



# Technical Assistance Consultant's Report

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**PUBLIC**

Project Number: KSTA 54059-001  
March 2024

## Assessing and Improving Policy Response to Economic Shock in Palau

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Prepared by Emil Friberg, Ph.D., with support from the GSUSA EconMAP team

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For Asian Development Bank

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**Asian Development Bank**





ASIAN DEVELOPMENT BANK

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March,  
2024

Palau's  
Koror–Babeldaob  
Bridge



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## Foreword

Coronavirus disease 2019 (COVID-19) was a significant external shock to the three ADB North Pacific developing member countries (DMCs): the Federated States of Micronesia, the Republic of the Marshall Islands, and the Republic of Palau. For the three nations, ADB provided support to address the adverse economic impacts of the pandemic on government revenue, private sector businesses, and households.

This review provides an assessment of Palau's policy response to the COVID-19 pandemic, outlining the timeline of key Palau government and donor actions, evaluating the implementation of mitigation programs, and providing a presentation of Palau's economic experience during the COVID Period, Fiscal Years 2020-2022 and Post-COVID FY 2023. Observations on this experience are outlined as lessons learned, and data gaps that emerged during the COVID Period are outlined to strengthen the response and planning for future economic shocks.

Further, this review presents an in-depth assessment regarding four data areas where ADB has identified data gaps: migration, remittances, foreign direct investment (FDI), and small-to-medium enterprise (SME) information. For these four areas, this report reviews the existing public information on each topic from Palau government and international sources. In several cases, underlying Palau survey/census data and administrative records/data are analyzed to provide additional insights. This demonstrates how existing data and records can be used further to understand migration/remittances and FDI/SMEs. Suggestions to improve data availability are also offered.

This review was conducted in 2022 and 2023. Interviews and data collection took place in Palau in July 2022 and October 2023. A draft report for the ADB was finalized in December 2023.



## Abbreviations

ADB	Asian Development Bank
BOP	Balance of Payments
BRT	Bureau of Revenue and Taxation (Palau)
CARES Act	Coronavirus Aid, Relief, and Economic Security Act (US)
CDC	Centers for Disease Control and Prevention (US)
CDF	Contingent Disaster Financing (ADB)
COVID-19	Coronavirus disease 2019
CPRO	COVID-19 Pandemic Response Option (ADB)
CROSS Act	Coronavirus One Stop Shop Relief Act (Palau)
DRCEF	Disaster Resilient Clean Energy Financing (ADB)
DMC	Developing Member Countries (ADB)
DOL	US Department of Labor (US)
DRP	Disaster Resilience Program (ADB)
DSA	Debt Sustainability Analysis
EconMAP	Economics Monitoring and Analysis Program (GSUSA)
EIN	Employer Identification Number
FAS	Freely Associated States
FDI	Foreign Direct Investment
FIAC	Foreign Investment Approval Certificate (Palau)
FIB	Foreign Investment Board (Palau)
FIC	Financial Institutions Commission (Palau)
FPUC	Federal Pandemic Unemployment Compensation (US)
FSM	Federated States of Micronesia
FY	Fiscal Year
GDP	Gross Domestic Product
GSUSA	Graduate School USA
HIES	Household Income and Expenditure Survey
IIP	International Investment Position
KNOMAD	Global Knowledge Partnership on Migration and Development
makit	a Palauan word for market, but is more narrowly oriented towards fish, crabs, and produce sold at open-air stands in “informal” markets
PBL	Policy Based Loan (ADB)
PFM	Public Financial Management
PGST	Palau Goods and Service Tax (Palau)
PIHOA	Pacific Island Health Officers Association
PPE	Personal Protective Equipment
PPUC	Palau Public Utilities Corporation (Palau)

PRC	People's Republic of China
PUA	Pandeic Unemployment Assistance (US)
PVA	Palau Visitors Authority (Palau)
RISES	Recovery through Improved Systems and Expenditures Support (ADB)
RMI	Republic of the Marshall Islands
RPPL	Republic of Palau Public Law
SME	Small and Medium Enterprise
SOE	State-owned enterprise
SSA	Social Security Administration (Palau)
TIN	Taxpayer Identification Number
US	United States
UNICEF	United Nations Children's Fund
WHO	World Health Organization
WIOA	Workforce Investment and Opportunity Act (US)

NOTES: Palau government fiscal year (FY) ends on September 30.

Currency unit: United States dollar (US\$).

Figures may not add in this report due to rounding.

## Acknowledgments

The authors would like to thank officials from the Government of Palau for their valuable time in discussing their implementation of programs during COVID as well as for providing data regarding the mitigation period and the four data under special review. Offices consulted included: Ministry of Finance (Bureaus of Budget and Planning, Customs and Border Protection, National Treasury, and Revenue and Taxation); Ministry of Health and Human Services; Ministry of Human Resources, Culture, Tourism & Development; Financial Institutions Commission; Foreign Investment Board, Palau Visitor Authority, and the Palau Workforce Investment and Opportunity Act (WIOA) office.

The authors also benefited from meetings with the Embassies of Australia; Japan; Taipei, China; and the United States as well as representatives of the Palau Chamber of Commerce and The Filipino Community in Palau.

In addition, the authors would also like to thank Katherine Barrameda, Paul Curry, Jung Ho Kim, Zoe Kintaro, Alfonsa Koshiba, Rommel Rabanal, Emma Veve and other staff of the Asian Development Bank who assisted them in various phases of this research. Any errors or omissions remain the responsibility of the authors.

## Executive Summary

### Palau's COVID Response and Experience

#### *Palau Health and Economic Response Initiated with Donor Support*

The worldwide COVID-19 pandemic began unfolding in tourism-dependent Palau in early 2020 and Palau's largest industry collapsed. Palau's overarching goals were to minimize the import of COVID and to delay community spread. Bolstered by its recent experience with a dengue outbreak, the Palau government began traveler screening and quarantine in late January/early February from some countries. But events overtook planning and Palau's border was closed by airline decisions in mid-March. Fortunately, Palau avoided importing COVID during February-March 2020 and with no air arrivals, scaled back several community restrictions by mid-May. Palauans lived more normal lives than the rest of the world during COVID.

The closure of borders protected Palau from the 2020 transmission that circulated worldwide and gave Palau time to distribute vaccines and to prepare for COVID transmission before community spread of the disease. COVID vaccinations began by the end of 2020 and Palau benefitted from widespread community support for the vaccination campaign. Community spread did not occur until early 2022, after the population had been vaccinated. As of June 2023, Palau had recorded only 9 deaths, out of 6,018 cases. Officials planning the vaccine campaign reported that they lacked current data on the population and geographic distribution of households, as well as reliable information on the foreign worker population.

In addition to its public health operations, the government took steps to maintain government operations and support tourism-dependent businesses and workers. By April 2020, the Palau Legislature authorized the President to borrow \$60 million for the purpose of offsetting lost government revenues and for mitigating the economic and social impacts of COVID-19. The government benefitted from timely economic projections of the impact of the COVID pandemic on tourism, business operations, employment, and government revenue. The availability of business and employee tax and social security data enabled the economic projections of COVID's impact. The government established programs under the Coronavirus Relief One Stop Shop Act (CROSS Act) to address the negative impact on the private sector due to the collapse of tourism.

Palau prioritized protecting health over reopening the economy. This tradeoff was faced in almost all nations, but tourism-dependent economies were most greatly affected by closing the economy to travel. Palau primarily focused on protecting health, but in limited ways tried to restart tourism with a "sterile corridor" for tourism with Taipei, China. However, this approach retained quarantine, testing, and limits on movement and was costly. It failed to lift the economy; an experience seen around the world where travel bubbles were tried. Following community spread of COVID, Palau reopened its borders, but tourism did not spring back. Ultimately, Palau's economic recovery is dependent on external actors and their decisions to travel again.

These government efforts were made possible due to donor loans and assistance. ADB reports it provided Palau almost \$119 million in resources from 2020 to 2022, with \$115 million as loans. ADB loans stabilized public sector employment and provided resources to support the private sector work force, especially the unemployed foreign workers. In the absence of this support, Palau would have faced widespread

unemployment accompanied by destitution. ADB loans prevented a humanitarian and social crisis. The US government provided Palau about \$64 million in support, including in-kind support for the health sector, but primarily \$52.2 million made available as unemployment benefits to Palau (and Micronesian, Marshallese, and US) citizen workers. Other donors included Australia, Japan, New Zealand, and Taipei, China. Together, donor loans and assistance successfully sustained the economy, livelihoods, and government operations.

### *Palau Implemented Mitigation Programs*

The Palau Ministry of Finance implemented the government's economic and fiscal response to the COVID pandemic and secured ADB loans that funded government operations and private sector support. Funds also supported efforts to repatriate Palauans stranded overseas. Data from tax and social security records enabled the Palau government to craft its Coronavirus Relief One Stop Shop Act (CROSS Act) and helped Finance implement the programs. The CROSS Act for the private sector included: business loans, temporary jobs, unemployment benefits, non-resident worker employment transfers, and utility assistance.

Throughout the COVID period, Palau prioritized workers relative to firms in mitigation efforts. Of the \$19.1 million spent through the CROSS Act, 48 percent went for unemployment benefits and 27 percent paid for temporary jobs. COVID-impacted businesses received about 7 percent of CROSS Act assistance, and the loans were relatively small and not scaled for the large tourism hotels most affected by the COVID closure. For unemployed workers, Palau provided most of the temporary jobs to Palau citizens and maintained humanitarian levels of aid mostly for unemployed foreign workers.

Palau unemployment program incentives did not compete with employers. Palau set the payment structure for the temporary jobs program at the minimum wage so that temporary job earnings would not exceed the earnings of jobs available in the private or public sectors. For the unemployment/humanitarian assistance program, Palau set the payment level to be less than the minimum wage, such that holding any available job would yield more income. Palau rejected a strategy of large-scale repatriation of foreign workers, seeking to maintain the foreign workforce for reopening the tourism economy.

Palau disbursed \$47.4 million of US Coronavirus Aid, Relief, and Economic Security (CARES) Act unemployment grant assistance to support 1,384 unemployed workers. The Palau government had no input into the CARES Act benefit structure and program payments were several times higher than local wages. Palau CARES Act implementation also faced serious challenges. While Palau was a fortunate beneficiary of the US CARES Act, its beneficiaries received a significant unemployment windfall, which very likely delayed reemployment. The program went only to a subset of all households but temporarily changed the distribution of household income.

Overall, the Palau CROSS Act and US CARES Act mitigation programs had large beneficial impacts on average household incomes during the COVID pandemic, as they more than offset the negative impact of declining tourism on average household income in Palau.

Several data gaps emerged during Palau's mitigation response:

- » When establishing aid for the private sector, policy makers lacked information on its financial health preceding the COVID pandemic, such as private business balance sheet and debt information.
- » Hours worked information by employee, as one finance official noted, would have been valuable to the mitigation planning effort. Going forward, hours worked information will be added to Palau wage tax documentation reported by employers in FY2023, as part of the Palau tax reform.
- » Data on the informal economy such as its scale and the number of participants was unavailable for mitigation planning and implementation. Government planners used counts of employees working for tourism-related businesses in the formal sector as the basis for projecting the adverse impact of COVID. This information came from tax and social security records. When unemployment programs became available, many informal sector workers applied for support. These included tour boat drivers and sellers to tourists of prepared food, handicrafts, produce and fish. The government reported that it lacked visibility about these small business operations. Recently enacted Palau tax reform may reduce this gap in the future, as small enterprises in the informal sector may qualify for social payments if they report on their sales each quarter.

### ***Palau's Economy Declined Sharply Due to COVID Impact on Tourism***

Palau's economy declined sharply due to the COVID restriction on tourist travel, particularly from its primary source markets of China, Japan, Korea and Taipei, China. In total, the number of visitors to Palau in 2020 dropped by 54 percent over 2019 levels. In mid-June 2021, with an estimated 99.9 percent of its adult population vaccinated, Palau eased visitor entry requirements to allow vaccinated travelers who tested negative before departure to Palau.

The private sector directly experienced the pandemic with large losses in tourism demand that reduced private sector GDP by 36 percent and employment by 23 percent. In contrast, the public sector mostly maintained its operations and employment, using ADB loans to finance its operations. Palau entered the COVID period with financial reserves that provided an initial government finance cushion when the pandemic economic crisis began, however the need to increase spending on the medical response and the dramatic reduction in tourism-related revenue created a significant fiscal deficit. Total financing needed to support Palau through the COVID crisis amounted to \$60 million or about 24 percent of GDP.

Despite the government and donor mitigation efforts, in total, across the COVID Period and the FY2023 Post-COVID year, Palau's economy is projected to have declined by 21.8 percent (adjusted for inflation) in FY2023 as compared with the pre-pandemic FY2019 GDP level.

Even with the end of the pandemic, the Palau tourism rebound remained slow, with only 35,052 tourists visiting Palau in FY2023. While a positive change, that level is not sufficient to offset other decreases in economic demand due to inflation and other economic factors. As a result, FY2023 GDP is forecast to decline 1.6 percent. It is forecast to return to 95 percent of its FY2019 level in FY2025.

## Data: Migration, Remittances, FDI, and SMEs

The ADB identified four specific data areas for examination: migration, remittances, foreign direct investment (FDI), and small-to-medium enterprise (SME) information. Migration and remittances are closely related with a country's migrants moving overseas and then transferring some income home to family members as remittances. In the case of FDI and SME data, they both represent information on the structure of the economy, albeit at opposite ends of the scale. FDI is likely tied to large investments in tourism or manufacturing, while SMEs are likely to be comprised of small local firms.

### *Palau Migration Data*

Palau has a small but dynamic population. Palau citizens migrate to the United States and establish residency, although some later return to Palau. Foreign citizens enter Palau on fixed-length work permits and become residents of Palau during their time of employment. A robust tourism sector brings in many temporary visitors.

Data on Palau's inward and outward migration can be drawn from the Palau census, providing valuable information on migration for making long-term policy. For example, following an age cohort across censuses shows long-term patterns of migration. The cohort of 5- to 9-year-olds born in Palau in 2005 had fallen in number by 53 percent in the 2020 census, fifteen years later, which suggests a strong outward migration pattern. Information on inward migration of foreign workers is also included in the Census.

Further, Palau has implemented a Border Management System that records all arrivals and departures. With this scope of data collection, statistics can be developed to measure the flow of Palauan and non-Palauan residents, as well as flows of temporary visitors. This can be done by computing net arrivals (differencing arrivals and departures for a given time period) or matching the arrival and departure of unique individuals.

- » The differencing method can be readily implemented, but it is incomplete at the start and end periods of the data period selected. For example, a Palau citizen who arrives the first month of a study time frame, could be either a Palau resident returning from a temporary visit abroad or a returning migrant reestablishing residency in Palau. However, net arrivals over a long time period represent a simple and valid way to look at Palau migration movements.
- » With a matched travel history approach, an individual that arrives in Palau and does not depart within a set time period can be classified as an in-bound migrant to Palau. Conversely, a resident who leaves Palau and does not return within a set time period can be classified as an out-bound migrant. Creating a matched travel history draws from the individual passport-level information collected in the Border Management System. The quality of the data is good and implementing travel history matching is feasible. However, additional steps are needed to automate the calculation of such travel history.

Some specific steps could improve our knowledge of Palau migration:

- » Existing census and survey information could be further tabulated to reveal migration patterns. Improved information on foreign worker migration can be developed using a combination of worker permit data, withholdings tax data, and/or passport clearance information.

- » Palau could implement travel history matching through its border management system, which would allow travel information to segment Palauan vs foreign travelers. Technical assistance to support this effort could be sought from the immigration offices of partner nations that use this approach.
- » Lastly, consideration can be given to a publication strategy for information on migration. This publication could also include information on remittances, which are linked to migration actions.

### **Palau Remittance Data**

Remittances are payments by residents of a country to households in another country, and a reflection of the migration of people. Palau is on both sides of remittance flows, with outbound remittances from foreign workers who send some of their earnings home and inbound remittances from Palauan citizens who have migrated to the United States and send some of their earnings to family in Palau.

Palau publishes information on remittances in its Balance of Payments statistics and reports on remittances from periodic censuses and household surveys.

- » Palau's Bureau of Budget and Planning (Ministry of Finance) publishes annual Balance of Payments (BOP) statistics, including data on household remittances, both larger outflows and smaller inflows. Outflows of remittances from foreign workers fluctuate with economic conditions; they declined in FY2020 and FY2021, the first two years of the COVID pandemic. Inflows of household remittances are reported at a much lower level.
- » Palau Censuses and Household Income and Expenditure Surveys include questions related to remittances, both inflows and outflows. However, the structure of the questions changed over time and in some cases define remittances as payments from another household, whether overseas or local. For some surveys, the questionnaire responses regarding remittance questions have not been tabulated in published tables.

One challenge in the Palau context in collecting remittance data is separating this concept and activity from data on “customary” gifts given and received among Palauans related to homes, births, marriages, and deaths. For example, for ethnic Palauan households in 2006, income from “customs” was \$3,656 on average, while remittance cash and goods (value) were \$821. In the published 2006 tables, these results are not allocated between domestic and overseas sources. However, the 2014 Household Income and Expenditure Survey reported cash remittances from within Palau versus from overseas among sources of income. For 2014, the average annual household cash income was \$20,620, of which \$30 came from remittances within Palau, and \$140 from overseas. The report summarized that 8 percent of Palau households received remittances and for those households, their annual total averaged \$2,100. Further, of the money transferred to Palauan households, 21 percent was from an overseas military member.

Some specific steps could improve our knowledge of Palau remittances:

- » Assumptions used for the current BOP estimates can be compared to updated information from the most recent Census and household survey and updated



as merited. This will require further tabulations of underlying census and survey information by the Palau statistics office.

- » Data collected from banks operating in Palau by the Palau Financial Institutions Commission (FIC) on incoming and outgoing international money transfers may provide a new measure of certain remittance activities.
- » Census and survey questions should be consistently structured to reflect the inward and outward flows of remittances to and from Palau. Additionally, collected census and survey data should be more consistently tabulated and published. Currently, while remittance information is covered by census and survey questionnaires, it is sometimes not reported in publications.
- » Lastly, consideration can be given to a publication strategy for information on remittances. This publication could also include information on migration that leads to remittance actions.

### **Palau FDI Data**

Foreign Direct Investment (FDI) is cross-border investment where an individual/entity resident in one country makes a long-term investment in a business in another country. FDI is a large component of Palau's economic activity as demonstrated by the large external investment in the construction and operation of hotels. The Foreign Investment Board (FIB) grants a Foreign Investment Approval Certificate (FIAC) to approved businesses who report quarterly to the FIB, which in turn reports annually to the President and legislature. Other Palau agencies collect firm-level data from FDI businesses, such as corporate registration, social security, and tax/revenue information.

Palau's Ministry of Finance publishes annual Balance of Payments (BOP) and International Investment Position (IIP) statistics that record external financial transactions, based on IMF guidance.

- » BOP data captures the annual flow of financial transactions.
- » IIP captures the stock value of assets and liabilities at the end of a fiscal year. The published IIP table shows the net value of foreign investment at the end of each fiscal year. Corporations represented 95 percent of the total and land represented the remaining 5 percent. Within the corporate investment category, hotels had a 70 percent share and fuel companies another 16 percent.

To illustrate other possible reporting on the role of FDI in the Palau economy, this report takes existing data on Palau's private-sector GDP and allocates it to either FDI or "local" businesses. The underlying GDP presentation draws on revenue from the sale of goods and services reported by the Palau private sector on tax forms that identify foreign-owned businesses.

- » Over the FY2001-FY2022 period, FDI firms accounted for about one-third of private-sector GDP. The FDI share of private-sector GDP reached its highest in FY2008 at 37 percent and was at its lowest during COVID at 19 percent. Local businesses' share of private-sector GDP ranged from 63 to 81 percent.
- » FDI and local businesses can also be analyzed by industry. For example, for the FY2017-FY2019 period, tourism represented 58 percent of FDI business GDP, but only 26 percent for local Palauan businesses.

Some specific steps could improve our knowledge of FDI in Palau:

- » BOP statistics can be improved by using FDI firm financial statement data included in Annual Corporate Reports and by reviewing the residency of foreign owners of FIAC enterprises to confirm the allocation of FIAC firms between “domestic” and “foreign” for BOP statistics.
- » Modernizing the procedures and reporting at the FIB would be beneficial for foreign investors and compliance, as well as for statistics and public reporting. Using quarterly firm data would provide enhanced and timely reporting about the role of FDI in Palau. Similarly, using existing firm information in Palau’s tax data could provide routine reports on FDI’s role in the economy.

Lastly, consideration can be given to a publication strategy for routine information on FDI. The FIB, with a required annual report, is a natural location for additional reporting on FDI. Palau’s Office of Planning and Statistics is best positioned to report on FDI’s role in the economy.

### **Palau SME Data**

To date, Palau small and medium enterprise information has not been available and information on the structure of the business sector is not part of regular reporting. Palau has not conducted business surveys or economic censuses. According to Palau’s Minister of Finance, information on small and medium enterprises (SME) had not been a data focus, but during the period of COVID policy response, the government realized it needed more data on business sizes and their activities, in particular on the smallest enterprises and the informal sector.

Two Palau administrative data systems, at the Social Security Administration and the Bureau of Revenue and Taxation, receive information from businesses on a quarterly or more frequent basis that can be used to develop SME statistics. To demonstrate some of the analyses and presentations that it could support, EconMAP used tax data by business taxpayers and by business licenses to analyze their counts, gross revenue, and number of employees for FY2021, based on their level of employment.

- » In 2021 there were 894 business taxpayers reporting gross revenue. Of that number 403 (45 percent) had no employees, while 6 businesses had more than 100 employees.
- » For the 308 firms with 1 to 4 employees, they made up 34 percent of business taxpayers, 9 percent of gross revenue, and 12 percent of private employment. Larger businesses with 5 or more employees made up 21 percent of business taxpayers, 88 percent of gross revenue, and 88 percent of private employment.
- » It is also possible to conduct analyses by sector based on taxes at the level of business license data. In 2021, there were 2,389 active business licenses, with 2,063 reporting revenue; accommodation, construction, and wholesale/retail trade were the largest sectors.

Some specific steps could improve our knowledge of Palau SMEs:

- » SME information can be developed in Palau through the routine analysis of existing tax data. If routine analysis and publications about SME roles and activities are desired, consideration can be given to a publication strategy for information on SMEs. The Office of Planning and Statistics is well positioned for this reporting, with its existing access to the information in Palau’s tax system.

- » For routine reporting on the business sector, Palau can conduct economic censuses or business surveys. These could be informative for broader social and economic policies.
- » Improving information about the informal sector is challenging. The reformed tax system is expected to provide improved information, as social payments may increase tax system revenue reporting for small enterprises. However, other household and economic activities surveys may more directly address this sector. For example, Palau censuses and surveys can be better utilized to reflect on the smallest family-level business enterprises, including publishing additional information from questionnaire responses.



## I. Palau's COVID Pandemic Response and Experience

This report section presents information on Palau's COVID response experience in three segments. First, it provides a timeline of key health and economic responses along with a description of the resource used to address COVID, both local and through donor grants and loans. Second, it presents an assessment of the mitigation efforts to address the dramatic decline in the private sector economy. And third, it recounts Palau's economic experience across the COVID Period and Post-COVID fiscal year 2023.

### A. Palau Health and Economic Response Initiated with Donor Support

#### i. COVID Leads to Collapse in 2020 Tourist Arrivals

Palau's COVID experience reflected regional and worldwide trends and experience. In mid-December 2019, a “pneumonia-like” illness emerged in the city of Wuhan, China and after information shared between doctors was made public, Chinese officials notified the World Health Organization (WHO) about the spreading disease on 31 December 2019. By 31 December, 27 patients were hospitalized, many of them in critical condition. Within several days, Hong Kong, Singapore, Taipei, China, and Vietnam instituted health screening of travelers arriving from Wuhan. China reported its first death on 11 January 2020 while the first laboratory-confirmed cases were recorded in Thailand (13 January) and Japan (15 January). These developments and the evidence of human-to-human transmission led to health screening of travelers across Asia and targeted restrictions on travelers from certain areas of China.

- » By 31 January 2020, as WHO declared a “public health emergency of international concern,” Wuhan was in lockdown and travel restrictions and quarantines were underway. At that time there were 9720 confirmed cases in China where 213 people had died<sup>1</sup>, and 106 cases in 19 countries outside of China.
- » By 11 March 2020, when WHO declared COVID-19 a “pandemic,” there were more than 118,000 cases in 114 nations and 4,291 recorded deaths worldwide. The WHO Director-General's declaration noted that countries must “balance between protecting health, minimizing economic and social disruption, and respecting human rights.”

Palau's initial actions in response to COVID reflected an effort to minimize the economic and social disruptions of the pandemic and protect health.

- » Palau implemented health screening at the airport and seaport on 23 January 2020 of passengers and crew who may have traveled through areas affected by COVID-19.
- » A Presidential Executive Order (Executive Order 433, 28 January 2020) suspended flights from Hong Kong, Macau, and the People's Republic of China (PRC) and initiated the process to institute a quarantine policy and establish quarantine locations.

<sup>1</sup> WHO data for China includes cases in Hong Kong, Macau, and Taipei. See: World Health Organization. 2020. *Novel Coronavirus (2019-nCoV) Situation Report-11*. 31 January.

- » Further Executive Orders in February 2020 established traveler quarantine rules and restricted the entry of cruise ships for travelers who had been in mainland China, Hong Kong, or Macau.<sup>2</sup>

Palau's tourism business sector recommended in early March that the government minimize health risk and the economic impact of the virus with loans to businesses and assistance to workers. The private sector projected a one-to-two-year tourism recovery period, drawing on prior experience with health emergencies such as SARS, MERS, and bird flu.

The Palau government's immediate budget actions included tapping the Hospital Trust Fund (17 March 2020) to support health sector efforts. Further, the Palau legislature appropriated additional funds to the Hospital Trust Fund (\$916,808) and authorized up to \$6 million in funding to maintain government services in the face of declining government tourism revenue.<sup>3</sup> Palau's President outlined the government's plan in a 17 March 2020 letter to the country:

“Our goal is to keep all of our people and visitors safe and healthy while also keeping Palau open for business. We must do everything we can to support our tourism industry and encourage tourists to continue to visit. .... With help from our international partners, we do not have to choose between tourism and good health. We can have both.”

However this plan was overtaken by external events: the following day, 18 March 2020, the President notified the nation that Taipei, China and the Philippines had adopted severe travel restrictions and that United Airlines was reducing its flights to Palau from Guam to one per week (while drastically cutting service to multiple other markets), and that China Airlines' flights between Taipei, China and Palau would be severely reduced.

These international actions immediately reduced tourist travel, and effectively ended air travel to Palau for all travelers.

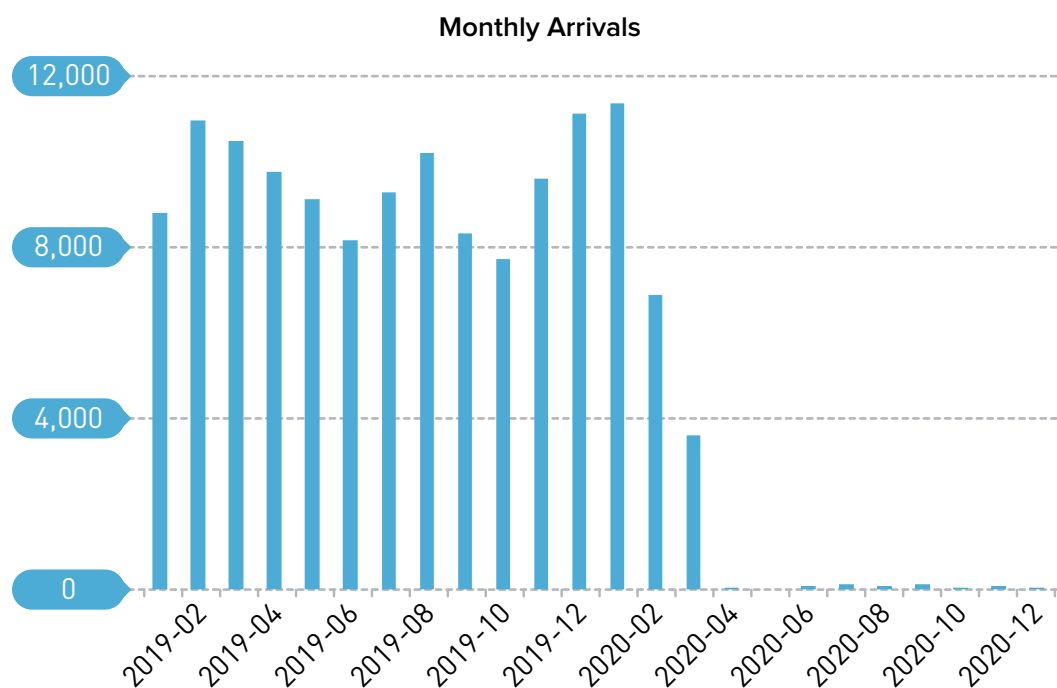
- » Monthly data on all arrivals, (tourists, migrants, and Palauans) show the dramatic change in air travel as the COVID pandemic unfolded. While arrivals in January 2020 exceeded those of the prior January, beginning with February 2020 all arrivals plummeted and in April there were no recorded arrivals (see [Figure 1](#)).<sup>4</sup>
- » Palau tourism collapsed as travel declined from Palau's primary source markets of China, Japan, Korea, and Taipei, China. This collapse followed a favorable outlook

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- 2 As a frame of reference, the US CDC began screening passengers on direct and connecting flights from Wuhan, China to San Francisco, New York City and Los Angeles on 17 January 2020 and on 31 January 2020 began to restrict entry of foreign nationals other than immediate family of U.S. citizens and permanent residents who had traveled in China in the previous 14 days.
  - 3 Palau. 2020. *The Fiscal Year 2020 Supplemental Budget Authorization and Appropriations Act, RPPL No. 10-53*. 19 March. The \$6 million in funding was authorized from the General Fund Reserve to offset any local revenue shortfall related to the impact of COVID-19. Further, the General Fund Reserve was authorized to be used to maintain the Civil Service Pension plan on a sound actuarial basis and to offset any local revenue shortfall.
  - 4 Data in the report is often sourced to EconMAP – the Economic Monitoring and Analysis Program managed by the Graduate School USA and primarily supported by the US Department of the Interior's Office of Insular Affairs. Supplemental program funding has been supplied by Asian Development Bank and the World Bank. EconMAP was established in 2006 with a focus on the Federated States of Micronesia and the Republic of the Marshall Islands. Since 2011 EconMAP has also supported the Republic of Palau. In all three Freely Associated States, EconMAP monitors economic performance and assists with annual comprehensive updates of fiscal and economic statistics.

for tourism at the start of FY2020 (beginning 1 October 2019) when visitor arrivals reached 32,255 in the first four months and Palau was on track to attract 120,000 visitors by the end of FY2020. The total number of FY2020 visitors was 41,674, a 54 percent reduction from FY2019.

- » Although Palau took actions to screen travelers early on, the closure of Palau's border to travelers was effectively due to the actions of airlines and regional partners. By early April 2020, all scheduled and charter airlines had suspended flights, with only a weekly cargo and mail flight remaining. Palau did undertake efforts to ensure the continuation of shipping services for imports to Palau. The Palau government sought and received assurances from shipping companies that their container ship schedules would be maintained, allaying public concern about disruption.

**Figure 1:** Palau Monthly Arrivals, January 2019–December 2020



Source: EconMAP analysis of all movements recorded in the Palau Border Management System.

## *ii. Palau Health Operations Evolved with Pandemic*

Palau's health operations went through three phases: protecting the population by minimizing the risk of importing COVID, distributing vaccines, and preparing for community spread when travel resumed.

**2020 health operations.** When COVID emerged in Asia in 2020, Palau had just concluded its response to a 2018–2019 dengue outbreak and the Ministry of Health had an emergency response team and plan in place for dengue. Aspects of the dengue response included communicating with the public, understanding the vulnerability of residents with preexisting conditions, and protecting vulnerable populations. A World Health Organization 2019 assessment of Palau's health system cited Palau's emergency

response operations and vaccine coverage, access, and delivery as key strengths, while noting insufficient human capacity across many technical areas.<sup>5</sup>

Palau reactivated its Incident Command Structure on 22 January 2020 for COVID:

- » Under the COVID-19 response, Palau's overarching initial goal was to minimize the risk of importation and local transmission of COVID-19. This led to policies regarding travel restrictions, screening and surveillance, and isolation and quarantine. Only later, with the development of vaccines could Palau organize that campaign to protect residents.
- » On 17 March 2020 the Minister of Health certified COVID-19 as an unavoidable emergency, which allowed the ministry to access the Hospital Trust Fund.
- » On 8 April 2020 the Minister of Health authorized isolation and quarantine measures: anyone testing positive for COVID was isolated for at least 14 days at government facilities, while those exposed to COVID-19 had a mandatory quarantine of at least 14 days at a government facility. Importantly, all arrivals from any international jurisdiction were considered to have been exposed to COVID-19 and subject to the mandatory 14-day quarantine.
- » Other initial responses included the closing of schools for the remainder of the 2019-2020 school year and restrictions on public operations and businesses.

