

PROGRAM PERFORMANCE AUDIT REPORT

ON THE

**ECONOMIC RESTRUCTURING PROGRAM
(Loan 1466-COO[SF])**

IN THE

COOK ISLANDS

December 2002

CURRENCY EQUIVALENTS

Currency Unit – New Zealand dollar (NZ\$)

	At Appraisal (August 1996)	At Project Completion (October 1998)	At Operations Evaluation (September 2002)
NZ\$1.00 =	\$0.69	\$0.54	\$0.49
\$1.00 =	NZ\$1.44	NZ\$1.84	NZ\$2.05

ABBREVIATIONS

ADB	–	Asian Development Bank
BCI	–	Bank of the Cook Islands
CIDB	–	Cook Islands Development Bank
CISB	–	Cook Islands Savings Bank
DIB	–	Development Investment Board
ERP	–	Economic Restructuring Program
FDI	–	foreign direct investment
FEM	–	finance and economic management
GDP	–	gross domestic product
GFS	–	Government Finance Statistics
HOM	–	head of ministry
MFEM	–	Ministry of Finance and Economic Management
NDC	–	National Development Council
NZODA	–	New Zealand Official Development Assistance
OEM	–	Operations Evaluation Mission
PCR	–	project completion report
PERCA	–	Public Expenditure Review Committee and Audit
PSC	–	Public Service Commission
PSIP	–	Public Sector Investment Program
SDR	–	special drawing rights
SOE	–	state-owned enterprise
TA	–	technical assistance
VAT	–	value-added tax

NOTES

- (i) The fiscal year (FY) of the Government ends on 30 June.
- (ii) In this report, “\$” refers to US dollars and “NZ\$” refers to New Zealand dollars.

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BASIC DATA
Economic Restructuring Program (Loan 1466-COO[SF])

Program Preparation/Institutional Building

TA No.	TA Name	Type	No. of Person-Months	Amount (\$ '000)	Approval Date
2424	Strengthening Institutional Capacity for Financial and Economic Management	ADTA	53	892.0	17 Oct 1995
2650	Management of the Cook Islands Development Bank and Business Ventures Development	ADTA	36	740.0	26 Sep 1996
2651	Institutional Support to the Development Investment Board	ADTA	9	251.0	26 Sep 1996
2750	Strengthening Institutional Capacity for Financial and Economic Management (Phase II)	ADTA	36	600.0	27 Jan 1997

Key Program Data (\$ million)	As per ADB Loan Documents	Actual
Total Program Cost	5.0	4.8
Foreign Exchange Cost	5.0	4.8
ADB Loan Amount/Utilization	5.0	4.8

Key Dates	Expected	Actual
Appraisal		5–15 Aug 1996
Loan Negotiations		30–31 Aug 1996
Board Approval		26 Sep 1996
Loan Agreement		26 Sep 1996
Loan Effectiveness	25 Dec 1996	26 Sep 1996
First Disbursement		2 Oct 1996
Second Tranche	End Jul 1997	29 Sep 1997
Loan Closing	31 Dec 1997	18 Mar 1998
Program Completion ¹	Jun 1999	Jun 1999
Months (effectiveness to completion)	30	33

Borrower Government of the Cook Islands

Executing Agency Ministry of Finance and Economic Management

Type of Mission	No. of Missions	No. of Person-Days
Fact-Finding	1	24
Appraisal	1	27
Project Administration		
Review	1	9
Project Completion	1	22
Operations Evaluation ²	1	54

ADB = Asian Development Bank, ADTA = advisory technical assistance, TA = technical assistance.

¹ Reflects period for additional reforms after release of second tranche.

² The Operations Evaluation Mission comprised C.B. Amerling, Principal Evaluation Specialist/Mission Leader; R.M. Sturton, Economic Restructuring and Policy Analyst/International Consultant; and V. Wichman, Social Impact Assessment Specialist/Local Consultant.

EXECUTIVE SUMMARY

The economy of the Cook Islands grew strongly from the early 1980s till the mid-1990s until it was hit by a recession, which was caused, in large part, by a significant decline in tourism. At the same time, a financial crisis emerged as a result of unsustainable fiscal expansion involving a growing wage bill, an expanding welfare system, and increasing capital expenditures largely funded by external borrowing. By early 1996, it was evident that fundamental policy changes were necessary. In response to the crisis, and with technical assistance (TA) support from the Asian Development Bank (ADB), the Government introduced various restructuring measures, which included the sale of state-owned assets and an overhaul of the country's tax system.

