

Chapter 6

Managing the Public Sector for Results

6.1 Introduction

Public sector management rests on four pieces of legislation enacted as part of the economic reform. These are the Ministry of Finance and Economic Management (MFEM) Act, Public Expenditure Review Committee and Audit (PERCA) Act, Public Service Act, and Cook Islands Investment Corporation (CIIC) Act (Box 6.1).

The MFEM Act provides for detailed annual statements of the Government's financial position and its activities according to modern principles of budgeting. Updates of economic and financial conditions are also provided for. PERCA provides a safeguard against financial impropriety through its financial audits of government accounts and special-purpose reviews of the use of public funds. Heads of ministries operate under performance-based contracts which the public service commissioner oversees, who also has a role in establishing and overseeing the public service. CIIC was established with responsibility for the overall management of public enterprises and other public assets.

**Public sector
management
has been
modernized**

Box 6.1: The Pillars of Public Sector Management

The MFEM Act of 1996 specifies in considerable detail the process of budget formulation, fiscal disciplines that the Government must adhere to, and information that must be made public and presented to Parliament. Most significantly, the MFEM Act requires the Government to keep operating expenses within the limits of the government's internal revenues until debt levels are reduced and to publish statements of its economic and fiscal strategy in advance of budgets being drawn up.

The PERCA Act of 1996 created an independent committee appointed by the Queen's representative in the Executive Council (i.e., effectively the Cabinet) endowed with wide powers to review all aspects of public finance. The purpose is to ensure transparency in national and local government bodies. It also provides for the adoption of "generally accepted accounting principles" throughout the Government.

The Public Service Act of 1996 defines the powers and responsibilities of the PSC and senior public sector managers. Significantly, it gives heads of ministries the power and responsibility to staff and manage their departments according to "good-employer" principles to achieve defined outputs integral to their own performance contracts. The intent is to free senior managers from undue political interference—though, for constitutional reasons, heads of ministries are appointed by the Cabinet.

The CIIC Act of 1998 provides for the control and management of government assets and undertakings, subject to the specific objectives of the efficient management of assets, privatization, and a requirement to be socially responsible.

CIIC = Cook Islands Investment Corporation, MFEM = Ministry of Finance and Economic Management, PERCA = Public Expenditure Review Committee and Audit, PSC = Public Service Commission.

Financial management has improved

The main achievement of the modern management system established under this suite of legislation has been a substantial improvement in the quality of financial management. Internal management reports are prepared regularly; almost all expenditure is on budget; all assets and liabilities, including contingent liabilities, are identified; public disclosure of the financial position is good; audits are conducted timely, and most concerns they raise are minor; and expenditure is generally in line with approved funding. The improvements have been achieved across the public sector, including in public enterprises. In stark contrast to the situation 10 years ago, the Government now has in place one foundation of an effective and efficient management of public resources.

The progress that has been made is most readily evidenced by the substantial improvement in the Government's financial position. The fiscal position was unsustainable a decade ago. Now, the Government is almost debt free and the fiscal year (FY) 2007 budget was able to afford a significant easing of the tax burden by removing most import duties. It is also evident in the improved alignment and harmonization of donor funds, as initiated by the New Zealand and Australian aid programs.⁹⁸

**The gains
are readily
apparent**

This chapter examines the opportunities for continuing to improve the performance of the public sector.

6.2 A National Perspective on Service Standards

As more people experience life elsewhere, in Rarotonga and in New Zealand, their expectations of service quality can be expected to rise. For example, the community generally aspires to the same standard of teaching and medical care as is available in New Zealand. Even mundane aspirations can be costly to address. For example, community discussions in Mitiaro centered on the need for a school bus to transport children to and from school—though they all live close by—so that they would not have to use umbrellas or towels, and on the unsatisfactory situation of having composite classes and a principal who had both teaching and administrative duties. Responsiveness to the community is an important element of people's aspirations. For example, in Mitiaro, there were complaints about the slowness of people in authority to respond to community requests.⁹⁹

**Expectations
of service
standards are
rising**

One key issue to be faced in the use of public resources is the standard of service to be supplied on different islands.

**Standards are
lower in the
outer islands**

⁹⁸ As presented in the Paris Declaration (High Level Forum on Aid Effectiveness [2005]).

⁹⁹ Community consultative meeting, Mitiaro, 10 August 2006.

It is important that the economic gains from development be shared among Cook Islanders through improved services, including in the outer islands. Nevertheless, most of the outer islands can never expect to achieve the same opportunities or standards of service as in Rarotonga, the expense of which would be prohibitive. Even the understandable goal of achieving New Zealand standards in Rarotonga is unobtainable, not least because the goal is a moving target as New Zealand standards themselves rise.

Agreement on target standards is important

Planning and budgeting the use of public resources would be helped by agreeing on an acceptable standard of services that all the outer islands can realistically expect. Ideally, the community should understand and accept this standard broadly despite falling short of what is achievable in Rarotonga.

In setting standards, it is important to recognize that the potential increase in economic activity from each dollar of expenditure will tend to be much larger in the main centers than in the outer islands. The crowding effects of a large public sector and the shocks arising from the mismanagement of the 1990s have stymied the prospects for sustainable private sector growth in most outer islands. These prospects were already weak given the islands' remoteness, small populations, and shallow resource bases, and their long-term sustainability was unclear even without the mid-1990s shocks. The demonstrated inability of the outer islands to respond to the improved private sector environment in the same way that Rarotonga and Aitutaki have is firm evidence of the absence of prospects for economic sustainability. Despite the best intentions, in the economic environment of most outer islands, it will be difficult to expect good returns from investment and expanded services justified on economic grounds (i.e., as the basis of increased or more productive commercial activities).

Costs will rise in the outer islands

As time passes and the outer islands' populations decline, the role of most outer island governments is narrowing to providing basic services to the small

communities that choose to remain. An option available to outer islanders in search of better services is to move to Rarotonga. Allowing outer islanders to exercise this choice may be preferable to spending considerable public funds seeking to slow their seemingly inevitable departure from the outer islands. The community's resources may be better used targeting instead a slowdown in the rate of departures from Rarotonga and Aitutaki to overseas, so that the long-term prospects of these centers and the country overall are strengthened.

These arguments suggest that it is more important to enhance services and employment opportunities in Rarotonga and Aitutaki than on the increasingly dependent outer islands. Funding per head for the outer islands is already substantially above that of Rarotonga. A further widening of this gap may carry a significant cost in terms of opportunities lost in the main centers.

The main centers warrant higher standards

6.3 Providing Public Infrastructure

The tight fiscal position required post-reform to reduce very high-debt levels was at the expense of the country's physical infrastructure. A backlog of works has accumulated in the areas of roads, ports and harbors, electricity, water, liquid and solid waste management, telecommunications, and government buildings. Nonfinancial factors have contributed to the backlog of works.

Infrastructure has been underfunded, and an infrastructure plan is needed

The absence of a clear plan for infrastructure has (i) made it difficult to agree on a schedule of works; (ii) allowed poorly designed projects to proceed; (iii) led to cases of a poor choice and prioritization of works (e.g., the construction of new public buildings without sufficient funding for operating costs or maintenance, the construction of two hospitals in the small island of Manihiki, and the provision of health facilities on outer islands for functions no longer undertaken); and (iv) created an environment where

political gain can be placed before public need.¹⁰⁰ Maintenance has been less than optimal, both of works completed and of the equipment used for construction and installation, such that value for money has fallen below its potential.

The policy environment has room for improvement, including devolution

The policy environment has also been an important factor. Notably, user charges have generally been absent or below operating costs and contributed to funding shortfalls and the inappropriate use of the infrastructure (e.g., overuse, high leakage).¹⁰¹ In addition, the sharing of responsibilities between the central Government in Rarotonga and the outer islands appears to have played a role in weakening infrastructure provision.

In the outer islands, island councils and administrations are responsible for the operating expenditure of infrastructure on their islands, which is mainly funded by the central Government but also by internal revenue (e.g., fees and charges). Responsibility for capital expenditure (and public infrastructure in Rarotonga) rests with the central Government in cooperation with donors. Some island administrations lack sufficient technical or managerial capacity to operate or maintain infrastructure, and they are at risk of allocating too little of their funds to maintenance. It is also unclear whether the governance environment that has developed on some least-populated outer islands is suited to its responsibilities. Indicators of these problems are provided by the closure of the public water system in Atiu and the recent transfer back to Rarotonga of responsibility for Aitutaki's electricity supply. Expenditure on outer island infrastructure has fallen below available funding despite the availability of donor technical support in project preparation.

100 See, for example, Financial Secretary. 2006.

101 For example, free reticulated drinking water is supplied to all users on Rarotonga. This promotes inefficient and excessive use of water, reduces funds available, and poses disincentives to improve water quality or repair the distribution system. Leakage rates are currently some 70%. Large water users are the resorts (some 40%), which generally must install their own treatment plants to improve water quality and agricultural irrigation.

The Government's strong financial position means it is now well placed to fund infrastructure works. The improved financial capacity is timely as economic expansion has led to potential bottlenecks in the infrastructure network, risking growth and public safety. Roads, airports, water and sewerage systems, and the electricity network are all candidates for higher capital and maintenance spending.

The financial capacity exists to rebuild

The road network in Rarotonga is a priority. It has yet to be upgraded to match the increased usage arising from broader vehicle ownership and higher tourism demand, and this creates congestion and a worsening incidence of serious accidents, including fatalities. Periodic health problems arising from pollution in Rarotonga's lagoon have provided an early warning of the potential cost of inadequate provision for the higher demands placed on the environment arising from sustained tourism growth. Such episodes may increase in frequency if solid and liquid waste-management infrastructure is not upgraded, and if complementary improvements to land-use planning are not put in place. Tourism development in some parts of Rarotonga and in Aitutaki has been curtailed by insufficient water supplies, and both islands are susceptible to water shortages during dry periods because storage systems have little capacity.