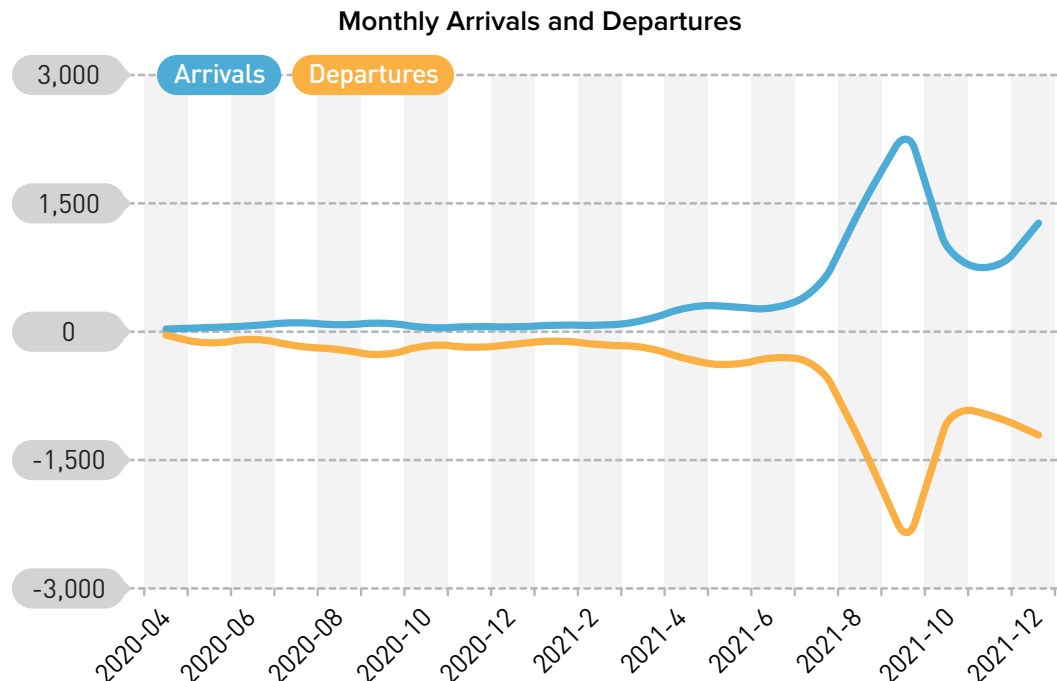
Repatriations were an important policy consideration during 2020. The end of air travel left Palauans stranded overseas and foreign workers in Palau separated from their homes. Further the decline in employment in Palau also spurred a need for foreign workers to return home. In addition, Palau needed to accommodate US defense needs, to bring in essential workers, and secure access to overseas health care for Palau residents. The Palau government operated an extensive pre- and post-travel quarantine process and provided funding to support these operations.

- » Beginning in April 2020 when scheduled air service had ended, Palau recorded 37 arrivals and 34 departures. Over the interval April 2020 through December 2020, arrivals totaled 563, with departures at 1,411, a net outward movement of 848 travelers (see [Figure 2](#) for arrival and departure numbers each month).
- » The government of Palau chartered 8 flights in 2020 at a cost of \$378,000. The first 4 charters were for a Taipei-based charter flight with aircraft that can carry up to 14 passengers. One key concern was bringing Palau students back from the United States and other countries. In addition to paying for these repatriation flights, the Palau government also provided food and lodging for the required quarantine period. The total costs of travel and quarantine operations for 2020 and 2021 was \$1.4 million.
- » Over calendar year 2021, more flights took place and the movement of inward and outward travelers increased. Flights increased towards the end of 2021, such that total arrivals for the year were 8,240 and departures were 8,673. Net outward movement in 2021 was 430 travelers.

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5 World Health Organization. 2020. *Joint External Evaluation of IHR Core Capabilities of the Republic of Palau: Mission Report 19 July—2 August 2019*.



**Figure 2:** Palau Arrivals and Departures, April 2020-December 2021

Source: EconMAP analysis of arrival and departure data in the Palau Border Management System.

Unlike most countries, Palau avoided importing COVID during the February-March time period when the virus spread worldwide. With the stability provided by no COVID cases and virtually no arrivals in Palau during April, in mid-May 2020, the Ministry of Health scaled back some community restrictions and recommended that worksites, restaurants, and businesses resume regular operating hours; and that public parks, gyms, and recreational areas resume regular operations. The 2020-2021 school year returned to in-person classes. Behind its closed border, residents of Palau were able to live more normal lives than residents of most nations across the world.

In July, proposals were made to restart tourism through the establishment of a travel bubble with Taipei, China – a significant source of visitors and a diplomatic ally. The Palau government Bureau of Tourism and the Palau Visitor Authority and private sector organizations, the Palau Chamber of Commerce and Belau Tourism Association outlined the dire financial condition of the tourism sector and the opportunity to partner with Taipei, China. Partially the rationale was that Taipei, China had had zero community transmission since April and had successfully contained COVID and that a “safe” restart would provide financial relief to the economy and restore access to education, healthcare, and technical assistance.

With a 31 July 2020 Executive Order, Palau's President mandated that essential air services be reestablished by 1 September 2020 with Taipei, China and the United States with a focus on travel for emergencies, repatriation, medical referral, and worker recruitment. The order noted that the charter flight program was not sustainable. Travelers would remain subject to Ministry of Health quarantine requirements. In September a service schedule of one flight every two weeks between Palau and Guam had been established and steps were underway to plan the restart of tourist travel.

The “Essential Air Services Policy” required that travelers have a negative COVID test result in advance of travel to Palau and then enter quarantine upon arrival. The cost of quarantine (food and lodging) for returning Palau residents or visiting citizens would be covered by the government, while these costs would be charged to arriving workers and visiting noncitizens. Palau’s outgoing and incoming Presidents both advocated for reopening travel with Taipei,China at a time when United States unemployment support to Palau and Palau’s own stimulus program were scheduled to end.

By the end of 2020, COVID-19 vaccines became available and were first given to Palau health workers. Palau remained one of the few nations in the world with no confirmed COVID cases.

**2021 health operations.** Beginning in 2021, the Ministry of Health’s operational goals expanded to include the mass vaccination of Palau’s population. The initial goal was 80 percent coverage, and by 25 May 2021, over 12,500 individuals had received the COVID-19 vaccine.

The promotion of a “sterile corridor” between Palau and Taipei,China was cited in the newly elected Palau President’s inaugural address on 21 January 2021 as a way to revitalize personal, medical, educational, and business relationships. In addition, it would boost Palau’s economy and support bilateral relations. However, on that date only 2,404 first vaccine doses had been administered and the Palau Ministry of Health resisted implementing the arrangement until vaccine goals had been achieved.

The sterile corridor travel was started April 2021, at a time when 5,251 people in Palau were fully vaccinated, with another 3,569 partially vaccinated. Palau’s President accompanied tourists from Taipei on the first flight into Palau on 1 April 2021, demonstrating the serious effort of the Palau government to restart tourism. This “travel bubble” also allowed Palau citizens to travel to Taipei,China for medical care. Arrivals of tourists from Taipei,China were 180 in April. However, this travel was costly, with testing requirements and restrictions on movement to protect public health in Taipei and in Palau. Tourist arrivals fell to 98 in May. The bubble was suspended due to low demand and the emergence of a growing number of COVID cases in Taipei,China. Palau’s former Minister of Health reported that Palau had “dodged a bullet” as case levels rose in Taipei,China.

On 17 June 2021, with 13,290 adults fully vaccinated, estimated to be 99.9 percent of its adult population, Palau eased its entry requirements. Travelers were to be vaccinated and provide proof of a negative result from a COVID test before departure to Palau. Upon arrival in Palau, travelers were to follow mitigation orders and to be retested.

The travel bubble with Taipei,China was restarted in August 2021. At that time Palau had two COVID cases (travelers from Guam) in quarantine, but no community transmission. One promotional feature of this second travel bubble effort was that visitors from Taipei,China could be vaccinated upon arrival in Palau as the US CDC had agreed that unused vaccines nearing expiration could be used to vaccinate travelers. Out of 148 travelers arriving 14 August 2021 from Taipei,China, 136 received a vaccination. According to Palau arrival data: 664 people tourists from Taipei,China arrived in August, 870 in September, and 336 visited in October. Officials in Taipei noted that demand was initially high due to a shortage of vaccines in Taipei that then lessened over time. China Air cancelled November flights due to low consumer demand, and only 299 tourists arrived from Taipei,China in December. Arriving travelers had restrictions on movement and activities for 4 days upon arrival and on the fourth day a mandatory COVID test.

Throughout the fall Palau saw some passenger flights (Guam and Taipei,China) and military flights, and the number of COVID cases among travelers and their contacts grew slowly. The last week of December recorded 10 cases (8 travelers with restricted movement and 2 contacts), after having 7,944 travelers arrive since April 2020. Of the 10 cases, 8 had recovered and 2 were in quarantine. Community spread of COVID had not come to Palau at the end of 2021. The fully vaccinated Palau population (age 5 and older) exceeded the entire population-level recorded in government data that had been used by the Ministry of Health during its vaccination campaign.<sup>6</sup>

**2022 health operations.** January 2022 saw rapid community spread of COVID in Palau: 8 new cases the first week, 38 the second, 227 the third, and 1,060 the fourth. Face mask mandates and restrictions on activities were instituted. By the beginning of March, new cases per week were falling and total cases had reached 3,844, and tragically with 6 deaths. Palau's experience was part of an explosion of COVID cases in Pacific Island nations after two COVID-free years, with community spread also occurring in Kiribati, Samoa, and the Solomon Islands. This Pacific COVID outbreak took place as the Omicron variant of COVID was sweeping the world. By the end of June, total Palau cases reached 5,237, but there had been no additional deaths since February. Travel restrictions on arrivals were reduced by summer and additional vaccines and boosters were widely distributed among the population. Case increases slowed and by October most public restrictions were lifted.

In its last posted COVID situation report at the end of June 2023, Palau reported it had had 6,018 COVID cases and experienced 9 COVID deaths. Almost 70,000 COVID tests had been administered. Government and private sector officials and Palau residents reported in interviews that Palau approached the COVID pandemic with great community support and cohesion. Government and traditional leaders supported the health response and vaccinations campaign.

**Lessons learned from the COVID health response.** Palau's COVID health response was built on the experience of prior SARS and dengue outbreaks. As Palau health officials noted, "the team was warmed up" and experienced in mapping community cases, conducting public education and community outreach. Facebook became the main communication strategy. The Palau health response benefited from external in-kind support from the US, Taipei-China, Australia, and Japan. This included vaccines, personal protective equipment (PPE), test kits, and laboratory support, as well as medical teams in country from the US and Taipei,China. Palau also benefited from virtual technical assistance contacts with the Pacific Islands Health Officers Association and medical officials at the US Department of Health and Human Services, the US CDC, Japan, and from Taipei,China.

Palau benefited from its social cohesion to support the medical response and the positive response to the vaccination campaign. Also, Palau was very fortunate to avoid early COVID cases and community spread. Palau executed expanded travel through the essential air service policy and the establishment of "sterile" corridors and travel bubbles before achieving high vaccination rates. The actions of Taipei,China to suspend flights and close its border when COVID surged protected Palau, while its vaccination campaign was being completed. By the time community spread occurred, Palau was as well positioned for handling the outbreak with minimum deaths.

<sup>6</sup> As of 30 December 2021, 16,728 Palau residents were fully vaccinated. Data on vaccinations and COVID cases are drawn from: Pacific Islands Health Officers Association. Weekly. *US Affiliated Pacific Islands Regional COVID-19 Situation Reports*. [www.pihoa.org/COVID19/](http://www.pihoa.org/COVID19/).

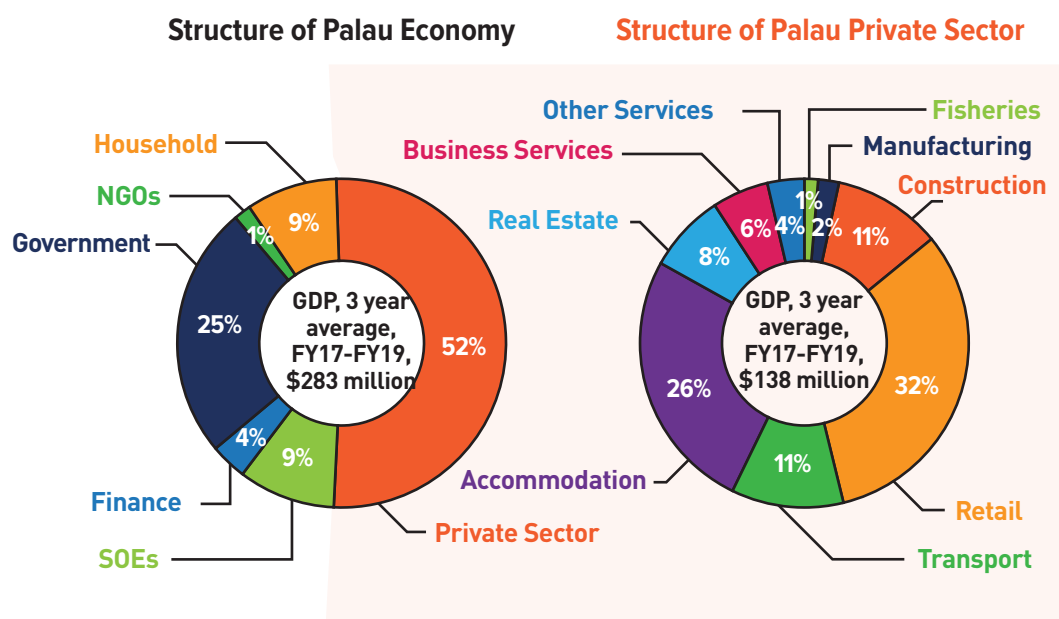
According to Palau health officials, a key challenge in planning its COVID operation was the need for better demographic data. The most recent available Palau population data was from a 2015 census, which became the basis of health planning. It proved to be inadequate for planning the vaccination campaign when Palau found itself vaccinating more than 100 percent of the estimated national population. Further, the lack of up-to-date information on outward and inward migration or the foreign workforce made it challenging to target the health response to different communities. The vaccination campaign found more foreign residents than were recorded in official workforce data.

A second key issue facing the health response was the limited number of local health staff. Health operations were supplemented with other government employees who supported administration, distancing, and isolation efforts. However, when community spread came, health workers with COVID had to isolate and staffing challenges emerged. At critical times, Palau was fortunately supported by external medical resources. For example, US teams supported vaccination campaigns in 2021 and deployed again to respond to “community spread” in 2022. Taipei, China also deployed personnel to support Palau’s COVID operations.

### iii. The Government Responded to Economic and Fiscal Crises

**Economic and fiscal crises projected in March 2020.** The government economic response to COVID-19 incorporated the results of projections of the impact of declining tourism on the business sector and government revenues. Before COVID, the private sector represented 52 percent of Palau’s economy and tourism dominated the private sector (see Figure 3). Direct tourism activity is reflected in the accommodation/restaurant and transport industries where it represented 37 percent of the private sector FY2017-FY2019 GDP. The retail sector, which serves both the local population and visitors, is an additional 32 percent of the private sector.

**Figure 3:** Structure of Palau Pre-COVID GDP and Composition of Private Sector GDP, FY2017-FY2019 (3-year average)



Source: EconMAP analysis of Palau economy prepared February 2023.

As regional travel stalled in early 2020, Palau government officials began exploring options to maintain government operations and support the private sector for what was expected to be only a few months. Funding sources focused on using the Compact Trust Fund or borrowing from the ADB. Government officials used economic projections developed by the EconMAP and information from the Palau Social Security to plan its private sector support program. Government planners assumed that 112 businesses needed support and that 2,600 jobs would be affected.

Economic analysis prepared by EconMAP that was released 31 March 2020 projected the impact of the cessation of tourism on Palau and its subsequent impact on GDP growth, employment, and on the government's fiscal position.<sup>7</sup> The March 2020 projection assumed that travel would remain restricted in FY2021, but that effective vaccines would be developed by September 2021, allowing tourism to rebound to normal levels in FY2022 and FY2023. Also, the economic projections assumed that major construction projects would continue as planned. The study's sponsor, US Department of the Interior's Office of Insular Affairs, noted that the projection did not assume any additional external donor assistance and was prepared in the absence of any confirmed domestic COVID cases. If cases were present this would make the situation worse.<sup>8</sup> The analysis covered four areas (see [Figures 4-7](#)):

- » Tourism. The analysis projected a tourism fall of 51 percent in FY2020 to 44,075 visitors, and a further 89 percent fall in FY2021 to 4,800. With vaccines assumed available, tourism was projected to fully rebound by the end of FY2023, exceeding the FY2019 level.
- » GDP. The analysis projected a GDP fall of 9.5 percent in FY2020, and a further 12.8 percent fall in FY2021. With vaccines assumed available and tourism rebounding, GDP was projected to rise 24.3 percent in FY2022 and 10.8 percent in FY2023.
- » Employment. The analysis included separate projections for Palauan and foreign workers, as foreign workers made up a little over half of the workforce in FY2019. The analysis projected Palauan employment to fall by almost 1,000 jobs over two years, FY2019 to FY2021, or 18 percent, while foreign worker employment falls by 2,128 jobs or 35 percent. These differences reflect the employment of foreign workers in the tourism sector and the employment of Paluans in the public sector, which is assumed unaffected by the tourism decline.<sup>9</sup>
- » Government revenue and expenditure. The analysis projected a budget deficit equivalent to 7 percent of GDP in FY2020, rising to 10 percent of GDP in FY2021. Revenue would fall with the decline in tourism and the economy, while government expenditures were projected to be stable through FY2022. The analysis suggested that cash reserves would be exhausted by the projected deficit and would require

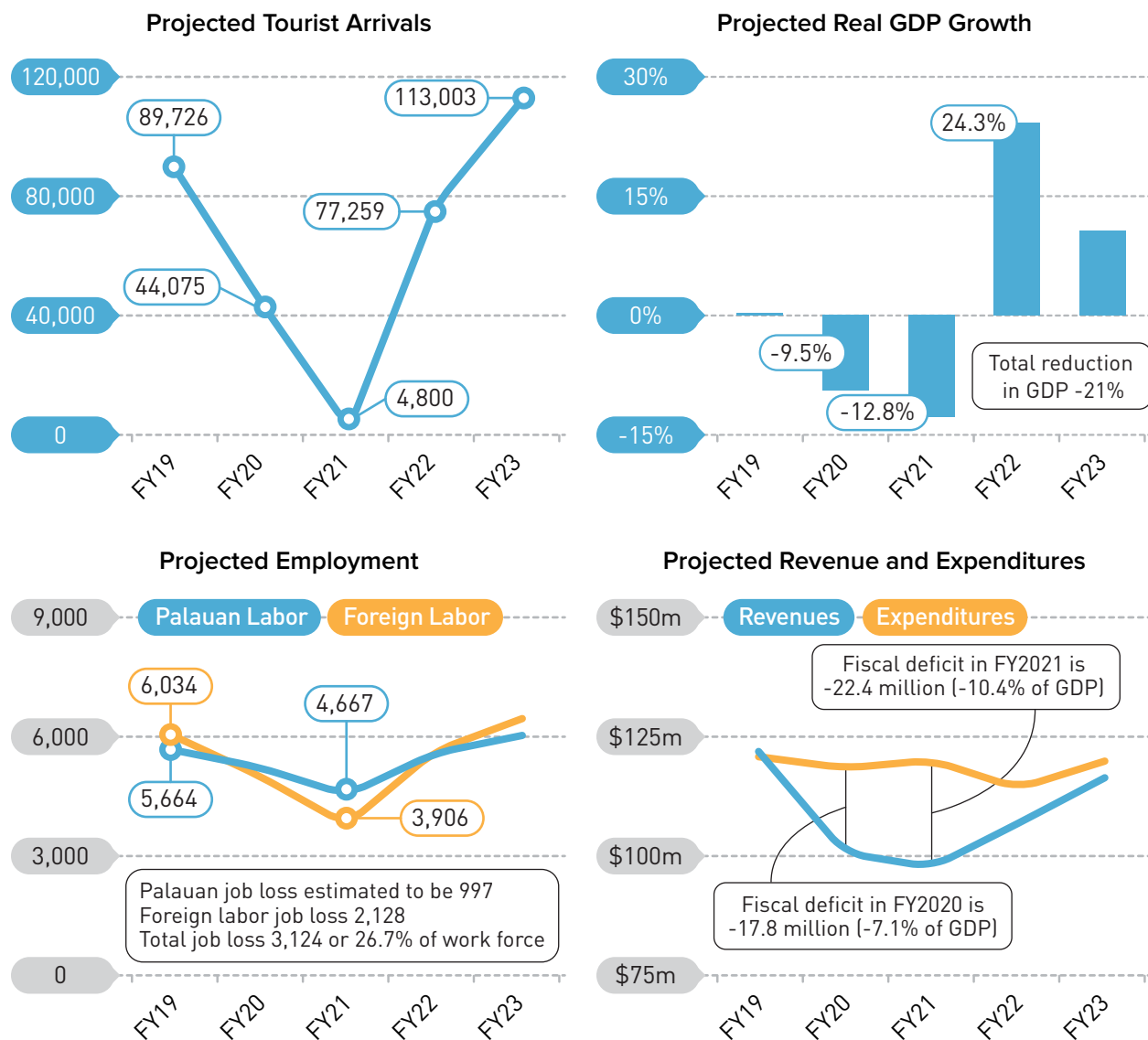
7 EconMAP/Graduate School USA. 2021, *Technical Note: Assessing the Impact of COVID-19 on the Palauan Economy* 31 March. This research was funded through the US Department of the Interior's Office of Insular Affairs, with projections prepared for Palau, the Federated States of Micronesia, and the Republic of the Marshall Islands. <https://pubs.pitiviti.org/palau-covid-impact-assessment>.

8 US Department of the Interior. 2020. *OIA News: Initial Economic Impact of COVID-19 Reported for Micronesia, the Marshall Islands, and Palau* (6/22/2020 web post). <https://www.doi.gov/oia/press/initial-economic-impact-covid-19-reported-micronesia-marshall-islands-and-palau>.

9 Usually, foreign worker unemployment does not occur in Palau as the workers leave when their employment contract ends. However, the unplanned nature of the tourism decline, constrained travel restrictions, and limited flights is assumed to have left unemployed foreign workers stranded in Palau.

external financing and/or a reduction in spending. For example, expenditure reduction could entail reduced public sector hours and pay, and reduced purchases of goods and services.

**Figures 4-7:** March 2020 Projection of COVID-19 Impact on Palau's Tourism, GDP, Employment, and Government (FY2019-FY2023)



Source: EconMAP Technical Note, 31 March 2021, "Assessing the Impact of COVID-19 on the Palauan Economy," (Graduate School USA, PITI-VITI, Honolulu, HI).

The March 2020 economic analysis identified the need to seek donor grants or loans to finance the fiscal gap and presented a fiscal adjustment program to address the COVID economic crisis. Components of a fiscal response could include health sector strengthening program to address COVID needs, unemployment relief for Palauan and

foreign workers, repatriation of unemployed foreign workers, business relief, public sector expenditure controls, and the acceleration of public investment projects.

**Palau 2020 legislation responded to crisis.** By March 2020, the need for legislative action was clear as COVID health-related costs increased, and government revenues were falling. A FY2020 Supplemental budget was enacted 19 March 2020 that provided \$916,808 to the Hospital Trust Fund and appropriated \$6 million in reserve funds to ensure ongoing government operations.<sup>10</sup>

In response to the cascading economic consequences of COVID-19, the President of Palau, the President of the Senate, and the Speaker of the House of Delegates announced the establishment of the Joint Leadership COVID-19 Impact Mitigation Working Group on 20 March 2020. Working Group members included representatives from the executive and legislative branches, state governments, and the private sector. The Working Group mandate was to develop recommendations to ensure the availability of government services, support vulnerable residents and the private sector, and ensure a swift recovery.

The Working Group's recommendations and legislation to implement them were submitted by the President to the Senate and House of Delegates on 18 April 2020, drawing on published economic projections and incorporating mitigation planning already underway in the Ministry of Finance. (This process took place after the United States had enacted a law addressing the COVID pandemic on 27 March 2020, in which unemployed Palau citizens would qualify for US unemployment benefits.)

The Working Group identified a need for the government to borrow \$65 million, with \$45 million to maintain government operations and support the economy, and \$20 million to support the private sector. The Working Group proposed funds for the following:

- » Public Sector Support (\$45 million). Proposed public sector support was primarily to offset declines in tax and fee collections due to the collapse of tourism for FY2020 and FY2021, but the recommendations also included \$2.23 million in new FY2020 appropriations. These new appropriations were: to support Palau state governments (\$800,000), a payment to the civil service pension (\$813,575), aid to private schools (\$236,750), support for four NGOs (\$200,000), and consular services to repatriate Palau citizens stranded overseas (\$180,000).
- » Private Sector Support (\$20 million). Proposed private sector support was allocated between loans for businesses (\$5.8 million), a temporary jobs program (\$8.0 million), unemployment benefits (\$5.5 million), and a lifeline utility service (\$700,000). This support was to end 21 January 2021. Further recommended changes were for deferral of business taxes and relaxed rules for employing foreign workers. Enacting the view of Palau's President, the planned support program treated Palauan citizen and foreign workers equally.

Palau legislative action was rapid, authorizing borrowing authority and enacting the private sector relief program:

<sup>10</sup> *RPPL No. 10-53.* In the Act, \$6 million was authorized and appropriated to the General Fund from the General Fund Reserve to offset any local revenue shortfall related to the impact of COVID. To support the cost of emergency COVID monitoring and treatment, \$916,808 was authorized and appropriated from the Non-Communicable Disease Fund.

- » The COVID-19 Presidential Borrowing Act of 2020 became law 22 April 2020. The law authorized the President to borrow \$60 million for the purpose of mitigating the economic and social impacts related to COVID-19.<sup>11</sup>
- » On 27 April 2020, the Coronavirus Relief One Stop Shop (CROSS) Act became law, implementing the recommendations of the Working Group.<sup>12</sup> The \$20-million Private Sector Relief Program was funded with \$4 million from the ADB Disaster Resilience Program loan (DRP Loan No. 3725-PAL, that had been approved in 2018) and by a \$16 million loan as authorized the previous week. Importantly, the private sector relief measures were only authorized through 31 January 2021 – a nine-month program. The private sector relief program had a single appropriation to allow the executive branch flexibility in managing the program. For the public sector, spending was increased to reflect the Working Group recommendations and funds authorized to cover the anticipated local revenue shortfall. Public sector needs were covered by \$13 million from Palau’s General Fund Reserve and an additional \$11 million from the ADB Disaster Resilience Program loan. One area of need funded in this Act was the expense of supporting and repatriating Palau citizens stranded abroad.

#### *iv. Donor Programs Supported Palau’s COVID Response*

The ADB and US government provided substantial resources to Palau to implement its 2020 response to the COVID crisis and continued to support Palau through 2022. The ADB reports it provided 16 COVID-related projects to Palau totaling \$118.63 million. The US provided Palau about \$67 million in financial support. Additional support came from other nations.

**ADB.** ADB regional actions during the first four months of 2020 responded to COVID-19’s growing negative impact on its developing member countries (DMCs) with a \$6.5 billion package to address the immediate needs of its DMCs as they responded to the health and economic consequences of the pandemic and an additional \$13 billion in available countercyclical expenditure financing.<sup>13</sup> These additional funds supported the COVID-19 Pandemic Response Option (CPRO) and increased the total size of ADB’s response package to about \$20 billion. In addition, the ADB extended access to its Contingent Disaster Financing (CDF) to health-related emergencies, such as COVID-19.

The ADB reports it provided Palau 16 COVID-related projects totaling \$118.63 million, including \$115 million through six loans, \$1.86 million in technical assistance (8 projects), and \$1.77 million through two grants.<sup>14</sup> Some of the technical assistance projects covered multiple Pacific Island nations. During 2020-2023 Palau engaged with the ADB to secure loans that directly supported government operations during a period of revenue shortfalls, supported private sector businesses and workers, improved public utilities, and secured the preapproval of funds to respond to a future disaster.

ADB loans that supported government operations and the private sector:

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<sup>11</sup> *RPPL No. 10-55.*

<sup>12</sup> *RPPL No. 10-56.*

<sup>13</sup> By 11 March 2020, when the World Health Organization (WHO) determined that the world public health emergency had become a global pandemic, ADB had provided \$32.3 million in regional assistance.

<sup>14</sup> ADB. 2023. *ADB COVID-19 Response: Palau*. <https://www.adb.org/where-we-work/palau/covid-19-response>.



- » \$15 million, Disaster Resilience Program (ADB Project No. 52018-001), approved on 15 October 2018 to respond to future disaster needs, it was modified on 13 April 2020 to include health-related emergencies. Palau requested these funds for its COVID response. Drawdown was 22 April 2020.
- » \$20 million, Health Expenditure and Livelihoods Support (ADB Project No. 54245-001), approved 29 July 2020 for strengthening Palau's health system and assisting unemployed workers and affected businesses. Drawdown was 28 August 2020.
- » \$25 million, Recovery through Improved Systems and Expenditures Support (RISES) Program (Subprogram 1, ADB Project No. 54284-001), approved 23 April 2021 to support public sector management reforms and to bolster Palau's recovery from the COVID-19 crisis. This program was structured as two separate loans of \$5 million and \$20 million with differing rates of interest. Drawdown was 23 August 2021 and 26 August 2021.
- » \$30 million, Recovery through Improved Systems and Expenditures Support Program (Subprogram 2, ADB Project No. 54284-002), approved 31 August 2022 to support public sector management reforms to bolster Palau's recovery from the COVID-19 crisis. Drawdown was 18 October 2022.
- » In total, the Palau government borrowed a total of \$90 million to respond to the impact of COVID on the private sector and on the government's budget. As of October 2023, Palau only needed to use \$60 million of ADB loan support for its COVID response and has retained the remaining \$30 million as a reserve fund.

ADB loans that supported public utility reform:

- » \$5 million, Palau Public Utilities Corporation Reform Program (Subprogram 1, ADB Project No. 54151-001), approved on 7 December 2020 to strengthen the governance and financial management of the utility. Drawdown was 10 May 2021.
- » \$5 million, Palau Public Utilities Corporation Reform Program (Subprogram 2, ADB Project No. 54151-003), approved on 22 July 2022 to strengthen the governance and financial management of the utility. Drawdown was 20 September 2022.

ADB loan to respond to a future disaster:

- » \$20 million, Pacific Disaster Resilience Program (Phase 3, ADB Project No. 50028-003), approved on 24 November 2020 for responding to a future disaster. No funds have been drawn down and these funds remain available to respond to a future disaster.

ADB grants related to COVID:

- » \$1 million, COVID-19 Emergency Response Project (ADB Project No. 54135-003), approved 29 July 2020. Grant for Palau dated 4 August 2020 to provide services to communities affected by COVID. Funded by the Asia Pacific Disaster Response Fund – Government of Japan for COVID-19.
- » \$766,442 (ADB portion of the project), COVID-19 Response for Affected Poor and Vulnerable Groups Project (ADB Project No. 54196-001), approved 2 August 2021. Grant for Palau dated 6 August 2020 to address the needs of poor and vulnerable groups affected by COVID. ADB provided \$766,442 through the Asian Development Fund. In addition, ADB administered grants for the project on behalf

of the Ireland Trust Fund for Climate Change and Disaster Resilience in Small Island Developing States (\$550,000) and the Japan Fund for Poverty Reduction (\$2.4 million). Total resources from the project were \$3.7 million.

In addition, Palau benefited from ADB support that funded technical assistance and in-kind supplies for the health sector.

**United States.** The US government provided COVID support to US states and territories as well as the Freely Associated States (FAS), including Palau, through a series of four 2020 laws that addressed the COVID pandemic. These laws provided resources to federal agencies to cover COVID-related costs (domestically and overseas) and for new activities, such as Operation Warp Speed, to develop and produce COVID vaccines and fund new unemployment insurance programs for workers who lost their job due to COVID. According to the US Congressional Budget Office, these 2020 laws increased the US budget deficit by about \$3.3 trillion.<sup>15</sup>

In most cases, COVID pandemic laws added funds to existing federal programs, some of which already had authorization to support the Freely Associated States, including Palau. However, in one key instance, the “Coronavirus Aid, Relief, and Economic Security Act” (CARES Act) created several new unemployment programs, and Palau was named as a “US state” for purposes of two new US Department of Labor (DOL) COVID-19 pandemic unemployment insurance programs.<sup>16</sup>

Overall, the US provided Palau about \$64 million in COVID grants.<sup>17</sup> Four US agencies provided COVID-related assistance directly to Palau: Centers for Disease Control and the Departments of Education, the Interior, and Labor.

