



STATE OF THE REPUBLIC ADDRESS

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

April 2, 2004, Palau National Gymnasium

I. Introduction

Good morning, ladies and gentlemen. It seems amazing that I am already giving my 4th State of the Republic Address, the final such Address during this term as your President. I guess that the old saying, that when you are very busy, time flies, applies to these first three years of service to the Republic.

When I addressed you just three years ago, I indicated that we, as a people, and as a nation, were entering a "Non-Payday Weekend." I made this characterization because our government was spending considerably more than it was bringing in. Not only were we spending more, we had exhausted most of our discretionary funding revenue sources. On top of this, our private sector was under serious attack as a result of the Asian Economic Crisis. Taking these realities into consideration, we could follow one of two paths. We could continue on our path towards fiscal imbalance until a crisis was arrived at or we could bite the bullet.

We chose the prudent course – we bit the bullet. That is why I told you that Palau was now running on 'E'. Not 'E' for Empty, but 'E' for Efficiency and 'E' for Effectiveness and 'E' for Excellence. In dedicating Palau's path towards a comprehensive fiscal reform, I introduced the Management Action Plan (MAP). This plan established a MAP of our immediate economic future and permitted, not only my office, but all Palauans, to monitor our course towards economic independence.

Looking back, it is clear that this conservative and constructive path was well worth taking. Little did we know three years ago that, in addition to the Asian Crisis, we would be struck with the United States Stock Market crash, Tropical Storm Utor, '9/11', the War in Afghanistan, the War in Iraq and the SARS epidemic. Each of these events had a very real and significant impact on our local economy, especially on our tourism.

But my friends, we survived. Like warriors after a battle, we can all stand together, and as one people, say that we have survived these external events and that we refused to allow ourselves to face economic ruin. We can look to our neighboring economies and be proud of the fact that Palau is now in an unmatched position to move forward, into our future, and prosper.

During the last three years, we have followed, with great effort and care, the MAP of our economic future and we are now in a position to reap the benefits of the foundations that we have laid. As with our Compact Road, despite setbacks, despite frustration, despite rainy weather, we are nearing the completion of our economic highway. We must therefore set a new course down this highway that recognizes our opportunities. As with the highway, we must be alert to the challenges that await us.

Palau does not want to follow the undisciplined approach of many of its neighbors in realizing prosperity. Rather, we want a voyage that will strengthen our culture, not destroy it. We want a voyage that will preserve our unique environment, not damage it for future generations. We want a voyage that will benefit all of the people of Palau, not just the few.

We must therefore take the careful path of sustainable development, one in which we steer our ship and are not steered by other countries or outside events. My friends, there is no rush. Our course is true. Let us not forget the gift that we have been given through our independence. Let us not rush headlong towards a future that we do not define. We will all arrive there together, at our promising future, if we work together, and if we plan together, and if we select our partners with care and patience.

And most importantly, let us not forget that we control our own destinies. We do not need to rush our development by developing public institutions and rules that look only to today, that look for easy solutions to complex problems, and that set a course towards unsustainable growth patterns.

We Palauans are not a quiet people. We freely express our ideas and our differences to one another on a daily basis. Yet we also often defer to our leadership too frequently. I would ask you today, to become more involved in the government process. If you disagree with my decisions, tell me. I will listen. If you disagree with your Congress and the laws that they pass, tell them. They should respond. This is the peoples' government. You are not the government's people. Let your voices be heard. Ultimately, and I say this with the greatest emphasis, your government is only as good as your involvement in its decisions.

Finally, we must all remember that the financial provisions of the Compact of Free Association will expire in only five years. We must therefore make our final preparations, preparations that will place Palau in a strong position to negotiate its economic future. We cannot place ourselves in the position of others, where any deal offered must be accepted because the need for outside funding overrides the best interests of the nation. Rather, we must be in a position to freely offer our partnership, on terms that are fair and acceptable and that are established through an equal and negotiated process.

To accomplish this, we must move forward with the establishment of laws that strengthen our economy. We cannot wait any longer to pass modern laws that permit our private sector not only to survive, but to prosper in the face of the challenging reality of our small island economy. Three years have passed and we still do not have a modern tax law that will help new businesses to survive and that will spread the tax burden equitably. Three years have passed and we still do not have a transparent foreign investment law that will allow our businesses to gain needed partners and financing. Three years have passed and we still do not have complete banking laws that protect Palauan depositors and meet international standards. Three years have passed and we still do not have a uniform commercial code that establishes consistent rules for private sector transactions. Three

years have passed and we still do not have a statistics law that permits us to evaluate our economic growth prospects and limitations. Three years have passed and we still have not passed incentive laws for the development of our economy. Ladies and gentlemen, for three years each and every one of these pieces of legislation has been developed and has been sitting before the OEK. Three years have passed and our legal mandates are still mired in the Trust Territory days. It is time to make the hard decisions, to take the courageous courses and to establish a legislative path that protects and provides opportunities for all Palauans.