An Infrastructure Master Plan (IMP) has been prepared to help guide future infrastructure management. The plan's emphasis is on the reconstruction of cyclone damage and preparing for future adverse weather events. IMP covers transport (by air, sea, and land); water supply; sanitation; solid waste management; energy; and telecommunications infrastructure to be funded from the budget. It identifies the potential demand for new infrastructure and provides a schedule of works for the next 20 years, broken into years 1–5 and the longer term. The plan also addresses relationships between agencies and the capacity to undertake public works.

A 20-year IMP is ready, at a cost of NZ\$237 million

The preliminary estimate is for a total cost of NZ\$237 million over the 20 years of the plan (in 2006 prices).¹⁰² This implies an annual level of expenditure approaching double that was achieved in recent years and compares to total budgeted expenditure for FY2007 of NZ\$100 million and a gross domestic product (GDP) in 2005 of NZ\$260 million. In preparing the plan, only the first 5 years of expenditure were prioritized and subject to a cap of approximately NZ\$50 million. Priorities were established based on evaluation by multiple criteria, adjustments to recognize urgent technical needs, and approval of donor funding. Prioritization resulted in the identification of 44 projects for the first 5 years, with a further non-prioritized 42 projects identified for years 6–20 (Box 6.2).

The arguments presented above regarding the allocation of funds to the main centers versus the outer islands test the focus of IMP in the outer islands.¹⁰³ The proposed allocation of 60% of funds over years 1–5 appears out of line with the 19% of the population and 14% of formal employment located in the outer islands in 2001 (which would have since declined) and the relatively weaker prospects in the outer islands.

Prioritizing works is critical

This observation highlights the importance of the process for prioritizing works. IMP recognizes that its proposed prioritization will need to be frequently revisited to factor in (i) changing circumstances such as cyclones, new development proposals, or technological advances; (ii) building works and other infrastructure beyond the scope of IMP; and (iii) evolving political imperatives and the availability of financing.¹⁰⁴ MFEM has only recently initiated work to integrate IMP and its newly developed project planning cycle. The need to have a workable prioritization process is thus not a one-off requirement, but ongoing.

102 Note that this excludes infrastructure to be funded by public enterprises; government buildings; and infrastructure for the health, education, agriculture, fisheries, and marine resources sectors.

103 The terms of reference of the Infrastructure Master Plan specified that the plan should emphasize the outer islands.

104 ADB. 2006b. Volume 5, 236–240.

Box 6.2: Infrastructure Needs Identified in the Infrastructure Master Plan

Marine transport has the highest capital cost requirement, at 26% of the 20-year budget. In the short term, the major need is to reconstruct the outer island harbors damaged by cyclones. Construction costs are high, but the facilities should operate for many decades. In the long term, the high capital cost is for improvements to Avatiu harbor and the protection of Rarotonga's north coast from the airport to Avarua.

Roads have the second-highest cost requirement, at 21% of the 20-year budget, because of the high cost of improving the inner ring road in Rarotonga and roads in Aitutaki and the outer islands in the short term, and the cost of rehabilitating the main ring road in Rarotonga in the long term.

Energy priorities include rehabilitating power systems in the outer islands. The high cost, at 19% of the 20-year budget, results from the need to construct a second power-generation plant in Rarotonga, which is assumed to require budget funding. Total energy sector costs would be much higher if Te Aponga's capital improvement program were included, but it is excluded as it is assumed to be internally funded.

Air transport priorities are to improve the Northern Group airports to enable a Saab 340 service and build a new departure area in Rarotonga. Longer-term projects are to install cyclone protective measures in Rarotonga and continue improvements to the outer island airports (13% of the 20-year budget).

Water supply improvements are needed on all islands and have a high priority, at 10% of the 20-year budget. The capital costs of individual projects tend to be less than the civil works costs associated with harbor or airport improvements. Over the 20-year period, operating and maintenance costs are proportionately higher.

Sanitation improvements are needed on all islands, with highest priority given to treatment plants in Rarotonga. Overall capital costs are not as high as other sectors, so it should be possible to achieve all targets for the sanitation sector with 5% of the 20-year budget. A similar situation applies to solid waste management, at 1% of the 20-year budget.

Providing emergency management centers in all islands is one of the highest priorities and has the fourth highest capital cost in the short term, consuming 4% of the 20-year budget. Equally, maintenance facilities have to be provided in all the outer islands in the short term to improve the island administrations' capacity to maintain all other infrastructure (1% of the 20-year budget).

In the short term, about 60% of costs are for projects in the outer islands, excluding Aitutaki, with only 32% in Rarotonga and 8% in Aitutaki. This reflects the high capital costs of harbor and airport projects.

In the longer term, projects in Rarotonga represent 67% of the total capital cost, in Aitutaki 12%, and the outer islands 21%. Several projects such as coastal protection, road rehabilitation, and harbor improvements involve high capital costs and these will require staging over several years.

Source: Asian Development Bank. 2006. Volume I, 21–23.

Simple and adaptable processes work best

A prioritization process will enjoy the most success if it is simple to apply and if the results can be assessed and understood by the broader community. Ideally, the community should be engaged in identifying and selecting works. This is likely to be so even if community engagement comes at the expense of not getting what experts identify as the “right” decision every time. In practice, there is often a tendency to adopt too sophisticated an approach to identifying and selecting a project. While this may initially produce better results, particularly when supported by early enthusiasm and technical assistance, it can quickly become unworkable and ultimately fail to strengthen decision making. In the worse case, complex processes can become a tool to legitimize decisions that are technically poor or lack transparency and accountability. It will be important to monitor the effectiveness of the prioritization process adopted and to tailor it as necessary to the local environment and available resources.

Many issues require a whole-of-government response

The bureaucratic weaknesses that have contributed to the current situation are key challenges to be faced in improving the provision of infrastructure. While the lack of funding has been an important cause of shortcomings in infrastructure, it has not been the only cause, and more than extra funding is required. Bureaucratic weaknesses are in the relationships between agencies, such as between outer island administrations and the central MOW, and in management within agencies. IMP presented proposals for reviewing agency roles and capability, including increased technical support for the outer islands from MOW and increased private sector involvement.¹⁰⁵ In some cases, IMP presented options but declined to present recommendations, sensibly recognizing the importance of finding locally owned solutions.

One proposal put forward to overcome capacity constraints is for the Aid Management Division of MFEM to

105 ADB. 2006b. Volume 3 provides a detailed discussion of current arrangements.

accept responsibility for project management. While this is a practical short-term response to shortcomings in agencies, it would be preferable to build the capacity of sector agencies so that, over time, they can accept more responsibility for managing their entire budget, leaving the Aid Management Division to concentrate on its core business. This highlights the need for capacity building in the use of funds to go hand-in-hand with increased expenditure.

In moving forward, it is important to look beyond a sector-based response to problems that are cross-sectoral and may require a deeper whole-of-government reform than can be envisaged in a sector plan. Shortcomings in providing infrastructure tend to be dimensions of wider challenges, such as ensuring a result-oriented public service, the financial and managerial independence of public enterprises, and finding a sustainable response to outer island governance issues.

The best solutions are likely to be found in outsourcing works to the private sector competitively. Outsourcing can extend from construction to maintenance and, in some cases, take the form of asset sales. Outsourcing is an opportunity for public sector agencies to focus their efforts on planning and supervision, with day-to-day functions undertaken by agents able to achieve a stronger drive for efficiency. The main infrastructure needs are likely to be in Rarotonga and Aitutaki, and the private sector on these islands is now strong and deep enough to be engaged innovatively. Private-public partnerships are, for example, well suited to many of Rarotonga's infrastructure needs in cases where privatization is considered inappropriate.

The private sector would need time to build its capacity to meet existing needs, but the experiences of other countries in the region have shown it possible. This is particularly the case where a sufficiently large and lengthy program of works is in place to make it viable for international firms to develop local partnerships. The Cook Islands is now well suited to committing to such a program of works. The potential for

The private sector has a key role

Long-term commitments are helpful

private sector engagement is not great in the outer islands, but the potential is nonetheless there through, for example, packaging works across islands so they are viable propositions for contractors, or outsourcing some routine functions such as maintenance to permanent local providers.

The aim is to minimize the cost of infrastructure

Contracting out works best when the objective is to provide infrastructure at the lowest cost, subject to meeting technical standards. Attempts to favor local suppliers of infrastructure to develop the private sector are generally misguided. They add to the costs of infrastructure—costs that have to be borne by other sectors—and can be expected to reduce community returns, rather than maximize them. Government support for the private sector is best provided through low-cost infrastructure and a favorable enabling environment for all businesses. Targeted support for local businesses is an inferior approach to private sector development. The experience of the Cook Islands tourism industry illustrates how a sustainable, vibrant private sector can and will develop in a highly competitive environments.

6.4 Raising the Quality of Public Expenditure

Progress has been made in the quality of public expenditure, underpinned by solid auditing

Key Achievements So Far. Important progress has also been made in improving the efficiency and effectiveness of public expenditure. The annual budget process requires ministries to prepare budget submissions that are scrutinized for potential improvements by the Cabinet and MFEM, and efforts are afoot to make the process more sophisticated as agency capacity allows. Capacity has been built through modernizing the financial management system and improving corporate planning that is overseen by the Public Service Commission (PSC), with attention paid to staff training.

Forming a budget committee of outside parties to engage in the budget process has emerged as an important initiative. The reports of the committee are notable for

their vigorous analysis of agency budgets and performance, and they have considerable standing in the process and in the Cabinet's final consideration of the proposed budget. Efficiency and effectiveness are also boosted by the practice of conducting publicly available, special-purpose reviews of key issues, recent examples of which are the outer islands' funding, health management, and police force funding and operations.