- » Centers for Disease Control and Prevention (CDC) provided Palau almost \$6.8 million: (a) \$1 million in funding for emergency operations, surveillance, epidemiology, laboratory capacity, infection control, mitigation, communications, and other preparedness and response activities; (b) \$3.9 million to build epidemiology, laboratory, and health information systems capacity; (c) \$1.6 million to support the Palau Community Health Center. In addition to several small health grants (totaling \$276,000), Palau also received technical assistance, vaccines, and

15 US Congressional Budget Office. *The Budgetary Effects of Laws Enacted in Response to the 2020 Coronavirus Pandemic, March and April 2020*, 6 June 2020 <https://www.cbo.gov/publication/56403> and 2021 *Summary Estimate for Divisions M Through FF, H.R. 133, Consolidated Appropriations Act, 2021, Public Law 116-260 Enacted on December 27, 2020*, 14 January 2021. [https://www.cbo.gov/system/files/2021-01/PL\\_116-260\\_Summary.pdf](https://www.cbo.gov/system/files/2021-01/PL_116-260_Summary.pdf) Note: this accounting does not include the \$1.9 trillion American Rescue Plan Act, enacted on 11 March 2021 that included an economic stimulus package. In addition, this Act further extended COVID unemployment programs, including for the Freely Associated States.

16 *US Public Law 116-136*, 3/26/2020. The FSM and RMI were also named as US states for these two programs.

17 According to US government compilations of support (awards) and data from Palau on the award of COVID unemployment grants, the total COVID assistance provided to Palau was about \$67 million. Note, not all grant funds were necessarily drawn down. For example, COVID unemployment grants totalled \$55.4 million, but Palau expenditures were \$47.4 million. [The United States All-of-Government Response to COVID-19 in Pacific Island Countries - United States Department of State](#) (US Department of States, 9/18/2020); [Federal Assistance to the U.S. Territories and Freely Associated States during the Coronavirus Disease 2019 \(COVID-19\) Pandemic | U.S. Department of the Interior \(doi.gov\)](#) (US Department of the Interior, undated); and [Interior Office of Insular Affairs Announces Full and Final Allocation of \\$55 Million in Cares Act Funds to Insular Areas | U.S. Department of the Interior \(doi.gov\)](#) (US Department of the Interior, 11/1/2021).

ventilators from the US and US medical personnel traveled to Palau to assist local health system staff.

- » Department of Education provided \$762,000 to the Palau Community College.
- » Department of the Interior provided \$4.3 million to Palau in grant awards to address health sector COVID needs, including \$1.6 million made available through the CARES Act. Interior also provided funding to the Pacific Island Health Officers Association (PIHOA) to provide COVID test kits and testing equipment throughout the Pacific, including to Palau.
- » Department of Labor authorized \$52.2 million to Palau through the CARES Act, according to Palau's Ministry of Finance, for eligible individuals whose employment was affected by the spread of COVID-19.
- » Department of State and US Agency for International Development support included funding to the International Federation of the Red Cross and the World Health Organization for Pacific Island activities, including in Palau.

#### **Other donors.**

Australia recognized the primary role of the US to address Palau's COVID health needs and provided complementary medical supplies to Palau. For example, Australia provided funding for 10 ventilators and 15 cardiac monitors, as well as a \$61,000 grant. In addition, with other partners (New Zealand, WHO, PIHOA, and UNICEF) Australia provided technical advice, personal protective equipment (PPE) and test kits. Australia also provided air transport of medical supplies to Palau.

Japan funding passed through as ADB grants and supported Palau's COVID response. For example, Japan provided \$1 million for providing services to communities affected by COVID and \$2.4 million to address the needs of poor and vulnerable groups affected by COVID. In addition, officials from Japan noted that they had previously supported investment in Palau's hospital prior to COVID, which in turn provided services during COVID.

New Zealand provided Palau's Ministry of Health a COVID support grant of \$800,000.

Taipei, China provided Palau with medical supplies and medical support during the COVID pandemic. Officials from the Embassy noted that the short travel time from Taipei to Palau facilitated this supply role. Taipei provided regular charter flights that brought medical supplies as well as medical staff to support Palau health efforts. In addition, Taipei provided food for unemployed workers in Palau as well as \$1.1 million in financial support for medical equipment repairs, medical referrals of Palauans to Taipei, and vaccination support. COVID support continued into 2022, when Taipei donated six container-based medical units that provided two laboratories, a swabbing station, a fever clinic station, and two isolation wards.

## B. Palau Implemented Mitigation Programs

### *i. Palau CROSS Act Implementation*

The Ministry of Finance was the lead agency for implementing the Palau government's economic and fiscal response to the COVID pandemic.<sup>18</sup> Finance secured a series of loans from the ADB that funded government operations during a sustained period of low revenue.

The 27 April 2020 Coronavirus Relief One Stop Shop (CROSS) Act established temporary relief measures including unemployment benefits, utility assistance, job programs, nonresident worker employment transfer, business loans, and tax and employer contribution deferrals with \$20 million authorized through 31 January 2021 (later increased to \$21 million). The Minister of Finance issued regulations on 6 May 2020 to implement the CROSS Act and to operate a central location (i.e., a one-stop shop) where employers and employees could apply for benefits. While the recommendations of the Working Group had outlined expected spending for each provision of the CROSS Act, the enacted legislation did not lock in specific spending, thus providing flexibility to reallocate financial resources.

#### **Key areas of CROSS program implementation included:**

- » Finance established eligibility for employer and employee benefits. The Minister determined whether employer and employee applicants qualified for benefits based on (1) the connection of ordinary business activity to the COVID-19 pandemic and (2) a demonstration of a negative economic impact in 2020.
- » The National Development Bank of Palau provided loans to eligible employers. The Working Group proposed a planning allocation of \$5.8 million for loans to cover the “fixed costs” required to maintain business operations and mandatory costs. The National Development Bank of Palau reported that 117 businesses requested applications and 39 loans were made, totaling \$1.45 million, or 25 percent of the COVID Working Group's planning allocation.
- » Finance made employment contributions for social security and the health care fund. The Working Group did not propose a CROSS Act budget allocation for this program. By the end of this program in February 2022, \$1.1 million had been paid on behalf of employers.
- » Palau Visitors Authority implemented a temporary job program funded by Finance. The Working Group proposed an allocation of \$8.0 million for temporary jobs. The jobs were either with a ministry or agency or one of the state governments. By the end of the program in December 2022, 948 individual workers had participated at some point in the program comprised of 672 Palauan citizen workers and 276 foreign workers.<sup>19</sup> In total, \$5.3 million had been utilized, which was 66 percent of the COVID Working Group's expected allocation of \$8.0 million.
- » Finance provided eligible employees unemployment assistance or “humanitarian assistance.” According to Finance, this program was not intended to replace

<sup>18</sup> See Appendix 1 for more details about program implementation and participants.

<sup>19</sup> This analysis reflects counts of unique Social Security numbers among all recipients who received payments over the course of the program. Program participants over the 67 two-week pay periods of the program ranged from 4 to 671.

wages, so benefits and payments were set at a level lower than Palau minimum wage earnings. By the end of this program in October 2022, \$9.5 million had been utilized to benefit partially or fully unemployed workers. This was 72 percent greater than the COVID Working Group's expected allocation of \$5.5 million.

- » Palau Public Utilities Corporation had authority to subsidize utilities through an existing "Lifeline" program for low- or fixed-income households. The Working Group proposed a CROSS Act allocation of \$700,000 for the "Lifeline" utility subsidy. However, Finance did not provide any CROSS resources as the utility had sufficient Lifeline funds to cover them.

**Cross Act expenditure totaled \$19.9 million.** At the end of December 2022, total CROSS Act spending came to \$19.9 million (see [Table 1](#)). Out of total appropriations of \$21 million, this left \$1.1 million in unused funds. Table 1 shows the expenditure categories by CROSS Act program. Among the programs, the Unemployment Benefits/ Humanitarian Assistance Program represented 48 percent of expenditures, while the Temporary Job Program was second, at 27 percent. Expenditures aligned with the assistance categories in the CROSS Act were 87 percent of total expenditures. Among the remaining additional expenditures, the largest was to cover the cost of providing tax refunds to beneficiaries under the US-funded unemployment program that had been mistakenly withheld (see discussion below).

**Table 1:** CROSS Act Temporary Relief Measure Expenditures by Program, May 2020-December 2023

<b>CROSS ACT Expenditure by Listed Categories</b>	
Concessionary Loans, RPPL 10-56, Section 3 Part 3(a)	\$1,500,000
Payment Deferral/Subsidy, RPPL 10-56, Section 3 Part 3(b)	\$1,075,935
Temporary Job Program, RPPL 10-56, Section 3 Part 3(c)	\$5,300,000
Transfers, RPPL 10-56, Section 3 Part 3(d)	\$0
Unemployment Benefits, RPPL 10-56, Section 3 Part 3(e)	\$9,512,042
Expanded Lifeline Utility Service, RPPL 10-56, Section 3 Part 3(f)	\$0
<b>Subtotal</b>	<b>\$17,387,977</b>
<b>Additional CROSS Expenditure Categories</b>	
Administration Cost @ 1%	\$101,986
Summer Learning Skill Employment (CSLSE)	\$544,818
National Development Bank Solar Program Funds	\$500,000
Labor Refund	\$80,825
WIOA Tax Refund	\$1,282,338
<b>Subtotal</b>	<b>\$2,509,967</b>
<b>Total Expenditures</b>	<b>\$19,897,944</b>

Source: Palau Ministry of Finance compilation of expenditures under CROSS appropriations.

## ii. US CARES Act Implementation

US Coronavirus Aid, Relief, and Economic Security Act unemployment programs were implemented by the Palau Workforce Innovation and Opportunity Act (WIOA) office.<sup>20</sup> Citizens of Palau, the Federated States of Micronesia, the Republic of the Marshall Islands, and the United States were eligible for the US programs in Palau under the CARES Act. Other unemployed foreign workers in Palau were ineligible.

### Two programs from the CARES Act were available to Palau:

- » Pandemic Unemployment Assistance (PUA) temporarily extended unemployment benefits to people who otherwise would not qualify for unemployment insurance benefits. Since Palau did not have an unemployment insurance program, the PUA was available for all unemployed Palauan citizens as well FSM, RMI, and US citizens in Palau. For Palau, it provided \$397 a week for unemployment from 02 February 2020 to 26 December 2020.
- » Federal Pandemic Unemployment Compensation (FPUC) increased the level of unemployment benefits to workers affected by the COVID pandemic. Under the FPUC, eligible workers who collected unemployment compensation (including PUA payments) received an extra \$600 in federal benefits each week they were unemployed. For Palau, the period of eligibility was from 1 April 2020 through 31 July 2020.

### Palau experienced a series of challenges in CARES program implementation:

- » Palau WIOA officials expected 700 unemployed people to apply for the CARES program. However, many more applied and the program served 1,384 beneficiaries.
- » WIOA officials reported that US DOL had informed Palau that Palau wage and salary taxes, social security, and health charges should not have been deducted from unemployment payments and would be returned to beneficiaries.
- » More significantly, on 22 June 2021, the Palau police closed the Palau WIOA office. According to a statement by the President of Palau, an investigation into complaints about the distribution of COVID funds led to an investigation by the Office of the Special Prosecutor and the Office of the Public Auditor that led to the office closure.
- » US DOL later granted 642 individuals the opportunity to reapply to receive assistance who had been previously told they were ineligible but were not provided a required written notice.
- » On 12 January 2023, the Acting Public Auditor of Palau provided a *Final Report on the Audit of WIOA's PUA* program to the Director of WIOA. The audit found problems in the review and approval of applications and claims; non-compliance with eligibility requirements; lack of support for calculated benefits; miscalculations of payouts; poor financial management; and a lack of documents to support awards.
- » Following the release of the audit report, the Palau Office of the Special Prosecutor brought felony and misdemeanor charges during June and July of 2023 against four WIOA staff from the initial period of PUA and FPUA implementation. As of 31 October 2023, court proceedings are underway for two of the defendants,

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20 See Appendix 1 for more details about program implementation and participants.

and one defendant has pled guilty and agreed to testify in the trials of the other three defendants.

The work of the Palau WIOA office to close out the program was still underway in October 2023.

**Palau CARES Act fund expenditures totaled \$49.8 million to support 1,384**

**unemployed workers.** In total, the Palau WIOA CARES program spent \$49.8 million as of 30 September 2023 of \$52.2 million made available from US DOL (see [Table 2](#)).<sup>21</sup> Problems in making timely payments and the need to reconsider past implementation decisions spread the actual expenditure of CARES Act support across two additional fiscal years, beyond the period of work weeks eligible for unemployment compensation.

**Table 2:** CARES Act Unemployment Grants and Expenditures, FY2020-FY2023

Unemployment Grant Categories	Federal Authorization	Palau WIOA Expenditures
Pandemic Unemployment Assistance Administration	\$1,419,371	\$915,899
Pandemic Unemployment Assistance (PUA)	\$29,017,948	\$27,950,271
Federal Pandemic Unemployment Compensation (FPUC)	\$21,753,500	\$21,044,129
<b>TOTAL</b>	<b>\$52,190,819</b>	<b>\$49,910,300</b>

Source: Palau Ministry of Finance, Schedule of Expenditures of U.S. Federal Grants (as of 30 September 2023).

The compensation provided by the US PUA and FPUC benefits significantly exceeded the Palau worker's average weekly compensation. For example: when the FPUC paid an additional \$600 per week, the CARES Act provided almost five times the average level of Palau earnings, or seven times minimum wage earnings.

### *iii. Impact of Mitigation Programs on Household Income*

Mitigation programs had two distinct objectives: supporting the business sector suffering through the decline in tourism and supporting unemployed workers and their families. The ADB loans supported the Palau CROSS Act efforts that provided businesses with loans, operated an employment program that provided temporary jobs to unemployed workers, and humanitarian assistance to unemployed workers. The US CARES Act provided unemployment benefits to qualifying unemployed workers in Palau.

<sup>21</sup> This presentation of disbursements does not capture activity after 30 September 2023. Program activities were still being concluded as of October 2023.

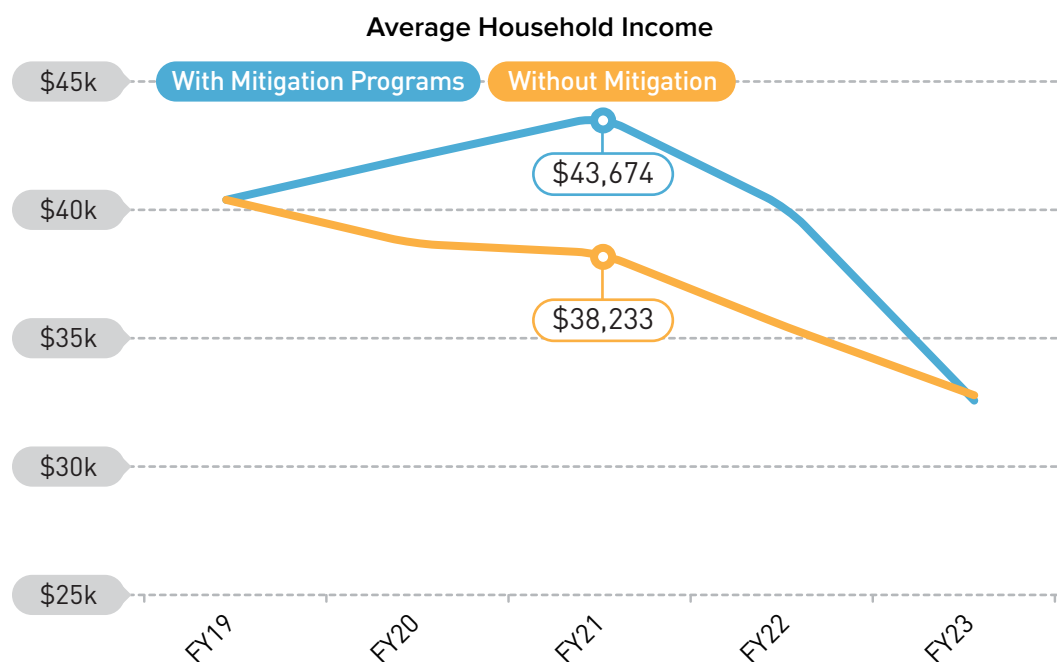
Mitigation programs had large beneficial impacts on average household incomes during the COVID pandemic, as they more than offset the negative impact of declining tourism on average household income in Palau. Average household income increased in FY2020 and FY2021, even while the economy was in decline. By FY2021, average household income was 8.1 percent higher than its pre-COVID FY2019 level. The actual experience of most households would differ from these findings, since only certain households were eligible for the US CARES Act program.

The economic model used to prepare economic and fiscal forecasts can be used to simulate the impact of CROSS and CARES mitigation by comparing household income while receiving the mitigation income to a counterfactual experience that excludes the receipt of mitigation funds.<sup>22</sup> The mitigation programs covered in this analysis are the Palau CROSS Act temporary jobs and unemployment/humanitarian assistance programs and the US CARES Act unemployment programs. The difference in the ‘with’ and ‘without’ scenarios represents the impact of mitigation on average household income (see [Figure 8](#)).

- » In FY2020 average household income would have fallen by 4.2 percent without mitigation but instead rose by 4.1 percent.
- » In FY2021 the impact was stronger, with average household incomes rising 8.1 percent above their FY19 levels and 14.2 percent above the level without mitigation.
- » In FY2022, while the CARES Act provisions had expired, WIOA was still making payments to workers whose applications had been improperly rejected in 2020

22 This presentation is constructed by estimating total household income and dividing by an estimate of the number of households. It is not a direct measure of household income.

**Figure 8:** Palau Average Household Income With and Without Mitigation Programs FY2019-FY2023 (FY2019 prices)



Source: EconMAP analysis of Palau economy prepared September 2023.



and 2021. This allowed a stream of benefits to some households to continue. This was a fortuitous development, as unlike in the United States where the recovery was well underway, in Palau it had yet to start so these remaining payments continued to mitigate the impact. Figure 8 indicates average household incomes were 13.2 percent above the level without mitigation, close to the real level prevailing before the pandemic in FY2019, and despite the high level of inflation experienced in FY2022.

Overall, the magnitude of the coordinated government and donor response was both timely and significant. The government and donor community should both take credit for rapid and effective mitigation efforts during the pandemic.

However, average household incomes dropped dramatically in the post-COVID period. Figure 8 also indicates the impact of inflation on household incomes in FY2023. Based on termination of the mitigation programs and high rates of inflation experienced during FY2023, a large drop of 18.9 percent in real household incomes is estimated compared with FY2019. During the pandemic Palau was able to protect the average living standard of its population. However, in the post-pandemic stage of FY2023 that is before full recovery of the economy, the impact of inflation has been strongly adverse.

One consideration of an assessment of the mitigation programs is the impact on the distribution of household income as well as the differing impacts of the economic contraction on Palau citizen and foreign worker households. While household-level data to illuminate these impacts is not available, the structure of the mitigation program provides insights on the likely distributional impact.

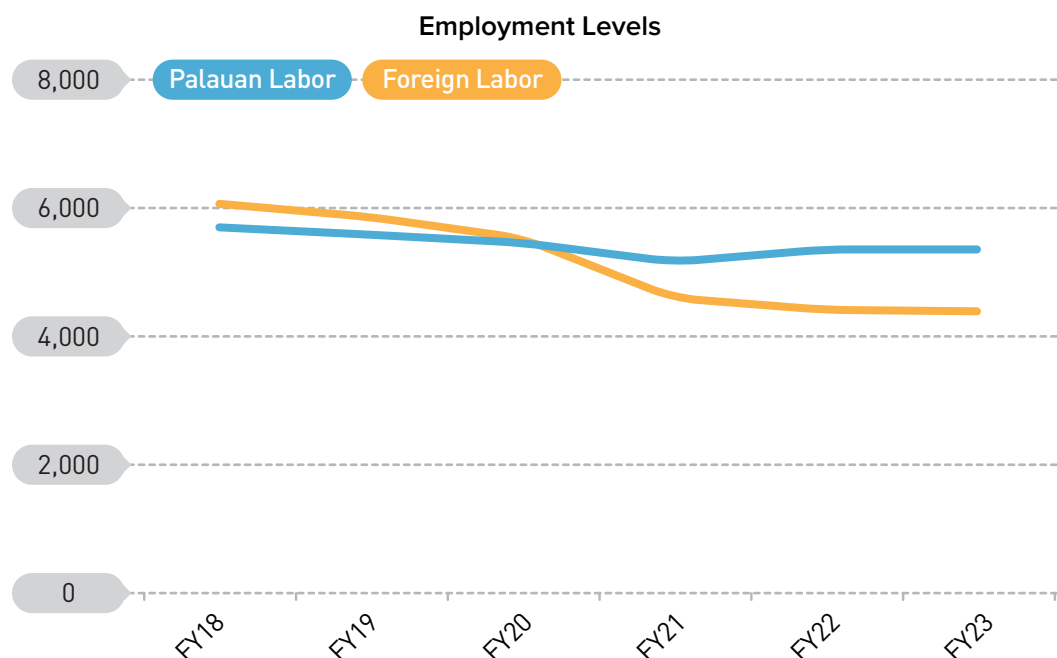
Palauan citizens primarily work in the public sector, while foreign workers primarily work in the private sector.<sup>23</sup>

- » Public sector. Palauan citizens represented 87 percent of public sector employment in FY2019, with foreign workers representing 13 percent. In FY2019, 3,394 or 61 percent of 5,544 Palauan citizen workers and 499 or 8.4 percent of 5,896 foreign workers were employed in the public sector.
- » Private sector. Palauan citizens represented 30 percent of private sector employment in FY2019, with foreign workers representing 70 percent. In FY2019, 1,955 or 35 percent of Palauan citizens and 4,645 or 79 percent of foreign workers were employed in the private sector.
- » Note. This employee data is from social security data and only counts formal employees of a business. It excludes the “self-employed” and workers in the informal sector that sell goods and services.

Public sector operations were sustained with ADB loans that offset the loss in government revenue and employment declines were small. Private sector employment contracted without tourism, and a large number of foreign workers were laid off. While some unemployed foreign workers were repatriated, others remained in Palau.

- » FY2021 employment of Palauans was 7.6 percent less than the FY2019 level, while foreign worker employment was 21.5 percent lower (see [Figure 9](#)).
- » Palau citizen employment rose after FY2021 and is projected to exceed its FY2019 level in FY2024.

23 These computations focus on the public and private sectors and omit non-profit, household, and embassy employment. Most of the employees in these sectors are foreign workers.

**Figure 9:** Palau Employment of Palau Citizen and Foreign Workers, FY2018-FY2023

Source: EconMAP analysis of Palau economy prepared September 2023.

- » Foreign worker employment fell further after FY2021 to a low in FY2023 of 25.2 percent below its FY2019 level. Current projections are that foreign worker employment will reach its FY2019 level in FY 2027.

Mitigation programs had differing impacts on workers and households, depending on the sector of employment and citizenship.

- » ADB loans offset the loss in government revenue and preserved government operations and the employment of these workers. This stabilizing impact accrued primarily to Palauan citizen workers and Palauan households.
- » CROSS mitigation programs addressed unemployment with a temporary jobs program and humanitarian assistance. At the initiation of the CROSS programs, Palau citizen and foreign workers were treated the same; however, differences in treatment were implemented beginning in 2021. The temporary jobs program paid the Palau minimum wage, so was equivalent income for an unemployed worker who had earned the minimum wage. For higher-paid workers, the temporary jobs program was less income. The humanitarian assistance provided \$100 per week or 71 percent of a minimum wage worker's income (\$140 per week).
- » CARES unemployment benefits were only available to Palau, other FAS, and US citizens and significantly exceeded Palau's average weekly compensation of \$210 per week in FY2019, before COVID. For those households with a CARES beneficiary, the weekly benefit was as high as \$997 per week. Household income differences in Palau grew during the period of this program. Due to the way the program operated, CARES checks could be quite large and cover long periods of unemployment.

- » CARES unemployment benefits exceeded working pay to such an extent that they were a disincentive to rejoin the labor market. This has been noted by private sector employers.
- » Community stakeholders in Palau noted the inequities between households due to the program and how it changed household consumption; for example, enabling the importation of automobiles.

Overall, the CARES program had a significant impact on Palau households in aggregate, but assuredly altered the distribution of income. As an external US government program, the local government could not alter the terms of the program, including the levels of assistance or eligibility requirements. The scale and complexity of the program was difficult to implement and manage. In addition to the current legal charges regarding management misuse of program funds, Palau was not able to always cross-check recipients of CARES Act payments against beneficiaries of the CROSS Act unemployment and temporary jobs program to check for beneficiary misuse. Further, the lack of CARES Act data limits analysis of the program's impact on the economy and households.

### C. Palau's Economy Declined Sharply Due to COVID Impact on Tourism

To assess the impact of COVID on Palau's economy, economic statistics are used to describe the "COVID Period" of operations, FY2020-FY2022, when substantial travel restrictions remained in place. Beginning with FY2023, travel restrictions were normalized, thus starting the "Post-COVID Period" for the economy where tourism can recover. Economic statistics for FY2023 combine existing economic data and projections.

#### *i. GDP Declined by 22 Percent FY2019-FY2023*

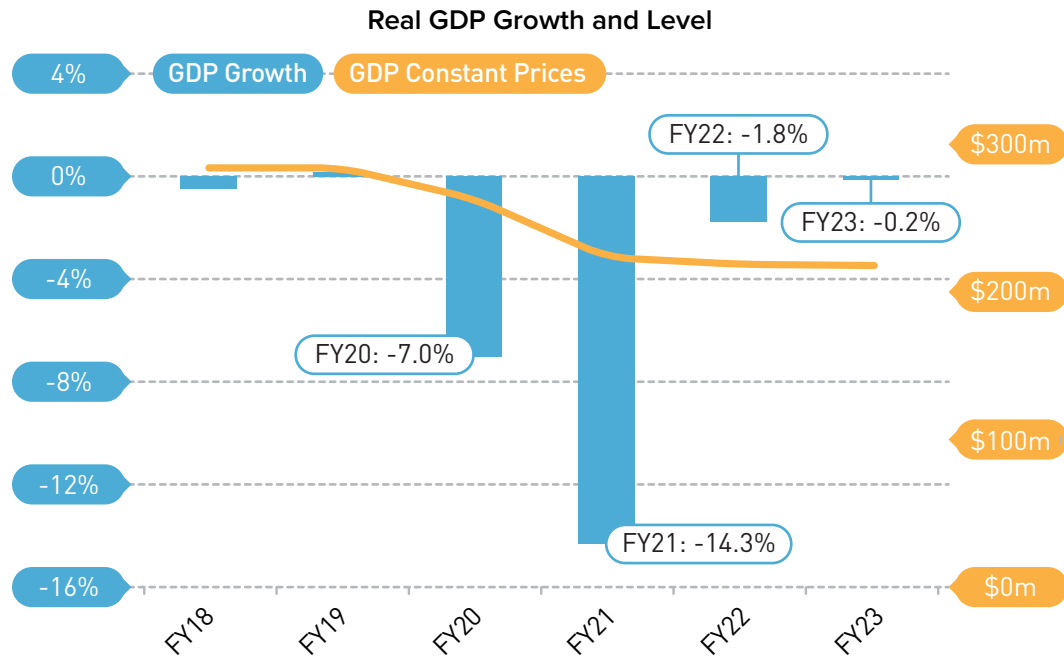
Palau's economy declined sharply due to the COVID restriction on tourist travel. Even with the end of the pandemic, Palau's economy is not projected to grow through the end of the FY2023 as the Palau tourism rebound remains limited (see [Figures 10 and 11](#)). In total, across the COVID Period and the FY2023 Post-COVID year, Palau's economy is projected to have declined by 21.8 percent (adjusted for inflation), in FY2023 as compared with the pre-pandemic FY2019 GDP level.<sup>24</sup>

#### **For the three COVID Period fiscal years:**

- » FY2020. Pre-COVID FY2020 was to be a good year for the Palau economy as construction activity increased and by February the tourism industry was projected to be 35 percent higher (120,000) than fiscal year FY2019 (89,000). Then COVID-19 descended on the world, international travel stopped, and no further visitors arrived. GDP contracted by 7.0 percent in FY2020 due to the loss of tourists for part of that fiscal year, to a final level of just below 42,000 visitors.
- » FY2021. Palau experienced the loss of tourism for the entire year and GDP fell by 14.3 percent in FY2021. The full force of the collapse in the tourism economy was felt, with only 3,400 visitors for the year. In addition to the

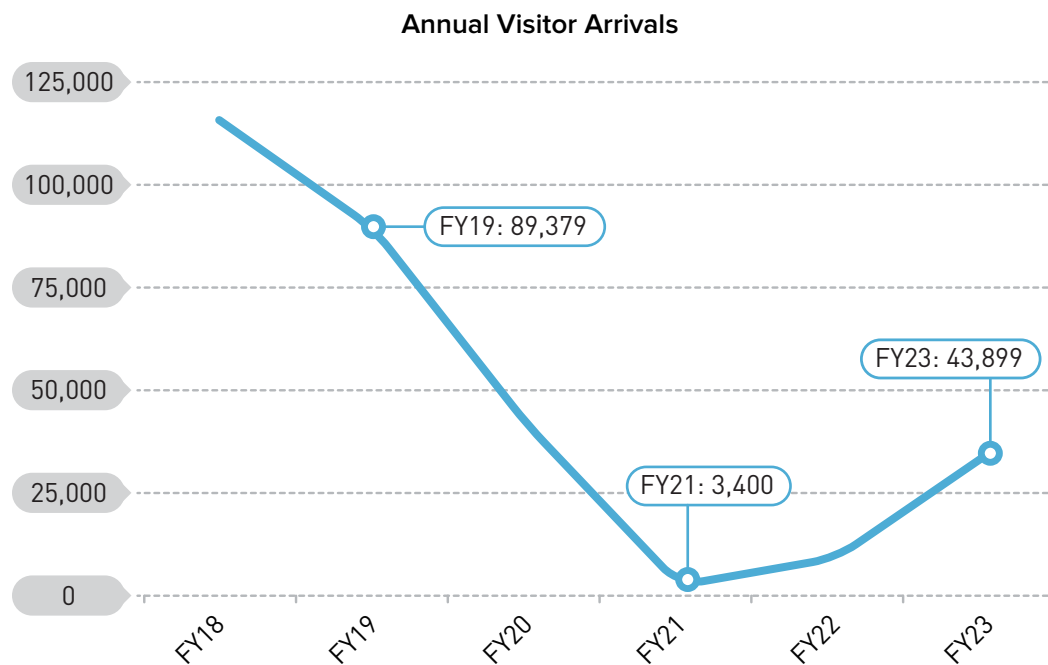
<sup>24</sup> Data in this section are drawn from EconMAP analysis of the Palau economy prepared in September 2023. Data are estimated where information was not yet available.

**Figure 10:** Palau Real GDP Level and Annual Percent Growth, FY2018-FY2023 (FY2019 prices)



Source: EconMAP analysis of Palau economy prepared September 2023.

**Figure 11:** Palau Visitor Arrivals, FY2018-FY2023



Source: EconMAP analysis of Palau economy prepared September 2023.

tourism decline, construction declined as did household consumption and government expenditures. However, household consumption and government expenditures benefited from the positive impact of mitigation programs; in their absence GDP would have fallen precipitously. Palau's CROSS Act supported government expenditures and household consumption, while US CARES Act unemployment payments significantly supported household incomes and consumption expenditures.

- » FY2022. By the start of FY2022 Palau had opened its borders to travelers but the advent of community spread in early 2022 and a reluctance to resume travelling from Palau's tourist markets resulted in only 9,247 visitors arriving during FY2022. While increased tourism made a positive change in FY2022 GDP, it was insufficient to offset other decreases in economic demand as high rates of global and domestic inflation increased prices and reduced consumer demand. The overall result of the positive gains in tourism with declines in other sources of demand was a 1.8 percent GDP decline in FY2022.