II. State of the Republic

Before I review and analyze the specifics of the state of our national economy, I must once again mention that these discussions will follow the same basic format as in past years in order that our progress can be monitored from year to year. However, because we have developed annual performance reporting requirements under the new annual national budget process, I will not be highlighting Ministry and other Agency accomplishments in 2003. These are much more comprehensively set forth in these Annual Performance Reports and I could not do them justice in this speech. However, I would once again like to offer my thanks and sincere appreciation to the management and employees of the Executive Branch. Every year you get better at your jobs. It is my hope that the government is also getting better at providing you with the tools and direction that make your jobs more fulfilling.

1. Overview.

After the U.S. Stock Market crash, Tropical Storm Utor, the Events of 9/11, the war in Afghanistan, the war in Iraq, and the SARS epidemic, how is our economy faring? In one sentence, the state of the Republic is very promising. Finally, it appears that the Asian economy is resurfacing after the dreadful impacts of the Asian Financial Crisis. Finally, stock markets are beginning to once again demonstrate dynamic rises after the international collapse of 2000. And finally, Palau's tourism is once again showing dynamic signs of growth to match the recent advancements in the global and the regional economy. And Palau is prepared to reap the benefits of this economic up-turn.

Palau now has in place a Public Sector Investment Program that identifies necessary infrastructure. We have instituted a Cost Reduction Plan that will limit government growth and encourage private sector expansion. We have contained the cost of government over the past three years, so that we have greatly limited the negative impacts of the slow international, regional and local economy. We have created the National Environmental Protection Council (NEPC) and the Office of Environmental Response and Coordination (OERC) to ensure that Palau's environmental future will be incorporated into any economic planning and projects. We have established the Communications Information Technical Advisory Group (CITA) to identify and implement Palau's telecommunications future. We have established a working performance budgeting system that tracks the performance of our government agencies and that provides sound information and indicators to our country's decision-makers and permits them to make better decisions for our future. We have reorganized the government in order to make it more efficient and less costly. And finally, we have the Management Action Plan which coordinates all of the planning activities of the Executive Branch and which provides a cohesive vision for Palau's future.

2. Economic Data.

A look at Palau's Gross Domestic Product (GDP), which estimates all economic activity, both public and private, indicates that Palau's overall output is estimated to have grown by an average of 2% per year since 2000, in real terms (taking into account inflation). The low growth rates over the past few years reflect the adverse impacts of various international events that affected tourism, which is our major industry. The largest sector of the economy continues to be the public sector with an estimated 27% share or contribution to the total economy. Public sector spending, both for operations and capital improvement projects, is credited for sustaining our economy through the economic slow-down and uncertainties over the last few years. However, we cannot continue to rely primarily on the government if we are to minimize the negative impacts of external shocks on our economy. We have to diversify and increase the contributions of those sectors of the economy that have the potential to support sustainable growth such as agriculture, fisheries and manufacturing. In this regard, our policy of prioritizing as well as establishing the financing mechanisms to expand economic opportunities in these sectors are expected to significantly increase their contributions to our local economy and our growth prospects.

3. Tourism.

Despite the fact that the Asian economy failed to rebound during 2002 and 2003, Palau's tourism figures show some very positive signs. In 2000, approximately 57,000 visitors arrived on our shores. This figure dipped by 6% in 2001, but showed some strong resilience in 2002 with approximately 58,000 visitors. This 8% increase was realized despite the impacts of the post 9/11 events in the Middle East. And despite the events of SARS in 2003, tourism continued to grow to approximately 63,000, another 8% increase. Had SARS not occurred, tourism might have reached 70,000 last year. And early signs in 2004 indicate that this expanding tourist base will continue with a record setting January of over 8,000 tourists. This represents an almost 60% increase for our first month in 2003. The bottom line is that we should have more tourists in Palau in 2004 than at any time in our history. We must therefore take advantage of the revitalized U.S. and Asian economies to identify partners and to expand our tourism and hotel infrastructure. And we must insure that this expansion benefits all Palauans.

The revitalization of tourism in Palau is the result of the apparent revitalization of the Asian economy and the addition of new airlines. During the last three years, the Executive Branch has actively pursued these new airline options. Palau Trans Pacific Air (PAIR) began operations in Palau in 2003. This year, another new airline will begin operations. The new domestic airline, Palau Micronesian Air (PMA), which services regional transportation needs, will begin operations around mid-year. Initial services will be provided to and from Guam, Saipan, Australia and the Federated States of Micronesia. Future routes should include the Philippines and Japan. In addition, Japan Airlines continues to increase its charter flights to Palau and negotiations are on-going with the Philippines for direct flights. In this effort a new bilateral air agreement has been finalized. Flights should begin some time later this year. The Executive Branch is also pursuing bilateral agreement with South Korea and Hong Kong to expand our access to the Asian and European markets.