The budget process is greatly strengthened by the activities of PERCA, which has a solid record of providing forthright, detailed assessments of the use of public funds. PERCA has been prepared to go public identifying inappropriate practices at the most senior levels of the Government and the community. Areas subject to PERCA's review include the actions of ministers, accounts of ministries, sale, or attempted sale of government assets, and donor-funded projects. The key limitations of the audit process have been the 2–3 year gap in the complete submission of public accounts for audit, which can delay PERCA's work until well after events have taken place, and the discretion provided to Parliament regarding when PERCA's reports are tabled or responded to. Imminent actions to improve financial management systems are scheduled to narrow the gap in the submission of public accounts to less than 1 year. The scope and standard of public disclosure achieved through the Cook Islands audit are probably now the highest among Pacific island nations and approaching those achievable by the Cook Islands' larger neighbors.

Sector Priorities. Rising community aspirations in the face of government revenue's declining share of GDP require a clear sense of priorities if expenditure is to focus on community needs. Prioritization is at the heart of public expenditure management but is inevitably difficult as it requires saying no to some proposed activities. For the Cook Islands, economic priorities are likely to be economic infrastructure, education, and health. An infrastructure

**Priorities
need to be
clear**

backlog needs to be addressed; considerable potential exists to raise education standards (and doing so is important to meeting the needs of the economy); and the health system faces the challenge of rising incidences of noncommunicable diseases.

Health, education, and infrastructure are high priorities

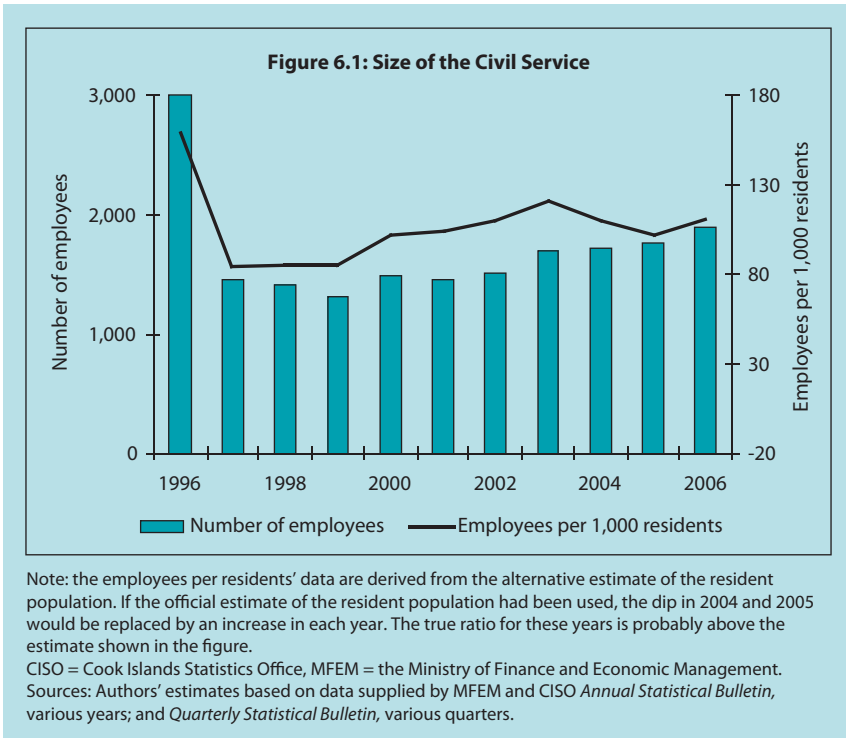
In health, reallocating the sector's funding, notably from curative to preventative health care, offers considerable potential to get better value for money. There is also some potential in education to reallocate the sector's funds toward primary and secondary education. However, the potential to upgrade education standards, and the economy's need, are so great that the emphasis may need to be on increasing the sector's share in total expenditure. For physical infrastructure, a larger share of expenditure is required given low current levels of funding.

Welfare and wage payments are low priorities

Low-priority areas of expenditure will need to be trimmed if funding is to be increased for priorities. Welfare payments, which are large and poorly targeted, provide some of the most likely sources of future savings. Savings may also need to go beyond the functional level to the economic composition of expenditure. In this respect, the key is likely to be control of the wage bill so that expenditure can be shifted to capital and maintenance costs.

The mix of expenditure can be improved

The Wage Bill. The number of public sector employees has grown considerably since the cuts of the mid-1990s. There were 3,200 employees in early 1996. Numbers had been cut to 1,500 by early 1997 and fallen further to 1,320 by mid-1999, but then began to rise and had reached 1,520 by mid-2002. There were 1,900 public servants by mid-2006. An upward trend is also evident in the number of public servants per 1,000 residents (Figure 6.1). The growth is explained in part by an increase in part-time employment in the outer islands, apparently motivated by the aim to spread the cash incomes available from island administrations. It also reflects a general expansion in the civil service.



The significance of these estimates lies in their consequences for the mix of expenditure. These were presented in the 2004 half-year fiscal update:

“In the past (particularly in the early 1990s), there has been a tendency for personnel costs to increase at the expense of purchases of goods and services. This has meant Government employees have had insufficient resources to perform their tasks efficiently, with negative consequences for the delivery of Government services.”

The ratio of Government personnel costs to GDP is estimated at 13.7% in FY2007/08, and is forecasted to increase as a result in rises in CPI and numbers of civil servants. By contrast, expenditure on recurrent purchases

of goods and services has fallen from 8.2% of GDP in 2001–2002 to a budgeted 6.3% of GDP in 2004–2005 and further to 5.6% in FY2007/08 estimates.

Public service has grown and may squeeze out other expenditure

Hence, in a period of fiscal restraint, excessive growth in personnel costs has evidently squeezed the level of funding available for purchases of goods and services. While it is difficult to measure, this has likely impacted on government service delivery. It is important that growth in personnel costs be constrained to free up resources for spending on necessary goods and services and on development activities.¹⁰⁶

The share of public expenditure on wages is set to rise slightly

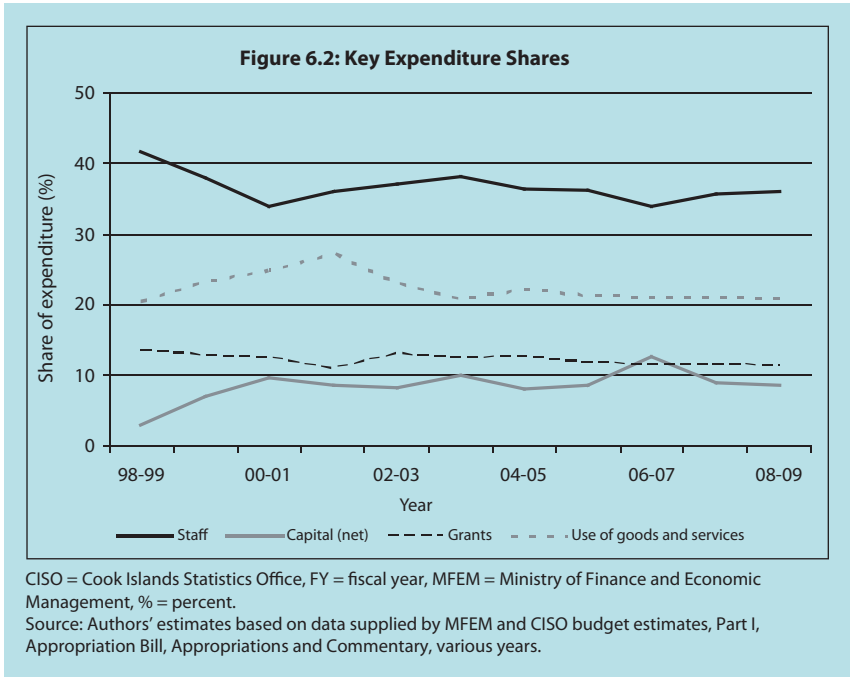
These adverse impacts were noted in 2004 but have yet to be corrected, and a solution is not yet in sight. The FY2007 budget projects that the ratio of expenditure on staff to GDP will fall over the medium term. But a projected decline in revenue, mainly from a fall in customs and duty rates, requires that expenditure, as a share to GDP, be trimmed across the board. The result is that the share of expenditure spent on staff costs is projected to rise slightly over the medium term and stabilize for other key expenditure items (Figure 6.2). One implication is that staff costs are likely to remain a barrier to the shift in expenditure toward capital and maintenance needed to recover from the backlog of public infrastructure works.

Funding varies markedly across islands

Inequities among Islands. The regional distribution of expenditure could be improved. A 2006 MFEM review of central Government funding for island administrations identified significant differences in the level of funding per head across islands. Most of this funding is provided for operating infrastructure, including energy, as this is the main function still retained by island administrations. The exceptions are the Rakahanga and Palmerston island administrations, which also fund health and education. Large variations in funding across islands extend to the

¹⁰⁶ MFEM. 2004, p. 20.

distribution of health and education spending, which is funded directly by the central Government on most islands.