**For Post-COVID Period fiscal years:**

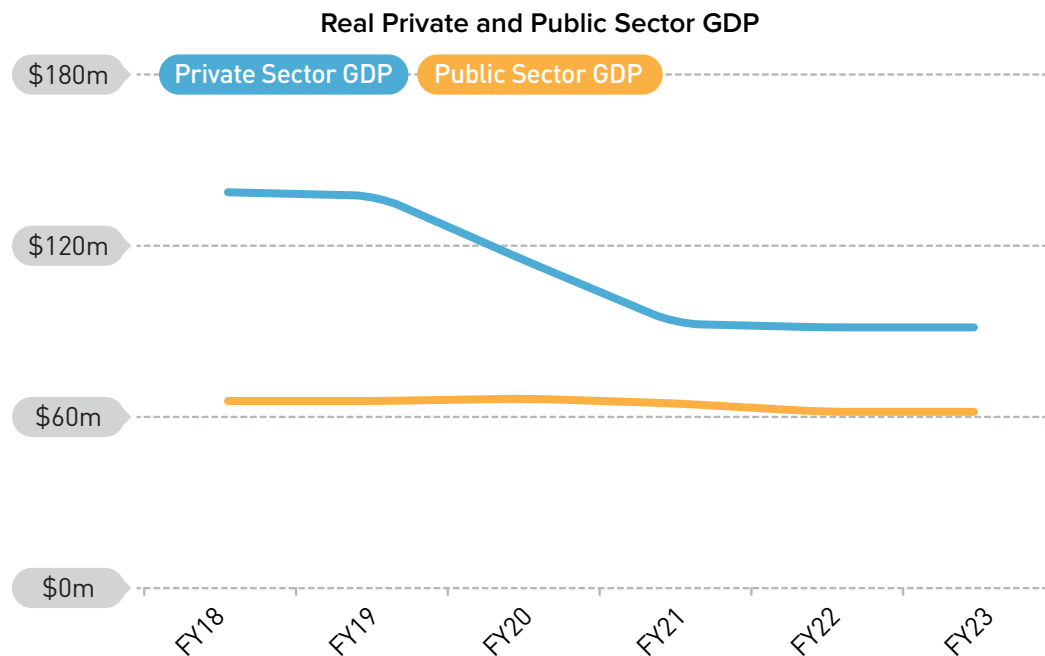
- » FY2023. With continuing reticence to resume travel, only 35,052 tourists visited Palau in FY2023. While increased tourism is a further positive change in GDP in FY2023, it remained insufficient to offset other decreases in economic demand. In FY2023, high rates of global and domestic inflation continued to increase prices and reduce demand. Further, Palau implemented its tax reform program in January 2023 and as retailers marked up prices, inflation surged, further reducing household consumption. Government expenditures also declined during FY2022 and FY2023, while capital formation fell in FY2023. The overall impact of the positive gains in tourism with declines in other sources of demand was a 1.6 percent decline in projected FY2023 GDP.
- » Future fiscal years. Looking at the period through FY2025, tourist arrivals are projected to rise, such that by FY2025 visitors slightly exceed the FY2019 level. Mirroring this, GDP is projected to rise, such that by FY2025, GDP has grown to 95 percent of its FY2019 level.

## ***ii. Private Sector GDP and Employment Declined***

The private sector directly experienced the pandemic with large losses in tourism demand that reduced private sector GDP and employment. In contrast, the public sector mostly maintained its operations and employment using ADB loans to finance its revenue shortfall and to fund additional COVID-related needs. Foreign workers in Palau represented most of the economy's lost employment (see Figure 9).

- » Private sector. Private sector GDP, adjusted for inflation, fell sharply by 32.5 percent by the end of FY2021 from FY2019 (see [Figure 12](#)). In total, across the COVID Period and the FY2023 Post-COVID year, Palau's private sector GDP is projected to have declined by 33.5 percent (adjusted for inflation) in FY2023 as compared with the pre-pandemic FY2019 GDP level. Private sector employment is projected to be 5,030 in FY2023, 23 percent lower than the FY2019 level of 6,525. The lower percentage decline in private sector employment than GDP was due to a reduction in working hours and reduced pay rates of employees that tourism operators used to offset lost revenue.

**Figure 12:** Palau Real Private and Public Sector GDP Levels, FY2018-FY2023 (FY2019 prices)



Source: EconMAP analysis of Palau economy prepared September 2023.

- » Public sector. Public sector GDP, adjusted for inflation, fell by 1.3 percent by the end of FY 2021 from FY2019 and the overall decline from FY2019 to FY2023 was almost 6.2 percent. Public sector FY2023 projected employment of 3,983 was essentially unchanged from the FY2019 level of 3,968.
- » Foreign worker employment. In FY2019, foreign worker employment of 5,858 exceeded Palauan citizen employment of 5,585.<sup>25</sup> However, by FY2023, projected foreign worker employment had fallen to 4,386 -- a 25 percent decline, while projected Palauan citizen employment had fallen to 5,343 -- a 4 percent decline. Foreign worker employment is primarily in the private sector and substantially dependent on tourism where jobs were lost due to COVID.

### **iii. Government Operations Supported With Significant Debt**

Palau entered the COVID period with financial reserves, as it had saved surpluses during pre-COVID boom years when revenue exceeded spending. Initially, these reserves provided a significant cushion when the pandemic economic crisis began. However, the need to increase spending on the medical response combined with the dramatic reduction in tourism-related government revenue created a significant fiscal deficit that required financing each fiscal year.

**Palau's annual budget deficit and financing needs.** Total financing needs amounting to about 24 percent of annual GDP have been required to support the fiscal deficit

<sup>25</sup> Note: this reported data on foreign and Palauan employment includes the private and public sectors, as well as non-profits, households, and foreign embassies.

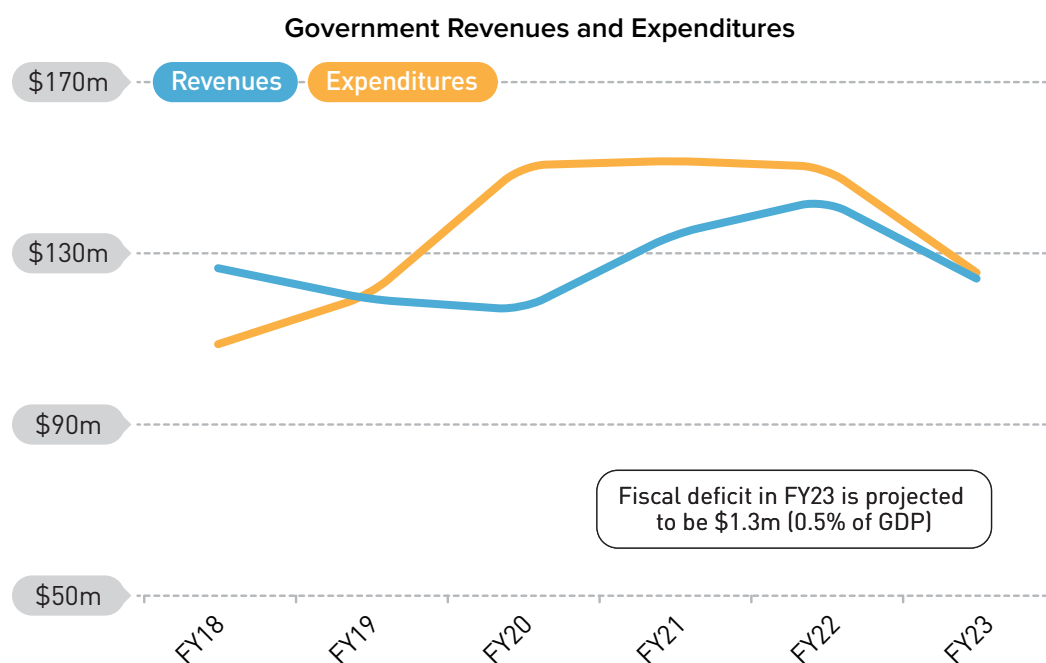
during the COVID Period FY2020-FY2022 and Post-COVID FY2023. The levels of required fiscal deficit funds needed have fallen with respect to GDP over the four fiscal years (see [Figure 13](#)).

- » FY2020: With the onset of COVID-19, the fiscal position deteriorated rapidly from a balanced fiscal position in FY2019 to a large deficit of \$33.8 million or 13 percent of GDP in FY2020.
- » FY2021: While it was anticipated that a larger deficit would result in FY2021, rapidly rising grant levels covered the large mitigation programs. The FY2021 deficit fell to \$17.1 million or 7 percent of GDP.
- » FY2022: The fiscal position continued to improve in FY2022, despite the deterioration in the economy, as donor grant levels continued to rise, and the deficit declined to \$7.5 million or 3 percent of GDP.
- » FY2023: The government implemented a tax reform program in FY2023 and despite anticipated continued high levels of deficit, tax revenues rose strongly, and the deficit fell yet again to \$1.3 million.

Looking ahead, future Post-COVID fiscal years are projected to have budget surpluses.

Total financing needs during the COVID period thus amounted to a total of \$60 million or about 24 percent of the average COVID Period GDP. It was sufficient to keep the government open throughout the COVID Period and provide for private sector relief. A series of ADB loans totaling \$90 million were initiated: (i) a \$15 million facility under the DRP (Disaster Resilience Program), (ii) \$20 million under the CPRO (COVID-19 Pandemic

**Figure 13:** Palau Government Revenues and Expenditures, FY2018-FY2023 (FY2019 prices)



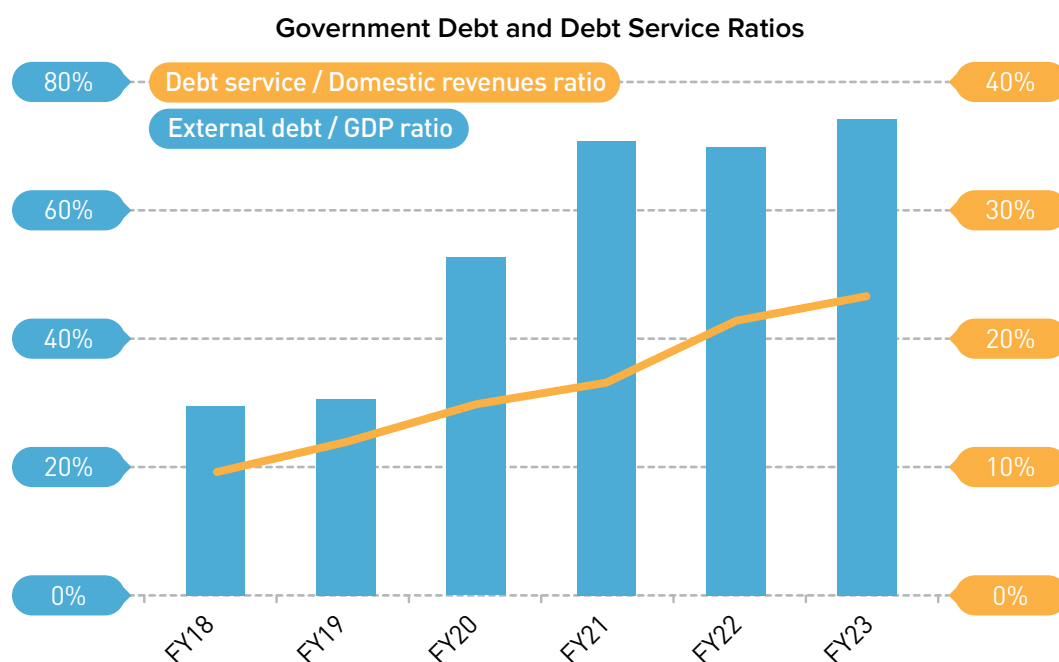
Source: EconMAP analysis of Palau economy prepared September 2023.

Response Option), and (iii) a further \$55 million Policy-Based Loan (PBL) comprised of two subprograms amounting to \$25 million and \$30 million each. The availability of ADB funding, coupled with Palau's own reserves from the tourism boom years, turned out to be more than sufficient to cover the \$60 million needed to keep the government operational. These funds maintained financial stability during the COVID crisis. Currently Palau has reserved the unused funds borrowed from ADB.

**Measures of Palau debt and debt service.** COVID Period and Post-COVID borrowing significantly raised the ratio of external debt to GDP as well raising the amount of Palau local revenues required for debt service (see [Figure 14](#)).

- » External Debt/GDP Ratio. With the additional borrowing, external debt/GDP ratio is projected to rise rapidly to 74 percent of GDP in FY2023, as compared to 30 percent of GDP in FY2019, before COVID. While the rise in the debt/GDP ratio is projected to attain record levels, much of the increase is due to the decline in the GDP. For example, reevaluating the FY2021 debt/GDP ratio based on the average level of nominal GDP in the FY2016-FY2018 period indicates the structural debt/GDP level is about 22 percent lower. After peaking in FY2023, the ratio is projected to decline to 63 percent by FY2025 when the economy recovers in the Post-COVID period. For a country of Palau's level of income, the IMF considers a debt/GDP ratio more than 50 to 60 percent as an indicator of debt stress. After the recovery, Palau's debt is projected to decline slowly, but regular debt sustainability analysis (DSA) will remain important.
- » External Debt Service/Domestic Revenue Ratio. External debt service is projected to rise significantly but should not result in a high risk of debt stress. From representing 12 percent of government domestic revenues before the crisis in

**Figure 14:** Palau Government Debt/GDP Ratio and Debt Service/Domestic Revenue Ratio, FY2018-FY2023



Source: EconMAP analysis of Palau economy prepared September 2023.



FY2019, debt service, including state-owned-enterprise (SOE) debt payments, rises to 23 percent in FY2023 and declines thereafter as the economy recovers. Not counting the State-Owned-Enterprise components' legacy borrowing, Palau national government debt service is projected to stabilize at around 13 percent of domestic revenues in FY2025.

After a period where debt service has been a minor component of the national budget, it will end up consuming a significant but manageable proportion. While the level of debt Palau will incur is large by historical standards, it should not, given fixed low interest rates on many loans and the concessional nature of the debt, pose a high risk of debt stress. Return of growth in the economy, the tax reform initiative, and careful control of expenditures should enable Palau to maintain fiscal and economic stability in the years ahead without debt stress.

## D. Conclusions

Palau's response to health and economic impacts of the COVID pandemic required numerous key actions, and many were determined by external parties. In addition, Palau had to make key decisions regarding its targeting of mitigation resources. In addition, several data gaps were reported during the implementation of the government response. These observations explore some of these actions and the outcomes.

### **Mitigation program implementation:**

External decisions protected Palau's population during the pandemic. As an island nation without a land border, travel to Palau can be stopped so that the population is protected from a pandemic until a vaccine can be distributed. Although Palau took actions to screen travelers early on, the closure of its border during COVID was effectively instigated by decisions of the airlines serving Palau. Palau was fortunate that travel ended in 2020 before it had COVID cases and that the closure of borders protected Palau from the 2020 transmission that circulated worldwide. This gave Palau time to prepare for COVID and to distribute vaccines before community spread of the disease.

Palau prioritized protecting health over reopening the tourist economy. This tradeoff was faced in almost all nations, but tourism-dependent economies were most greatly affected by closing the economy to travel. Palau primarily focused on protecting health, but in limited ways tried to restart tourism with a "sterile corridor" for tourism with Taipei, China. However, this approach retained quarantine, testing, and limits on movement, was costly, and failed to lift the economy; an experience seen around the world where travel bubbles were tried.<sup>26</sup> Following community spread of COVID, Palau reopened its borders, but tourism did not spring back. Ultimately, Palau's economic recovery is dependent on external actors and their decisions to travel again.

26 A Taipei, China study of the Palau travel bubble found that: "The policy is flawed, and the prices are not in line with the market demand. These factors reduce public acceptance of the travel bubble policy, leading to a wait-and-see attitude about participating in the next travel bubble event." Yu, J.-H.; Lin, H.-H.; Lo, Y.-C.; Tseng, K.-C.; Hsu, C.-H. 2021. Is the Travel Bubble under COVID-19 a Feasible Idea or Not? *International Journal of Environmental Research and Public Health* 2021, 18, 5717. <https://doi.org/10.3390/ijerph18115717>

Palau prioritized workers relative to firms in mitigation efforts. Palau focused its mitigation on unemployed workers, with the bulk of CROSS Act expenditures for temporary jobs and humanitarian unemployment payments. Among those workers, Palau policy prioritized its citizens -- providing most of the temporary jobs to citizens and maintained humanitarian levels of aid mostly for foreign workers. Businesses received about 7 percent of CROSS Act assistance, and the loans were relatively small and not scaled for the large tourism hotels most affected by the COVID closure. The small scale of Palau's support for COVID-impacted private businesses is in contrast to the support provided by the FSM and RMI, where more resources were provided to COVID-impacted businesses. However, both the FSM and RMI economies are less tourism-dependent and had a smaller number of impacted firms than did Palau.

Palau program incentives did not compete with employers. Palau set the payment structure for the temporary job program at the minimum wage -- so that temporary job earnings would not exceed the earnings of jobs available in the private or public sectors. For the unemployment/humanitarian assistance program, Palau set the payment level to be less than the minimum wage, such that holding any available job would yield more income. Further, the structure of the program encouraged the continuation of part-time employment of workers by their employers. Employers with low revenue could maintain workers at reduced hours and pay, with the humanitarian aid program making payments smaller than lost wages. After February 2021, the unemployment program was restructured to pay most recipients the equivalent of the minimum wage for 20 hours per week (\$70/week) as an unemployment payment, with the direction that workers return to their employers for 20 hours of paid work per week. Only late in program implementation was firm eligibility reassessed such that only employees of companies that had not yet reached a 70-percent recovery would be eligible. This removed employees of companies that had substantially recovered from the COVID impact. Palau rejected a strategy of large-scale repatriation of foreign workers, seeking to maintain the foreign workforce for reopening the tourism economy.

The US CARES Act unemployment program was a disincentive to employment. While Palau was a fortunate beneficiary of the CARES Act, it had no input on the CARES Act payment structure. The payments were very high relative to Palau wages so that being unemployed resulted in a windfall and very likely delayed reemployment. The program went to a subset of all households and temporarily changed the distribution of household income.

ADB loans stabilized the Palau economy and supported the population. ADB loans stabilized public sector employment and provided resources to support the private sector work force, especially the foreign workers. In the absence of this support Palau would have faced widespread unemployment accompanied by destitution. Thus, the ADB loans prevented a humanitarian and social crisis. The government of Palau and donors successfully sustained the economy, livelihoods, and government operations.

### **Data for mitigation:**

Statistics and economic analysis were critical to Palau's COVID response. Critical data undergirding Palau's COVID response were:

- » Business information from the tax system regarding industry, sales volume, and employment provided the ability to project the impact of the COVID pandemic as well the basis for approving benefits.

- » Employment data derived from tax and social security records provided the basis for developing the temporary jobs program and unemployment benefits. Understanding the structure of wages in the labor market allowed both to be structured to not be a disincentive for employment. One finance official noted that information on hours worked would be valuable additional information. Going forward, hours worked information will be added to Palau wage tax documentation in FY2023, as part of the Palau tax reform.

These data elements allowed the projection of the impact on Palau of the contraction of tourism, including changes in GDP, employment, household incomes, government revenue, and fiscal balance. In turn, the projections spurred Palau's government to develop policies to address the impact on the population. Additionally, data and modeling provided a solid basis for critical loans from the ADB.

Unavailable information hampered Palau's COVID response:

- » The health response was challenged by the lack of current population data and reliable information on the foreign worker population. Further, data on the geographic distribution of households was not available for planning the vaccine campaign. Existing internal individual medical and hospital records should be assessed to see if they could be useful in planning a health emergency response.
- » The COVID economic response lacked data on private sector business finances and the extent to which they could survive the economic shock. Government planners used counts of employees working for tourism-related businesses in the formal sector as the basis for projecting the adverse impact of COVID. However, when establishing aid for the private sector, they lacked information on that sector's financial health preceding the COVID pandemic, such as private business balance sheet and debt information. Under tax reform, additional information will be collected from large firm balance sheets, but planned tax reporting does not provide adequate coverage of private sector debt.
- » The economic response lacked data on the informal economy regarding its scale and participants. Government planners used counts of employees working for tourism-related businesses in the formal sector as the basis for projecting the adverse impact of COVID. However, when unemployment programs became available, many informal sector workers applied for support. This area of missing data may be reduced in the future, as small enterprises in the informal sector file taxes under the recently enacted Palau tax reform.<sup>27</sup> However, having better information about the "household" economy and how residents use and supplement earnings by working, or through remittances remain a data gap. Addressing this gap requires surveys at the household level that better capture economic and labor activities.

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27 The enacted tax reform has incentives for small informal "*Makit*" enterprises with gross revenue less than \$15,000 to file quarterly tax documents with the government. Doing so makes them eligible for a "social assistance payment" of 4 percent of their gross revenue. This action may effectively expand the formal sector as small "nano" enterprises leave the informal sector and report to the tax system.

## II. Data: Migration, Remittances, FDI, and SMEs

The ADB identified four specific data areas for examination in 3 of its North Pacific members: migration, remittances, foreign direct investment (FDI), and small-to-medium enterprise (SME) information. The task was to examine existing information and provide insights on how additional information can be developed. Where data was available, information is presented on recent trends.

- » Migration and remittances. In the case of small island economies, migration and remittances are closely related with a country's migrants moving overseas and then transferring some income home to family members as remittances. This relationship is often cited as a key structure for Pacific economies.<sup>28</sup>
- » FDI and SMEs. In the case of FDI and SME data, they both represent information on the structure of the economy, albeit at opposite ends of the scale. FDI is likely tied to large investments in tourism or manufacturing, while SMEs are likely to be comprised of small local firms. FDI is often studied due to its importance in providing capital, management and technology for economic development and growth, but also as it reflects foreign influence in the national economy and society. SMEs often are dynamic new enterprises that may spur economic growth and diversification.

For these four areas, this chapter reviews the existing public information on each topic from Palau government and international sources. In several cases, underlying Palau survey/census data and administrative records/data are analyzed to provide additional insights. This demonstrates how existing data and records can be used further to understand migration/remittances and FDI/SMEs. Suggestions to improve data availability are also offered.<sup>29</sup>

### A. Palau Migration Data

#### i. Existing Migration Data

Palau has a small but dynamic population. Palau citizens migrate to the United States and establish residency, although some later return to Palau. Foreign citizens enter Palau on fixed-length work permits and become residents of Palau during their time of employment. A robust tourism sector brings in many temporary visitors.

- » Under the terms of the Compact of Free Association with the United States, Palau citizens can move to, reside, and work in the United States freely, without entry visa requirements. This outward migration has been measured through surveys conducted in the United States, computed from airline travel information, and derived from an analysis of passport entries upon arrival and departure from the

28 The MIRAB model, standing for “migration-remittances and aid/bureaucracy”, was first outlined by Geoff Bertram and R. Watters to reflect the stylized facts and experience of small Pacific islands. See: Geoff Bertram. 2006. Introduction: The MIRAB model in the twenty-first century. *Asia Pacific Viewpoint*, vol. 47, no. 1, April. In the North Pacific, researchers have mostly reported on Kiribati, Marshall Islands, and Micronesia, not Palau.

29 Upon the completion of initial reports on the three FAS nations under this ADB Technical Assistance project, EconMAP will assess the approaches used by the three FAS in these four areas to make recommendations to further improve available data. The recommendations will address survey strategies that can be used to expand data and how administrative data can be enhanced to improve routine information for government policy making.

United States. Concerns are often cited in Palau about this outward migration of citizens: the damaging losses of citizens, young people, and skilled workers.

- » Palau has long augmented its domestic labor force and backfilled for its migrating citizens with a work permit system where employers apply for foreign workers to enter Palau for work. This inward migration has been recorded in Palau household surveys and censuses, as well as from administrative data. Such administrative data includes work permit data and wage and salary tax withholding documentation that employers file each pay period.
- » The economy of Palau relies on a large tourism sector. The extent of tourism is evident in transportation data on the number of flights and passengers boarding or leaving aircraft. For example, in 2019, the year preceding COVID, Palau had 1,225 flights, with 104,829 passengers recorded as deplaned and 103,167 passengers boarding. Administrative data collected from visitor passports at arrival is the basis of visitor arrival statistics.

Existing data on Palau's inward and outward migration can be drawn from demographic and administrative data sources. In addition, the US government has reported on the migration of Palau citizens to the United States.

**Palau census data.** To date, Palau has not published census data on outward migration, either in total or by its citizens or by foreign residents. However, across its periodic censuses, demographic data that Palau collects can illustrate certain migration trends. In contrast, information on the inward migration of foreign citizens is published by Palau.

- » Outward migration. Palau household censuses capture the age, citizenship, gender, and place of birth of each resident. This information can be used to illustrate outward migration patterns. For example, an analysis can track the population number of the age 5- to 9-year-old cohort in the 2005 Census by assessing that population count 15 years later when that cohort is now the age 20- to 24-year-old cohort in the 2020 Census. Data is publicly available by age cohort for the “Palau born” population, which is a close but imperfect proxy for the Palau citizen population.<sup>30</sup> As an example of how this analysis works, in 2005 the age 5-9 cohort of residents born in Palau was 1,316. Fifteen years later, in the 2020 census, that number can be compared to the same cohort of Palau-born residents, now age 20 to 24. The cohort of Palau born residents now numbers 615, a 53 percent reduction (see [Table 3](#)). The next older cohort shows a similar reduction in population, suggesting a strong outward migration pattern. Additional tabulations of Palau Census data could provide more granular data by reporting on Palau citizen migration and do so for individual birth years of the population, rather than grouping observations in 5-year cohorts.
- » Inward migration. Palau household censuses capture personal characteristics of residents based on citizenship, place of birth, and ethnicity; information relevant to understanding inward migration. For example, in the 2020 Census 5,922 residents were born outside of Palau and they constituted 34 percent of the population. The census collects information on the year of entry, as well as the reason for migration. Seventy percent cited employment as their reason for migrating. Moreover, those born outside of Palau represented 45 percent of the total labor force and were 75

30 Comparing data across censuses assumes that the censuses are of equal quality. If not, some of the observed numerical change may reflect differences in population coverage rather than implied migration.

**Table 3:** Place of Birth by Age: Palau, 2005 and 2020

2005 Palau Census Place of Birth: Palau		2020 Palau Census Place of Birth: Palau		Change 2005 to 2020
Age Group in 2005	Count	Age Group in 2020	Count	Percent
age 5 to 9 cohort in 2005:	1,316	age 20 to 24 cohort in 2020:	615	-53%
age 10 to 14 cohort in 2005:	1,567	age 25 to 29 cohort in 2020:	657	-58%
age 15 to 19 cohort in 2005:	1,130	age 30 to 34 cohort in 2020:	600	-47%
age 20 to 24 cohort in 2005:	757	age 35 to 39 cohort in 2020:	616	-19%
age 25 to 29 cohort in 2005:	796	age 40 to 44 cohort in 2020:	720	-10%

Source: Palau Census of Population and Housing, 2005 and 2020.

percent of private sector and 16 percent of public sector employees in the 2020 Census. There are challenges in reconciling foreign workforce information in the census with administrative data on work permits.<sup>31</sup>

Bottomline: Census data can provide valuable information on migration for making long-run policy but are not sufficiently timely for short run decision making.

**US government data.** US government agencies have collected data and reported on Compact migration into the United States from the Freely Associated States, including Palau. The US defines “Compact migrants,” as FAS citizens arriving after each Compact began, and any children under age 18 in the household, including US-born and therefore US-citizen children.<sup>32</sup>

» Official enumerations of FAS migration. Beginning in 1993, the US Census Bureau had reported FAS migration to Guam, Hawaii, and the Northern Mariana Islands for the US Department of the Interior.<sup>33</sup> Prior to 2003, the reports detailed the characteristics of Compact migrants, but have not included this information since 2003. US Census has not prepared official enumerations of FAS migration to the mainland.

31 How well the Census covers foreign residents can be checked by reviewing data on foreign workers from administrative records. For example, data on the number and characteristics of foreign workers is published in the annual *Palau Statistical Yearbook*, which is based on work permit data. Reconciling 2020 foreign worker permit data with the 2020 Census is difficult: in 2020, the number of foreign worker permits totalled 5,972; compared to the Census tally of 4,993 non-citizens—a category that includes workers and non-working family members. The differences may reflect Census coverage gaps of foreign residents or a permit count that includes inactive foreign worker permits.

32 For FAS nation migrants who arrived before the effective dates of their respective Compacts, they and their children, including US-born children, are not captured in these enumerations.

33 US Department of the Interior, <https://www.doi.gov/oia/reports/Compact-Impact>.

- » Special US Census tabulations. Through special requests, the US Census Bureau has reported two special tabulations from the ongoing American Community Survey to report on FAS migration.<sup>34</sup> The ACS covers the 50 states, Puerto Rico, and District of Columbia, but it omits Guam and Northern Mariana Islands from its coverage, where both have FAS populations. For the 2005-2009 period, 3,395 Palauan Compact migrants were recorded, with 205 in Hawaii.<sup>35</sup> For the 2013-2017 period, Census reported that 3,435<sup>36</sup> migrants born in Palau had entered the United States after 1996, with 390 in Hawaii.<sup>37</sup>
- » US arrival and departure immigration data. US GAO used US Department of Homeland Security's Customs and Border Protection's Arrival and Departure Information System data to estimate net arrivals to US areas by travelers with FAS passports. This effort calculated monthly FAS net arrivals to US areas. For 2017-2019, on average, 440 more Palauan citizens departed from the US than arrived each year: 680 in 2017, 461 in 2018, and 179 in 2019. One concern about this data source is whether dual US-Palau citizens use different passports to enter versus leave the US.<sup>38</sup> If occurring, such behavior could easily create a false observation of persistent home-bound migration to Palau from the United States. For policy makers, summary data from US passport scans could be a source of information on FAS and Palauan population movements but it is not currently available to Palau officials. Further, the US government does not routinely derive such data.
- » US transportation data. EconMAP/Graduate School USA had previously used flight data from the US Transportation Department to report measures of net migration from the Marshall Islands and Micronesia where all flights transit Guam or Hawaii. However, for Palau, US flight data only captures flight movements via Guam and could not account for travelers transiting other nations.

Bottom line: US government information on Palau migration to the United States is not reported on a regular basis. Further, the information may not be made available to Palau officials.

**Palau wage and salary tax data.** Administrative data from the Bureau of Revenue and Taxation and the Social Security Administration are additional sources of information about the number and characteristics of foreign workers in Palau. Each pay period, employers file wage and salary tax withholding information for each employee, including foreign workers. This documentation can provide annual or monthly counts

34 These special tabulations were requested by the US Government Accountability Office (US GAO). The US Census, *American Community Survey* collects data on the ethnicity, place of birth, and citizenship of respondents. For persons born outside of the United States, it asks the year when you last arrived to live in the United States. For statistical validity, multiple years of survey results are pooled when reporting on small subpopulations, such as the number of Compact migrants.

35 This measure includes US born children under the age of 18. US Government Accountability Office. 2011. *Compacts of Free Association: Improvements Needed to Assess and Address Growing Migration*. GAO-12-64, 14 November. <https://www.gao.gov/products/GAO-12-64>.

36 As a survey, the American Community Survey has a margin of error on the estimate which is exacerbated for a small subpopulation; for the 2013-2017 date, the 90 percent margin of error is plus or minus 707.

37 This measure excludes US born children under age 18. US Government Accountability Office. 2020. *Compacts of Free Association: Populations in U.S. Areas Have Grown, with Varying Reported Effects*. GAO-20-491, 15 June. <https://www.gao.gov/products/GAO-20-491>.

38 Entering the United States on a US passport can ease entry at a US airport, while entering Palau with a Palau passport would also ease entry. Further, Palau has fees incorporated into airline tickets that are refundable for Palauan citizens, thus possibly providing another reason for travellers to be aware of which passport they use.

of workers by citizenship, as well as information on earnings and the industry of employment.

Bottom line: Among the several sources of available Palau data on inward migration and number of current foreign residents, tax data is the timeliest for workforce information.

**Policy considerations.** Census information is useful for long-run analysis of migration trends and changes in the composition of the population and workforce. For policy makers, no current data source provides timely data on out-migration of Palauan citizens and a source such as that of Palauan citizens movement across the US border is not readily available to Palau. While foreign worker data is available from worker permits, that number may not match the actual worker population in Palau. Palau government tax data represents a timely data source that can track the activities and numbers of the foreign workforce.

## *ii. Palau Border Management Data*

Since 2012, Palau has implemented a Border Management System funded and developed by Taipei, China. Initially the system focused on recording the entry and exit of non-Palauan visitors and foreign work permit holders. Graduate School USA (GSUSA)/EconMAP developed processes to generate visitor statistics from the system that have been used since 2014 in economic reporting, statistical yearbooks, and by the Palau Visitor Authority. After upgrades to the border management system and immigration procedures, all arrivals and departures, including of Palauan and non-Palauan travelers, have been included since 2018. With this enhanced scope of data collection, statistics can be developed to measure the flow of Palauan and non-Palauan residents, as well as flows of temporary visitors.

Border Management System data can provide insights on net inward or outward migration in total, and it allows disaggregation for Palau and other country citizenship categories. One challenge using this data to isolate migration events is that migration represents a small fraction of cross-border movements. For example, in 2018 there were over 251,000 border crossings (arrivals plus departures), whereas the number of actual migration events are likely less than one percent of this.<sup>39</sup> Data on migrants can easily be swamped by any anomaly in the data on non-migrant movements such as if dual-citizen Palauans travel on both passports, as discussed above.

