depicted below (Figure 11). The arrangement builds from the current mandate of the National Trade Facilitation Committee and recognizes the role of the EAG in the implementation of trade and investment policies. In addition, it seeks the involvement of State Governors in the implementation of this Policy Framework. This reflects the Government's approach to inclusive governance and its pursuit of mainstreaming trade into national and state development plans/strategies.

1.1 Figure 10: Organizational Chart: Institutional arrangement for the implementation of the National Trade & Investment Policy Framework



To assist in the implementation of or addressing an urgent specific sector trade and trade-related issues, the following Sector Working Groups (SWGs) are established.

a. Sector working group on Market Access and Trade Facilitation.
b. Sector working group on Investment and Private Sector Development.
c. Sector working group on Tourism.
d. Sector working group on Agriculture and Manufacturing.

10.3. Roles and Responsibilities of each Organ

The EAG or its mandated successor shall provide oversight, monitor and evaluate the implementation of this TIPF. It has the powers to assign specific duties to the chairs of the NTIDC or SWGs. In addition, the EAG may establish a new SWG depending on the existing circumstances or to accomplish a given task. Chairing and reporting of the EAG meetings shall be in accordance with the existing Executive Order establishing the EAG. In terms of AfT resources, the EAG and the chair of the NTIDC will liaise with development partners and international organizations in the implementation of this TIPF. In addition, the EAG will provide bi-annual updates/reports to the Office of the President, as well as undertake any directives from the President. The NTIDC is responsible for technical oversight in the implementation of this Policy Framework. NTIDC meetings shall be chaired by the Minister for Public Infrastructure, Industries and Commerce or his/her designee. The NTIDC shall meet on a quarterly basis and provide bi-annual (January-June and July-December each year) progress reports on the implementation of this TIPF to the EAG. SWGs are not expected to meet on a regular basis, except where necessary. As such, they shall only meet in case a specific sectoral issue emerges. In the event a SWG meeting is convened, representatives of the private sector and State governors (where possible), shall be invited. Within a period of 14 working days after the meeting, the Chair of the SWG meeting shall provide a report to the Chair of the NTIDC.

10.4. Establishment of the Joint Secretariat

The Ministry of Public Infrastructure, Industries and Commerce and the Chamber of Commerce shall form a Joint Secretariat responsible for the implementation of TIPF. They shall be in charge of producing bi-annual progress reports and convening NTIDC and EAG meetings. The Joint Secretariat shall follow upon SWGs, if any, and prepare monitoring and evaluation frameworks. Further, the representative of Ministry of Public Infrastructure, Industries and Commerce shall be the chair of the NTIDC, whereas the representative of the Palau Chamber of Commerce shall be the co-chair.

10.5. Implementation and Review of the Trade and Investment Policy Framework

This TIPF shall be implemented in accordance with the implementation matrix attached (to be developed later). The EAG or any other mandated body shall be the overall administrative institution responsible for monitoring and evaluating the implementation of this TIPF. This Policy framework shall be reviewed in a period not less than 3 years unless otherwise required. The review shall be through a consultative process involving all the relevant stakeholders at national, state and regional levels.

10.6. Policy Recommendation

It is recommended that:

i. The National Trade Facilitation Committee (NTFC) be renamed as the National Trade and Investment Development Council (NTIDC), and report to the EAG or its successor organ. This shall include seeking the expansion of the existing NTFC Mandate.

ii. The NTIDC capacity be strengthened. Where appropriate, a trade policy officer shall be recruited to coordinate the implementation of this policy.

Annex II:

11. List of Acronyms, Tables and Figures.

11.1. List of Acronyms

ACP: Africa, Caribbean and Pacific
ADB: Asia Development Bank
AfT: Aid-for-Trade
BMR: Bureau of Marine Resources
BOT: Bureau of Tourism
BTA: Belau Tourism Association
CFAS: Compuct Freely Associated States
CIF: Cost, Insurance and Freight
CSO: Civil Society Organisation
CTF: Compact Trust Fund
DTF: Distance to Frontier
EAG: Economic Advisory Group
EBA: Everything but Arms
EEZ: Exclusive Economic Zone
EPA: Economic Partnership Agreement
EQPB: Environmental Quality Protection Board
EU: European Union
FAO: Food and Agricultuure Organisation
FDI: Foreign Direct Investment
FDIC: Federal Deposit Insurance Corporation
FIA: Foreign Investment Act
FIAC: Foreign Investment Approval Certificate
FIB: Foreign Investment Board
FIC: Financial Institutions Commission
FICs: Forum Island Countries
FIT: Free Independent Travellers
FOB: Free on Board
FPR: Framework for Pacific Regionalism
FSM: Federated States of Micronesia
FTA: Free Trade Area
FINANCIAL YEAR: Financial Year
GDP: Gross Domestic Product
GFC: Global Financial Crisis
GRT: Gross Revenue Tax
GSP: Generalised System of Preference
HS: Harmonized System
ICT: Information and Communications Technologies
IUU: Illegal, Unregulated and Unreported
LDCs: Least Developed Countries
MFN: Most Favored Nation
MoU: Memoradum of Understanding
MSC: Monitoring, Control and Surveillance
MSMEs: Micro, Small and Medium Entreprises
MTDS: Medium-Term Development Strategy
MTEC: Micronesia Trade and Economic Community
NADP: Natioanl Aquacultre Development Plan.
NDBP: National Development Bank of Palau
NDP: National Development Plan.
NGOs: Non-Governement Organisations
NMDP: National Medium Development Plan
NTB: Non-Tariff Barrier
NTIDC: National Trade and Investment Development Council
NTFC: National Trade Facilitation Committee
ODA: Official Development Assistance
OECD: Organisation fo Economic Cooperation and Development
PACER: Pacific Agreement on Closer Economic Relations
PAN: Protected Area Network
PCAA: Palau Community Action Association
PCC: Palau Community College
PCOC: Palau Chamber of Commerce
PCS: Palau Conservation Society
PICTA: Pacific Island Countries Trade Agreement
PIFS: Pacific Islands Forum Secretariat
PMDC: Palau Mari-culture Demostration Center
PNA: Parties to the Nauru Agreement
PNG: Papua New Guinea
PPP: Public-private partnership
PRC: Peoples Republic of China
PVA: Palau Visitors Authority
RMI: Republic of Marshall Islands
RoO: Rules of Origin
RTA: Regional Trade Agreement
SBDC: Small Business Development Center
SPC: Secretariat of the Pacific Community
SPS: Sanitory and Phytosanitory
SWG: Sector Working Group
TBT: Technical Barriers to Trade
TIPF: Trade and Investment Policy Framework
TIS: Trade In Services
TNC: The Nature Conservancy
TPP: Trans-Pacific Partnership
TTM: Taiwan Technical Mission
UNCLOS:United Nations Convention on the Law of the Sea
UNFSA: United Nations Fish Stocks Agreement
US: United States of America
USDA: United States Department of Agriculture
VAT: Value Added Tax
WCPFC: Western and Central Pacific Fisheries Commission
WIPO: World Intellectual Property Organization
WITS: World Integrated Trade Solution
WTO: World Trade Organisation

11.2. List of Tables.

11.2.1. List of Figures.

Annex III:

12. References

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