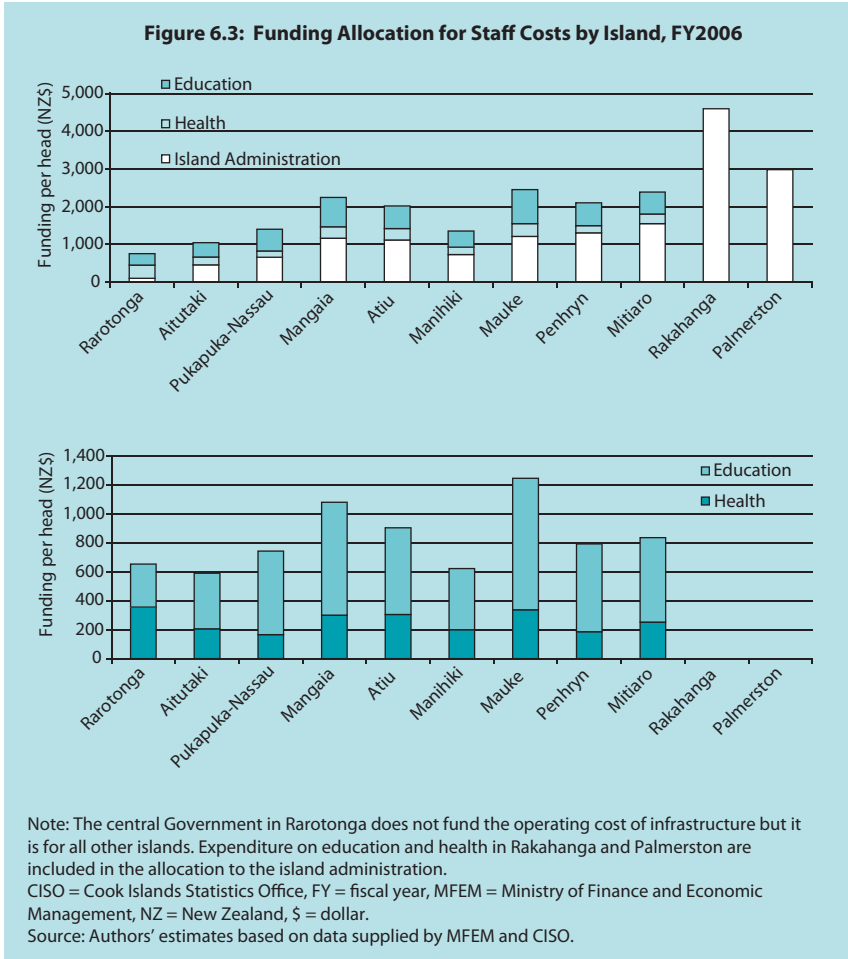
This is shown by Figure 6.3, which reports central Government funding for staff costs per head for island administrations, education, and health. These estimates are prepared on a broadly similar basis and so can be compared to assess equity in providing essential public services.

Outer islands funding per head is high

In total, funding for outer island staff costs for education, health, and island administration vary from NZ\$1,050 per head in Aitutaki to NZ\$4,600 per head in Rakahanga.¹⁰⁷ The average for the outer islands of NZ\$1,590 per head is

¹⁰⁷ The estimate for Aitutaki excludes any staff subsidy paid by the central Government for airport maintenance and cleaning. These activities are undertaken by public enterprises in Aitutaki but by island administrations elsewhere.

double the allocation to Rarotonga, which is estimated at NZ\$760 per head.¹⁰⁸



108 The estimate for Rarotonga includes (i) all health personnel on the island (except those for administration and policy advice and the nursing school), who also support outer islands patients referred to Rarotonga; (ii) the Internal Affairs outputs related to civil services, disability, youth and sports, gender and development, and Rarotonga local government; and (iii) the work outputs related to road works, water works, and waste management. It excludes any staff subsidy for functions that public enterprises undertake (i.e., energy or airport maintenance and cleaning) on Rarotonga.

There is no obvious public policy rationale for these variations in funding. Islands with smaller populations tend to receive more funding (Figure 6.3 is ordered by population size). As a general principle, higher funding for smaller islands is defensible because unit costs may be higher in small populations, as some costs incurred in service delivery are fixed regardless of population size. But the range of the variation between the largest and the smallest islands appears too high. Moreover, some islands appear to miss compensation for their small size, suggesting that the principle is not in fact broadly applied. For example, Penhryn has about half the population of Atiu but the two receives a similar level of funding per head. Moreover, there are large variations in the allocations for islands of similar populations. For example, the allocation to Mangaia is 60% above that of Pukapuka–Nassau, though their populations are similar.

**Smaller islands
tend to receive
more**

These observations on the inequities among islands are based on staff costs. But they can be expected to apply to other costs of the three sectors, as these allocations tend to follow patterns established in staff costs (e.g., the observations also apply to the distribution of the total appropriation to island administrations).

Similarly, there is no obvious development rationale for the variation between islands. Generally, Northern Group islands are seen to be the most disadvantaged but, as a group, they are relatively poorly funded. The funding differences may in fact be a key factor behind the relative disadvantage facing the Northern Group.

**The dis-
advantaged
receive less**

It is significant that no formal mechanism exists to compensate the Northern Group for their remoteness. In some countries, regional allocations are based on simple formulas that proxy for the effect of disadvantage. For example, for many years, allocations to Papua New Guinea's provincial governments were based not only on population size but also on land and sea areas. This provided some

compensation for those provinces with larger areas to service, and hence, relatively higher-transport costs.

**MFEM is
reducing the
inequity**

Some inequities apparent between islands will reduce because of the recent MFEM review, which proposed a gradual realignment of funding for island administrations commencing in FY2007. But the realignment does not necessarily go far enough to achieve equity in funding. The review was based on an initial broad assessment of need that did not specifically address the lower standard of living on some islands.¹⁰⁹ The recommended funding was also based partly on the existing standard of service, such as whether an island has sealed or unsealed roads and the value of equipment to maintain. While this is a pragmatic approach, it has the disadvantage of potentially locking in, rather than correcting, existing inequities. Moreover, the realignment does not address inequities in other central government funding, notably on education and health, or ensure that other expenditure, such as capital expenditure on infrastructure, will be allocated equitably.

**Deliberate,
planned actions
are required
for pro-poor
orientation**

Achieving a Pro-Poor Orientation. Achieving a pro-poor orientation in government expenditure rests on finding ways to reduce general or particular forms of disadvantage by ensuring more equitable access to services and welfare payments. This requires that patterns of disadvantages be identified and addressed through specifically targeted public policies and programs that favor the poor or disadvantaged, and that the necessary data are collected and analyzed to monitor progress on reducing disparities. It also requires that bottlenecks to improved service delivery be identified and addressed. It further requires that citizens have a voice in determining the nature and quality of services for their community and effectively demand better services from their government. Finally, it requires that explicit national and sectoral policies be implemented effectively and not

109 The review recommended a comprehensive review of the funding methodology be prepared for the FY2010 budget (MFEM 2006, p. 25).

undercut by implicit but hidden policies (e.g., through the neglect of plans when agencies conduct business as usual).

No formal system exists in the Cook Islands for targeting the disadvantaged other than loosely through welfare payments. There is almost no systematic analysis to identify the disadvantaged, their needs, or means to address their needs. Because of the widely held but not necessarily correct perception that health, education, and living standards are good throughout the Cook Islands and that there is little poverty, poverty reduction does not figure prominently in government plans and policies.

No formal targeting of poverty exists

An emphasis on equity, however, has long characterized public policy, especially in access to basic services such as health and education, and in the development of the outer islands. This emphasis on equity has done much to raise the quality of public expenditure. But more could be done to focus more sharply on the disadvantaged. For example, as a group, the outer islands receive a relatively high level of funding, and this has done much to address the disadvantages they face. However, the more disadvantaged islands, notably the Northern Group, lack the special attention they appear to warrant. They receive less funding, rather than more, despite their disadvantage. In addition, the absence of welfare payment targeting means the system contributes less than it should. Its potential contribution is large, as welfare payments represent more than 2.5% of GDP and 8.0% of total expenditure.

Equity warrants stronger emphasis

6.5 Refining the Revenue System

Good progress has been made on the revenue side of the budget, with the tax and customs system modernized during the economic reform. A modern tax system was adopted, centered on a progressive income tax and flat-rate VAT. Tax rates have been kept reasonable and stable, and attention has been paid to maintaining the simplicity of the system. The improved design corrected many inefficiencies and inequities

The revenue system is well designed and administered but still has room for refinement

in the old system. Moreover, over time, improvements have been made to administration and compliance, further raising the performance of the tax and customs system.

Removing penalty tax rates on second jobs is warranted, as is increasing user charges

The performance of a revenue system is normally judged against criteria of efficiency (which relates to the distortions imposed on economic activity), equity, administration cost (for both taxpayers and the Government), and revenue adequacy (which normally relates to the stability of revenue and the share of income and expenditure captured). Some opportunities remain to improve the performance of the revenue system against these criteria, notably through the following:

- Phased removal of the remaining protective tariffs, mainly because of the efficiency costs they impose, was discussed in Chapter 5.
- Early removal of the high tax rates that apply to second jobs are inequitable, as people earning the same income can pay different amounts of tax, depending on whether they have one job or more. An equitable outcome would be one where the tax paid is equal. The high tax rates are also inefficient as they offer a disincentive to work.
- Adoption over the medium term of a capital gains tax and fringe benefits tax would include all sources of income in the definition of taxable income, which is routine in better-performing tax systems. Failure to do so can lead to inequities and people at the same income level paying different tax amounts, depending on the share of their income from untaxed capital gains and fringe benefits. Inefficiencies can also arise, as economic activity is distorted toward activities offering capital gains (e.g., real estate speculation) or allowing the receipt of more income as fringe benefits.
- Greater reliance on user charges is possible, subject to equity concerns being addressed (e.g., through concessions for the disadvantaged). There is very little

user charging for government services (e.g., public health and education are provided free of charge). Where charges are levied (e.g., most infrastructure services) they tend to fall short of operating costs. Undercharging for services tends to encourage overuse and the expansion of services out of line with clients' real needs, creating supply inefficiency. It is normally an inequitable way to support the disadvantaged, as both high- and low-income users benefit, not just those in need. It would be better to raise more revenue directly from users, allowing the reliance on tax and customs revenue to be reduced.