Of great significance to the willingness of new airlines to fly to Palau is the new Palau International Airport terminal building, which became operational in May of 2003. To ensure that we can take advantage of this new capacity, the Republic is negotiating a low interest \$15 million loan, through the Republic of China, Taiwan, to resurface the airport runway and to make additional improvements and expansions to the new terminal. Airport revenues will cover most of the costs of the loan. The loan will also consider the purchase of an 'Instrument Landing System (ILS), which will not only make our air transportation safer, but will also assist in bringing more air traffic to Palau. With this greater service capacity and competition, we hope to see the development of coordinated routes from Europe and the larger cities of Asia before the end of 2004.

In addition, the completion of several ongoing projects should also provide for expanded visitor related activities or tourism product diversification. The opening of the Cultural Performing Arts Center and its conference hosting capacity, and the planned deployment of additional Fishing Aggregate Devices (FADS) to support the Sports Fishing Industry later this year will further enhance the attractiveness of Palau as a visitor destination area.

It is time that we incorporate new tourism programs to take advantage of the strong economy and our expanded airline services. Tourism is truly the key to our future prosperity. If we put into place appropriate legislation and programs, we can expand not only the quantity of tourists to Palau, we can also improve the quality of our tourists. We should therefore look towards new markets, such as long-term tourists, who will enjoy expanded tourist activities like golfing, health salons, diving, and who will benefit from expanded health and education opportunities. A 'Silver-Hair Town Program' would be very appropriate in this scenario, permitting more elderly tourists who have gained wealth in their lives to enjoy extended stays in the Republic and to take advantage of Palau's expanded facilities. In order to accomplish this, we must change our immigration laws to permit longer-term stays and new residency statuses.

We must also expand sports tourism to take advantage of real opportunities, at the pro, semi-pro and collegiate levels. The large populations in Korea, Taiwan and Japan would be very ready for such opportunities if we develop the infrastructure and the laws to encourage such activities.

4. Construction Projects.

Not only will our tourism industry be vibrant in 2004; once again, we are moving aggressively to respond to our infrastructure and construction needs to support our tourism industry. During the past number of years, expenditures on public construction projects have permitted the Republic to survive the domestic impacts of the slow Asian economy. Now we can expect the construction industry to partner with tourism to stimulate the Republic's economic expansion.

As in past years, our good friends, the United States, Japan and the Republic of China, Taiwan, must be offered our sincere appreciation for continuing to recognize Palau's need to develop its basic infrastructure. While the Compact Road continues towards its completion, we also see the National Capital project entering its final phase. Early this year we should also see the completion of both the National Museum and a new Cultural and Performing Arts Center, both in time for the Pacific Arts Festival to be held in July of this year.

By late 2004 we will also see the initiation of a major Koror/Airai road rehabilitation project, funded by the Government of Japan. In addition, we should see the initiation of the Palau International Runway Repair Project.

In 2003, the CIP Office carried a relatively consistent project load of roughly 40 projects, as new projects commenced and as older projects were completed. Over the course of the whole year, the CIP Office administered a total of roughly 60 projects. In 2003, 19 projects were commenced, with a value of \$14 million. Already scheduled for 2004 are 17 new projects with a value of over \$22 million.

a. Current and New Projects

A review of the major projects currently underway or funded for construction in 2004, and their cost, includes the following:

The Compact Road	\$149.0 million	US
The Koror/Airai Road Rehabilitation	20.0 million	Japan
The Palau Int'l Runway Repair Project	15.0 million	ROC
The National Capital – Phase II Add Packages	13.0 million	ROP & ROC
The Peleliu and Angaur Harbor (Fishery) Development Projects	8.0 million	Japan
The Malakal Sewage Treatment Plant	4.5 million	US
The Airport Ngerikiil Compact Road Connection	3.8 million	ROC
The New Belau National Museum Complex	2.6 million	ROC
New Capital/Melekeok Sewer System	2.6 million	ROC
The Cultural and Performing Arts Center	2.5 million	ROC
The State Economic Stimulus Package	2.0 million	ROC
The Pacific Arts Festival Facilities Improvement	1.3 million	ROC
The Northern Babeldaob Water Dist System	1.1 million	ROC

b. Projects Completed in 2003

The CIP Office also completed 20 projects in 2003 at a value of over \$27 million. I would

like to compliment the Office on its diligent efforts to bring these projects in on time and on budget. I would also compliment the Office on its efforts to upgrade its capacity. Some of the projects that were completed include:

Phase II of the National Capital Relocation;
 The Echang Marina Dock Improvement Project;
 The PMA Road Paving Project – Phase II;
 The Malakal Natural Wastewater Treatment Park;
 The Ngarchelong Concrete Road Paving Project;
 The Kayangel Harbor Construction & Improvement Project;
 The Angaur Concrete Road Paving Project; and
 State Stimulus Projects in Aimeliik, Airai, Angaur, Melekeok, Ngaraard, Ngardmau, Ngaremlengui, Ngchesar, Ngiwal and Peleliu

c. Projects that Need Funding

Finally, I continue to work diligently to identify funding for a number of very important projects, as identified in the proposed Public Sector Investment Program (PSIP). Some of the key projects include:

A Comprehensive Solid Waste Disposal Management System	\$16.5 Million
The Rehabilitation and Expansion of Malakal Commercial Port	\$10.0 Million
The Improvement and Expansion of Wastewater Collection System in Koror	500,000
Cross-Island Roads-Babeldaob-Kokusai to Compact Road at Shimizu	500,000

d. Other ODA Projects

In addition to these regular Overseas Development Assistance (ODA) projects, we continue to negotiate with Saga University and the Japanese Government on a special project to establish a \$90 million Ocean Thermal Energy Conversion (OTEC) Pilot project that we hope can see some progress in 2004. The project is currently before the Japanese Parliament. We are also working with Japan to expand our tele-health and tele-medicine capacity to improve health care and education for our citizens through a \$5 million grant.

Very significantly, we have also successfully negotiated a \$5 million loan through the Republic of China, Taiwan to finance loans through the Palau National Development Bank. This loan will be used for housing and small business loans to assist our private sector community to expand. This funding will be used for priority sectors of the economy, such as agriculture, aquaculture and cottage industry projects relating to tourism.

e. Private Sector Projects

As reported in the last State of the Republic Address, a number of private sector projects are also on the immediate horizon. The new Royal Palau Hotel, located in Malakal, will begin construction in July of this year and should be completed by June of 2005 at a cost of \$20 million. The hotel will have 165 rooms, multiple restaurants and all quality hotel amenities.

Another very exciting project has just been reported to us, a new 5-star, \$40 million hotel and resort at an undisclosed location. The hotel will be financed by the Cathay Group in Taiwan and construction is anticipated in late 2004 or early 2005.

Palau's first 18-hole golf course should also begin construction within the next year. The Palau Aimeliik Golf Course is a \$30 million project, which will include 100 to 200 villas on 2.2 million square meters. The Golf course has been designed by Robin Nelson, world-renowned golf course designer who has won awards for developing environmentally sensitive golf courses throughout the world.

Another hotel of 66 rooms is also scheduled for Malakal. The hotel is owned by Sea Passion Corporation and will be constructed for approximately \$10 million. The hotel should be completed by October 2004.

The Malakal Marine Resort, with a price tag of approximately \$22 million, and its companion resort, the Ngerur Island Resort, with a price tag of approximately \$45 million, have been delayed but are still being planned to begin construction in late 2004 or early 2005.

Two other smaller local projects are also planned, the VIP hotel project in Ngermid, valued at \$3.5 million, which should be completed in July of this year and the PMIC Commercial Complex, estimated at \$2.5 million, which is scheduled to commence construction this year.

With the revitalization of the Asian economy, these and other private sector projects are available to Palau. However, as I have stated on so many other occasions, we must take responsibility for our private sector development by establishing the appropriate private sector friendly legislative environment. This means we need a modern and transparent foreign investment law, appropriate economic incentive laws, modern tax laws and revised banking laws that provide foreign investors the necessary comfort and assurances that Palau is ready to do business. Ladies and gentlemen, there is a competitive world out there, and if we really want to compete, we must play the game by the rules of the investor. What better time to do so than when the U.S. and Asian economies are regaining their momentum. We can no longer assume that foreign investment has and always will be available to us. Let us be realistic and recognize that international foreign investment over the last number of years has gone primarily to major countries such as China, and that the amounts of foreign investment have been steadily declining worldwide. Let us also recognize that until we amend our laws, we will continue to find back-door partners operating front businesses.

5. National Debt.

In terms of Palau's national debt, as I have already indicated, two important concessionary loans are being negotiated through the Republic of China, Taiwan. The first is a \$5 million loan to the Palau National Development Bank. Funds from this loan will, as I mentioned, go to local businesses and to local homeowners. The second loan, for \$15 million, will finance the resurfacing of our airport runway. Both of these loans comply with the Executive Branch policy that loans must only be taken where a strong revenue source exists

to make repayment, meaning that it has the potential to "pay for itself". We do not want to become a nation of debt. I plan to work with the OEK to develop a national Ports Authority that will ensure that revenues equal any debt obligations that arise out of the operation of the airport or the seaport. In the meantime we are also actively pursuing potential loan and grant financing, to improve and expand our seaport.