Broadly, passport data analysis to measure migration can be approached two ways:

- i) computing net arrivals by differencing arrivals and departures in total or by citizenship for a given time period, or
- ii) matching the arrival and departure of unique individuals. With a matched travel history, an individual that arrives in Palau and does not depart within a set time period can be classified as an in-bound migrant to Palau. Conversely, a resident who leaves Palau and does not return within a set time period can be classified as an out-bound migrant.

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39 Palau has a very high number of border crossings relative to its population. The 2018 figure of 251,000 border crossings represents over 14.3 border crossings per capita. By contrast, in the same year New Zealand had only 2.8 border crossings per capita.



This report section explores the feasibility of these two approaches to generate migration statistics from immigration data. A dataset of 541,699 border movements recorded over 2018-2021 was extracted from the immigration system by Ministry of Finance IT staff. This was provided as annual data files where each row was an individual border crossing event, with 25 fields for each event, including individual identifiers.<sup>40</sup>

### Net arrivals: differencing arrivals and departures

Net arrivals can be measured either across total travel events or for subsets of travelers, such as by purpose of travel or by citizenship.

Differencing raw numbers of arrivals and departures. During the period 2018-2021, Palau recorded 541,699 border crossing events, with 2,855 more departures than arrivals during those four years (see [Table 4](#)). On balance, there appears to be outward migration during the period. It is also capturing several impacts of the COVID pandemic: travel plummeted in early 2020 and the larger departures in 2020 is consistent with foreign workers returning home.

However, this “differencing” analysis approach is inherently incomplete at the start and end periods of the data. Travel is a flow that takes place over time, so some departures recorded in January 2018 (and later months) will match arrivals that took place in late 2017 (or before) and are outside of the analysis period. Similarly, some departures recorded in December of 2021 (and before) will be matched to arrivals (returns) in 2022 and later. In that sense, net arrivals for short periods of time are difficult to interpret at the end points and the problem is heightened when the end point dates correspond to a holiday period. However, net arrivals over a long time period represent a valid way to look at Palau’s overall migration movements.

**Table 4:** Palau Arrivals, Departures, and Net Arrivals (2018-2021)

	2018	2019	2020	2021
<b>Arrivals</b>	125,525	113,318	22,336	8,243
<b>Departures</b>	126,288	111,404	25,912	8,673
<b>Net arrivals</b>	(763)	1,914	(3,576)	(430)

Source: EconMAP analysis of arrival and departure data in the Palau Border Management System.

Differencing arrivals and departures by purpose of travel categories. In concept, border control data can also be analyzed based on the recorded purpose of travel. For foreign nationals entering the country, the immigration process records the purpose of travel that in turn can be assigned to “visitor” or “work” categories. The Palau data system uses 53 “purpose of entry” categories, which GSUSA/EconMAP has sorted between those deemed to identify as “Visitors” and those to identify as “Foreign Migrants.”<sup>41</sup>

40 Working with this data file has parallels with routine EconMAP work to create visitor statistics from passport data. In that case, persons who arrived in Palau and departed within 30 calendar days were identified and tabulated as “Visitors”.

41 Precise allocations between “Visitors” and “Foreign Migrants” may be indeterminate for certain categories, such as investor and missionary where the purpose could be short or long term.

- » Examples of the “Visitor” category include travel purposes such as diving, tourist, bird watching, wedding, honeymoon, as well as other categories such as business, investor, crew, and transit.
- » Examples of the “Foreign Migrant” category include travel purposes such as employment, dependent, student, and missionary.

Reviewing immigration data from 2018 to 2021 for the 541,699 recorded arrivals and departures:

- » Visitors. 436,599 travel events (arrivals and departures), representing 81 percent of total events, had “visitor” travel purposes. Over the four calendar years, total visitor net arrivals (total visitor arrivals minus total visitor departures) were positive, with 165 more arrivals than departures.
- » Migrants. 32,567 travel events, representing 6 percent of total travel events, had “migrant” travel purposes. Over the four calendar years, total migrant net arrivals were negative, with 769 more departures than arrivals. As these entries were of non-Palauan passports, this is consistent with outward movement of foreign workers, a plausible outcome during the COVID period when tourism employment collapsed.
- » No purpose. 72,533 travel events, representing 13.4 percent of total events, had “no purpose” recorded. Over the four calendar years, total “no purpose” net arrivals were negative, with 2,196 more departures than arrivals.
- » Across the four calendar years, total net arrivals for all categories were negative, with 2,855 more departures than arrivals, a result driven by the “no purpose” recorded cases.

Travel events with “no purpose” recorded needed further analysis:

- » Investigating the citizenship of these 72,533 traveler arrivals/departures without a recorded purposes show that travelers on a Palau passport constituted 75 percent of these events.
- » Further, travelers on a US passport were another 6 percent.<sup>42</sup> Most of these US passport holders appear to have Palauan names.
- » Other nations’ passports made up the remaining 19 percent of these events.

According to Palau Immigration officials, they use a check box in the data system to record travelers on a Palauan passport or ethnic Palauans on other national passports without a purpose entry. To record the purpose of their travel would require a change in procedures.

Bottom line: “Purpose” of travel can identify movements of visitors and migrants; it is not useable to review Palau citizen movements and may not be valid for travelers using US passports. Further, there is a small number of additional “no purpose” travel events that require further analysis.

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42 Overall, further examination of travel records by citizenship revealed that very few movements of Palauan passport holders have a recorded purpose (about 200 over the four years of data).

### Travel history: matching the arrival and departure of unique individuals

Two approaches are presented to illustrate the feasibility of this approach. Both approaches require that an individual's arrival or departure record can be matched (if both occur during the time period) and multiple travel events can be grouped. The first approach looks at individual traveler events within a fixed time period. The second approach presents a "rule-based" approach to identifying a traveler as an inward or outward migrant.

Travel history: time period approach. For the 2018-2021 period, the border control database's 269,422 arrivals and 272,277 departures are used to identify unique travelers, create a travel history for each traveler, and sort the histories between travel as a visitor versus migration.<sup>43</sup> See [Table 5](#) for the results of travel matching by nation.<sup>44</sup>

Interpreting these results is challenging, but using traveler passport data provides a more nuanced report on migration behavior than the prior raw data presentation and data based on purpose. However, the results suggest that additional analysis may be warranted to better understand border-crossing behavior.

- » Palau passports show a net outflow except for 2018. The flows declined during the first COVID year but increased in 2021 as flights resumed. The net results are broadly plausible. However, the levels of both inward and outward migration each year appear high relative to the Palauan citizen population of 12,438 in 2020.
- » USA passports show an overall inflow that seems unlikely. Further, half the net inflow is from the third quarter 2021.
- » It is noteworthy that the combination of USA and Palauan passports almost net out. Dual citizen Palauans traveling on both passports may be a factor in this finding. Reviewing individual records would be the next step in better understanding this finding.
- » Philippines and Bangladesh passports: The two largest foreign worker groups show high net outflows, which is plausible given Palau's weak economic conditions in all four years. They do show higher outward flows in 2020, the initial year of COVID. Foreign workers are on fixed contracts and so are likely to show higher total flows relative to net flow than other groups.
- » Other passports: There are high total numbers here, but they largely net out. A deeper review of the nationalities involved may be warranted.

43 From recorded arrival and departure events, 228,774 unique travelers were identified based on birthdate, sex, and name. (The passport number field can also be used for matching, but new passports with new numbers are issued as passports expire or are lost.) Travel histories were created for each unique traveler: a traveler with an "even" number of border crossings basically ended where they started, either in Palau or overseas – these travelers would not be migrants; a traveler that had an "odd" number of border crossings, where the number of departures and arrivals did not match would be classified as a migrant – inward or outbound. Outward migrants were those whose departures exceeded arrivals and inward migrants had arrivals exceeding departures. When tabulating the results by year and passport, GSUSA/EconMAP dropped all cases for the first three months of 2018 and last three months in 2021. This helped eliminate travelers who are primarily visitors and arrive in December one year, departing in the following year.

44 For the purpose of this test analysis, travellers with 7 or more events were presumed to be travelling for reasons other than migration, and so were excluded.

**Table 5:** Travel History-Migration Results by Nation, April 2018-September 2021

Nation of Passport	Time Period	In-migration	Out-migration	Net-migration
<b>Palau</b>	2018	420	285	135
	2019	288	459	-171
	2020	78	150	-72
	2021	62	219	-157
	<b>2018-21</b>	<b>848</b>	<b>1,113</b>	<b>-265</b>
<b>USA</b>	2018	185	142	43
	2019	183	169	14
	2020	82	46	36
	2021	170	59	111
	<b>2018-21</b>	<b>620</b>	<b>416</b>	<b>204</b>
<b>Philippines + Bangladesh</b>	2018	315	585	-270
	2019	500	646	-146
	2020	120	342	-222
	2021	8	182	-174
	<b>2018-21</b>	<b>943</b>	<b>1,760</b>	<b>-817</b>
<b>Other nations</b>	2018	590	669	-79
	2019	871	787	84
	2020	345	417	-72
	2021	85	84	1
	<b>2018-21</b>	<b>1,891</b>	<b>1,957</b>	<b>-66</b>
<b>Total</b>	2018	1,510	1,681	-171
	2019	1,842	2,061	-219
	2020	625	955	-330
	2021	325	544	-219
	<b>2018-21</b>	<b>4,302</b>	<b>5,246</b>	<b>-944</b>

Source: EconMAP analysis of arrival and departure data in the Palau Border Management System.

- » Total: The overall net outflow is a surprisingly stable result. It is hard to conclude if this is the true picture or an artifact of various data issues netting out.

Travel history: rule-based approach. With the incomplete recording of border crossing purposes and the challenge of interpreting the flow of travel activity on a time period basis, another method to measure migration is to look at the travel history of individuals and classify behavior as migration based on a “duration rule.”

- » For example, if a traveler arrives in Palau and does not exit by a certain number of days they would be classified as a migrant to Palau. This classification strategy is independent of whether the traveler has permission to remain in Palau, and/

or their declared purpose on arrival. Observing this behavior could identify in-migration by a citizen of Palau (returning from the United States) or by a foreign national entering Palau.

- » Conversely, if someone departs Palau, citizen or non-citizen, and does not return by a set amount of time they could be classified as a departing migrant.
- » Separate from statistical objectives, this record matching may also serve as a tool for administering the worker permit program and for border security purposes.

Using this approach would provide the Palau government with a better understanding of population dynamics than is available from household surveys and censuses. This approach represents a best practice methodology to create migration statistics. This travel history approach to estimating permanent and long-term migration statistics has been implemented recently in New Zealand<sup>45</sup> and is also used in Australia.<sup>46</sup> Outlining the approach undertaken in New Zealand, the key features are:

- » Immigration records alone are used – i.e. no separate arrival/departure cards.
- » Travel histories are generated for each individual. This depends on the ability to precisely link arrivals and departures, enabling measurement of the exact time that each traveler spends in New Zealand or overseas after crossing the border.
- » Residence status is determined using a 12-out-of-16-month rule: if a traveler remains in New Zealand for 12 out of a 16-month interval, they are deemed to be a resident, and are deemed non-resident if outside New Zealand for 12 out of 16 months. This allows the consideration of frequent travelers with multiple movements.
- » Estimation methods are used to allocate the status of travelers for the most recent months. Once four months have passed, the estimation component becomes relatively small.

Palau has the data collection system needed to implement this approach, since all persons crossing the border, including Palauan citizens, have been recorded since 2018. The key implementation question is whether the quality of the data allows the precise linkage of travel histories for each traveler. Currently, the Palau Border Management System matches arrival and departure records to facilitate identification of visitors who may be overstaying their permits. Discussion with Palau immigration IT staff confirmed this matching, but staff also reported that some records remain unmatched and that they would appreciate assistance on how to resolve them.

However, the Palau border management system matching is not set up to calculate the travel history of months within or away from Palau. To do this requires more than just matching sets of entry and exit, since there are people with multiple trips and incorporating multiple trips requires spanning more than one travel event. This is particularly the case for those Palau residents and Palauans who reside abroad (and some non-residents) who visit regularly for personal or business reasons.

Travel history matching: data quality assessment of Palau records. To test the feasibility of implementing the matching strategy, the quality of the Palau data is assessed. A small subset of data is arrayed for a detailed manual inspection:

45 <https://www.stats.govt.nz/methods/outcomes-versus-intentions-measuring-migration-based-on-travel-histories>

46 <https://population.gov.au/population-topics/topic-overseas-migration>

- » From the 2018-2021 period a subset of data for all travelers born in 1966 is extracted.
- » This provided a list of 8,668 travel records that were sorted by birthdate, sex, last name, and first name.
- » Then a manual review is conducted of the records with birthdates from 1 January 1966 to 30 June 30 1966, numbering about 4,311 records.

Within the 4,311 travel events manually reviewed, 97.4 percent of events were readily matched, for example, a departure paired with an arrival. However, there were 112 cases where data did not perfectly match within this data subset and were then subjected to visual inspection. The lack of pair match for about half these cases is because they were inward or outward migration. However, other mismatches were due to data issues, primarily cases with inconsistent names: slight spelling differences, inconsistent recording of compound names (such as with hyphens), and name suffixes such as Jr. or Sr.

Overall, the quality of the dataset is good and using it to implement the travel history approach to measuring migration is feasible. The core challenge is that the number of non-migrant/temporary travel movements in the data vastly exceeds the migrants that need to be identified.<sup>47</sup> This demands a high level of data accuracy to ensure that actual migrant data are not impacted by other data errors. For example, a single plane with 150 passengers not recorded in the database would be sufficient to distort the migration numbers.

To enhance data quality and produce regular migration reports using a travel history duration model would require additional investment. Areas of investment would include:

- » Improved data cleaning and editing. Some of this could be achieved programmatically, but it will always need manual input on at least an annual basis.
- » Programming to organize the travel records into individual travel histories, to generate the continuous day history and identify migration events. This could entail the deployment of statistical techniques to guide matching for the creation of individual travel histories.<sup>48</sup>
- » Establishing and maintaining the analytical capacity to compile and review the results, ensure the process is working, and disseminate the findings in a form useful to stakeholders.

If Palau decided to develop the travel history approach to generate migration statistics, the generation of overseas travel statistics should require a relatively low additional investment.

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47 This will be a greater issue once tourism returns to normal levels, as our data extracts include the COVID period.

48 See, Varghese P Kuruvilla. 2023. A Comprehensive Guide to Fuzzy Matching/Fuzzy Logic. 12 September 2023, <https://nanonets.com/blog/fuzzy-matching-fuzzy-logic/> ; Aaron R. Kaufman and Aja Klevs. 2021. Adaptive Fuzzy String Matching: How to Merge Datasets with Only One (Messy) Identifying Field. *Political Analysis* published online by Cambridge University Press, 11 October 2021, <https://www.cambridge.org/core/journals/political-analysis/article/adaptive-fuzzy-string-matching-how-to-merge-datasets-with-only-one-messy-identifying-field/275D7890548359215AC728C1E35B53CE> .

### *iii. Steps to Improve Palau Migration Data*

There are two areas of opportunity to improve existing information on Palau's migration:

- » Existing census and survey information could be further tabulated to reveal migration patterns. This approach would create a valuable source for understanding and measuring long-term trends but is less valuable for current policy making or for forecasting trends.
- » Improved information on foreign worker migration can be developed using a combination of permit data, withholdings data, and/or passport clearance information. Linking this information would provide real-time information on this important population in Palau.

Palau could implement travel history matching through its border management system, which would allow travel information to segment Palauan vs foreign travelers. Technical assistance to support this effort could be sought from the immigration offices of New Zealand or Australia since they already use this approach. Beyond providing real-time migration information, the passport match data would support other data needs as well:

- » Balance of Payments (BOP) statistics could be improved with better travel data. Palauan residents spend substantially when traveling abroad, and this is currently a data gap for the BOP current account statistics. Improving BOP data would flow into improved GDP expenditure estimates (travel service imports).
- » Program compliance could benefit. Matching would also be useful for immigration and border control purposes which is a current Palau government interest. Linking information from border control system with worker permit data would also provide information for foreign work permit program compliance and for the Foreign Investment Board operations and compliance.

Lastly, consideration can be given to a publication strategy for information on migration. This publication could also include information on remittances, which stem from migration actions. As data can be drawn from multiple sources across the government, organizing the analysis and publication will require cooperation across ministries and a clear lead agency responsible for reporting and disseminating information.

## **B. Palau Remittance Data**

### *i. Background on Remittance Measurement*

Remittances are payments by residents of a country to households in another country, and a reflection of the migration of people. Palau is on both sides of remittance flows: with outbound remittances from foreign workers who send some of their earnings home and inbound remittances from Palauan citizens who have migrated to the United States and send some of their earnings to family in Palau. The structure of Palau's two-way remittances would also be found in the US territories of American Samoa and the Commonwealth of the Northern Mariana Islands. This is not the usual structure of Pacific Island remittances, which are one-way, where citizens of Pacific islands go abroad to work and send funds home.

The IMF and the World Bank both worked to strengthen the conceptual basis for measuring remittances and to support developing data for these measures.

**IMF.** The IMF has addressed remittance concepts and definitions. The 2009 IMF balance of payments (BOP) guidance updated concepts to address increased globalization, including the increased economic integration of migrant workers and their associated remittance flows.<sup>49</sup> The IMF stated that remittance flows for some economies represent a sizable and stable source of funds that can exceed official aid or foreign direct investment. In addition, these flows to households may reduce poverty and support consumption.

Remittances represent household income from foreign economies arising mainly from temporary or permanent migration. The IMF definition of “personal remittances” includes cash and in-kind transfers between resident and non-resident households, plus compensation of employees, less taxes, social contributions, transport and travel costs. This second category covers the net earnings of residents of the host nation who work abroad for less than a year for a non-resident employer. (After one year abroad, under the IMF definitions, a migrant worker is “resident” in the destination country.) Special guidance applies for students and embassy staff who retain their resident status beyond one year.

Remittances can include cash that flows through formal channels such as banks and wire transfers or informal channels such as money or goods carried or shipped across the border (see [Figure 15](#)).

IMF guidance for data compilers of remittance information focuses on four data sources, each with strengths and weaknesses:

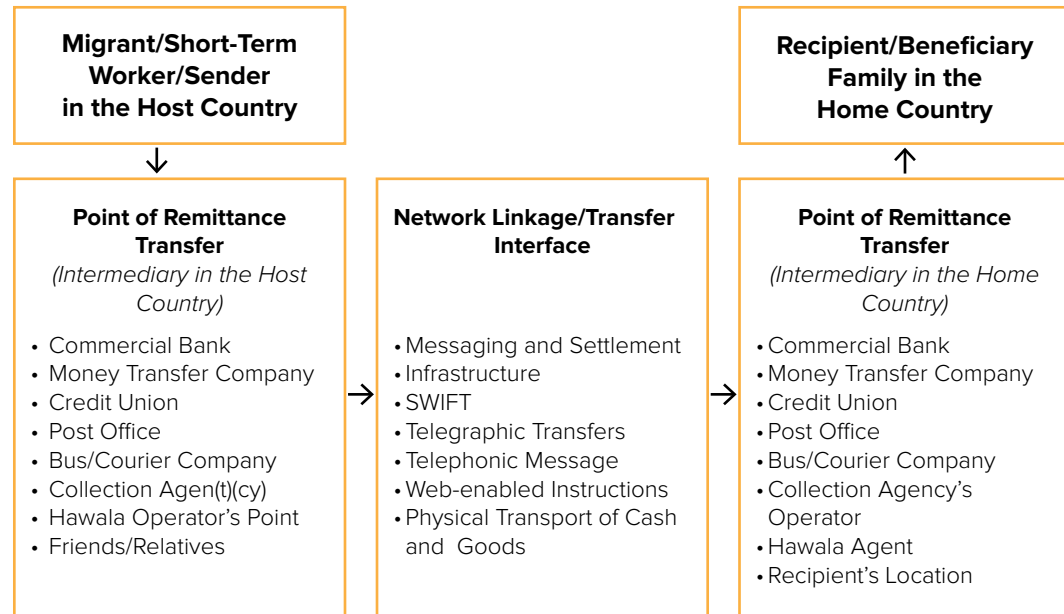
- » International Transactions Reporting Systems: collect individual transaction data from banks and through foreign exchange activities. The value of this as a data source depends on the government’s reporting requirements, including whether data is structured by sending and originating country and the level of reporting threshold values. This source may not cover money transfer operators and will not cover informal remittances.
- » Money Transfer Operators: this source may capture more detail than is captured in the bank clearance data but will be a subset of remittance activities.
- » Surveys of Households: questions on remittances can be incorporated in censuses, labor market surveys, living standards assessments, and household income and expenditure surveys. Surveys will not capture time series information and will suffer from reporting gaps.
- » Indirect Data Sources: this approach uses administrative data, demographic profiles, and econometric methods to estimate remittances. These techniques may build on other information, including survey data.

**World Bank.** The World Bank hosts a multi-donor trust fund to implement the Global Knowledge Partnership on Migration and Development (KNOMAD), with a focus on

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49 International Monetary Fund, *Balance of Payments and International Investment Position Manual*, Sixth Edition (BPM6), 2009. <https://www.imf.org/en/Publications/Manuals-Guides/Issues/2016/12/31/Balance-of-Payments-Manual-Sixth-Edition-22588>. IMF, *International Transactions in Remittances: Guide for Compilers and Users*, 2009. <https://www.imf.org/external/np/sta/bop/remitt.htm>.



**Figure 15:** Remittance Channels for Migrants to Send Funds to Home Country

Source: IMF, *International Transactions in Remittances: Guide for Compilers and Users*, 2009.

improving migration and development. It has established a working group to improve data on remittance flows.<sup>50</sup> Forty-one nations are participating in this effort (as of May 31, 2022); however, no Pacific Island nations are taking part, nor is the United States, which is the primary destination for North Pacific nations.

**Research studies.** Two studies have focused on remittances in the Pacific. However, neither had significant coverage of Palau remittance information.

- » An ADB study assessed remittances across the Pacific, finding that remittances “respond to an implicit social contract, contribute to human capital formation, and can be seen as a form of intergenerational transfer.”<sup>51</sup> Remittances are seen as supporting consumption, but also future migration.
- » An IMF working paper reviewed Pacific migration and remittance practices.<sup>52</sup> It found that migration in the Pacific consisted of families settling abroad for long time periods, but maintaining close ties to relatives, villages, and churches at home. These ties were altruistic, rather than investment-oriented as seen elsewhere in Asia. In the IMF paper’s comments on Palau, it was noted that Palau was an outlier, in that its outward remittances far exceeded those inward.

50 <https://www.knomad.org/>

51 John Connell and Richard P.C. Brown, *Remittances in the Pacific: An Overview*, Asian Development Bank, March 2005.

52 Christopher Brown and Aiko Mineshima, “Remittances in the Pacific Region,” *IMF Working Paper*, WP/07/35, February 2007.

## ii. Existing Remittance Data

Palau publishes information on remittances in its Balance of Payments statistics and reports on periodic censuses and household surveys.

### Balance of Payments Remittance Presentations

Palau Balance of Payments Statistics. Palau's Ministry of Finance publishes annual Balance of Payments (BOP) statistics, including data on household remittances, both outflows and inflows (see [Table 6](#)).<sup>53</sup> Outflows of remittances from foreign workers fluctuates with economic conditions which are also reflected in foreign worker permit levels. Outflows declined in FY2020 and FY2021, the first two years of the COVID pandemic, which reflected the serious contraction of the tourism sector. Inflows of household remittances are reported at a much lower level that does not vary by year.

**Table 6:** Household Remittances: Inflows, and Outflows (FY2014-FY2022)

(US\$ millions)	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022
Household remittances, inflows	0.8	0.8	1.0	1.1	0.9	0.9	0.9	0.9	1.0
Household remittances, outflows	13.8	16.4	18.6	19.9	20.0	19.7	18.1	14.9	15.1

Source: Palau, Balance of Payments Statistics (Ministry of Finance).

Graduate School, USA. EconMAP maintains a time series of household remittance data as part of its Balance of Payments data in support of Palau's statistics office.

For inward remittances, the GSUSA time series uses a 2006 data point that the average Palau household received \$182 per year in remittances.<sup>54</sup> This data point is adjusted for other years for changes in the number of households and for inflation over time.

For outward remittances, the GSUSA time series assumes that non-Palauan households remitted 36.6 percent of wages and salaries. Annual non-citizen worker wage and salary data are available from the Palau Social Security System each year for this estimate.

With respect to the four data sources outlined by the IMF, the EconMAP remittance time series combines data points from household surveys on remittance activity, with administrative data on household counts and worker income to estimate remittances.<sup>55</sup>

53 Palau's posting for FY2022 labels the data for FY2020 as "provisional" and the data for FY2021 and FY2022 as "preliminary." Data presented is from the posted PDF files. <https://www.palau.gov.pw/executive-branch/ministries/finance/budgetandplanning/balance-of-payments/> Palau also publishes BOP data in its annual *Statistical Yearbook*.

54 2006 Palau Household Income and Expenditures Survey (HIES) <https://www.palau.gov.pw/wp-content/uploads/2013/10/2006-Household-Income-Expenditure-Survey-Report.pdf>. Remittances were defined as regular cash payments or goods received by the household both from other households in Palau and from overseas. The average household reported \$143 in cash and \$39 in goods, totaling \$182 in regular income. Separately, the average household reported on ad hoc cash payments or goods received by the household from both other households in Palau and from overseas. The average household reported \$117 in cash and \$98 in goods, totaling \$215 in ad hoc income.

55 The IMF also posts estimated Palau remittance data on its website. <https://data.imf.org/>

### Palau census and household survey data

Since 1995, Palau Censuses and Household Income and Expenditure Surveys have included questions related to remittances, both inflows and outflows. However, the structure of the questions changed over time and in some cases the questionnaire responses regarding remittances have not been tabulated in published tables.

Palau Census. The 1995 census, the first undertaken and fully funded by the government of Palau included specific questions about whether a household received income from Guam/Northern Mariana Islands, Hawaii/United States, or from elsewhere. This income question was repeated in the 2000 and 2005 Censuses. For these three census efforts, the results were tabulated, although the basis of presentation changed over time from households to persons.

A census was not conducted in 2010 and the “mini census” conducted in 2012 did not include questions about household income. The 2015 and 2020 censuses included a question, “How much money did (person x) send out of Palau or receive from outside of Palau.” However, the responses to this question were not tabulated and reported in published tables.

Palau Household Income and Expenditure Survey (HIES). The 2006 Palau HIES questionnaire included an income question about remittances received (cash and goods) from overseas relatives. However, the published report of the HIES results covered gifts (cash or goods) “given by members of the household to either other Palauans or people overseas.” In this case, the 2006 HIES report was not properly structured to divide remittances between domestic versus overseas inflows or outflows. However, an examination of the underlying questionnaires suggest that the underlying survey data could be retabulated for this purpose.<sup>56</sup>

One challenge that is evident in the Palau context is the collection of data for customary gifts given and received among Palauans related to homes, births, marriages, and deaths. For example, for ethnic Palauan households, 2006 income from “customs” was \$3,656 on average, while remittance cash and goods (value) were \$821. On reported household expenditures, “customs” expenses are not broken out, but left in the “miscellaneous” category. In the published 2006 tables, results are not allocated between domestic and overseas sources.

In 2014, the HIES income questions asked about receiving money from a member of another household with questions about the sender and the characteristics of the remittance event. The questionnaire asks if the sender of the remittance is in the US military, the relationship of the sender to the recipient, and the location for the sender. Regarding these remittances, the questionnaire asks about the means of remittance (bank transfer, Western Union/Money Gram, cash by hand, cash by mail, other), whether it is regular or ad hoc, the frequency within the year, the amount and the purpose. Recorded purposes include living support, church gifts, traditional ceremony, funeral, wedding, birthday, or other reason.

The 2014 HIES report broke out cash remittances from within Palau versus from overseas in reporting on sources of income.<sup>57</sup> For 2014, the average annual household

56 See Palau 2006 HIES diary, expenditure, and income survey documents posted at the International Household Survey Network: <https://catalog.ihsn.org/catalog/3200/related-materials>. The underlying survey data is not available at this site, nor at the Pacific Community, Pacific Data Hub: Microdata Library, <https://microdata.pacificdata.org/index.php/catalog/28/related-materials>.

57 <https://www.palau.gov.pw/wp-content/uploads/2016/04/2014-ROP-HIES.pdf>.

cash income was \$20,620, of which \$30 came from within Palau, and \$140 from overseas. The report summarized that 8 percent of households in Palau received remittances and that for those households, their annual total averaged \$2,100. Further, of the money transferred to Palauan households, 21 percent was from a military member living overseas. Daughters and sons accounted for 66 percent of total remittances. In total, 88 percent of remittances to Palauan households were from overseas, with the United States being the source of 72 percent of the total. While the 2014 HIES report could have provided additional information from the survey questionnaire on outward remittances, in total and by citizenship categories, this information was not tabulated and reported.

### iii. Steps to Improve Palau Remittance Data

Balance of payment remittance data can be improved in two ways:

- » First, the assumptions used for the current BOP estimates can be compared to updated information from the most recent Census and household survey and updated as merited. This will require further tabulations of underlying census and survey information by the Palau statistics office.
- » Second, data collected from banks operating in Palau by the Palau Financial Institutions Commission (FIC) on incoming and outgoing international money transfers may provide a new measure of certain remittance activities. Five banks operate in Palau, three from the United States and two that are Palauan. FIC publishes quarterly statistics on incoming and outgoing international transfers by: Palau depository institutions, central and state governments, non-financial corporations, individuals, and non-profits.<sup>58</sup> For example, in FY2022 incoming flows from other countries to individuals in Palau totaled \$22.9 million, while outgoing flows from individuals in Palau to other countries were \$14.8 million. (A subset of these flows would be household-to-household remittances.) Separately, the FIC report aggregates these transfers, incoming and outgoing, by country and lists the flows for seven countries in its report. For example, in FY2022 incoming flows from the Philippines to Palau totaled \$2.1 million, while outgoing flows to the Philippines from Palau were \$15.4 million. (Only a subset of these flows would be household-to-household remittances, which will present a challenge.)

According to the FIC Commissioner, banks could report data on financial inflows to and outflows from individuals in Palau by source or destination country. For example, financial outflows from individuals in Palau to the Philippines (and other countries) could be provided. This could help validate remittance estimates and inform reporting on foreign worker remittances from Palau. This country-level information may be helpful for recording outgoing remittances. However, for incoming flows to Palau, the data are likely to not be as useful. For example, financial flows from the United States to individuals in Palau will contain household-

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58 The most recent posted quarterly report is for the quarter ending 31 December 2022. See, *Aggregate Banking Sector-Performance Indicators* reports, <https://ropfic.org/reports/>. The scope of bank data collection includes funds transmitted through traditional wire transfer offices but does not cover peer-to-peer transfers. Note the FIC reports use the term “remittances” for “money value of transfers”, so it is a concept that covers private business transactions with customers, investors, and suppliers; government fund transfers; as well as household-to-household transfers.

to-household remittances, but would also include other flows, such as pension payments from US sources, including military retirement.

Palau census and survey remittance data can be improved in two ways:

- » For improved remittance data collection, census and survey questions should be consistently structured to reflect the inward and outward flows of remittances to and from Palau. This data collection could separate out the categories of regular, ad hoc, and customs exchanges both of money and goods. Using the same questions across census and HIES surveys could provide a more frequent time series of relevant data on remittance activities.
- » Additionally, collected census and survey data should be more consistently tabulated and published. Currently, while remittance information is covered by census and survey questionnaires, it is sometimes not reported in summary documents. Further, there are opportunities to do additional cross tabulation of the information with other demographic characteristics. For example, at EconMAP's request, the Palau statistics office undertook special cross tabulation of the 2020 census remittance responses by the citizenship of the respondent (see [Table 7](#)).<sup>59</sup> Of the Census respondents, 4.4 percent had received remittances, while 21.9 percent reported sending remittances abroad. Among those sending remittances abroad, about 70 percent of Philippines citizens reported sending remittances, while 74 percent of Bangladesh citizens did so. Among Palau citizen respondents, 5.1 percent received remittances, while 4.7 percent sent remittances. The data was summarized with the number of respondents receiving or sending different dollar ranges of remittances. EconMAP aggregated this information, using the midpoint of the ranges to construct an estimated average amount for each respondent.

59 For purposes of comparison, the 2020 Census reported 17,614 people in Palau, with 14,039 age 16 or older. To use the 2020 Census information to estimate total information requires additional detailed data in order to adjust for the non-respondents to these remittance questions.