- Increased returns from public enterprises are discussed below.

6.6 Maintaining Fiscal Sustainability

The achievement of a sustainable fiscal position is one key result of the Cook Islands economic reform. Sustained budget surpluses have helped the Government almost completely repay its debt. Standard & Poor's reflect these improvements in the progressive upgrade in credit rating:

**Debt is
currently low**

- January 1998: Long- and short-term foreign currency ratings of B-/C and long-term local currency ratings of B-/C assigned; outlook stable.
- May 2000: Long-term foreign and local currency ratings of B-/C and short-term foreign and local currency ratings rose to B.
- October 2002: Outlook revised to positive from stable.
- August 2003: Long-term foreign and local currency ratings raised to B+; outlook positive.
- October 2004: Long-term foreign and local currency ratings raised to BB-; outlook stable.

- February 2005: Long-term foreign and local currency ratings placed on credit watch negative.
- April 2005: Long-term foreign and local currency ratings removed from credit watch negative.
- March 2006: Long-term foreign and local currency ratings placed on positive outlook.
- December 2006: Long-term foreign and local currency ratings retained as BB-; outlook positive.
- December 2007: Long-term foreign and local currency rating upgraded to BB/stable/B.¹¹⁰

The medium-term projections of a balanced budget imply a continuation of the sound bottom line. Yet the need to rebuild public expenditure to sustain growth and achieve ecologically sustainable development now poses a major long-term challenge to this fiscal position.

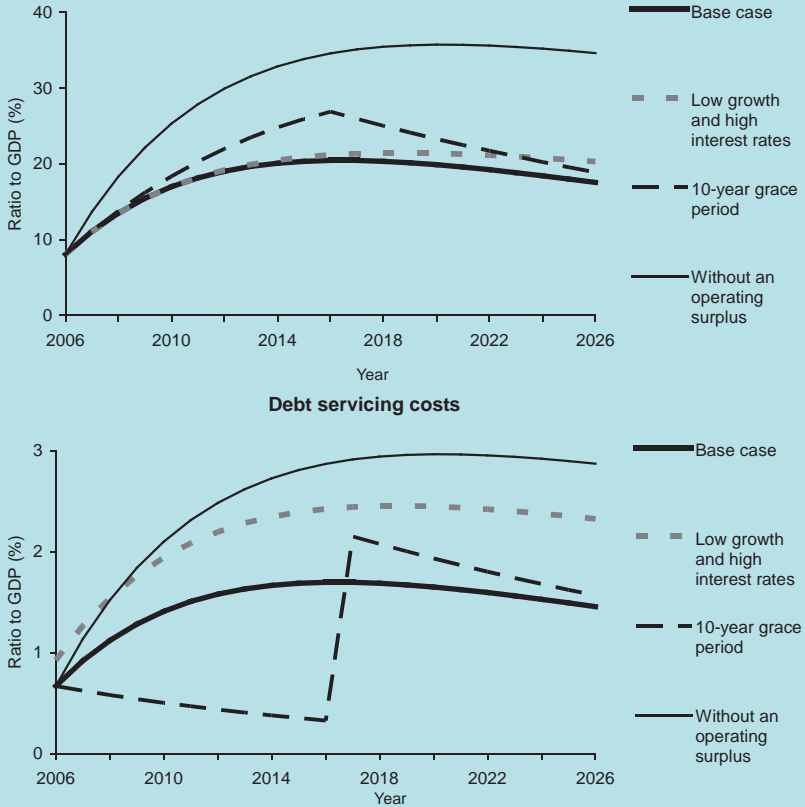
The IMP could see debt rise to 20% of GDP

The infrastructure expenditure proposed under the IMP could see net general government debt rise to about 20% of GDP by 2026 and debt-servicing payments rise to about 2% of GDP. The projection is based on the fiscal restraint that is projected for the medium term being maintained and on growth, inflation, and interest rates remaining at trend.

The sensitivity of this result is explored in Figure 6.4. If a grace period were available, debt-servicing costs would be lower initially but at the expense of an accumulation of more debt and somewhat higher debt-servicing costs in the long term. If the growth and interest rate outlooks were less favorable, the debt ratio would be somewhat higher and debt-servicing costs could be substantially higher. The worst-case scenario shown is that fiscal restraint is lost and the Government borrows to fund both IMP and capital expenditure that is currently funded from an operating surplus. Even under this scenario, debt and debt-servicing costs are not excessive though they approach the top of the comfort range.

¹¹⁰ Standard and Poor's, 2006.

Figure 6.4: Illustrative Debt Projections



Scenario	Key assumptions
Base case	Growth in real GDP and the GDP deflator remains at the average rate for 1996–2005 (3.6% p.a. for GDP and 3.8% p.a. for the deflator). Debt is secured at the average yield on 10-year New Zealand government bonds over the last 10 years (6.2% p.a.) plus a 1% risk premium. IMP is implemented over a 20-year period, with the cost of capital expenditure rising in line with the GDP deflator and all expenditure funded through long-term debt (i.e., the capital expenditure currently in the medium-term budget projections is allocated to items not covered by IMP, which includes education, health, and government buildings). Finally, other expenditure and revenue items continue at the ratio to GDP projected in the FY2007 budget.
Low growth and high interest rates	Base case but with half the real GDP growth rate and an interest rate 50% higher.
10-year grace period	Base case but with a grace period of 10 years applying to debt-servicing costs.
Without an operating surplus	Base case without the operating surplus projected in the FY2007 budget (i.e., 2.6% of GDP). That is, the projected operating balance is, near zero, and the overall budget balance moves into deficit.

CISO = Cook Islands Statistics Office, FY = fiscal year, GDP = gross domestic product, IMP = Infrastructure Master Plan, MFEM = Ministry of Finance and Economic Management, p.a. = per annum, % = percent.
 Sources: Authors' estimates based on CISO *Annual Statistical Bulletin*, various years; MFEM budget estimates, Part I; Appropriation Bill; Appropriations and Commentary, various years; and Reserve Bank of New Zealand website.

In interpreting these findings, it is important to keep in mind that the Cook Islands is vulnerable to natural disasters and adverse economic developments. This vulnerability means that the Cook Islands should aim for a lower debt level than normal to provide a buffer against shocks (e.g., to retain the capacity to borrow in adverse circumstances). A debt-to-GDP ratio of 20% accumulated over some years for sensible projects would be comfortable, but a 40% ratio probably would not be.

It is prudent to act early to ensure that fiscal sustainability is maintained as public debt rises. Fiscal sustainability would be maintained if capacity existed within the budget to meet rising debt-servicing costs without forcing major corrections on expenditure or revenue.

The best option is to outsource infrastructure works, but some will necessarily continue to be funded by the budget and require funding initiatives

The best way to pursue fiscal sustainability would be through open and transparent competitive processes with more responsibility for infrastructure delegated to the private sector or well-managed public enterprises, such that infrastructure funding is off budget. This approach has the potential advantage of minimizing the costs of provision and maximizing the recovery of costs from users. Costs are minimized because outsourcing allows competitive pressures in infrastructure provision to be maximized through competitive bidding (via sale or some form of lease and/or licensing arrangement) or, where this is not possible, greater performance orientation than is achievable with general government agencies. Recovering costs through user charges helps align infrastructure provision to client needs and provides a secure source of funding for operation, maintenance, and rehabilitation costs. This, in turn, helps maximize the facilities' value for money. User charges need not fully recover costs. Top-ups or subsidies from the budget are justifiable if they have a clear equity or efficiency rationale and are applied openly and transparently.

Not all infrastructure work can be outsourced, so a substantial share of the required work will need to be funded

by the budget. The additional debt-servicing costs must be met by either new revenue sources or trimming growth in noncapital expenditure. Even if infrastructure is initially funded through borrowing, ultimately adjustments will be required on either the revenue or the expenditure side of the budget to meet rising debt-servicing costs.

Options for raising more revenue include the introduction of capital gains and fringe benefits taxes, greater reliance on user charges, or better financial performance by public enterprises. On the expenditure side, the main opportunities are in relation to the civil service wage and salary bill and the improved targeting of sizeable welfare payments.

A sensible way forward is to guide the future budget position by adopting fiscal rules such as those that have already helped guide the Cook Islands to fiscal sustainability. The key rules are the principles of responsible fiscal management set out in the MFEM Act:

- ensuring that, unless the Crown's (i.e., public sector) debt is at prudent levels, operating expenses will be less than operating revenues (i.e., there is an operating surplus);
- achieving and maintaining levels of the Crown's net worth that provide a buffer against factors that may diminish net worth in the future;
- prudently managing the fiscal risks facing the Crown; and
- pursuing policies consistent with a reasonable degree of predictability about the level and stability of tax rates in future years.

Additional fiscal rules were established as part of the 1998 debt restructuring, and they provided a finer interpretation of the principles of the act. The Government had committed itself not to undertake new commercial borrowing for 7 years if the result would be noncompliance

The MFEM Act sets key fiscal rules that can be reinforced

with prudent financial ratios. These related to debt levels, the composition of expenditure, the operating balance, and borrowing by public enterprises. The practice has emerged for the budget papers to report on compliance with these ratios and the reasons for, and implications of, any noncompliance. This has helped develop the fiscal framework underlying the budget and provided clear benchmarks of performance.