6. Trust Fund.

There is very good news regarding Palau's trust fund. As you are all aware, our trust fund must be invested in U.S. securities. With the fall of the American Stock Market in 2000, Palau lost a significant portion of the value in its stock portfolio. However, the American Stock Market is now on the rise once again, and our portfolio has made significant gains in the past year. In general terms, the Dow Jones Industrial Average has risen 25% in the last year. This follows losses of almost 40% in 2000, 7% in 2001 and 17% in 2002. This rebound of the American Stock Market is a reflection of the rebound of the world economy and should have a dynamic impact on our own economy if we take advantage of our opportunities. I should also mention that not only the American Stock Market is rapidly rising in value. Japan, our other major trading partner, had an increase in the value of the Nikkei Stock Market of 24% in 2003. Worldwide, all stock markets have increased in value by an average of 33%.

In 2002, our trust funds sunk to their lowest level of approximately \$124.5 million. This year, as of January, these holdings have already risen to \$148 million. As I indicated in our State of the Republic Address last year, we have now withdrawn \$5 million from our stock portfolio to fund on-going operations for the last three budgets. While these withdrawals were anticipated in the Compact of Free Association, we would be wise to limit such withdrawals in the future in order to ensure that, at the end of the Compact, we will have sufficient holdings to guarantee \$15 million withdrawals per year from such holdings to support our government expenditures until 2043.

7. Annual Budget.

I would now like to discuss the Republic's 2004 Budget. I am sure that you have all been reading articles regarding prior year obligations. I would like to clarify to you exactly what is happening and assure you that we will pay all vendors for government debts to the private sector. Due primarily to the SARS epidemic in mid-year 2003, the Republic's revenues were short of appropriated revenues by almost \$4 million. This shortfall was compounded by already weakened revenue collections from the economic slowdown associated with the war on terrorism and also from the reduction of the Alcohol Tax in 2002. Making matters worse, the SARS epidemic occurred at mid-year and we could not know the consequences of the epidemic until around August of 2003, only 3 months before the end of the fiscal year.

Faced with the significance of the SARS epidemic on our revenue collections, the government had two choices. We could drastically cut our government expenditures in the 3rd and 4th quarter of 2003 to match actual revenue collection trends that would have brought the government to a standstill or we could continue to provide programs and services at a reasonable level. I chose the latter course because I did not feel that our economy or our families could handle the impacts of drastic expenditure reduction measures that would have had to include public sector personnel cuts at the same time that our tourism economy and its support businesses were near the brink of disaster. I still feel that this was the only realistic choice. Palau's current economy is still simply too small to immediately swallow nearly \$4 million reduction to government expenditures.

For governments everywhere, the potential for revenue shortfalls is a continuing challenge that, in hindsight, might have been avoided. Unfortunately, in actual practice, this is often very difficult, if not impossible, to accomplish. It is just a fact of life that sometimes revenues do not reach expected levels. Even the best of revenue projectors cannot predict a worldwide medical epidemic or war. For example, the United States' overspent its budget in 2003 by billions of dollars. The real issue is how your government reacts to this reality in any given year and how it responds in subsequent years to realign revenues with cumulative obligations.

The law says that the government and its employees may not obligate and spend more than the amount that is budgeted to it in any given year. We did not spend more than was budgeted in 2003. In fact, the Ministry of Finance monitored and analyzed revenue collections in 2003 and implemented expenditure reduction measures that saved \$2.9 million, or 5 percent of the fiscal year 2003 budget. The analysis of revenue trends also identified the need to implement revenue enhancement measures as well. The revenue enhancement measures included the restoration of the alcohol tax rates, as agreed to in the Memorandum of Commitment between the Executive Branch and the OEK, which would have provided an additional \$1.3 million in revenues. Unfortunately, the tax measure was not implemented in time to be effective.

And in 2004, the Ministry has already implemented a spending plan that closely monitors actual revenue receipts from the beginning of the fiscal year and which limits expenditures below the level of the 2004 budget. Additionally, the Ministry continues to implement the Cost Reduction Plan developed in 2003, while exploring other innovative ways of containing the cost of government services.