The Economic Restructuring Program (ERP) was designed in collaboration with the New Zealand Overseas Development Assistance, the Pacific Financial Technical Assistance Center, and the Economic and Social Commission for Asia and the Pacific/Pacific Operations Center. The design process included significant participation by businessmen, trade unionists, government officials, and representatives of the wider community. External funding agencies offered their support to the reform program and agreed to continue to coordinate their contributions, with ADB taking the lead role.

On 26 September 1996, the Board approved an Asian Development Fund loan equivalent to \$5 million to support the ERP. The loan agreement provided for a drawdown period of 10 months from date of effectiveness with the loan to be released in two equal tranches. Together with the loan, ADB approved two TAs to help implement the ERP and provide institutional support. In January 1997, a third TA was approved as part of a 3-year capacity building program aimed to provide continuing expert advice and training to strengthen the capacity of the Ministry of Finance and Economic Management, the Executing Agency for the ERP. The first tranche of the program loan of \$3.0 million equivalent was released immediately after its approval. The second tranche of \$1.83 million equivalent was released on 29 September 1997 after the eight tranche conditions were complied with. The loan account was formally closed on 18 March 1998. The Program Completion Report was circulated to the Board in January 1999.

The ERP had three major objectives: (i) macroeconomic stability, with a focus on achieving fiscal and external sector balances; (ii) reduction in the Government's role and increased private sector participation, especially in agriculture, fisheries and tourism; and (iii) mitigation of social costs resulting from the loss of civil service jobs and a rise in emigration. To address these objectives, the ERP comprised 122 reform measures aimed to redefine role of government (emphasizing regulatory functions); ensure fiscal responsibility; ensure effective financial and economic management; improve public sector management and efficiency; promote public confidence in the ERP; improve the environment for competitive growth led by the private sector; facilitate access to capital through an efficient financial sector; improve access to business advice; simplify access to land; facilitate foreign and domestic investment by the private sector; develop agriculture, marine resources, tourism, and other productive sectors; protect and support vulnerable groups; ensure environmentally sustainable socioeconomic development; and mainstream gender issues into development planning.

The Government completed and sustained most of the agreed reform measures. Of the 122 measures, 99, or 81%, were implemented. Significantly, 10 major legislative acts directly related to the ERP were signed into law and implemented.

The ERP's goals of achieving recovery and sustainable growth through major macroeconomic structural reforms, and promoting private sector-led growth were highly relevant to addressing the financial crisis facing the Cook Islands in 1996. The ERP has been a major achievement for the Government. The major cutback to the public sector and the generally sound policy framework progressively put in place provide a good foundation for long-term growth.

The ERP was instrumental in effectively and expeditiously resolving the Government's fiscal crisis. Key legislation established principles of fiscal responsibility, and improved accountability and transparency. Tax reforms that reduced distortions were embraced by the private sector. Effective implementation of tax reforms induced major improvements in compliance, added significantly to total collection in a sustained manner, and contributed to achieving fiscal balance. The Government's domestic debt was eliminated and significant cash surpluses generated. Good progress was also achieved on the corporatization and privatization of state-owned enterprises, and cost recovery of public services, particularly electricity. Major long-term debt restructuring was achieved as a result of the ADB-brokered Manila Agreement of 1998, and debt service capacity is no longer a significant issue.

Measures to achieve the objective of macroeconomic stability were the most successful, although there are signs of slipping back to imprudent fiscal behavior. Payroll and expenditures were cut, resulting in a rapid return to financial stability. With the implementation of reform in the tax system and restoration of private sector confidence, economic growth was resumed, and revenue growth was buoyant. From FY1998/99 through FY2001/02, the public sector reported a small operating surplus in each year. Clearly, the fiscal stabilization and reforms adopted by the Government were successful in returning the country to macroeconomic stability.

However, while the return of fiscal responsibility and stabilization was an impressive achievement, the situation remains fragile. With the economy still largely dependant on tourism, the fiscal position is vulnerable. Small disturbances in visitor arrivals and consequent dampening of revenues would undermine fiscal balance and result in deficit. With successful implementation of reform in the tax regime since FY1997/98, revenue performance has been buoyant. However, public expenditures have also grown rapidly, matching the growth in revenues, despite the large downsizing of the public service and accompanying cost savings. This has resulted in placing the public sector in a vulnerable position with little cushion to absorb any downturn in economic activity.