An updated set of prudent financial ratios that would help ensure fiscal sustainability, if followed, could be along the following lines:

- Financial Ratio 1: The ratio of the present value of the debt of the general government sector to GDP is to be within what is affordable given medium revenue and expenditure commitments.
- Financial Ratio 2: The ratio of wages, salaries, and supplements to GDP for the general government sector is to trend down over the medium term.
- Financial Ratio 3: The ratios of investment spending and maintenance spending to GDP are to trend up over the medium term.
- Financial Ratio 4: A budget operating surplus is to be maintained in each financial year (i.e., revenues to exceed operating expenses).
- Financial Ratio 5: Borrowing by public enterprises should be limited to activities that will generate sufficient additional revenue to service the debt after allowance for any subsidy (to be provided openly and transparently through the budget).

A medium-term budget framework is worth considering

These ratios highlight the need to manage the composition of expenditure and adopt a medium-term outlook. A further step would be to adopt a formal medium-term budget framework. This would formalize the medium-term outlook that is already presented in the budget (which provides projections for the budget year and subsequent

2 years) and allow agencies to seek multiyear commitments to their initiatives. This approach is particularly suited to the major infrastructure programs now being considered by the Government. It is important to keep in mind that borrowing for poorly conceived projects is never justifiable and that all projects should be subject to quality checks, such as are provided though the project cycle recently implemented by the Aid Management Division of MFEM.

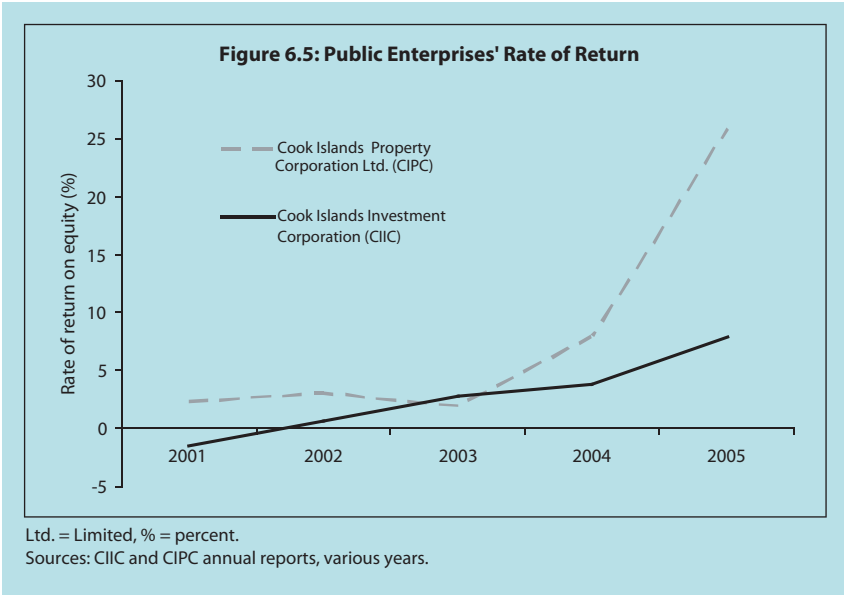
6.7 Strengthening Public Enterprises

Public enterprises are under the umbrella of the CIIC, the holding company for the public enterprise monopolies which include the CI Airports Authority (CIAA), the CI Ports Authority (CIPA), Te Aponga Uira (TAU, the government-owned power utility in Rarotonga), the CI Broadcasting Corporation (CIBC), and the CI Government Property Corp (CIGPC). The CIGPC is a holding company comprising the government's building and equipment assets, the Bank of the Cook Islands (BCI), and the CI Telecommunications Holding Ltd (CITHL, owner of the 40% government share in Telecom Cook Islands). The overall financial return from public enterprises deteriorated somewhat after 2005, following a period of improvement earlier in the decade. As of June 2006, the equity held in public enterprises was valued at NZ\$143 million (compared to NZ\$125 in the previous year), and assets were valued at NZ\$182 million (NZ\$175 million), generating a consolidated surplus after tax and before dividend of NZ\$5.2 million (NZ\$7.5 million) and a return on equity of 3.6% over the year (6%).

While the overall financial return on public enterprises is reasonable, most profits and all dividends in 2005 were generated by TCI. As discussed in the previous chapter, the very high rates of return earned by TCI indicate its exploitation of monopoly power. Such practices will always harm public welfare, and it is an important role of government to prevent them.

Public enterprises fall under the umbrella of CIIC

Public enterprises are profitable as a group, with overall profits trending up



The performance of the other public enterprises is clouded by their obligation to perform the social obligations of government by, for example, providing not commercially viable services or charging less than the cost of supply. A preferable approach is for such social obligations to be costed and funded through the budget as community service obligations.¹¹¹ This would help accountability and transparency by clarifying the implicit choices, enabling better comparisons of the alternative uses of public funds, and allowing the performance of public enterprises to be gauged from their financial outcomes. With public enterprise assets equivalent to 65% of GDP, it is important that they be managed to ensure a good return on the substantial capital they absorb.

CIIC provides a good basis for improvements to the financial performance of the public enterprises. It was established under the mid-1990s reform program as a

¹¹¹ This need not have an impact on prices, as the funds transferred from the budget could be returned to the budget as dividends, such that there would also be no net impact on the budget (i.e., it could be a paper transfer only).

mechanism for improving the governance and economic contribution of public enterprises by providing independent, professional management. The CIIC Act, which guides public enterprise management, is broadly in line with modern management practices. For example, in principle, formal ministerial involvement has been removed from most public enterprises and replaced by independent board members; management of public enterprises holds responsibility for day-to-day operations (an important requirement for achieving efficiency); and statements of corporate intent are prepared to set out the strategic direction of business activities as agreed with the Government and performance-monitoring arrangements.¹¹² Some public enterprises also have their own supporting legislation, which is generally sound.¹¹³

The CIIC Act is in line with modern practices, but the CIIC itself is hampered by attitudes that are out of line with good practice

The CIIC Act is a sensible response to conditions facing the Cook Islands. The holding company arrangement provides an opportunity to build a core group of professionals to provide important technical skills to public enterprises and to try to overcome the lack of independence that typically dogs managers of public resources in small communities. However, the practice has fallen short of intentions. The main concern is an apparent politicization of CIIC. This is reflected in the frequent changes of the chair of CIIC—six changes in the past 3 years—whenever political power changed hands. Senior ministers and public officers have also circumvented the management system. This is most evident in efforts to redevelop the Cook Islands High Commission in Wellington, New Zealand (Box 6.3). Such practices undermine the integrity of CIIC and have the potential to trigger a recurrence of the costly mistakes made in the early 1990s.

This example highlights that attitudes regarding what constitutes acceptable behavior make important contributions to the achievement of good governance, and

112 The exception is the board of CIPC, which is made up of the Cabinet.

113 A notable exception is legislation that has effectively removed BCI from CIIC's supervision.

More can be done to strengthen the system.

that inappropriate attitudes are difficult to guard against. Some additional actions that could be considered to help strengthen the system include

- a requirement that all ministerial directions be publicly released;
- the exclusion of all current and recent officials of political parties from board positions;
- the enactment of whistle-blower legislation to help protect those that provide early warning of inappropriate behavior;
- the establishment of a code of conduct to inform ministers and directors of their roles and acceptable behavior, monitored by PERCA and preferably backed up by sanctions (for example, along the lines of the Papua New Guinea codes); and
- tighter controls on the use of the proceeds from asset sales by, for example, requiring automatic distribution to the public accounts. At present, they are available for use by CIIC, and this may create the impression that CIIC is a potential source of off-budget funding free of normal parliamentary scrutiny.

Box 6.3: The Auditor-General’s Finding on the Diplomat Project

My review into the “Diplomat Project,” involving the sale and development of Government’s high commission property in Wellington identified unacceptable practices in the public sector.

This report highlights certain serious anomalies and chain of events that require the attention of the Government and the public, to review, comment, and take appropriate corrective measures.

A summary of my key concerns are:

- i) First, in my view, the then Prime Minister should not have been directly involved in the early setup, intricate details, and pre-project arrangements with the developer. This relationship, in the key initial stages, preempted government from awarding the sale and purchase agreement of the High Commission property at 56 Mulgrave Street in Wellington, without a contestable and transparent tender process. The Cabinet’s, including the Prime Minister,

involvement should only be in the area of public policy; in this case, approving the Project without further involvement.

- ii) Having done this, Government at the time, did not appropriately evaluate and assess all the available options and alternatives to ensure an informed conclusion was reached obtaining optimal return from a project of this magnitude.
- iii) Government failed to comply with applicable and established financial policies and procedures issued by MFEM, covering the sale of Crown assets. This noncompliance and deviation from financial procedures, opens the decision of the Cabinet to scrutiny, showing elements of favoritism and lack of accountability.
- iv) There is a perceived conflict of interest surrounding the planning and negotiation stages of this project. This involves three key people, being the then Prime Minister, the then chair of the CIIC, and the developer. The CIIC chair appointed by the Minister of CIIC (a statutory corporation charged with the authority to manage and facilitate the disposal of Crown assets) was also an active director in one of the developer's companies. At the same time, it was publicly known that he was also the developer's representative in Rarotonga. The Prime Minister and developer became close associates even to the extent that in early 2005, the Prime Minister—after his appointment to Wellington as High Commissioner—rented his private residence in Arorangi to the developer.
- v) The nonexistence of a clearly defined and prescribed code of conduct for Cabinet Ministers, Parliamentarians, and senior government officials makes it extremely difficult to adhere to standards of good international management practice, which sets the boundaries between what is acceptable and unacceptable behavior.
- vi) Inadequacies identified with regard to the lack of thorough and intensive due diligence compliance testing, specifically noting the material miscalculation of the NZ\$3-million gross difference between the developer's valuation of the diplomat project and an independent valuation [by a] company engaged by CIIC.
- vii) The spirit in which the developer intends to proceed with the construction of the diplomat project appears problematic given adjustments made by the developer without the consent of CIIC post signing the agreement for sale and purchase.