Despite these efforts, the fact, my friends, is that cash flow problems will continue to occur unless Palau builds up its cash reserves. We should therefore put into place a mechanism that permits us access to cash in anticipation of the revenues that are owed to us but which have not been received. As I have been stating in each of my last State of the Republic Addresses, prior to this Administration, the Republic spent almost all of its cash reserves to cover operational expenditures. That is why I told you that we were entering a Non-Payday Weekend. As I indicated in my first State of the Republic Address, our budget expenditures increased by 20% between 1995 and 2000. In 1999, your government spent \$14 million more than it collected. In 2000, your government spent \$11.5 million more than it collected. Where did this money come from? It came from our reserves, which we have now spent. For example, in Fiscal Year 2000, we had available and expended \$21.5 million in cumulative investment earnings. As a comparison, in 2003, we only had available and expended \$700,000 in cumulative investment earnings.

Over the past three years, we have made a very significant effort to balance these revenues and expenditures because we knew that we had no other choice. And until the SARS epidemic, we were well on the way to achieve this balance without using any reserve assets, as had been used in the past. In other words, we started on a path to live within our

means. And we shall continue to do so.

What then do we do to strengthen our current cash flow problems? What we cannot do is pretend that we currently have the current assets to pay these debts or that we can pay the \$3.6 million shortfall entirely out of this year's Executive Branch budget. We are trying to strengthen our economy, not shatter it through such an unrealistic approach. We simply cannot wish our debts away. Or we can take a realistic approach and put stringent spending measures in place for 2004 throughout the government, while at the same time taking serious actions to increase our revenue base. We can also look into the possibility of issuing government bonds to cover revenues that are due, but not yet paid. We are seriously exploring the possibility of instituting such a program.

Finally, as I have said on so many occasions, we must not only initiate a responsible government budgeting system, we must also develop a creative approach to revenue generation. Only by expanding our revenue base while limiting expenditures will we develop our own emergency reserve system to respond to external crises, such as the SARS epidemic. To do this, we must pass the laws and initiatives currently before the OEK that will increase the flow of money into our local economy.

8. New Opportunities.

In the area of telecommunications, PNCC has lowered most of its long distance rates to \$.99 per minute. While this is certainly an improvement over past rates that reached as high as \$3.00 per minute, we still need to improve our international access through even lower rates. In this effort, the Republic will continue to work with PNCC in our negotiation with the United States to gain Universal Services and membership in the National Exchange Carriers Association. Our discussions on this issue with the United States are still stalled because they have been tied to immigration provisions that, in their current form, are not acceptable to Palau's leadership.

Finally, Palau has a significant opportunity to become a regional and international center for large foreign corporations and banks that service them. Currently before the OEK are three bills that would begin this process by providing lawful tax incentives to large Japanese corporations if they locate in Palau. These Japanese corporations conducting international business have, over the past decade, located in Singapore. However, because Singapore recently lowered its tax rate below the level required in Japan to avoid the application of Japanese taxes on their transactions, they are now looking for a new corporate jurisdiction that is conveniently located and that has appropriate tax rates under Japanese law. With the new proposed laws before the OEK, Palau would have a great opportunity to provide this new venue for these corporations. If we are successful in attracting these corporations, we will then move to establish the legislative environment to attract Japanese and other international banks to Palau, as well.

III. Oil Exploration

But let me make one thing very clear: There are no easy fixes. As we all know, whether in our personal life or in our government, easy fixes always lead to more problems. The foundations of a strong economy can only be developed through comprehensive planning and careful establishment of appropriate programs and legislation.

That is why I want to briefly talk to you about a Petroleum Act that is being proposed by the Olbilil Era Kelulau. Let me first say that I am not opposed to the development of our natural resources, such as oil and natural gas, if we develop such resources so that they benefit all of our people and do not harm our environment for future generations.

Because a private company from America has been lobbying various government entities in Palau to drill exploratory wells around Velasco Reef, and in order to ensure that we take the right course in pursuing oil and gas exploration, and recognizing that we have absolutely no oil and gas expertise in the Republic, I contacted the World Bank and requested technical assistance. The World Bank responded by sending an international expert in these matters. After studying Palau's oil and gas issue, the World Bank representative wrote a report and concluded the following:

- By industry standards, the Velasco Reef is not an industry hot spot: by this I mean that there are only two primary oil belts in the world and Palau is not close to either of them;
- Neither the National Government or the Government of Kayangel have any expertise in the petroleum sector or the environmental risks from oil exploration;
- Neither the National Government or the Government of Kayangel State have a legal framework for oil exploration that is in line with international standards; and
- Licenses issued in the past by the State and National Government fell well short of international standards in terms of environmental, social and economic protection.

The consultant went on to recommend that:

- An independent study be undertaken regarding Palau's petroleum potential;
- An independent environmental study be undertaken to clarify potential environmental issues;
- Jurisdictional issues between the National Government and Kayangel State be clarified and resolved;
- Public Information and institutional capacity and education be instituted; and most importantly
- A comprehensive framework be developed, after which investment opportunities for international companies could be pursued.