**Table 7:** 2020 Palau Census Remittance Information by Citizenship

2020 Census		Remittance Received?					Remittance Sent?				
		Estimated					Estimated				
Citizenship	Number of Respondents	Number NO	Percent NO	Number YES	Percent YES	Average Remittance	Number NO	Percent NO	Number YES	Percent YES	Average Remittance
<b>Total</b>	<b>14,854</b>	<b>14,207</b>	<b>95.6%</b>	<b>647</b>	<b>4.4%</b>	<b>\$2,965</b>	<b>11,600</b>	<b>78.1%</b>	<b>3,254</b>	<b>21.9%</b>	<b>\$3,229</b>
Palauan	9,303	8,830	94.9%	473	5.1%	\$2,560	8,864	95.3%	439	4.7%	\$3,613
Dual Palauan	753	728	96.7%	25	3.3%	\$1,418	717	95.2%	36	4.8%	\$3,204
United States	164	155	94.5%	9	5.5%	\$11,306	152	92.7%	12	7.3%	\$9,904
China	406	337	83.0%	69	17.0%	\$4,144	352	86.7%	54	13.3%	\$5,538
Bangladesh	645	641	99.4%	4	0.6%	\$1,313	165	25.6%	480	74.4%	\$2,525
Japan	140	134	95.7%	6	4.3%	\$4,125	124	88.6%	16	11.4%	\$9,538
FSM	152	143	94.1%	9	5.9%	\$2,806	136	89.5%	16	10.5%	\$950
Philippines	2,998	2,955	98.6%	43	1.4%	\$1,928	906	30.2%	2,092	69.8%	\$3,076
Other	293	284	96.9%	9	3.1%	\$16,206	184	62.8%	109	37.2%	\$5,266

Source: EconMAP analysis of special tabulations of the 2020 Census prepared by the Palau statistics office.

For example, for the 647 respondents who reported receiving remittances, they may have averaged almost \$3,000. For the 3,254 respondents who reported sending remittances, they may have averaged about \$3,300. Further analysis of the underlying Census data could improve the precision of this estimate.

Lastly, consideration can be given to a publication strategy for information on remittances. This publication could also include information on migration which leads to remittance actions. As data can be drawn from multiple sources across the government, organizing the analysis and publication will require cooperation across ministries and a clear lead agency responsible for reporting and dissemination of information.

## C. Palau FDI Data

### *i. Background and Palau's Regulation of FDI*

#### **Background on FDI**

Foreign Direct Investment (FDI) is cross border investment where an individual/entity resident in one country makes a long-term investment in a business in another country. This long-term status is a critical aspect of FDI, where the foreign investor has acquired a lasting interest and some control over the operations of the business. Investment flows are presented as annual transactions that result in a stock of foreign-controlled assets.

FDI can have several forms of operation as well as differing motives for the investor. Research on FDI usually focuses on its economic impact of FDI on economic growth, employment, and trade, but there is also considerable interest in FDI's effects on non-economic areas such as environmental, political, and social sectors.

FDI forms and motives.

- » Forms of FDI can have different structures: new investment that builds something from the ground-up (greenfield investment), such as a hotel or factory; mergers and acquisitions, where a foreign investor acquires an interest in a company through stock purchases; and joint ventures. In the case of Palau, the establishment of hotels is a prime example of greenfield investment.
- » Several frameworks have been outlined regarding investment motives. One framework includes: access to resources (natural resources or labor) or markets (consumer or suppliers), ability to gain efficiencies (through scale or cheaper inputs); or acquire a strategic asset (technology and patents).<sup>60</sup> In the case of Palau, access to tourism resources, like the Rock Islands and marine resources is a prime motivation for FDI hotel investment, while access to markets is the basis for other FDI investors, such as banks.

Research on FDI. Measuring and understanding FDI is important for understanding the economy and informing economic policies, and it is relevant for informing political and social policies. These two areas of interest about FDI both recognize that FDI can have benefits and costs for the host nation. An example of benefits would be improvement in labor skills through training or the introduction of new production technology, while

60 This formulation is from J.H. Dunning, Multinational Enterprises and the Global Economy, Addison-Wesley, 1993.

an example of costs would be increased competition by the FDI entity crowding out domestic firm sales or supply of inputs such as labor.

- » FDI is cited as a key source of economic growth and poverty reduction, with the host country: gaining resources for “greenfield” investment, management expertise, and technology. Historically, FDI drives economic expansion with an increasing standard of living; however, individual country experiences can vary. A key consideration is whether FDI benefits or injures local firms and labor. Research on FDI in Pacific Island economies has been limited, and what has been done has not covered Palau, the FSM, or the RMI. Existing Pacific Islands FDI economic research includes:
  - Industry case studies in Fiji and Samoa: In 2003, in the context of a *general* view that inward FDI and linkages between foreign investors and domestic businesses are beneficial to a Pacific Island country’s development, the Secretariat of the Pacific Islands Forum recognized that some Pacific Island country governments were not yet fully convinced on the questions of *how* and *how fast* the liberalization process to promote FDI should proceed. The Secretariat commissioned a study that focused on five case studies in two countries of three industries: Fiji (apparel and footwear manufacturing, and tuna fishing) and Samoa (coconut processing and tuna fishing).<sup>61</sup> This study found benefits from FDI due to inputs purchased from the domestic economy (fish and coconuts) and the use of local labor (manufacturing). However, it found little benefit from FDI technology or worker training for domestic firms. Further, FDI firms had a negative impact on local firms through competition for supplies (coconuts and tuna). Study recommendations included promoting that FDI firms hire and train local labor, acquire inputs from local sources, and engage in joint activities with local firms.
  - Worldwide FDI statistical analysis: A study of worldwide FDI over a 40-year period (1971-2010), found that FDI impact on economic growth in Pacific Island nations, while positive, was much lower than for other regions of the world and that in the Pacific Islands, FDI crowds out domestic investment.<sup>62</sup>
  - Fiji case study: This study found that FDI had a positive impact on Fiji GDP and employment; and recommended that Fiji continue its proactive policy to attract FDI.<sup>63</sup>
  - Pacific island economic growth: A statistical study assessed the impact of tourism, inward remittances, FDI, and domestic credit on economic growth. The study covered Fiji, Samoa, Solomon Islands, Tonga, and Vanuatu. FDI was found to be positive in 4 of the 5 countries, and most conducive to growth

61 Foreign Investment Advisory Service (A joint service of the International Finance Corporation and The World Bank) *Linkages and flow-on impacts of foreign investment in Pacific island economies: Final report April 2004*, Secretariat Pacific Islands Forum.

62 The study covered 209 countries, including 7 Pacific Island nations. However, it did not include the FAS nations. Simon Feeny, Sasi Iamsiraroj, and Mark McGillivray, *Growth and Foreign Direct Investment in the Pacific, Economic Modelling* Volume 37, February 2014, Pages 332-339.

63 T.K. Jayaraman, Baljeet Singh, *Foreign Direct Investment and Employment Creation in Pacific Island Countries: An empirical study of Fiji*, *Asia-Pacific Research and Training Network on Trade Working Paper Series*, No. 35, May 2007.

in Fiji and Vanuatu. The study also found that tourism attracts FDI for all five countries.<sup>64</sup>

- » Non-economic interest in FDI also stems from historical, environmental, political, and social concerns. For example, for nations that were former colonies, a large role in the economy by foreign investors may extend or restore past colonial relations. In the political realm, FDI operations may raise concerns about undue political influence and corruption. Meanwhile, in the social realm, FDI may require the importation of foreign labor that has a large social local impact or environmental impact within the host country.<sup>65</sup> Especially in the case where FDI is seeking natural resources, concerns are cited about FDI having an adverse environmental impact.<sup>66</sup> However, in the case of Palau, where FDI is oriented towards tourism, protecting the environment is aligned with FDI interests. The small body of research on non-economic FDI impact has, to date, not covered the Pacific Islands.

Developing consistent and robust statistics on FDI is important for understanding FDI's role in the economy and to build a broader understanding about other impacts.

### Palau's FDI regulations

In the case of the Palau economy, FDI is a large component of economic activity as demonstrated by the large external investment in the construction of and operation of hotels. Like other Pacific Island nations, Palau has laws and regulations that directly affect the FDI entities, including, foreign investment licensing, corporate registration, foreign labor permits, and taxation. Palau's regulatory system recognizes the benefits and costs of FDI. In legislative findings for its FDI law, the Palau legislature found that "private business within the Republic of Palau must be protected. In effect, a proper balance must be found that encourages foreigners to invest money in the Republic of Palau to create a vibrant economy and lift up the livelihoods of all, while at the same time protecting Palauans from foreigners who could swallow up their ability to compete."<sup>67</sup>

Foreign investment is approved and regulated by the Foreign Investment Board (FIB). Palau law establishes the foreign investment framework and outlines foreign ownership restrictions on certain area of business operations. Foreign investors apply to the FIB for approval to invest and operate in Palau. Any non-citizen, whether resident in Palau or living abroad, is required to apply for approval of any ownership stake in any business operating in Palau. FIB rules are based on citizenship and not residency. Approved applicants are granted a Foreign Investment Approval Certificate (FIAC).

Foreign ownership is prohibited for certain business operations and in some cases restricted to joint ownership with Palau citizens. In other areas there are no restrictions:

64 Ronald Ravinesh Kumar and Peter Josef Stauvermann, 2021. *Tourism and economic growth in the Pacific region: evidence from five small island economies*, *Journal of the Asia Pacific Economy*, 22 Jul 2021. <https://doi.org/10.1080/13547860.2021.1944796>.

65 Stephen D. Cohen, *Multinational Corporations and Foreign Direct Investment: Avoiding Simplicity, Embracing Complexity* (Oxford University Press, 8 February 2007)

66 Eric B. Yiadoma, Lord Mensah, and Godfred A. Bokpin, *Environmental Risk and Foreign Direct Investment: the role of Financial Sector Development* *Environmental Challenges* (Volume 9, December 2022).

67 Notes to Palau National Code, Title 28-Foreign Relations and Trade, section 101.



- » Foreign owner or partial ownership prohibited: wholesale or retail sale of goods, land transportation services (bus service, taxis, and car rentals), water transportation, travel and tour agencies, land-based and water-based tour services (dive shops, fishing charters, and surfing), and commercial fishing for other than highly migratory species.<sup>68</sup>
- » Foreign and Palau citizen joint ownership allowed: handicraft and gift shops, bakeries, bar services, existing Palauan-owned manufacturing enterprises, equipment rentals, and farm-raised fish and marine-farmed species.
- » Areas of no foreign restrictions: lodging and restaurants, and bars and gift shops within hotels.

One concern in FIB regulations is the operation of front companies that are not complying with FDI regulations. Front businesses are defined as being nominally owned by Palau citizens, but are in fact owned or financed, in whole or in part, by non-citizens. The operations of a front business could involve a foreign investor operating a permissible business, but without a proper certificate it is violating the Foreign Investment Act. Or the operations of a front business could lack a proper certificate and be operating a business where foreign ownership is prohibited (see above).

The FIB requires those granted a Foreign Investment Approval Certificate to maintain a workforce with at least 20 percent Palauan citizens and to submit a quarterly report to the FIB. Required quarterly FIB reports include: information on each firm employee, including citizenship, passport number, and work permit number (if a non-citizen); the forms and receipts for all fees and taxes paid that quarter, such as revenue taxes, wage and salary taxes, social security, and import taxes. The form does not collect information on firm production or sales activity beyond gross revenue. According to FIB officials, all processes at FIB are done on paper forms, without on-line forms or data collection. Quarterly reports from FIAC holders are retained in storage, but data are not extracted as part of any electronic record or system.

The FDI law requires FIB to report annually to the President and legislature. The most recent FIB annual report is for FY2017. That report includes the names of all approved and denied FIAC applicants that year and a summary of the annual non-citizen worker fees (\$500 per worker per year) collected by FIB. The FIB also reported that it was doing compliance reviews in order to revoke the FIAC of defunct operations.<sup>69</sup> In 2020, in communication with the incoming President's transition team, the FIB Chairman noted that the office had never been modernized with digital records and procedures and that FIB no longer had an active website to attract FDI. In addition to seeking operational assistance, the Chairman also advocated for changes in the foreign investment law to encourage more inward investment. An additional proposal was to link land lease agreements with FIAC to prevent foreign investors from tying up land without development for an extended period.

68 This is a summary extract of the Palau Foreign Investment Act that is listed in full on the FIB website: <https://www.palau.gov.pw/fib/>.

69 For FY2017, of 220 outstanding FIACs, slightly more than half belong to ongoing concerns and a further 50 were entities who had not begun operations or had ceased to operate. At that time, the FIB investigator had been unable to collect information on the remainder. According to press accounts, in 2018 the FIB took action against several front companies. EconMAP tried to identify and analyze the prevalence of front companies but this was difficult due to lack of data and uncertainty of legal status.

The Pacific Private Sector Development Initiative (PSDI), co-financed by the ADB, the Government of Australia, and the Government of New Zealand, assessed 2016 amendments to the Palau Foreign Investment Act.<sup>70</sup> The assessment found that the FDI Act appears to be ineffectual and that new requirements made foreign investment unattractive to multinationals and failed to deter the operations of front-company investors. For example, the act requires the Palau FIB to approve any changes of five percent or greater in investor financing -- such as stock sales or loan arrangements -- and the accountant who certifies the investment level each year. In addition, the company board is required to hold a board meeting in Palau each year. The PSDI assessment advocates a more “free market” approach, questioning the static list of economic areas reserved for Palauan operators and notes that the Board’s subjective approval discretion includes determining whether there is an economic need for the proposed investment, considering its likely impact on existing local businesses, and allows the board to set minimum employment requirements. In addition, the requirement that foreign investors are required to pay \$500 to the government for each foreign worker they employ is an additional cost only for foreign firms as compared to local companies who also employ foreign labor. Further, the act requires that foreign investors “make and maintain” a minimum investment of \$500,000 or, in the case of a hotel, \$5,000,000. Front company operations likely have significantly less investment in Palau than could meet the requirement and this requirement would deter service sector investors.

### Other government data collected from FDI firms

In addition to information collected by the FIB, several other Palau agencies collect firm-level data that can be used to measure and analyze FDI activity:

- » Corporate Registration. Registration of corporations in Palau had been under the Office of the Attorney General, but on 12 January 2023, the President transferred the Registrar of Corporations to the Financial Institutions Commission (FIC). Public information on registered firms had not been posted in the past. Going forward, according to the FIC Commissioner, an “e-registry” is being developed with technical assistance from the ADB and new regulations will be promulgated by the FIC.<sup>71</sup> Further, prior corporate reports that had been submitted to the Registrar are being scanned. Under current regulations, registered corporations submit annual reports, including financial information, to the Corporate Registrar.<sup>72</sup>
- » Foreign Worker Registration. Government policy provides an employment preference to Palau citizens, but if qualified Palau citizen workers are unavailable, allows the employment of noncitizen workers. However, such employment may not impair the wages and working conditions of citizen workers.<sup>73</sup> For FDI firms (as well as Palauan firms), foreign workers can be employed if a qualified Palauan is unavailable to work. Work permits are issued for a two-year period and can be renewed for up to two additional years. Each non-citizen worker has a work permit

70 A good review and critique of FDI in Palau is presented in Private Sector Assessment for Palau: Policies for Sustainable Growth Revisited (Asian Development Bank Institutional Document, February 2017). <https://www.adb.org/documents/palau-private-sector-assessment>

71 ADB, Project Number: 53072-001: Regional Pacific Private Sector Development Initiative, Phase IV. For additional information on the project’s assistance regarding corporation law and administration, see: <https://www.adb.org/documents/pacific-psdi-annual-report-fy2022>.

72 Two Palau Public Laws 11-10 and 11-24 are the basis for a new Corporation Law and Registry system. However, neither law or accompanying regulations are publicly available.

73 Summarized from Palau National Code, Title 20-Labor, Protection of Resident Workers Act, section 102.

and the work permit number is used in other government reporting to FIB and tax officials.

- » Social Security. FDI firms are required to apply for an Employer Identification Number (EIN) from the Palau Social Security Administration, providing their FIAC number and Corporation registration number. For employees, the application for a social security number asks for the name and EIN of their employer. If they are a foreign worker, they also record their foreign worker permit number. On quarterly tax reports to Social Security to pay social security and health care fund taxes for each employee, all employers provide their EIN and for each employee's Social Security Number and gross wages. Thus, within Social Security data, FDI firms are linked to wage and salary payments and the citizenship of the workers can be derived.
- » Tax and Revenue. Businesses in Palau apply for a Taxpayer Identification Number (TIN) from the Bureau of Revenue and Taxation (Ministry of Finance). The form has a check box for whether the applicant is FIAC firm. Further, as needed, each business applies for a business license for each of its establishments. This business license application collects the FIAC number. For example, a business with FIAC status and a TIN could have separate business licenses to operate a hotel, a bar, a restaurant, etc. Under the newly revised Palau tax law, every FIAC business must register under the Palau Goods and Services Tax (PGST). The Palau Tax office posts a list of all PGST-registered firms, a list that should contain all FIAC firms.<sup>74</sup>

Across these administrative systems it is possible to link data and create profiles of the role of FDI among registered corporations and in terms of revenue and employment by sector. The FIAC number is the most consistent link between data sets for statistical presentation.

## ii. Existing FDI Data

### Existing FDI information

The Office of Planning and Statistics (Bureau of Budget & Planning in the Ministry of Finance) annually publishes several reports that include data relevant to understanding FDI in Palau.

Balance of Payments and International Investment Position. Formal estimates of FDI are part of Palau's Balance of Payments (BOP) and International Investment Position (IIP) statistics that record external financial transactions. The terms and definitions for these statistics are developed by the IMF.<sup>75</sup> These data are posted on the Palau statistics website.<sup>76</sup> These two sets of statistics are linked, with BOP capturing the annual flow of financial transactions and IIP capturing the stock value of assets and liabilities at the

<sup>74</sup> <https://www.palau.gov.pw/wp-content/uploads/PGST-Registry-as-of-101123.pdf>

<sup>75</sup> International Monetary Fund, *Balance of Payments and International Investment Position Manual*, Sixth Edition (BPM6), 2009. <https://www.imf.org/en/Publications/Manuals-Guides/Issues/2016/12/31/Balance-of-Payments-Manual-Sixth-Edition-22588>

<sup>76</sup> Palau's posting for FY2022 labels the data for FY2020 as "provisional" and the data for FY2021 and FY2022 as "preliminary." Data discussed here is from the posted PDF files. <https://www.palau.gov.pw/executive-branch/ministries/finance/budgetandplanning/balance-of-payments/> Palau also publishes BOP data in its annual *Statistical Yearbook*. EconMAP has determined that the previous FDI data is misleading and will be revised in 2024 to reflect newly available corporate information.

end of a fiscal year. Investment is usually the value of equity (stocks) but can be based on the provision of in-kind goods and services, such as equipment or technology.

To be counted as FDI under BOP and IIP definitions, two criteria must be met:

- » **Control.** A foreign investor must acquire control or a significant degree of influence on the management of an enterprise in another economy. Stock ownership of 10 percent is considered to represent significant influence, while control is ownership exceeding 50 percent. Foreign direct investment in Palau is recorded as a liability in this framework.
- » **Non-resident.** One key aspect of the BOP concept of foreign investment is that investors are non-resident. For example, a Palau citizen who resides in another country and invests in Palau represents foreign investment in the BOP. Or a Palau business owner who moves overseas would convert a domestic firm to a FDI firm with that action. Moreover, a foreign citizen who externally invests in Palau is treated as FDI, but if that investor moves to Palau and establishes residency, the investment becomes domestic.

With this focus on residency as the driver for the BOP definitions, data collected for this purpose will not match the reporting by the FIB, where citizenship is the key factor. No Palau entity tracks whether Palau citizen owners of an enterprise are resident in Palau. So, the only real difference in the concept is whether a foreign owner of a Palau business is resident in Palau. With this difference the number of BOP FDI firms will be smaller than the number of FIB FIAC firms, as some foreign investors are resident in Palau.

- » **Annual FDI Flows.** For Palau, the published BOP table records direct investment in Palau.<sup>77</sup> Annual inward direct investment captures: any net equity investments in Palau through stock or the acquisition of an existing Palauan-owned business, reinvested earnings from ongoing investments, shareholder loans to the firm, as well as a measure of the annual value of holding long-term land leases. The underlying data for some of these categories are not directly observable and are estimated from other economic variables.
- » **FDI Stock Measures:** The published IIP table for foreign investment shows the net value of foreign investment at the end of each fiscal year, after accounting for any inflows or outflows during the year.<sup>78</sup> That measure of direct investment is divided between two components, corporations representing 95 percent of the total and land representing about 5 percent of the investment in 2021. Within the corporate investment category, hotels had a 70 percent share and fuel companies another 16 percent. The remainder is allocated between banks and other firms.

Foreign Investment Approval Certificates. A table of approved Foreign Investment Approval Certificates is included in the annual Palau *Statistical Yearbook*. The data originates from the Foreign Investment Board and presents approval data by industry and by year. For example, for the six-year interval FY2017-FY2021, FIB issued 120 FIAC certificates with 49 (40 percent) for accommodation and food service activities.<sup>79</sup>

77 In Palau's reported data, any external investments abroad by Palau residents are not reported, so effectively entered as zero each year.

78 This allows the stock of FDI to be compared to Palau's GDP each year.

79 <https://www.palau.gov.pw/executive-branch/ministries/finance/budgetandplanning/rop-statistical-yearbooks/>

Hotels, Motels, and Resorts. Given the importance of hotels for FDI, detailed information on this industry is important. The annual Palau *Statistical Yearbook* includes a table listing all accommodation providers and the number of rooms for each. The data originates from the Palau Visitors Authority. From 2018 to 2022, 21 hotels stopped operating over the COVID period and room count declined from 1,538 to 993, a 35 percent decline.

#### Opportunities to improve existing annual BOP FDI flow and stock data

An IMF Balance of Payments project over the 2014-2015 period developed an initial template for recording data from Annual Corporate Reports for FDI businesses. This was during the period when corporate registration was under the Attorney General. The Office of Planning and Statistics undertook an effort to use the financial statements included in those Annual Corporate Reports submitted by foreign companies to build its BOP data series. The template was to be completed by Palau statistics staff from paper copies of the Annual Corporate Reports from the Attorney General's office; however, at that time insufficient reports were available to generate an adequate set of results. Project results were not incorporated into the BOP statistics.

Recently, the statistics office received more annual reports and the template is now largely complete up to FY2021. Two main issues remain: a) some new FDI entities are not yet reporting; and b) the time lag for corporate reporting is too late for the BOP timetable. However, the template is a useful indicator of the overall level of FDI and evolution over time, and it is anticipated that Balance of Payment flow and stock data will soon be modified to incorporate this.

In addition, under the recent Palau tax reform, all FDI corporations will provide balance sheet information with their annual Business Income Tax returns, starting in 2023. Going forward it is anticipated that this will provide a more timely, comprehensive, reliable, and digitized source for FDI data.

### **Palau FDI information developed from GDP and tax data**

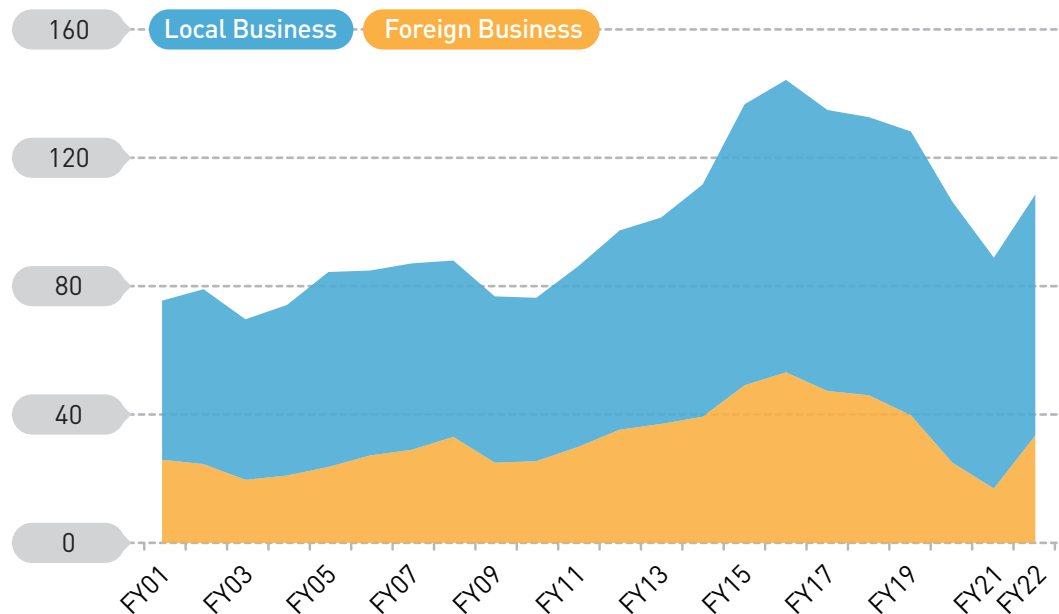
This report section uses existing data on Palau's private-sector GDP to illustrate possible future reporting on the role of FDI in the Palau economy. The underlying GDP presentation draws on revenue from the sale of goods and services reported by the Palau private sector on tax forms. Using identifiers for foreign-owned businesses (based on FIAC status and the owner being resident outside of Palau) it is possible to allocate reported tax data to either FDI or "local" businesses within the private sector.<sup>80</sup>

Two decades of FDI. Analysis of "FDI" and "local" business operations show that FDI firms account for about one-third of private sector GDP over the FY2001-FY2022 period. The FDI share of private-sector GDP reached its highest in FY2008 at 37 percent and was at its lowest during COVID at 19 percent. Conversely, the local

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80 This presentation is using a BOP-consistent definition of FDI regarding residency, so that FIAC enterprises where the foreign investor is known to be resident in Palau are counted as local. A comparison of this presentation to an analysis using FIAC status alone as the definition of "foreign" found it does not change these results in a meaningful way. Further, these calculations use 50 percent foreign ownership as the basis for inclusion in the FDI category, as compared to 10 percent in the BOP definition. Note, the commercial banking sector is not included in this presentation of private sector GDP but could be included in future presentations.

**Figure 16:** Private Sector GDP of FDI and Local Palauan Businesses, FY2001-FY2022 (million \$, current prices)



Source: EconMAP analysis of Palau Bureau of Revenue and Taxation data.

business share of private-sector GDP was smallest in FY2008 at 63 percent, and the largest in FY2022 at 81 percent (see [Figure 16](#)).<sup>81</sup>

Composition of Palau private sector GDP by industry categories. FDI and local business GDP contributions can be allocated by industry categories at the level of business license tax reporting. Business licenses are assigned to 38 industry categories, that are then consolidated into 7 categories for presentation.<sup>82</sup> Below, the industry composition of the overall pre-COVID economy is presented, and then reported separately on the FDI and local Palauan business sectors. Three years of private sector GDP data is averaged for these presentations with FY2017-FY2019 as the pre-COVID period. This analysis is then replicated for the “COVID” period, FY2020-FY2022 (see [Figure 17](#)). The underlying administrative data source that allows this analysis is from business gross revenue tax filings.

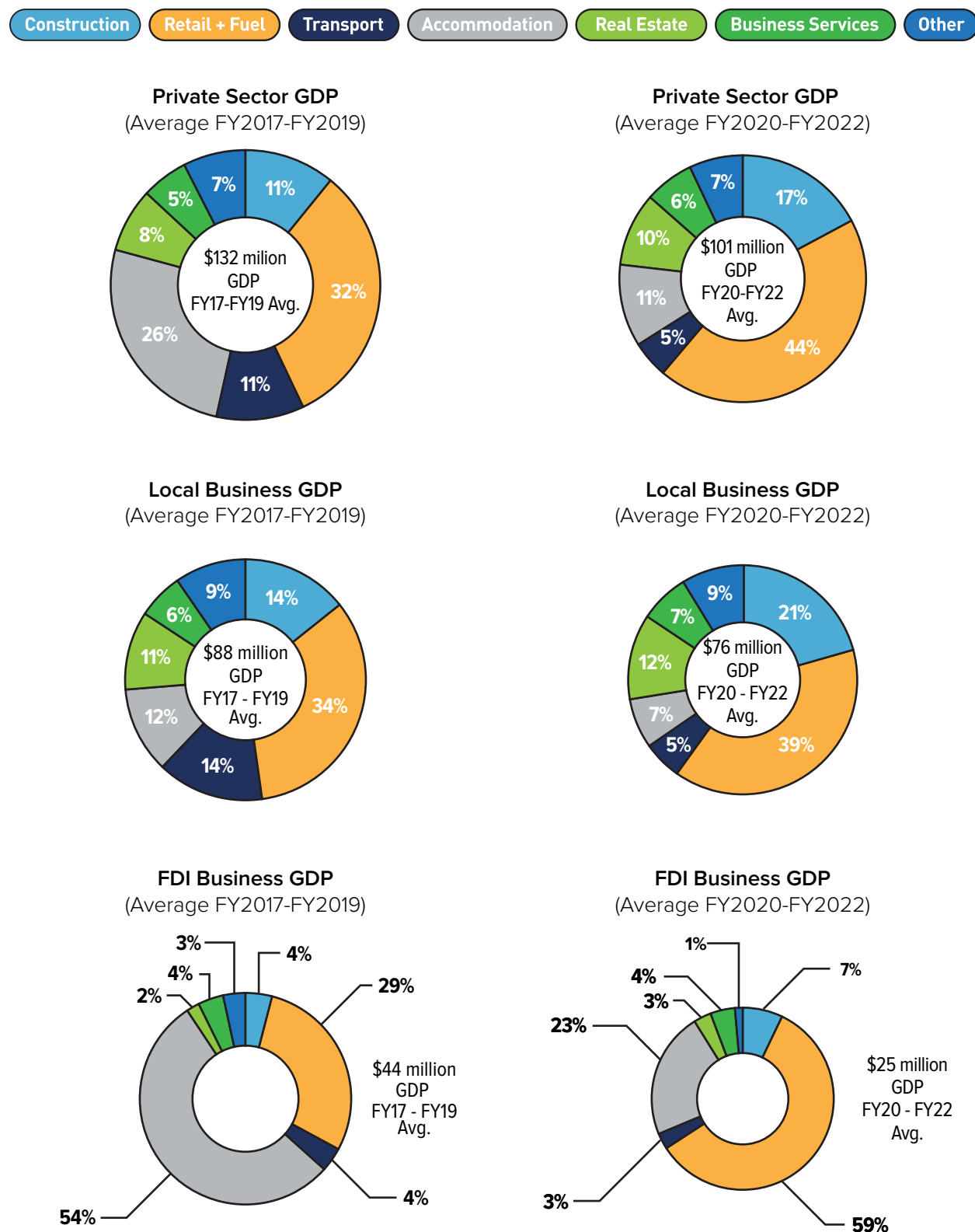
#### Pre-COVID period:

- » The Palau economy was dominated by the tourism sector before the COVID pandemic. Combining accommodation (26 percent) and transport (11 percent); the tourism economy, represented 37 percent of private-sector GDP.

81 For this graphic, FDI includes firms with FIAC status but excludes any firms where the foreign business owner is resident in Palau.

82 In the graphic, the “other” category includes agriculture, fisheries, manufacturing, and other services. Also, for this graphic, FDI includes firms with FIAC status but excludes any firms where the foreign business owner is known to be resident in Palau. Within the “retail+fuel” category, fuel plays a large role, but cannot be broken out due to confidentiality requirements.

**Figure 17:** Private Sector GDP of FDI and Local Palauan Businesses by Industry, FY2017-FY2019 and FY2020-FY2022 (current prices)



Source: EconMAP projections of Palau private sector GDP by industry.

- » FDI businesses overall had a smaller role than did local Palauan businesses, accounting for 33 percent of average FY2017-FY2019 private-sector GDP, as compared to 67 percent for local firms.
- » The FY2017-FY2019 GDP composition of industries varied between FDI and local Palauan businesses. For FDI businesses, tourism represented 58 percent of FDI business GDP, but only 26 percent for local Palauan businesses.

**COVID period:**

- » As tourism fell in the COVID period, total private-sector business sector GDP fell an average of 23.5 percent, with local business GDP falling by 13.6 percent, and FDI business GDP falling 43 percent.
- » COVID also changed the composition of private-sector revenues, as the tourism sector GDP fell from 37 percent pre-COVID to 16 percent during the COVID period. For FDI businesses the tourism sector declined from 58 percent of FDI business GDP to 26 percent.

Other opportunities to use administrative data

In addition to the above analysis that draws on gross revenue tax data, other Palau administrative data can be used to analyze the different roles of FDI and local businesses. For example, all firms report wage and salary data to the Social Security Administration for each employee. With this information, numerous additional presentations are possible, including the comparative role of FDI and local businesses in the labor market with respect to total compensation, income per worker, and the distribution of income payments to employees within the firm. Further, as Social Security data includes worker citizenship, analyses are possible regarding any employment and compensation differences between FDI and local businesses based on citizenship. As Palau implements its new value-added tax system, further administrative data may be available to present information on how FDI and local businesses structure their supply chains, such as their reliance on imports.