On a positive note, the previous board of CIIC and current management staff are commended for their efforts to protect the interest of the Crown by engaging a reputable New Zealand law firm to mitigate and provide strict conditional measures to minimize the Crown[s] risk [of] exposure and to ensure the transaction is structured in a cost-efficient manner.

CIIC = Cook Islands Investment Corporation, CIPC = Cook Islands Property Corporation, MFEM = Ministry of Finance and Economic Management.

Source: Cook Islands Audit Office. 2005a.

6.8 Reforming the Political System

Political support is needed to maximize results, which requires a healthy political system

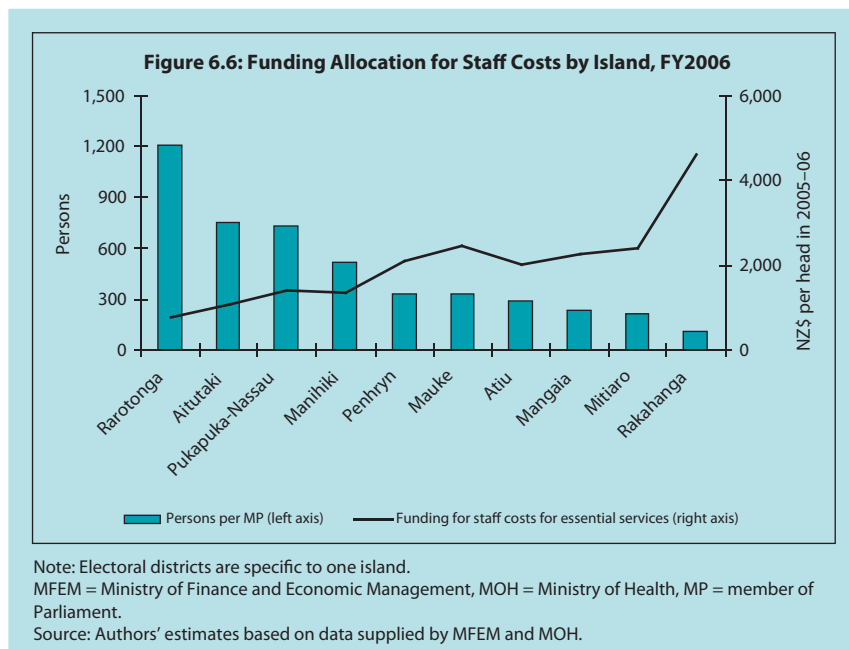
Attempts to improve the results of the public sector are sensitive to the support provided by the political system. In the Cook Islands, political instability has hampered such support. Four coalition governments headed by three prime ministers have ruled in the past 5 years. The broad similarity of the policy platforms of the main parties, the Democratic Party and the Cook Islands Party, has meant that changes of government have not had a major impact on the direction of public policy. But the frequent need to form and then preserve coalitions—including threatened and actual party switching by individual members of Parliament—add to uncertainty and tend to politicize the use of public resources. This harms the business environment. Further, the way the political system operates is cited as one factor behind the departure of Cook Islanders.

For example, the inability to form a stable coalition prompted the Queen's representative to call a snap election in mid-2006, causing a 6-month delay in the passage of the FY2007 budget. Agencies were required to keep expenditure to FY2006 levels and largely deferred new spending initiatives.

While politicians need to retain responsibility for the allocation of public resources, the underlying political system needs to be healthy to deliver desirable outcomes. Following the mid-1990s reform, the Commission of Political Review identified many weaknesses in the political system and recommended comprehensive reforms, which largely remain unimplemented. It is likely that this lack of action has undermined the efficient use of public funds.

One indicator of a potential problem is apparent regional inequities in funding. A relationship can be observed between political representation. Islands that have more residents per member of Parliament (MP) tend to receive less funding for essential services per head (Figure 6.6). Political representation appears to have important

influence than population size or development need, both of which are preferable bases for allocating funds. Indeed, it appears that the political system is helping create inequities among islands.



Political representation has also been a factor, and may remain so, in distributing public funds within an island. The 1998 Commission of Political Review noted:

Until recently, power was too concentrated in the central government. One effect of this has been that the MP, if a member of the political party in power at the time, has assumed a greater and sometimes autocratic role in the community, because they [sic] have become gatekeepers channeling government resources, jobs and contracts to those they favor, and starving supporters of opposition parties. The disparity between constituencies which support [what]ever party is in power, and those which do not, is quickly obvious.¹¹⁴

The link between political representation and island funding indicates politically skewed priorities

114 Commission of Political Review. 1998, p. 53.

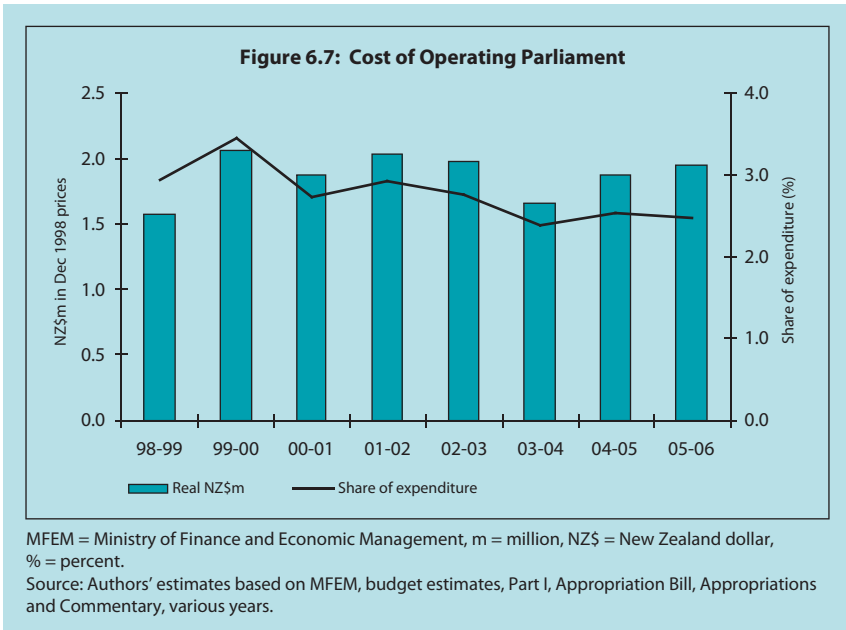
A further indicator of the health of the political system is the high financial cost of Parliament arising from the high number of political representatives.¹¹⁵ The Commission of Political Review observed:

“New Zealanders pay about NZ\$3 each per year (which the average worker there can earn in less than half an hour’s work) for their MP’s salaries and allowances. Cook Islanders pay about NZ\$61 each per year for their MP’s salaries and allowances, which is about 20 hours’ work for the average Cook Islands worker. In other words, we [Cook Islanders] pay 20 times more in cash, and about 40 times more in the time needed to earn that cash. If we add the other costs of operating Parliament and related expenses paid by the people, the difference is greater again... We have not had time to calculate the cost per person which Cook Islanders have to pay for the travel of their ministers, but rough comparisons show that it is enormously more than people in most countries of the world have to pay.”¹¹⁶

The high financial cost is ongoing. In real terms, expenditure on the 24 MPs is now higher than it was at the completion of the Commission of Political Review, and it remains a significant share of total expenditure (Figure 6.7). The NZ\$2.5 million allocated to MPs in FY2006 compares to the NZ\$3.0 million allocated to staff costs for education in the outer islands in that year, the NZ\$1.3 million allocated to staff costs for health care in the outer islands, and the NZ\$1.1 million allocated to the maintenance of government buildings, including schools and health facilities.

115 There are about 700 constituents per member of Parliament in the Cook Islands; fewer than the 900 in Tuvalu; 2,000 in Kiribati; 11,000 in the Fiji Islands; and 32,000 in New Zealand (based on material provided by the Office of the Prime Minister and the Political Reform Commission).

116 Commission of Political Review. 1998, p. 64.



The relevance of the high level of funding extends beyond opportunity cost—i.e., the results that could be generated if the funds were used elsewhere. It extends to the risk that the high returns gained by winning a seat in Parliament generates inappropriate incentives to gain political power and the associated risk of rent-seeking behavior. The high turnover of governments and prime ministers, the apparent politicization of the position of CIIC chair, recent moves to undermine the independence of the civil service, and the political influence over funding decisions at the expense of equity point to the presence of inappropriate incentives in the political system.¹¹⁷

The politicization of the civil service and public expenditure was generally at the heart of the 1990s crisis, yet the political reform agenda established to address the problems remains incomplete. This history and the

117 In 2006, the new contracts of heads of ministries were modified to add a minister's right to dismiss heads of ministries they deem incompatible. Previously, dismissal was reserved for incompetence or insubordination.

indications of ongoing concerns suggest that it is important to revisit political reform with a view to ensuring the health of the political system.

6.9 Achieving Results Orientation

One initial achievement of the 1990s reform program was an increased role for the community in managing public resources. This was triggered by intense community dissatisfaction with the performance of the Government and facilitated by measures to increase information flows and provide for broader input in decision making. Measures adopted included the (i) release of regular statements of economic and financial conditions as part of the budget process, including pre-election statements; (ii) release of draft budgets for public consultation; (iii) establishment in 1996 of the National Development Council, comprising business, nongovernment organizations (NGOs), and traditional and church leaders, as a focal point for national consultation; (iv) conduct of national retreats as forums for policy debate; and (v) establishment of PERCA. An active, free media backed these measures.

While the flow of information from the budget and PERCA has remained high, most other measures faded. A notable exception was the conduct in 2003 of the National Development Forum and follow-on consultation that culminated in the Cook Islands National Sustainable Development Plan (NSDP) 2007–2010 (Box 6.4). NSDP sets out the national vision and goals, the direction to be followed by lower-level sector strategies, corporate plans, and the annual budget. It aims to clarify the prioritization of public policy and the use of public funds, assisting coordination across agencies and with NGOs and the private sector, and providing the basis for improved harmonization and alignment of donor assistance (which is already well advanced with the governments of New Zealand and Australia).