The strong growth of the private sector during the period indicates that the second objective has been substantively achieved, particularly in terms of tourism growth and the overall growth of the black pearl industry, notwithstanding major disease problems and falling black pearl prices. Following the 4 years—FY1994/95 to FY1997/98—during which economic activity declined by a total of 11%, there has been a strong recovery in FY1998/99 (5.8%), FY1999/2000 (9.8%), and FY2000/01 (3.0%). The economy now stands at 6.3% above the peak real gross domestic product level recorded in FY1993/94. Growth has also been fueled by rapid increase in a broad range of other major economic sectors, including finance and business services, retail and wholesale trade, transport and communications, and construction. The thriving offshore financial services sector has experienced rapid growth, but the Cook Islands remains on the list of non-compliant countries by money-laundering oversight agencies. Unlike previous growth spurts, the role of public administration spending (increased government jobs and salaries) has been negligible in the economic recovery.

In spite of the recent robust growth, the private sector has expressed serious concerns about the growing shortage of skilled workers, the perceived insufficient government action on long-term human resource development, and the lack of political reforms needed to sustain the longer-term economic reform process and maintain fiscal stability. A new foreign investment code has yet to be implemented, and recent lack of transparency on foreign direct investment could also affect long-term private sector growth prospects. Measures in agriculture and fisheries were not very successful, and growth in these sectors has been disappointing. This has significant economic and social effects on many from the lower income groups, particularly in the outer islands, which have fewer economic options. The recent potential prospects for long-line fishing could yield a substantial economic boom, but require the resolution of a number of issues (capital, marketing facilities and information, training, technical expertise, and industry knowledge).

Achievement of the third objective—mitigation of social costs resulting from the loss of civil service jobs and a rise in emigration—has been the least successful. Although emigration has been ongoing for many years, it is generally agreed that the ERP accelerated emigration from the outer islands to Rarotonga (main island) and overseas, and from Rarotonga to overseas. Emigration had serious effects on the social fabric of communities (particularly in the outer islands). Health and education sectors also suffered and continue to get inadequate resources. Adverse changes in important social indicators were observed early in ERP implementation, but the indicators have recently returned to near pre-ERP levels. The New Zealand Overseas Development Assistance financed the Transition Services and Community Action Program (NZ\$5 million), which provided much-needed financial and technical assistance to retrenched government staff and other affected persons, but effectively operated only in FY1996/97. Neither agricultural policies/programs designed to attract retrenched staff, nor the strong growth of the private sector have been able to effectively stem continuing emigration, particularly of the young and skilled, or to attract overseas Cook Islanders to return.

The Government appears to remain committed to the New Zealand model of performance-based contracts and results-oriented public management introduced under the ERP. However, there are serious questions whether the model is well suited for developing Pacific Island countries, and, even on the assumption that it is, whether pre-conditions exist today in the Cook Islands for the model to be successfully implemented.

Although public participation was a key to strong ownership of the ERP, the local media, among others, indicate that poor transparency and accountability in the Government have reemerged as significant issues once again. One of the most important ERP changes has been the separation of roles between ministers and heads of ministries along the lines of the purchaser-provider model, giving the latter operational discretion and control, and the contractual obligation to produce agreed outputs for an agreed level of funding. However, there are strong indications that ministers are again becoming involved at the operational level, which introduces bias to government expenditures toward political agendas rather than community needs, as well as weakens controls on budget overruns. There are signs that a degree of reform fatigue has set in. With the immediate economic crisis over and the economy growing, although the reform agenda is unfinished, the political costs of further reforms must be weighed against the political benefits. The government responsible for implementing the ERP was voted out of office in 1999, and four coalition governments have been formed since (without elections).

In short, whether the ERP's achievements will be sustained is primarily a question of political reform—whether behavior and culture of the executive and legislative branches of government can be permanently changed. An active open media, a politically active, well-

informed and educated population, and a solid government framework created by the ERP from which to build on suggests guarded optimism.

Notwithstanding the ERP's achievements, the reform agenda remains unfinished in such areas as the privatization program, a truly foreign investment-friendly environment, the quality of outputs produced by the public sector and effective monitoring of those outputs, further reductions in the size of government, removal/reduction of tariffs and price controls, more effective and affordable local government, and public service planning and management.

On balance, based on all the major achievements and some shortcomings, the overall rating of the ERP is **successful**.