Realizing that this institutional framework was crucial to Palau's future development of its potential oil and gas resources, the World Bank offered another consultant to help develop a framework for oil and gas exploration. This framework indicated that the following three steps be followed.

First, three independent studies, and I stress independent, should be undertaken to determine the appropriateness of exploring oil and gas potential in Palau:

- A study of the potential oil and gas resources in Palau;
- An environmental study; and
- A socio-economic study, which would include an evaluation of capacity, institutional arrangements, and a comprehensive economic model.

Second, these three studies will provide the basis and design structure of an institutional framework, to include a Petroleum Code, a standard Petroleum Contract, and environmental and fiscal regulations.

Third, upon completion of the institutional framework, if it is determined that oil and gas exploration is reasonable, implementation and capacity building would begin in earnest.

This sounds to me like a very reasonable approach to follow, one that would guarantee that not only our oil and gas resources will be protected, but also that our environment will be protected.

I should also mention that the World Bank offered Palau assistance estimated at \$2 million to put this framework into place.

So how did the OEK initially respond to this very generous offer? First, they developed a Petroleum Act prior to undertaking any unbiased assessment and study. Second, they recommended, through their proposed legislation, to create a super 'Petroleum Authority' that completely excludes the EQPB from the process of oil exploration. Third, along with EQPB, the bill also excludes the Executive Branch from being involved in the process of oil exploration. Fourth, the bill excludes you, the public from involvement in the process by exempting actions of this Authority from the Administrative Procedures Act. Thus, there are no public hearings, no public input, no distribution of rules and regulations and no notification of meetings. Fifth, the OEK appoints and confirms its own Authority Board, once again excluding the Executive Branch from its constitutional role in our government. Sixth, the bill allows the Authority to define how state, national and authority revenues shall be divided. If there is a dispute, only the OEK can make a final determination regarding this revenue distribution. Consequently, the bill excludes the Judicial Branch from its constitutionally mandated involvement in the process.

I would ask you, does this sound like the best plan for the Republic? No studies, no environmental controls, no Executive or Judicial Branch involvement as provided for in the Constitution, and most importantly, no public voice on this very important issue? This proposed bill is very similar to another pending law that excludes the EQPB from reviewing state projects. Not even the states agreed to this proposed bill, recognizing that the states lack the capacity to properly undertake such assessments.

Fortunately, after a fourth visit by World Bank consultants this past week, the OEK has agreed that we need an expert review of this proposed bill. Hearings on the bill will therefore be suspended until we receive this analysis of the bill from experts at the World Bank. I applaud those members of the OEK who have decided to take this more prudent course.

It is certainly my hope that the bill will be revised after this independent analysis is conducted and that these revisions will take into account the long-term best interests of the people of Palau.

But let me make one thing clear regarding oil exploration in Palau. I will continue to work with those members of the OEK who share my view that Palau must take this issue seriously and take the steps that are necessary to protect Palau's economic and environmental future. I will therefore continue to demand that we institute a valid and reasonable process that permits unbiased studies of key issues, that ensures constitutional protections, and that involves the people in the decision-making process. I ask you to support me in my stand to ensure that only a law that provides these protections be permitted here in Palau.

Ultimately, if the OEK wants our support, then they must make us partners in this process. If, in fact, oil resources exist in Palau, they are certainly not going anywhere else. They will be here when we are ready and capable of exploring for and using them.

IV. Constitutional Amendment Initiative

I would also like to briefly talk to you about the choices that you, the Palauan people, have to make regarding the amendment of our Constitution. As you all know, I have put before the electorate five potential constitutional amendments. These amendments would

- Allow Palauan dual-citizenship;
- Require the President and the Vice-President to be elected on a single ticket;
- Replace the two-house legislature with a one house legislature;
- Require a uniform fee for OEK member compensation; and
- Limit the term for members of the OEK.

I put forth these initiative petitions because the people have expressed their concern over these issues for many years now. I felt that it was my obligation to give you, the people, the right to vote on these issues.

In response to these proposed initiatives, the OEK decided that they would put before the people the issue of whether to hold a Constitutional Convention. My friends, to put it as clearly as I can, we do not need a Constitutional Convention. Constitutional Conventions are very expensive. Constitutional Conventions confuse important issues with many other issues that do not need review. Constitutional Conventions are not required by our Constitution. If the sail on your boat is ripped, you do not put the boat into dry-dock. You just patch the sail. My fellow Palauans, let us just patch the sail.

The placement of this Constitutional Convention issue on the November ballot will merely cause confusion regarding the issues put forth in the Initiative Petitions, which are issues near and dear to the hearts of the Palauan people. I should add that the Council of Chiefs has, by official resolution, already agreed that we do not need a Constitutional Convention.