**iii. Steps to Improve Palau FDI Data**

Opportunities to enhance FDI administrative data and FDI related statistics include:

**Corporate Registry Data.** The transfer of the Corporate Registry function to the FIC may result in a more modern system with online data entry for forms of their annual report information. The original design of the electronic corporation registry was limited to a transparent publicly available portal, which would not include details previously collected in the Attorney General's Corporation financial and statistical returns. It would be advantageous to retain as much information as possible from the legacy system. This could increase the scope of that data to be beneficial in the construction of economic statistics, including FDI-related data. Further, FIC staff and consultants can coordinate with Palau statistics staff as the system is modernized. In addition, the ongoing efforts of the FIC to scan prior corporate submissions, including financial statements, creates the opportunity to update past data with more complete information. Statistical needs should be taken into account in the design of Corporate Registry information, and annual corporate updates.



**FIB reporting.** Any effort to modernize the procedures and processes at the FIB would be beneficial for foreign investors and compliance. Currently, the quarterly reports filed by FIAC firms are not easily used for compliance or FIB reporting. Creating a digital database with data exchange protocols with other agencies could allow FIB to compare submitted quarterly reports to labor permit and tax information. For example, FIAC numbers may be linked to information in the tax system to review compliance with taxation and Social Security requirements and to monitor compliance with Palau citizen employment requirements. Simultaneously, the quarterly data could be used to prepare enhanced and timely reporting about the role of FDI in Palau. FIB data may also be found useful to other Palau government agencies, either for compliance efforts or statistical reporting. One consideration for FIB reporting is that the residency of the investor is not at issue, as it is in BOP reporting. From the standpoint of understanding the broader role of foreign investors in Palau, reports that explicitly include resident foreign investors could be informative.

**BOP and IIP statistics.** For Palau official statistics, the data collection systems and future process plans of the Registrar of Corporations and FIB could be reviewed to see if they generate new information that could improve BOP and IIP statistics. Currently, for example, FDI ownership shares may be updated from annual reports that FIAC companies file with the Registrar of Corporations, but the new system could facilitate doing this on a more frequent basis, which would improve the allocation of retained earnings for FDI estimates. Updated ownership share data can then subsequently increase the precision of allocating revenue, taxes paid, labor compensation, and employment counts between foreign and domestic firms.

Beyond these actions, other steps can be taken to enhance these ongoing statistics:

- » Review of the residency of foreign owners of FIAC enterprises to confirm the allocation of FIAC firms between “domestic” and “foreign” for the purpose of BOP statistics. For example, if a foreign investor with a FIAC becomes a resident of Palau, that investment ceases to be FDI under the BOP statistical rules. Currently, there is not an available process to track this change.
- » Establish a mechanism to regularly update land lease information for foreign operations.
- » Develop procedures for when to remove closed FDI operations from annual BOP and IIP reporting. During COVID, the closure of some foreign owned hotels highlighted the need to have such procedures.
- » Identify any FDI that may not be covered by the Corporate Registry and FIB data. For example, the Palau International Airport Corporation (a recent joint venture with the Palau government) and entities involved in the development of the large-scale Palau Solar electricity installation appear to be omitted from those sources.

International efforts to improve BOB and IIP data should be incorporated into the Palau statistics program. Recent IMF and OECD guidance on direct investment measures and data collection can be reviewed to identify areas for enhancement.<sup>83</sup> For example, recent guidelines on FDI include the principle of collecting data on the ultimate country of corporate control of an investment. For example, if a company in Korea makes an investment in Palau, that investment is currently classified as a Korean investment. However, if that Korean company in turn is owned by a firm from Japan, that investment

83 For example: *Coordinated direct investment survey guide* (Washington, D.C. : International Monetary Fund, 2015.) <https://www.elibrary.imf.org/view/book/9781513519418/9781513519418.xml>

in Palau should be traced back to the ultimate source of the investment, Japan.<sup>84</sup> This constitutes a data consideration that is not part of the current process. Also, according to the OECD, many countries augment their FDI data through business surveys as well as data collected in administrative systems. The opportunity and usefulness for a Palau business survey should be reconsidered.<sup>85</sup>

**Government wide data interest.** Beyond the specific needs of agencies that directly deal with foreign investors and statistics, there are broader opportunities to enhance compliance across government programs and to increase understanding of the impact of FDI. A starting point for this is to ensure that FIAC numbers are consistently incorporated into government forms and included in administrative databases. Doing this would increase the capabilities of offices to track and report on the impact of FDI. For government statistics and analysis, this might facilitate enhanced reporting on immigration, labor force, taxation, economy, and trade flows. To improve the linkages between FDI data collection for statistics and compliance it may be useful to create a task force of stakeholders to review data gaps and identify opportunities for cooperation.

**FDI reporting.** Lastly, consideration can be given to a publication strategy for routine information on FDI. The FIB is a natural location for annual reporting from FIAC firm-submitted data in its required annual report. However, the FIB has not recently provided a report, nor has it posted past reports on its website. Palau's Office of Planning and Statistics is best positioned to report on FDI and provide comparative information about FDI and local firm roles in the economy. This draws on its existing access to administrative data, including from the tax system and Social Security Administration. Routine reporting on FDI will require an assignment of agency responsibility for reporting and dissemination of information.

## D. Palau SME Data

### i. Administrative Data Sources on Businesses

To date, Palau small and medium enterprise information has not been available. Palau's primary data publications, the annual *Statistical Yearbook* and its *Quarterly Economic Statistics* do not include information on the structure of the business sector. Further, Palau has not conducted business surveys or economic censuses. According to Palau's Minister of Finance, information on small and medium enterprises (SME) had not been a data focus, but during the period of COVID policy response, the government realized it needed more data on business sizes and their activities, in particular on the smallest enterprises and the informal sector. Palau has not outlined any definitions for classifying businesses as "small" or "medium" sized enterprises.

However, two Palau administrative data systems, at the Social Security Administration and the Bureau of Revenue and Taxation, receive information from businesses on a quarterly or more frequent basis that can be used to develop SME statistics.

84 Measuring International Investment by Multinational Enterprises: Implementation of the OECD's Benchmark Definition of Foreign Direct Investment, (Organization of Economic Cooperation and Development, 4th edition 2015). <https://www.oecd.org/corporate/FDI-BMD4-brochure.pdf>

85 Foreign Direct Investment: Trends, Data Availability, Concepts, and Recording Practices (Washington, D.C. : International Monetary Fund, 2004). <https://www.imf.org/external/pubs/ft/fdi/2004/fditda.pdf>

**Social Security Administration (SSA).** SSA issues an Employer Identification Number (EIN), which is renewed annually, to all business entities, including sole proprietors, partnerships, and corporations. For partnerships and corporations, the SSA EIN application requires the corporation number issued by Palau's Office of the Attorney General, and for foreign entities, the Foreign Investment Approval Certificate (FIAC) number issued by Palau's Foreign Investment Board. In addition, each business entity identifies its principal activity, such as construction or hotel/motel or retailer, and SSA assigns it an activity classification.

Each business is required to file an employer's quarterly tax report for each of its establishments that covers the owner and employees (if any). Taxes collected by SSA are 14 percent of gross wages for Social Security and 5 percent of gross wages for the Healthcare Fund, for a total of 19 percent. The tax report contains the name, Palau Social Security number, and gross wages for each employee. For employees, the taxes collected by SSA are equally divided between employer payments and withholdings from employee gross wages. For owner payments, the 19 percent tax due can be based on the owner's actual earnings or computed as being twice as much as the highest-paid employee's salary (for those firms with employees) or a percent of annual gross revenue (for those firms without employees).

Palau's Bureau of Budget and Planning uses SSA data to report annual total employment, wage costs, and average wage/salary earnings by institutional sectors (private corporate, national government, etc.) and by International Standard Industry Classification (ISIC) (fishing, accommodations, public administration, etc.) in the annual *Statistical Yearbook*.<sup>86</sup> These are also published within the Annual Economic Statistics Tables on the EconMap program website<sup>87</sup>.

**Bureau of Revenue and Taxation (BRT).** BRT issues a Tax Identification Number (TIN) to all business taxpayers, including sole proprietors, partnerships, and corporations. Once it has a TIN, the business taxpayer applies for a Business License Number (BLN) for each of its operations based on the physical location and type of activity.<sup>88</sup> Business taxpayers can have numerous business licenses; for example, if a business taxpayer operates multiple retail stores, it will have a license for each location or if it has different activities at a single location, such as a hotel, restaurant, and gift shop, it will have a business license for each. In addition, each business license describes the activity of the operation, which allows BRT to assign specific industry and sector codes. The business license application also includes the Foreign Investment Approval Certificate (FIAC) number issued by Palau's Foreign Investment Board (FIB).

Once it issues the business license, BRT requires two periodic reports and payments from each licensed business operation. First, employers withhold and report wage and salary taxes from each employee for each pay cycle – 6 percent for the first \$8,000 earned, 10 percent for additional earnings up to \$40,000, and 12 percent for any additional earnings.<sup>89</sup> The report and payment for each pay cycle includes the name of the employee, citizenship code, social security number, gross wages/salaries for the period, and the tax withheld. These reports and payments may be

86 <https://www.palau.gov.pw/executive-branch/ministries/finance/budgetandplanning/rop-statistical-yearbooks/>. An editing process excludes owners from the employment counts and earnings.

87 See, <https://pitiviti.org/palau>.

88 SSA embeds the same two levels within its ID with the BLN level identified by the last two codes in the EIN number. The SSA and BRT ids were in fact the same, but that was abandoned about 2019 as it became increasingly difficult to ensure the two numbering systems remained aligned.

89 These are the thresholds in effect after Jan. 1. 2023.

done more frequently than quarterly. Second, on a quarterly basis each licensed business operation until 31 December 2022 paid a Business Gross Revenue Tax (BGRT) — 4 percent tax of gross revenue minus certain deductions for employee wages.<sup>90</sup> Businesses report their gross revenue.

Beginning January 1, 2023, Palau commenced a reformed tax regime. Under the new system, businesses with annual gross revenue of \$50,000 or less will pay a flat tax of \$100 per year. In addition, there is a specific and new category for “Informal *Makit*<sup>91</sup> Sector” businesses, where a citizen registered with the Ministry of Finance and with gross revenue of \$15,000 or less shall receive a social assistance payment of 4 percent of their *makit* revenue. Finance Ministry officials believe that some businesses now operating in the informal economy may register with it under the new tax system and file the required quarterly revenue reports.

**Industry information.** Both the SSA EIN and BRT TIN units are classified by industry for statistical purposes by Palau Statistics staff with assistance from an EconMap statistician to align with international statistical classification practices, plus some local information needs.

## ii. Using Administrative Data for SME Analysis

To demonstrate some of the analyses and presentations that can be supported with existing administrative data, EconMAP used tax data by business taxpayers and by business licenses to analyze their counts, gross revenue, and number of employees. Based on the number of employees at the level of the business taxpayer or the business license, EconMAP sorted the size of the entity by the number of employees and created summary statistics for 2021.

Conducting this analysis is complex, as annual information must be rolled up from quarterly revenue submissions and monthly summaries of payroll withholding submissions. For example, to report on the number of employees associated with the business taxpayer (TIN) or business license on an annual basis, the monthly number of employees recorded on withholding submissions to BRT must be averaged across the calendar year.<sup>92</sup> The analysis rounded the computed average number of employees to the nearest whole number and used this to group business taxpayers (TINs) or business licenses by number of employees.

## Characteristics of Palau Businesses, 2021

Reviewing fiscal year 2021 illustrates the ways this SME data can be presented. In 2021 there were 894 business taxpayers reporting gross revenue.

Depending on policy analysis needs, business taxpayers can be analyzed based on their relative size. In some nations, sizes are set out in law or regulation for the

90 This tax structure was in effect prior to Jan. 1, 2023. Following that date, businesses with \$50,000 or less in revenue pay \$100 a year, those with revenue between \$50,000 and \$300,000 continue to pay the 4 percent tax, and those with greater revenue pay the Palau Goods and Services Tax and the Business Profits Tax.

91 *Makit* is a Palauan word for market, but is more narrowly oriented towards fish, crabs, and produce sold at open-air stands.

92 This does not align with the Gross Revenues which are summed on a fiscal year basis. Whilst not ideal, there is not an expectation that this discrepancy will be material to the conclusions likely to be drawn from the analysis.

implementation of economic or support programs. Palau has not established a framework for SMEs or a definition of the categories. A recent ADB review of Pacific SME focused on Fiji, Papua New Guinea, and Samoa and found different strategies to label firms as “micro” vs. “small” vs. “medium” sized firms; Fiji used annual sales and assets; PNG used annual sales, number of employees, and assets; while Samoa’s thresholds use employment and income.<sup>93</sup>

For this presentation, data on employment is used as the basis for reporting counts of businesses, levels of employment, and revenue-by-size categories. The presentation is to illustrate how the business sector can be analyzed and other size categories can be adopted. In 2021, there were 894 businesses that paid taxes. Of that number 403 (45 percent) had no employees<sup>94</sup> while 6 businesses had more than 100 employees (see [Table 8](#)).

For different sizes of firms (based on employment), shares of revenue and total employment can be computed. For example, for the 308 firms with 1 to 4 employees, they made up 34 percent of business taxpayers, 9 percent of gross revenue, and 12 percent of private employment (see [Table 9](#)). Larger businesses with 5 or more employees made up 21 percent of business taxpayers, 88 percent of gross revenue, and 88 percent of private employment.

Beyond analysis and reporting at the level of business taxpayers, it is possible to conduct analyses based on taxes at the level of business license data. In 2021, there were 2,389 active business licenses, with 2,063 reporting revenue. Tax data at the level of the business license can be presented by activity classification and further broken down by groupings of the average number of employees.<sup>95</sup> In 2021, the largest business sectors based on revenue and employment are accommodation, construction, and wholesale/retail trade (see [Table 10](#)).

### **iii. Steps to Develop Palau SME Data**

SME information can be developed in Palau through the routine analysis of existing tax data. If routine analysis and publications about SME roles and activities is desired, consideration can be given to a publication strategy for information on SMEs. The Office of Planning and Statistics is well positioned for this reporting, with its existing access to the information in Palau’s tax system. Further, reporting on SME firm information could be incorporated with analysis and reporting about FDI in Palau.

For routine reporting on the business sector, Palau can conduct economic census or business surveys. These could be informative for broader social and economic policies.

Future information on the informal sector, including, *makit* operators is expected to improve as tax reform brings more informal enterprises into the tax system. However, there are other potential information sources as well. For example:

93 ADB, *Asia Small and Medium-Sized Enterprise Monitor 2023: How Small Firms Can Contribute to Resilient Growth in the Pacific Post COVID-19 Pandemic*, October 2023.

94 More precisely, these employers averaged less than 0.5 employees across the 12-month period. If an employer averaged 0.5 employees or more across the 12-month period, they would be in the 1-4 or 5 plus categories. The 4 to 5 employee interval is also subject to rounding.

95 At the level of business licenses, activities are classified according to the International Standard Industry Classification codes.

**Table 8:** Number of businesses by number of employees, 2021

2021 Business Taxpayers		
Number of employees	Number of businesses	Percent of Businesses
Zero	403	45%
1-4	308	34%
5-9	74	8%
10-14	46	5%
15-20	25	3%
21-24	4	0%
25-29	7	1%
30-49	17	2%
50-99	4	0%
100+	6	1%
<b>TOTAL</b>	<b>894</b>	

Source: EconMAP analysis of Palau Bureau of Revenue and Taxation data.

- » The Palau WIOA office provided unemployment payments to many beneficiaries in the informal *makit* sector who sell crabs and bento boxes to the tourism sector. This administrative data could be used to better understand the informal sector.
- » Palau censuses and surveys can be better utilized to reflect on the smallest family-level business enterprises. The 2020 Palau Census included questions

**Table 9:** Number of businesses, revenue and employment by number of employees, 2021

2021 Business Taxpayers	Total	Number of employees		
		0	1 to 4	5+
Number of businesses	894	403	308	183
Gross revenue (\$ millions)	315	10.5	27.3	277.2
Number of employees	4,799	0	587	4,212
% of Total				
Number of businesses		45%	34%	21%
Gross revenue (\$ millions)		3%	9%	88%
Number of employees		0%	12%	88%

Source: EconMAP analysis of Palau Bureau of Revenue and Taxation data.

**Table 10:** Number of businesses, revenue and employment by number of employees and sector, 2021

2021 Business Licenses by Sector	Total Businesses			0 Employees		1-4 Employees			5+ Employees		
Sector Descriptions	Number Licenses	Revenue (\$ mil)	Total Employees	Number Licenses	Revenue (\$ mil)	Number Licenses	Revenue (\$ mil)	Total Employees	Number Licenses	Revenue (\$ mil)	Total Employees
Agriculture and forestry	33	0.7	82	4	0.01	7	0.08	8	22	0.57	74
Fishing	17	0.7	23	1	0.00	5	0.31	5	11	0.41	18
Mining and quarrying	15	3.5	57	0	0.00	2	0.56	6	13	2.90	51
Manufacturing	66	5.2	146	10	0.05	10	0.54	21	46	4.56	125
Electricity, gas, steam and air conditioning supply	0	0.0	0	0	0.00	0	0.00	0	0	0.00	0
Water supply; sewerage, waste management	6	0.6	19	2	0.02	1	0.04	2	3	0.57	17
Construction	144	32.3	924	9	2.67	38	3.19	64	97	26.49	860
Wholesale and retail trade; repair of vehicles	434	189.6	1,448	68	0.60	126	6.82	170	240	182.19	1,278
Transportation and storage	152	6.6	257	31	0.56	30	0.65	25	91	5.43	232
Accommodation and food service activities	284	19.6	957	20	0.18	60	1.91	75	204	17.53	882
Information and communication	30	15.8	174	5	0.14	6	0.41	17	19	15.27	157
Finance	37	11.4	68	7	0.05	14	4.42	23	16	6.92	45
Real estate activities	400	11.7	167	199	2.84	80	3.70	54	121	5.12	113
Professional, scientific and technical activities	98	5.9	66	41	2.70	27	2.22	30	30	1.00	36
Administrative and support service activities	189	4.8	154	46	0.48	51	1.59	51	92	2.69	103
Public Administration	0	0.0	0	0	0.00	0	0.00	0	0	0.00	0
Education	0	0.0	0	0	0.00	0	0.00	0	0	0.00	0
Human health and social work activities	19	4.0	92	4	0.02	5	0.19	7	10	3.84	85
Arts, entertainment and recreation	18	0.0	4	5	0.03	0	0.00	0	13	0.00	4
Other service activities	121	2.8	161	32	0.23	41	0.68	42	48	1.88	119
<b>Total</b>	<b>2,063</b>	<b>\$315.2</b>	<b>4799</b>	<b>484</b>	<b>\$10.57</b>	<b>503</b>	<b>\$27.28</b>	<b>600</b>	<b>1,076</b>	<b>\$277.4</b>	<b>4,199</b>

Source: EconMAP analysis of Palau Bureau of Revenue and Taxation data.

about economic activities in the previous week and during 2019.<sup>96</sup> Questions about economic activities in the prior week asked the respondent to identify their main as well as additional activity undertaken, some of which could correspond to the informal sector. Regarding these activities, one choice is to identify as self-employed, which included producing goods or services for sale. Additionally, questions about activities and income in the prior year included specific questions whether household members grew crops, fished, raised livestock, or made handicrafts for their own use or sale, including the total weeks engaged in the activity and total earnings in 2019. Compiled census tables published to date have not explicitly reported on these informal sector activities.

96 [2020\\_Census-of-Population-Housing-and-Agriculture-Basic-Tables.pdf \(palaugov.pw\)](#) and [2020-Census-of-Population-and-Housing.pdf \(palaugov.pw\)](#)





## Appendix: Palau Implementation of CROSS and CARES Programs

### CROSS Act Implementation

The Ministry of Finance was the lead agency for implementing the Palau government's economic and fiscal response to the COVID pandemic. Finance secured a series of loans from the ADB that funded government operations during a sustained period of low revenue.

The 27 April 2020 Coronavirus Relief One Stop Shop (CROSS) Act established temporary relief measures including unemployment benefits, utility assistance, job programs, nonresident worker employment transfer, business loans, and tax and employer contribution deferrals with \$20 million authorized through 31 January 2021. The Minister of Finance issued regulations on 6 May 2020 to implement the CROSS Act and to operate a central location (i.e., a one-stop shop) where employers and employees could apply for benefits. While the recommendations of the Working Group had outlined expected spending for each provision of the CROSS Act, the enacted legislation did not lock in specific spending, thus providing flexibility to reallocate financial resources.

During the initial period of authorized spending under the CROSS Act (RPPL 10-56), \$7.9 million was spent, leaving a balance of \$12.1 million to lapse on 31 January 2021. The first legislation enacted by the newly seated legislative body (RPPL 11-01, 8 February 2021) provided \$1.5 million of CROSS program funding through 31 March 2021 while later legislation extended program funding authorization and brought total spending authority to \$21 million. While the end of all benefit programs was set for the end of June 2022, some unemployment benefit payments continued past that date. On 23 February 2023, Finance informed the President and legislature that all CROSS Act programs had ended, and that as of 30 December 2022, expenditures totaled \$19.9 million, leaving \$1.1 million of the total appropriations unused.

**Finance established eligibility for employer and employee benefits.** The Minister determined whether employer and employee applicants qualified for benefits based on (1) the connection of ordinary business activity to the COVID-19 pandemic and (2) a demonstration of a negative economic impact in 2020. To determine business connection to COVID, Finance assessed to what degree goods and services were marketed to international visitors, or if business activities were dependent on the availability of international travel, large public gatherings, or close physical person-to-person contact. For economic impact, Finance asked: "Can the employer demonstrate a significant decline in customers served, gross revenue, or scale of staffing/operations?" Separate eligibility provisions were created for self-employed persons and for persons engaged in informal business activities, including the sale of fruit, vegetables, bento, and "Makit".

According to Finance, it projected that 112 businesses would qualify for support. With respect to employees who would be affected by the COVID contraction, Finance projected 2,600 workers in the formal sector would be affected by the pandemic and would need unemployment or be placed in temporary jobs. Palau government planning, as well as the economic projections, relied on government tax and social security information to identify affected employees.

**The National Development Bank of Palau provided loans to eligible employers.** The Working Group proposed a CROSS Act planning allocation of \$5.8 million for loans to cover the “fixed costs” required to maintain business operations and mandatory costs. Loans could be used for maintenance and marketing expenses, or lease, utility, and insurance payments but could not be used to cover wages, loan payments, or taxes. A maximum of \$30,000 could be borrowed per three-month period to cover fixed costs. Loans were for a ten-year period at a 2 percent rate of interest, with no payments for two years, interest-only payments in the third year, and principal and interest payments for the remaining seven years. Subject to available loan funds, the Bank could also provide loans of up to \$250,000 to finance the improvement of tourism facilities.

The loan program was executed within a six-month interval in the first year of the CROSS program. According to Finance, 187 businesses were pre-qualified for participation in the loan program as of July 2020 and the National Development Bank of Palau reported that 117 businesses requested applications and 39 loans were made totaling \$1.45 million as of December 2020. Loans were only made to Palauan-owned businesses and ranged in size from \$2,280 to \$90,000. The approved loans were all tourism related, with 15 to tour companies, 9 to restaurants/cafes, and 8 to hotels/motels. No additional loans were made under the program, even as the negative impact of COVID continued. According to bank officials, businesses that applied needed to meet normal bank loan requirements and their use of funds needed to comply with CROSS Act requirements. Many firms wanted funds for expenses that were not fixed costs and therefore not eligible for the program.

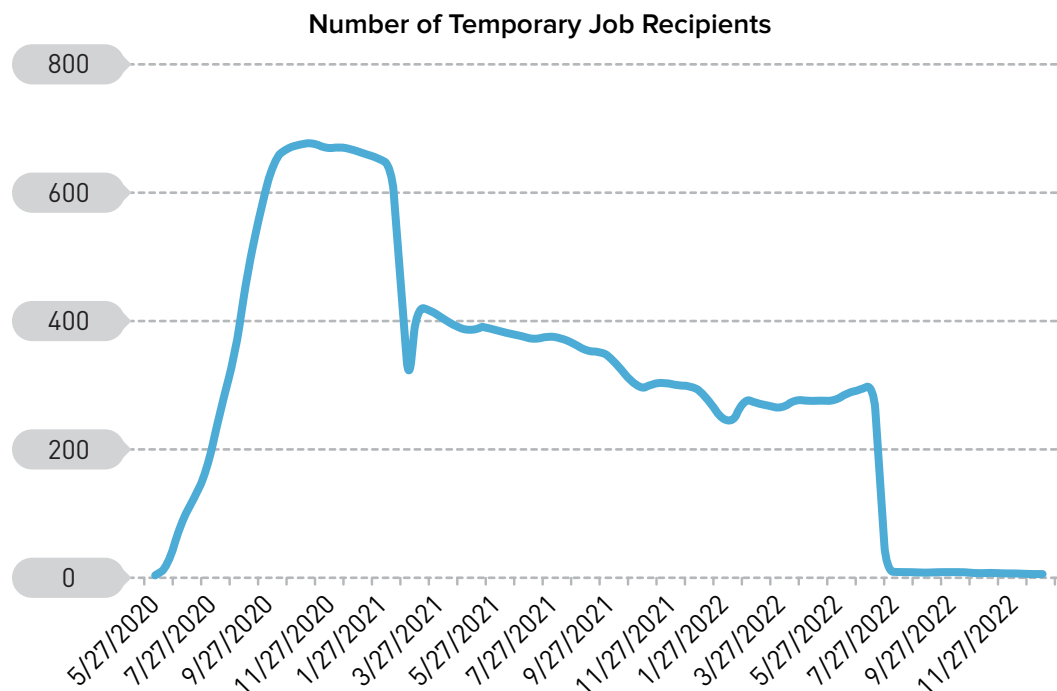
The CROSS Act loan program was too narrowly specified to cover the ongoing needs of businesses seeking to stay open amid very low demand. One private company noted the National Development Bank provided other loans with more flexible requirements that were critical to sustain operations. During 2021, the Development Bank did make loans available again for “reopening” activities, but this was early and there was no demand. Further, during the period when firms ramped up for tourism recovery, those activities would not qualify for the CROSS Act loan program.

By the effective end of this program 15 December 2020, when the last loan was awarded, \$1.45 million had been utilized for COVID private sector relief. This was 25 percent of the COVID Working Group’s expected allocation of \$5.8 million. In July 2022, Palau allocated an additional \$500,000 of CROSS Act funds to the National Development Bank to be used as the Palau government’s support for the ADB Disaster Resilient Clean Energy Financing (DRCEF) Solar Home Loan Program.

**Finance deferred tax payments and employment contributions.** For qualifying employers, Finance could defer gross revenue taxes. Also, for qualifying employers who maintained employees at normal hours, Finance could advance the required employer payments to the social security and medical savings fund accounts to cover those employees. The Working Group did not propose a CROSS Act budget allocation for this program.

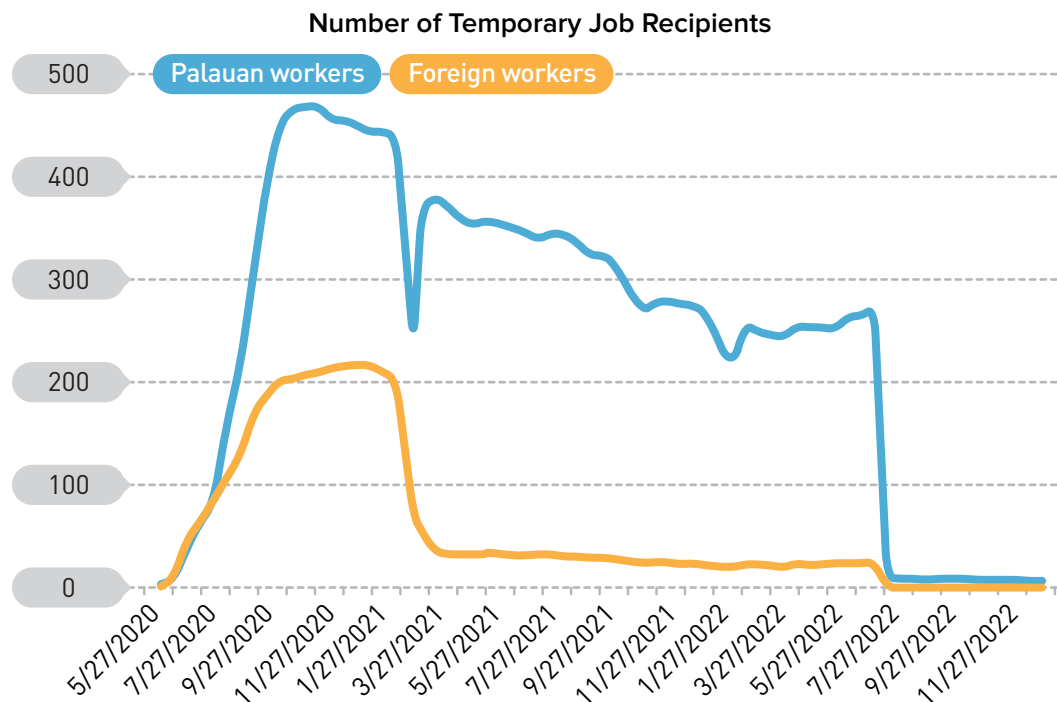
As implemented, Finance subsidized contributions for social security and health care funds on behalf of qualified employees who did not receive humanization assistance. For example, for pay periods from 24 May to 11 December of 2020, Finance provided \$287,000 in payments to the social security and health care fund. In addition, on behalf of the workers in the CROSS temporary job program, Finance made payments to the social security and health care funds on behalf of their employers.

**Figure 18:** CROSS Act Temporary Jobs Program-Payments and Number of Recipients by Pay Period, May 2020-December 2022



Source: EconMAP analysis of Palau Ministry of Finance program payment data.

**Figure 19:** CROSS Act Temporary Jobs Program-Number of Palau Citizen and Foreign Worker Recipients by Pay Period, May 2020-December 2022



Source: EconMAP analysis of Palau Ministry of Finance program payment data.

By the end of this program in February 2022, \$1.1 million had been paid on behalf of employers. The COVID Working Group did not provide an expected allocation for this program.

**Palau Visitors Authority implemented temporary job program.** Finance funded a temporary job program that was implemented by the Palau Visitors Authority. A Temporary Workforce Coordinating Committee cochaired by the Minister of Community and Cultural Affairs and the Chairman of the Palau Visitors Authority (PVA) organized the program. Priority under the program was for eligible employees who were unemployed due to COVID and for employment that furthered national priorities, including tourism enhancement, environmental protection, and care for a vulnerable population.

According to staff at the Palau Visitors Authority, they were given an implementation role because they were knowledgeable about tourism sector operators who were most affected by the pandemic. The Working Group proposed a CROSS Act allocation of \$8.0 million for temporary jobs. (For Palau citizens, the CROSS Act also covered employer Social Security and Health Care Fund payments for these jobs.) The program also provided employment for students repatriated to Palau.

The program started in May 2020 and the employers were either a ministry or agency or one of the state governments. Temporary jobs were primarily with national and state government agencies and the CROSS Act paid program participants the Palau minimum wage of \$3.50 per hour. In January 2021 just before the program's authorization was scheduled to end under the initial CROSS Act, PVA notified the employing agencies to submit final time sheets on January 29 for the program's then 679 workers, with final paychecks to be issued February 5. Program participation fell sharply after January 2021, and after the extension of the program was 423 in March 2021. The primary change in the program was the decline in foreign worker recipients from over 200 per pay period to 30. This reflected a new policy enacted by the incoming President. Palauan worker participation also fell from 450 per pay period to around 350, and then slowly declined in later months. Job placement numbers fell over time to 298 placements at the end of June 2022. Beginning in July, the number of employees covered fell to 10 and continued at low levels through December 2022 (see [Figures 18 and 19](#)).

By the end of the program in December 2022, 948 individual workers had participated at some point in the program comprised of 672 Palau citizen and 276 foreign workers.<sup>97</sup> In total, \$5.3 million had been utilized, which was 66 percent of the COVID Working Group's expected allocation of \$8.0 million.

**Finance provided eligible employees unemployment assistance.** For qualifying employees, Finance provided weekly unemployment benefits or "humanitarian assistance." According to Finance, this program was not intended to replace wages and benefits and payments were set at a level lower than Palau minimum wage earnings of \$140 per week (40 hours x \$3.50 per hour). Program implementation was also structured to support part-time employment and keep workers linked to their employers. Employers applied for unemployment benefits on behalf of their unemployed workforce (although workers could also make individual application). For most months of program implementation, benefit checks were delivered to employers to then distribute to their unemployed workers. One restriction on program access was that the eligible employee could not be receiving social security or retirement

<sup>97</sup> This analysis reflects counts of unique Social Security numbers among all recipients who received payments over the course of the program. Program participants over the 67 two-week pay periods of the program ranged from 4 to 671.