Box 6.4: The Prime Minister on the Role of the National Sustainable Development Plan

We have emerged from some painful years of structural and institutional adjustment because of national economic reforms. A consequence of this experience has been the acknowledgement that Government needed to take a long-term view of its development initiatives to meet the needs and aspirations of our people better in the context of a changing socioeconomic environment and a rapidly developing landscape shaped by increasing globalization, recent population trends, and an expanding private sector.

Government's reliance on its annual planning process as the basis for national budget allocation was deemed inadequate. Ministries and departments struggled to embrace the country's priorities for each approaching fiscal year while the corresponding Budget Policy Statement was often found wanting because of political uncertainty, changing needs, and resulting policy inconsistency. Government and its partners in the private sector and the wider community agreed at the 2003 Development Forum that the country required more coherence, consistency, and predictability in terms of long-term goals and objectives and a greater degree of consensus and participation for initiatives to move beyond the political will of the day and reflect the will of the people.

The National Sustainable Development Plan (NSDP) promises to help us move beyond the limits of political intervention and ensure our development efforts are guided by principles of good governance and sustainable development and focused on the welfare of all Cook Islanders, irrespective of power allegiances. NSDP also promises to provide us with a solid platform to engage with our development partners and seek targeted, coordinated, and harmonized development assistance based on our national priorities.

NSDP is by no means the solution to all our planning and priority-setting challenges. It is, however, significant because it represents the foundation of our future cooperation regarding the sustainable development of our nation. It is a forward-looking plan and it is comprehensive though not exhaustive. It provides more clarity and direction. It brings together the cross-linkages and relationships that will underpin the achievement of our national goals. Granted there are gaps in terms of the data and information we need to make better decisions, nonetheless, we have made a solid start in the right direction. NSDP presents us with an important opportunity to weave our ideas, to make our efforts more systematic and robust and to work together with common purpose. We should not lose sight of this.

Source: Extract from the Prime Minister's forward to NSDP (Cook Islands Government 2006a, p. 3)

The tools of results-based management are almost in place, but barriers remain

The next step is to finalize the sector plans and align the corporate plan with the higher level strategies of the NSDP. This planning process—combined with modernized public sector legislation, improved financial management systems, and a long period of capacity building in the public sector—will provide to the Cook Islands the basic tools required to achieve results-based management in the public sector.

There is, however, some uncertainty as to whether the tools will be used to their potential. The public sector's contribution to development has risen over time, but there nonetheless appear to be important barriers to achieving a stronger results focus.

Performance monitoring is weak

One indicator of such barriers is the limited effort made to assess performance. While the budget sets out a work plan with results and performance measures for the outputs of each ministry, they are not scrutinized in a systematic manner. The management system established for ministries requires a regular review by PSC of progress in delivering these outputs, but no such review is undertaken. Many performance measures are unrealistic—too high to be of use in the annual review of progress required under the budget system. Heads of ministries are subject to performance review, but without ministry-level information, this performance review can be only superficial. This means the cycle of inputs, activities, and outputs required to feed back into their reformulation in subsequent years is weak at best and, at worst, completely absent.

Statements on agency outputs sometimes lack realism

Achieving results requires a workable statement of what is to be achieved. Results or targets are most useful when they are set to be achievable with good performance but not achievable by mediocre effort. This allows monitoring to provide an indication of the quality of work undertaken. Goals or targets that are so ambitious they cannot be reached fail to do this—or to provide incentives. Budget documents suffer this weakness. Ministries have considerable financial autonomy under the current management system. For

example, heads of ministries can appoint staff if the personnel budget is not overspent, award bonuses and pay increases within specified bands, and reallocate funds among outputs excluding personnel costs.¹¹⁸ The failure to balance such autonomy with performance monitoring means that the Cook Islands system may lean too much toward autonomy.

The reasons for forming barriers against a results focus are unclear. Candidate explanations are capacity constraints in the civil service, resistance from political representatives to improved accountability and transparency, and similar resistance by the civil service or public agencies that hold the balance of power under the current system. Regardless of the causes, the solution is likely to lie in opening the system to scrutiny. This is likely to require revisiting the initial intention to engage civil society actively in decisions on the use of public resources.

The NSDP 2007–2010 provides an opportunity to achieve this broader engagement. It establishes the NSDP advisory committee—comprising representatives from government, the private sector, and community groups—meeting quarterly to provide high-level, multistakeholder analyses of outcomes. These reports are to be consolidated and presented to the Cabinet every 6 months, presented to Parliament, and then made available to the public and development partners. Each coordinating agency appointed under the plan (which includes parties from outside the Government) is to provide an annual progress report on the implementation of relevant strategies and associated key outcome targets. The vitality of this process will be critical to the success of the NSDP 2007–2010.¹¹⁹

It will be important that any faltering in the process be identified early so that corrective action can be taken. The NSDP 2007–2010 shares the tendency of budget

**More scrutiny
is needed—
and is
proposed by
the national
plan**

118 Cook Islands Government. 2006b, Part C, Sections 2 and 10.

119 Cook Islands Government. 2006a, pp. 42–43.

documents toward overly ambitious targets, and it is unclear whether the plan provides sufficient guidance on some key public policy issues likely to be faced in preparing and implementing sector and corporate plans, etc. The policy stance on foreign workers and investors is not spelled out, for example, nor are agreed minimum standards of service for outer islands, directions for the political system, or a policy of support for the disadvantaged. This situation appears to reflect difficulties in reaching consensus in consultation on NSDP. The same factors that hindered consensus building may also hinder implementation of NSDP. In the extreme, a mid-term update of NSDP could be contemplated to address any faltering in implementation.

Other measures could be taken to support accountability and transparency and improve the results focus of the public sector:

- It is very important that PSC succeed in its intention to establish an effective performance monitoring system for ministries and heads of ministries.
- Budget documents should be made more readable. Focus group discussions, for example, could be held with a cross-section of the community to clarify how widely read existing documents are, how well they are understood, and how they could be reconfigured to provide more information to the community. It is also important that the documents begin to report the latest actual fiscal outcomes. At present, these can be obtained only from audited accounts, which are available only with a time lag and in a different format to the budget documents that makes tracking the fiscal position difficult.
- The report of the Budget Committee should be released publicly. This would have the advantage of both providing important information to the public on the use of their funds and enhancing the

Budget documents could be made more readable and relevant

committee's public accountability and preventing it from straying from its essential role.

- Payments on behalf of the crown (POBOCs), which currently account for around 20% of public expenditure, should be reduced. Responsibility for POBOCs lacks the clarity of a ministry output. For example, MIA views its responsibility for welfare payments as limited to their administration, with responsibility for policy matters held by MFEM (the funding agency). This breaks the link between MIA's policy role and its ability to control achievement of the policy objectives. A recent PERCA report highlighted shortcomings in accountability with POBOCs and their vulnerability to political influence (Box 6.5). As this is a typical outcome of special-purpose funding mechanisms, they would better be folded into ministry outputs.
- A code of conduct for members of Parliament, civil servants, and officers of public enterprises should be adopted to help overcome evident shortcomings in attitudes and understanding of the role of public office. Ideally, these codes would provide for suspension from office for infringements and independent scrutiny of compliance, preferably by PERCA.
- Controls on the appointment of heads of ministries should be tightened to curb a tendency toward politicization. Specifically, it would be important to withdraw the right of a minister to remove incompatible heads of ministries.

Payments on behalf of the crown could be phased out

Box 6.5: The Auditor-General's Report into Payments on Behalf of the Crown

Payments on behalf of the Crown (POBOCs) are payments that the Crown is legally obligated to pay. They fall under three categories: (i) legislative/contractual, (ii) subscriptions, and (iii) other Crown commitments including grants and other funds. POBOCs are not an output of a ministry; however, ministries on behalf of the Crown administer them, and the head of the ministry is responsible for the use and management of the funds in line with the appropriation.

This is the first time a full review of POBOCs has been undertaken as part of the Crown audit. The focus of the audit was to evaluate the internal control processes and confirm the legitimacy of payments made by the ministries. The audit also looked at the administration of POBOCs at the Crown level by the Ministry of Finance and Economic Management (MFEM).

A key characteristic of the administration of POBOCs by the Crown has been the lack of accountability put in place to ensure funds have been utilized for the intended purpose. This may have been due to the emphasis being placed upon the output and capital appropriations of the ministries. However, we emphasize that the POBOCs appropriation should have come under the same scrutiny as all other appropriations. There is no differentiation in the MFEM Act 1995–1996 in the treatment of POBOCs.

Given the poor governance structure in place for the administration of POBOCs, it is not surprising that, at the ministry level, we have identified numerous deficiencies which have resulted in funds not being used most effectively and efficiently to meet the purpose of the appropriations.

Some ministers and heads of ministries have used POBOCs as a vehicle to make payments that would not pass the decisive test of public acceptance. These payments have been influenced by political bias, nepotism, and favoritism. It is a sad reflection on the Cabinet that approved some of these payments.

While some of our findings have been peculiar to the individual ministries, fundamental issues have been highlighted in our audit that applies to the overall management of POBOCs.

It is recommended that the financial secretary, who administers the MFEM Act, under which POBOCs are made, liaise with the respective heads of ministries, to ensure that a time frame for corrective action is implemented to strengthen internal control procedures and avoid the misuse of POBOC funds in the future. Again, we stress the need for a comprehensive code of conduct for all public officials.

Source: Cook Islands Audit Office. 2005.