I therefore seek your on-going support in either convincing the OEK to withdraw Joint Resolution No. 6-96 calling for the Constitutional Convention, or in defeating this issue when you vote in November. We don't need to re-think our current Constitution, at the

cost of hundreds of thousands of dollars. We merely need to make minor adjustments that improve our current system.

III. Conclusion

Ladies and gentlemen, members of the OEK, for the past three years, your Executive administration has worked very hard to establish a stronger governmental foundation for our future economic growth. When the Compact of Free Association came into effect in 1994, we were all riding high and had more money than what we knew to do with. With this money, we expanded our government, instituted new programs and initiated a number of construction projects to build the physical infrastructure for our nation's future. However, in doing so, we spent more than we brought in and we depleted our cash reserves that were made available through the Compact of Free Association.

To respond to this reality, this Administration focused on consolidating our gains, realigning our expenditures with our revenues, expanding and improving the capacity of our workforce, improving our planning capacity and developing institutions that will permit us to anticipate the issues that expanded development will bring. We have also worked very diligently to identify new funding sources for our capital infrastructure. This has set the stage for the future reality that ultimately we will have to take responsibility for our own infrastructure needs. We certainly cannot depend solely on foreign assistance in the future to meet these needs. Most importantly, we have attempted to expand our options prior to the termination of the financial provisions of our Compact of Free Association in 2009. It is never a good idea to negotiate from a position of weakness. When we negotiate with the United States, we want to do so as equal partners.

Except for the shortfall that resulted from the SARS epidemic and other external events, we have effectively reduced our operational expenditures so that they almost match our local revenue capacity. While we are certainly not through with our fiscal consolidation, we are now in a position to look forward, within the context of a newly vibrant world and regional economy, towards the expansion of our private sector.

Many exciting initiatives should serve us well in supporting this expansion. In a brief period of time, we will complete our national highway and our national capital. We will also see the repairs of the roads in Airai and Koror, as well as the repaving of our national airport runway. We will have in place at least two new airlines servicing Palau and its regional partners. We may also see new airlines servicing the Philippines and Hong Kong in the near future. These new airlines will, of course disembark in our new airport terminal and on our new runway.

With our new Palau International Coral Reef Center, we will see Palau taking an ever-greater role in the preservation of our coral reefs, as well as reefs throughout the world. This role will bring more and more scientists from the world environmental community to Palau. We will also see the improvement of our Malakal Port. And through the current and future state stimulus packages we will see our state governments developing their own capacity to support economic development. Through new funding options made available to the National Development Bank, such as our recent \$5 million loan, we will see the start-up of more small and medium size businesses. And with our new membership in the Asian Development Bank, we will see expanded private and public sector technical assistance and grants to support both our national government and our states. And most importantly, will see very significant expansions in our tourism industry. Ultimately, Palau's success will be defined by tourism.

My friends, our future is unlimited. We need only the patience and the foresight to recognize that good things come to those who plan. Our environment remains the soil of our garden. Whatever we do, we must preserve the unique beauty of Palau so that your children and my children can look out on the ocean 50 years from now and see the same pristine seascape that we see today. We will not accomplish this through nearsighted legislation that assumes that environmental protection will simply take care of itself. I will do everything in my power to ensure that environmental assessment will continue at both the state and national level, on every private and public sector project that deserves such assessment. I hope that you will support me in this.

We will, in the very near future, finally see many of our dreams fulfilled, moving many of our families and our businesses to Babeldaob. Koror will always be the center of our country. But now we will have the space to return to our points of origin and to create new development options for our country.

If we carefully plan this movement, we will also see the beginnings of new industries. If the OEK completes the passage of the proposed international corporate legislation that is before them, we should also see large Japanese corporations, and potentially corporations from other countries, relocating to Palau to take advantage of our new tax and incentive regime. And with these large corporations, we will look towards a second phase legislation that will draw international banks to our shores. My fellow Palauans, in order to respond to external events such as the SARS epidemic, we must diversify our economy. If we continue in our current direction, we should see this diversification through the development of our agriculture and aquaculture sectors. To accomplish this, we must continue to develop our capacity and provide real financing options to our people.

And for the last time today, I will reiterate that to accomplish any of these great goals, and to ensure that the benefits of our growth go to the people of Palau, we must establish the modern legislative framework that will set us apart from our competitors. I truly believe that the sky is the limit for Palau. We must simply plan our future and have the patience to see our garden grow in a sustainable manner. As I am sure you will hear many times during the course of this year, all we need to do is 'Preserve the Best and Improve the Rest'.

Thank you very much for your support during the last three years. It has been an honor to serve you all.