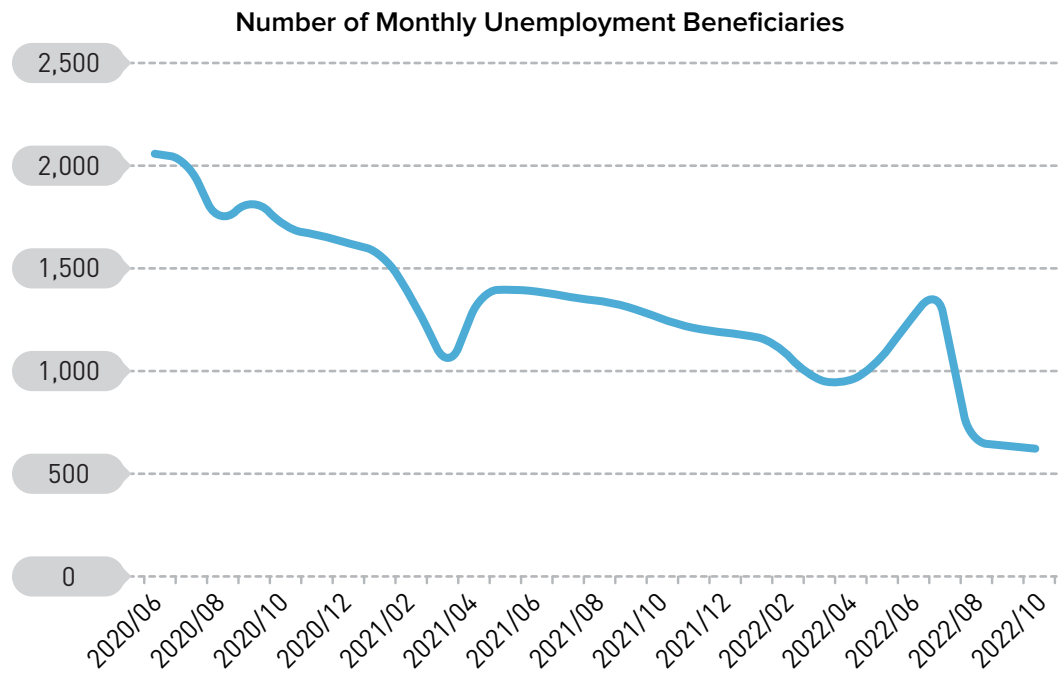
payments or unemployment benefits from the Palau government or any foreign country, including the US. The Working Group proposed a CROSS Act planning allocation of \$5.5 million in unemployment benefits.

This program had a large and significant impact on many workers in Palau, while also going through a series of transitions. The program had four different operational structures from May 2020 through October 2022.

- » Initially, the program had tiered benefits where the benefit level depended on the extent of the employee's unemployment. If an employee was fully unemployed -- the assistance was \$100 per week, if hours or earnings were reduced by 50 percent or more, they received \$50 per week, and if reduced by more than 25 but less than 50 percent they received \$25 per week. During the August 2020-February 2021 period, recipients with 0 hours of work were 22 percent of the program (\$100/week), those with fewer than 20 hours per week of work averaged 31 percent (\$50/week), while those working between 20 and 40 hours were 47 percent (\$25/week). The program operated with these rules through January 31, 2021. As the US CARES Act unemployment program was established, eligible Palauans left the CROSS programs for the higher US CARES benefits and some unemployed foreign workers were repatriated to their home nations.<sup>98</sup> Over time program beneficiaries fell from initial levels (see [Figure 20](#)). Palau unemployment program beneficiaries were primarily foreign workers after the first few months of the program (see [Figure 21](#)).
- » February 2021 saw a one-week period in which program funding was not authorized resulting in one week less assistance that month. Once program authorization was restored, the new incoming President's administration restructured the program to pay most recipients the equivalent of the minimum wage for 20 hours per week (\$70/week) as an unemployment payment, with the direction that workers return to their employers for 20 hours of paid work per week. This was the experience for 87 percent of beneficiaries for the next 13 months.
- » In May 2022, Palau, other FAS, and US citizens stopped receiving payments under the US funded unemployment program. At that point all of those who were unemployed were eligible to join the CROSS-Act unemployment program. Finance developed a two-tiered payment system for the remainder of program operations. According to a Finance report to the legislature, the new beneficiaries received on average \$499 per month in June 2022, while ongoing program participants received \$254 for the month. Essentially, this established a higher benefit structure for unemployed Palauans than unemployed foreign workers (see [Figure 22](#)). With the increased cost, the program needed to be realigned to fit with remaining available funding, according to Finance officials (see [Figure 23](#)). An additional concern was that numerous businesses were still in the program who were nearing their pre-pandemic performance. The program suspended operations in July.
- » In August 2022, the program restarted, but with the guideline that only employees of companies who had not yet reached a 70 percent recovery would be eligible. This removed employees of companies who had substantially recovered from the program. This change in eligibility caused the number of beneficiaries to fall and the program continued for 3 more months.

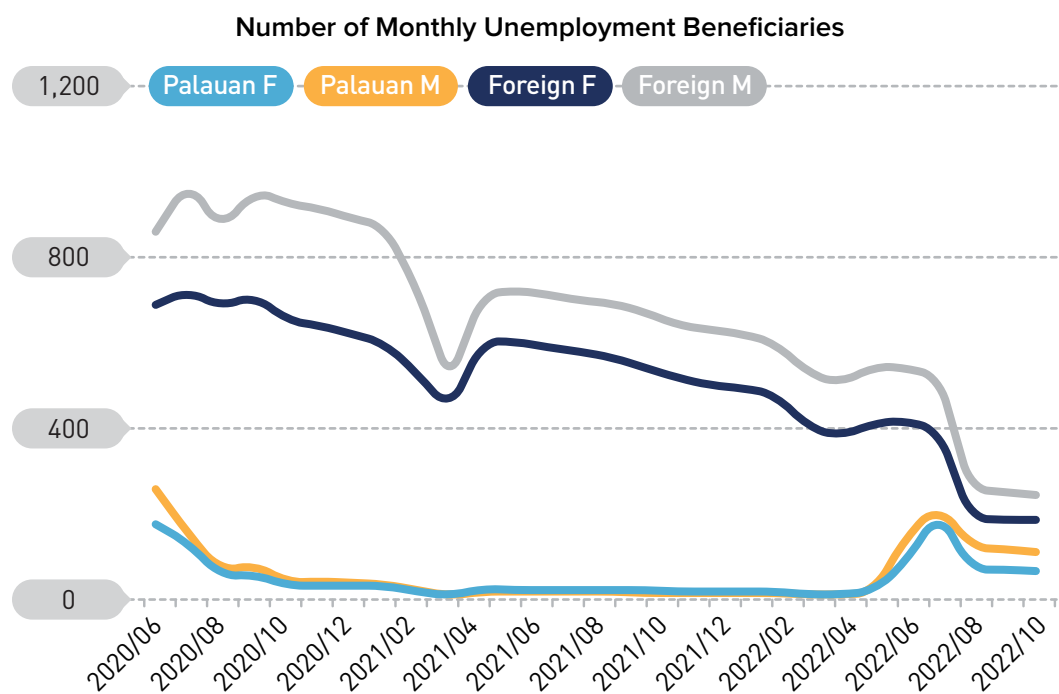
98 The July 2020 Finance report on CROSS implementation noted that 188 Palauan citizens were removed from the program since they had received US CARES Act unemployment payments.

**Figure 20:** CROSS Act Unemployment Program-Number of Recipients Paid Monthly, June 2020-October 2022



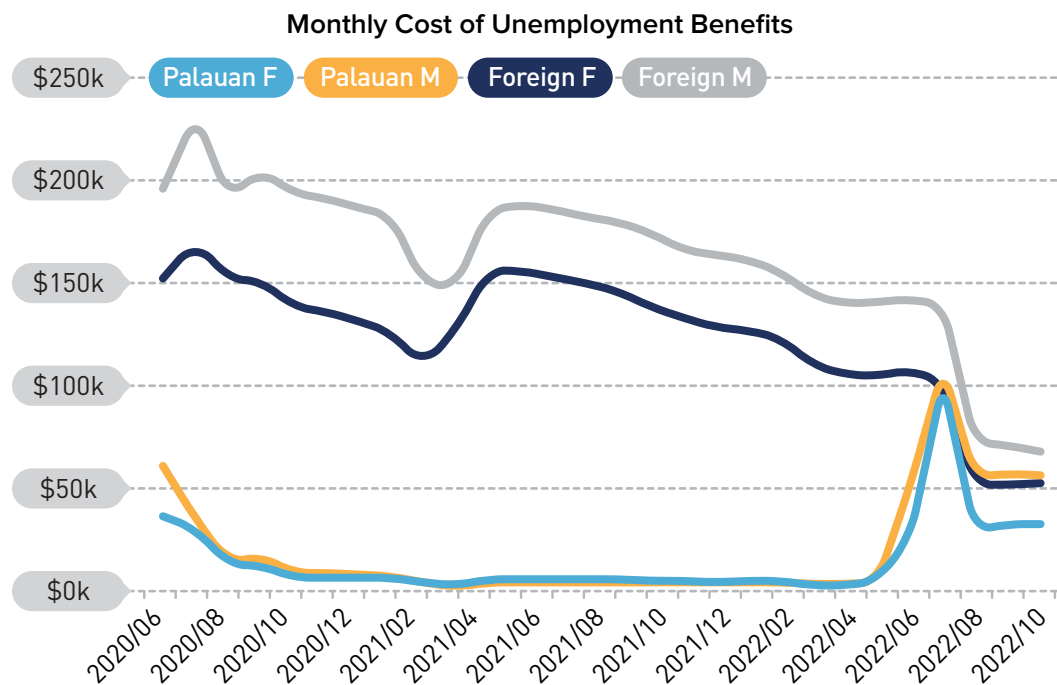
Source: EconMAP analysis of Palau Ministry of Finance program payment data.

**Figure 21:** CROSS Act Unemployment Program-Number of Palau Citizen and Foreign Recipients Paid Monthly by Gender, June 2020-October 2022



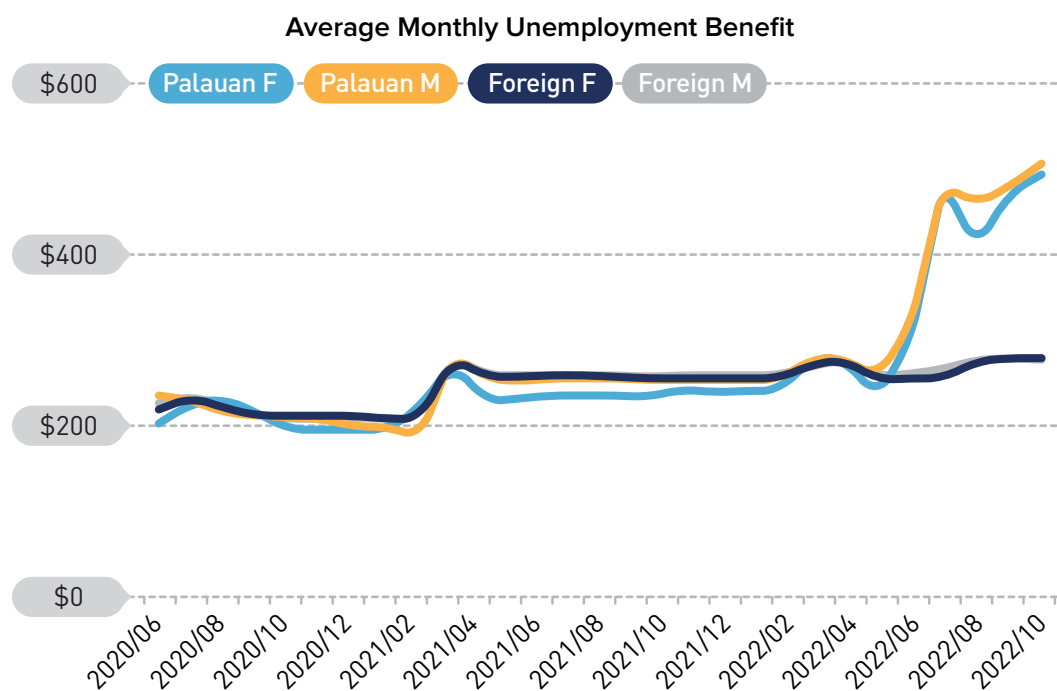
Source: EconMAP analysis of Palau Ministry of Finance program payment data.

**Figure 22:** CROSS Act Unemployment Program-Palau Citizen and Foreign Recipients Monthly Cost by Gender, June 2020-October 2022



Source: EconMAP analysis of Palau Ministry of Finance program payment data.

**Figure 23:** CROSS Act Unemployment Program-Palau Citizen and Foreign Recipients Average Monthly Benefit by Gender, June 2020-October 2022



Source: EconMAP analysis of Palau Ministry of Finance program payment data.

By the end of this program in October 2022, \$9.5 million had been utilized to benefit partially or fully unemployed workers. This was 72 percent greater than the COVID Working Group's expected allocation of \$5.5 million.

**Palau Public Utilities Corporation had authority to subsidize utilities.** This subsidized electricity and water/sewer COVID benefit was to be provided through an existing "Lifeline" program for low- or fixed-income households. The Working Group proposed a CROSS Act allocation of \$700,000 for the "Lifeline" utility subsidy.

By the end of the program, in February 2023, Finance had not provided the Palau Public Utilities Corporation (PPUC) any resources from the CROSS Act fund to subsidize COVID affected households as the utility had sufficient Lifeline funds to cover them. PPUC did track and report to Finance the number and cost of COVID affected households who received subsidies from the existing Lifeline program. Effectively, the CROSS Act utility subsidy program used 0 percent of the initial planning expectation.

**Cross Act expenditure totaled \$19.9 million.** At the end of December 2022, total CROSS Act spending came to \$19.9 million (see [Table 1](#)). Out of total appropriations of \$21 million, this left \$1.1 million in unused funds. Table 1 shows the expenditure categories by CROSS Act program. Among the programs, the Unemployment Benefits/ Humanitarian Assistance Program represented 48 percent of expenditures, while the Temporary Job Program was second, at 27 percent. Expenditures aligned with the

**Table 1:** CROSS Act Temporary Relief Measure Expenditures by Program, May 2020-December 2023

<b>CROSS ACT Expenditure by Listed Categories</b>	
Concessionary Loans, RPPL 10-56, Section 3 Part 3(a)	\$1,500,000
Payment Deferral/Subsidy, RPPL 10-56, Section 3 Part 3(b)	\$1,075,935
Temporary Job Program, RPPL 10-56, Section 3 Part 3(c)	\$5,300,000
Transfers, RPPL 10-56, Section 3 Part 3(d)	\$0
Unemployment Benefits, RPPL 10-56, Section 3 Part 3(e)	\$9,512,042
Expanded Lifeline Utility Service, RPPL 10-56, Section 3 Part 3(f)	\$0
<b>Subtotal</b>	<b>\$17,387,977</b>
<b>Additional CROSS Expenditure Categories</b>	
Administration Cost @ 1%	\$101,986
Summer Learning Skill Employment (CSLSE)	\$544,818
National Development Bank Solar Program Funds	\$500,000
Labor Refund	\$80,825
WIOA Tax Refund	\$1,282,338
<b>Subtotal</b>	<b>\$2,509,967</b>
<b>Total Expenditures</b>	<b>\$19,897,944</b>

Source: Palau Ministry of Finance compilation of expenditures under CROSS appropriations.



assistance categories in the CROSS Act were 87 percent of total expenditures. Among the remaining additional expenditures, the largest was to cover the cost of providing tax refunds to beneficiaries under the US-funded unemployment program that had been mistakenly withheld (see discussion below).

## CARES Act Implementation

CARES Act unemployment programs were implemented by the Palau Workforce Innovation and Opportunity Act (WIOA) office. The US Department of Labor (DOL) had an ongoing pre-COVID relationship with Palau through the US Workforce Innovation and Opportunity Act. The Palau WIOA office implemented small US workforce program grants through the WIOA Title 1 programs: Adult, Dislocated Workers, and Youth. Among all implementors of US WIOA programs, Palau was the smallest program. In FY2018 Palau WIOA expended \$279,000 in grant funds and \$262,000 in FY2019. In program year 2018 (July 1, 2018-June 30, 2019) the office served 88 individuals in the Adult Program, 9 individuals for the Displaced Workers Program, and 143 individuals for the Youth Program.

On 27 March 2020 the US President signed the CARES Act of 2020 into law which established Palau's eligibility for two new Unemployment Insurance programs. The President of Palau signed an agreement with the US Department of Labor on 31 March 2020 implementing the programs, with the Palau WIOA office as the implementing agency. Citizens of Palau, the Federated State of Micronesia, the Republic of the Marshall Islands, and the United States were eligible for the US programs in Palau under the CARES Act through these two UI programs. Other, unemployed foreign workers in Palau were ineligible.

These two programs from the CARES Act were available to Palau:

- » Pandemic Unemployment Assistance (PUA) temporarily extended unemployment insurance benefits to people who otherwise would not qualify for unemployment insurance benefits. In the US and Palau, this included self-employed workers, freelancers, independent contractors, and part-time workers impacted by the COVID pandemic. Moreover, since Palau did not have an unemployment insurance program, the PUA was available for all unemployed Palauan citizens as well FAS and US citizens that were unemployed due to COVID-19. For Palau, PUA provided \$397 a week as an unemployment insurance benefit from 02 February 2020 to 26 December 2020, with a total of 39 eligible weeks in the period.
- » Federal Pandemic Unemployment Compensation (FPUC) increased the level of unemployment insurance benefits to the eligible unemployed workers affected by the COVID pandemic. Under the FPUC, eligible unemployed workers who collected unemployment compensation (including PUA payments) received an additional \$600 in federal benefits each week they were unemployed. For Palau, the period of eligibility was from 1 April 2020 through 31 July 2020.

Subsequent US Congressional action extended the weeks of eligibility for the PUA and FPUC programs. The Consolidated Appropriations Act, 2021 (Public Law 116-260, 12/27/2020) and the American Rescue Plan Act (Public Law 117-2, 3/11/2021) extended PUA eligibility through 4 September 2021 (a maximum of 79 payable weeks overall) and restored eligibility for the FPUC (after a gap) for the period 27 December 2020 through 4 September 2021. For the FPUC program, the weekly benefit of \$600 per week (1

April 2020–31 July 2020) was reduced to \$300 per week (27 December 2020–4 September 2021).

The US Department of Labor awarded grants to Palau to implement the CARES programs and to support administration expenses. These grant awards were in FY2020, FY2021 and FY2022 and totaled \$52.2 million, allocated with \$1.4 million for administration, \$29.0 million for PUA benefits, and \$21.8 million for FPUC benefits (all as of 30 September 2023).

### **Palau WIOA implementation of CARES Act program**

CARES Act authorization period, 2020. According to Palau WIOA officials, the initial expectation -- based on government statistics -- was for 700 unemployed people to apply for the CARES program. Palau reported an initial award from US DOL of \$19 million, with \$14 million transferred for WIOA's use. Palau program implementation of the unemployment programs was challenging:

- » By mid-June 2020, over 1,000 applications had been received. Once an application was processed and approved, WIOA office issued checks to the approved individual. According to press accounts, certain applicant categories, such as self-employed local vendors at local markets (*makit*), handicraft makers, farmers, and fish sellers to the tourism sector were having a difficult time meeting application requirements due to their lack of records such as invoices or receipts. By late June, according to a press account, WIOA had released \$3.5 million in payments to 495 beneficiaries, with the payments retroactive for weeks of unemployment as far back as February.
- » By August, the scale of the program exceeded planning expectations. WIOA reported to the press that it had issued financial assistance to more than 800 individuals. The scale of claimants and level of funding involved with the PUA and FPUC programs far exceeded the historic scale of Palau office operations.
- » Palau WIOA office program determined that recipients of Social Security and pension payments that were “seasonal” workers, who sold to the tourism market, were ineligible for the program. Both determinations were later overturned by US DOL in September 2021.
- » In August, the management of Palau WIOA office announced it was no longer accepting applications from the “self-employed” such as boat operators, vendors from local markets “Makit,” taxi drivers, fishermen, craftsmen, farmers, and others engaged in the informal economy. The rationale was to extend the \$14 million in available US funds through the scheduled end of the US program in December 2020.
- » According to Palau’s FY2020 financial statement, by the end of September 2020, \$9.6 million in CARES funds had been expended. The WIOA Director reported that the \$14 million was depleted in October 2020 and that the remaining \$5 million had been requested.
- » The remaining \$5 million was released in February 2021 after the Palau WIOA office supplied additional documentation to US DOL and had undergone a US DOL Office of Inspector General desk audit. These released funds were then used to cover disbursements for eligible weeks of unemployment in November and December of 2020.

Consolidated Appropriations Act authorization period. The Act extended the PUA unemployment program through 14 March 2021 (with possible payouts through 10 April) and restarted the FPUC program for unemployment between 27 December 2020 and 14 March 2021, with a \$300 weekly payment. The Act also instituted additional documentation requirements. Palau WIOA faced implementation challenges during this period as well:

- » During February 2021, former recipients of the CARES benefits were hosted on a Palau Wave Radio talk show alleging mistreatment and raising questions about program management. WIOA officials responded that changes in eligibility were due to US DOL rules and rulings.
- » Further, Palau WIOA officials reported that US DOL had informed Palau that Palau wage and salary taxes, social security, and health care fund charges should not have been deducted from unemployment insurance benefit payments and would be refunded to the beneficiaries. The rationale for this US DOL notice was that unemployment compensation is personal income, not wage/salary payments and thus not subject to payroll taxation.<sup>99</sup> According to the Director, Palau WIOA stopped deducting Social Security and health insurance beginning in August 2020. This refund requirement led Palau to remit about \$1.3 million in tax collections to about 1,200 recipients and \$700,000 in Social Security and health system payments to 495 individuals.<sup>100</sup>

American Rescue Plan Act period. The Act extended the PUA and FPUC programs through 4 September 2021 and provided for changed US tax status for 2020:

- » One important provision of ARPA (section 9042) was to allow taxpayers to exclude up to \$10,200 in unemployment benefits on their federal tax returns for 2020. The legislative intent was to mitigate unexpected federal taxation due to the \$600 weekly FPUC payments (as \$600 x 17 weeks).<sup>101</sup>
- » The US IRS reminded residents of the US territories on 8 April 2021 that the federal 2020 income tax exemption may apply to them. This notice did not apply to residents of the FAS.<sup>102</sup>

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99 In the United States, unemployment benefits are considered personal income subject to federal income taxes, but not subject to payroll taxes, including Social Security and Medicare. During the two program years, 2020 and 2021, US states were required to offer to withhold federal taxes from FPUC payments and were required to inform PUA recipients that the benefits would be included in their gross income for federal taxation. Most US states treat unemployment benefits as income subject to state income taxation.

100 According to the Palau Social Security Administration, the population uninsured for health coverage rose from 3 percent to 10 percent after August 2020 deductions ended. Palau's Social Security office requested a waiver for making the refunds from US DOL, but it was denied.

101 However, as the tax change that applied to 2020 became law on 11 March 2021, many taxpayers had already completed their tax filings. On 8 April 2021 the US Internal Revenue Service (IRS) announced it would issue refunds for those who had filed taxes and it provided guidance on filing for the exemption if tax forms had not been submitted.

102 This federal action was not the reason that Palau needed to rebate payroll taxes, Social Security and health charges. <https://www.irs.gov/newsroom/irs-reminds-us-territory-residents-about-us-income-tax-rules-relating-to-pandemic-unemployment-compensation> This notice would apply to FAS citizens resident in the United States.

- » Some US states automatically followed the federal exclusion for their 2020 state income taxes, while other states enacted temporary income tax exclusions that were identical or similar.<sup>103</sup>

More significantly for Palau WIOA operations were police actions on 22 June 2021:

- » Palau police closed the Palau WIOA office and staff were sent home with their personal belongings as police secured the office to preserve documents and records. Staff were placed on administrative leave pending the ongoing criminal investigation.
- » According to a statement released that day by the President of Palau, an investigation into complaints about the distribution of CARES Act funds led to an investigation by the Office of Special Prosecutor and the Public Auditor that in turn led to the office closure.
- » Also, on 22 June 2021 the President reestablished Palau Workplace Development Boards to oversee subsequent WIOA operations. Subsequently, the Director, the Fiscal Officer, and 2 other management staff were either terminated or their contracts not renewed.
- » The WIOA office was reorganized immediately. The President of Palau appointed an interim-Director beginning 22 June 2021 and additional staff were hired during the summer of 2021.

Post PUA and FPUC period. The unemployment eligibility period for PUA and FPUC benefits ended 4 September 2021. However, the work of the Palau WIOA office to close out the program continued:

- » In an October 2021 press account, the Director reported that WIOA was issuing final payments to 1,200 recipients of CARES assistance. Further, the US DOL had granted a redetermination to 642 individuals who were previously denied for CARES Act in 2020 and did not receive a required written “Notice of Determination.” At the same time US DOL allowed Palau WIOA to reopen applications to give an opportunity to individuals to apply to receive assistance who had been previously informed in 2020 that they would not be eligible. The individuals were given a one-week window 28 September—8 October 2021 to apply.<sup>104</sup>
- » In an October 2021 press conference, Palau WIOA office announced it had received \$18 million in funding on 1 October 2021 that was reserved for those who had applied for assistance in 2020 and 2021 but were verbally denied application. Further, the office reported that it was in the fraud/investigative period of the CARES Act. Palau WIOA then processed these cases carefully and thus slowly. These cases were reviewed and supported by additional documentation provided by the claimant for the year 2021, and if found eligible, the claimant would be awarded a lump sum amount for the year 2021. Although, the claimant may have been eligible for the year 2020, the process only applied to 2021 claims. As of

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103 Out of the 37 states that tax unemployment compensation as income, 27 altered their treatment of unemployment benefits in 2020. Four states extended this temporary treatment of unemployment to 2021 as well. See, Congressional Research Service, *Taxing Unemployment Insurance (UI) Benefits: Federal- and State-Level Tax Treatment During the COVID-19 Pandemic*, 26 May 2022. <https://crsreports.congress.gov/product/pdf/R/R47105>

104 Also, further reimbursements of wage tax and Social Security deductions were then awaiting a US DOL legal response.

October 2023, Palau WIOA was still negotiating with US DOL regarding retroactive payments for the year 2020.

- » In a March 2022 press account, the Director reported that 678 applications<sup>105</sup> that had previously been denied as ineligible, incomplete, or seasonal by previous management were under review. Individual applications exceeded 180 pages, and for some workers in the informal economy, demonstrating income before and during COVID was difficult. Further, the payment records of all 1,384 former beneficiaries were under review to determine any under- or over-payments.
- » In October 2022, WIOA posted on Facebook that US DOL had given WIOA permission to use the remainder of the supplemental \$18 million to refund deductions from benefits that were made between 23 June 2020 and 31 December 2020. In total, 968 claimants would receive a refund.

### WIOA audit report and aftermath

On 12 January 2023, the Acting Public Auditor of Palau provided a *Final Report on the Audit of WIOA's PUA* program to the Director of WIOA. The report was covered in the Palau press on 26 May 2023.<sup>106</sup> The audit covered WIOA operations from 2 February 2020 through 16 June 2021.

The audit found problems in the review and approval of applications and claims; non-compliance with eligibility requirements; lack of support for calculated benefits; miscalculations of payouts; poor financial management; and a lack of documents to support awards. The audit outlines how a mistaken understanding of how many individuals would be affected by COVID drove other operational decisions that were detrimental. Planning for 700 beneficiaries, the office chose to use a paper application and a paper weekly claim process. However, by mid-July 2020, they had nearly 1,600 applications and were receiving more than 1,200 claim forms each week. Each weekly claim form was 5 pages long, so 6,000 pages of weekly claim forms. The office was buried in paper.

In WIOA's response to the audit findings, the new Director outlined several steps taken or underway to address problems and facilitate the close-out of the unemployment programs, including:

- » **Training.** Staff had previously received only one US DOL training in April 2020. As staff had not been continuously trained and/or shown the "Unemployment Insurance Program Letters" regarding changes to the programs, the US DOL was conducting weekly "backlog" training for staff. During program implementation, there were a total of 12 changes to the PUA and FPUC programs, with a total of 314 pages of program documentation.
- » **Staffing.** Palau WIOA was hiring 5 staff to review 1,271 prior claims and to process 680 retroactive claims for 2020. Working with US DOL, WIOA found 754 applications that had been rejected without a Notice of Determination. Of these claims, 680 were determined to be eligible and entitled to a retroactive payment

<sup>105</sup> In addition to the 642 individuals who had been previously told they were ineligible and not provided a required written "Notice of Determination", an internal file review identified other denials that were mistaken and inconsistent with guidance.

<sup>106</sup> The report is not available on the Public Auditor website as of 1 September 2023.

for the year 2021 (36 weeks). In addition, WIOA needed to finish refunding payroll tax and social security deductions as well as remedy other issues.

Following the release of the audit report the Palau Office of Special Prosecutor brought felony and misdemeanor charges during June and July of 2023 against four WIOA staff from the initial period of PUA and FPUC implementation. The previous Director was charged with Misconduct in Public Office and all four were charged with Theft of Government Property, as well as other misdemeanor charges. As of 12 October 2023, court proceedings are underway for two of the defendants, and one defendant has pled guilty and agreed to testify in the trials of the other three defendants.

The work of the Palau WIOA office to close out the program was still underway in October 2023. The Palau office was negotiating with US DOL regarding the status of retroactive payments to be made for the year 2020. Therefore, the information below on the program scale and number of claimants that the office was able to provide should be considered an estimate. For example, additional expenditures under the program may have been made in FY2024.

**Table 2:** CARES Act Unemployment Grants and Expenditures, FY2020-FY2023

Unemployment Grant Categories	Federal Authorization	Palau WIOA Expenditures
Pandemic Unemployment Assistance Administration	\$1,419,371	\$915,899
Pandemic Unemployment Assistance (PUA)	\$29,017,948	\$27,950,271
Federal Pandemic Unemployment Compensation (FPUC)	\$21,753,500	\$21,044,129
<b>TOTAL</b>	<b>\$52,190,819</b>	<b>\$49,910,300</b>

Source: Palau Ministry of Finance, Schedule of Expenditures of U.S. Federal Grants (as of 30 September 2023).

### Palau expended \$49.8 million of CARES Act grant support for unemployed workers

In total, the Palau CARES program spent \$49.8 million in grant support for about 1,384 unemployed workers in Palau as of 9 September 2022 (see [Table 2](#)).<sup>107</sup> As part of the \$52.2 million the US government made available, funds were included to offset the cost of administering the unemployment programs. Problems in making timely payments and the need to reconsider past implementation decisions spread the actual expenditure of CARES Act support across two additional fiscal years, beyond the period of work weeks eligible for unemployment compensation.

<sup>107</sup> Note, this data is from September 2022 and excludes drawdowns or disbursements since that date.

The US CARES program provided an important source of income for Palau citizens who became unemployed due to the pandemic. According to Palau WIOA data on program beneficiaries:

- » 1,384 claimants received payments, of which 55 percent were male and 45 percent female. Palau citizens made up 96 percent of claimants with FAS citizens at 3 percent and US citizens at 1 percent.
- » The leading industries of the claimants were: accommodation and food services, 45 percent; transportation and warehousing, 25 percent; retail and wholesale trade, 10 percent; and agriculture, forestry, fishing, hunting, 7 percent.

The compensation provided by the US PUA and FPUC benefits significantly exceeded the Palau worker's average weekly compensation. For example:

- » The average annual cost of compensation for private business workers in Palau was \$10,922 or about \$210 per week in FY2019, before COVID, while the Palau minimum wage of \$3.50, provided \$140 per week.
- » Under the US unemployment programs, unemployed Palau citizens with PUA and FPUC, had weekly unemployment payments as high as \$997 per week when FPUC was at \$600 per week. This was almost five times the average level of earnings, or seven times minimum wage earnings.
- » During the period when FPUC was \$300 per week, total weekly compensation was \$697. This amounts to unemployment payments almost five times the average annual labor cost. This was more than three times the average level of earnings, or five times minimum wage earnings.

Because the CARES program was benchmarked to Hawaii wage levels and unemployment system compensation, its benefit structure was not aligned to Palau's labor market.

CARES Act participant information was not shared with the government of Palau during many months of program implementation, which limits the analysis that can be conducted regarding the program. However, the Ministry of Finance made the beneficiary payments for the first four months of program operations, June 2020 through September 2020. During this time, Finance provided 1,165 payments totaling \$10.8 million. Individual payments varied enormously, from \$29 to \$35,068 during this period.