To consolidate and reinvigorate the reform process, a number of follow-up actions are recommended. They are related to organizing an economic summit with wide representation, redefining fiscal responsibility, revising the Government's financial statements, introducing the new foreign investment code, establishing a body for performance monitoring and regulation of state-owned enterprises and monopolies, developing a formal public sector investment program process, facilitating debate and action on public finance audits, and abolishing the remaining import levies.

I. BACKGROUND

A. Rationale

1. The economy of the Cook Islands recorded an average annual growth rate of 4.5% during the period 1982 to 1994 until it was hit by recession, which was caused, in large part, by a significant decline in tourism. The decline resulted from the appreciation of the New Zealand dollar¹ and competition from other tourist destinations. At the same time, a financial crisis emerged as a result of unsustainable fiscal expansion involving a growing wage bill, an expanding welfare system, and increasing capital expenditures largely funded by external borrowing. In late 1994, the Government requested assistance from the Asian Development Bank (ADB) to strengthen its institutional capacity for financial and economic management. A comprehensive 3-year program was agreed to establish the institutional framework for macroeconomic and financial analysis, planning, and policy formulation. The program was to be implemented in three phases, each with monitorable objectives and performance indicators. In the first phase, technical assistance (TA)² was provided to build, through advisory services and on-the-job training, capacity among local staff in financial and economic management (FEM). By early 1996, it was evident that fundamental policy changes were necessary. In response to the crisis, the Government introduced various restructuring measures that included, among others, sale of state-owned assets and an overhaul of the country's tax system.

B. Formulation

2. In early May 1996, the Government requested ADB to organize a consultative group meeting of external funding agencies. The Cook Islands' delegation presented "The Path to Recovery," a reform agenda to tackle the country's fiscal and economic crises.³ The external funding agencies strongly supported the broad direction of the Government's program. An ADB mission visited the Cook Islands to assist the Government develop the action plan and to undertake a fact-finding for a proposed loan and TA in support of the Government's reform agenda, which was subsequently referred to as the Economic Restructuring Program (ERP). The details of the policy and institutional measures are presented in the Development Policy Letter and a Program Matrix (Appendix 1), which outlines specific actions, timing, and monitoring mechanisms. A chronology of the events leading up to the ERP, actions taken to implement it, and key events following its completion is in Appendix 2.

C. Objectives and Scope

3. The ERP's main goal was to help the Cook Islands reduce the Government's domination of the economy and create an outward-looking and competitive economy led by a growth-oriented private sector. The policy and institutional measures covered the areas of public sector reform, private sector growth promotion, and social equity and sustainability.

4. The ERP had three major objectives: (i) macroeconomic stability, with a focus on achieving fiscal and external sector balances; (ii) reduction in the Government's role and increased private sector participation, especially in agriculture, fisheries, and tourism; and (iii) mitigation of social costs resulting from the loss of civil service jobs and a rise in emigration.

¹ The Cook Islands adopted the New Zealand dollar as its official currency in April 1995.

² TA 2424-COO: *Strengthening Institutional Capacity for Financial and Economic Management*, for \$892,000, approved on 17 October 1995.

³ Adopted by the cabinet in May 1996, this was the first comprehensive document outlining the Government's reform program.

5. The ERP was implemented by the Ministry of Finance and Economic Management (MFEM) in three phases over a period of 3 years. The first phase commenced in March 1996, 5 months before loan approval, and involved major cost-cutting measures such as reductions in non-personnel costs, retirement of public servants based on age and length of service, across-the-board pay cuts, elimination of 10 assistant minister positions, closure of most overseas diplomatic missions, and cancellation of some international events.⁴ The second phase largely focused on public sector reforms, especially in the restructuring and downsizing of government, while the third phase covered a five-pronged economic strategy to promote private sector-led economic growth. The ERP was ambitious and comprehensive, encompassing a policy matrix of 122 specific reform measures.

D. Financing Arrangements

6. On 26 September 1996, the Board approved a loan in the amount of SDR3.43 million (equivalent to \$5 million) from ADB's Special Funds resources to support the ERP. The Loan Agreement provided for a drawdown period of 10 months from the date of effectiveness with the loan to be released in two equal tranches. Together with the loan, ADB approved two TA grants to help implement the ERP and provide institutional support.⁵ In January 1997, another TA, representing the second phase of the 3-year FEM capacity building program, was approved to continue providing expert advice and training to MFEM staff.⁶

E. Program Completion Report

7. The ERP was rated generally successful in the Project Completion Report (PCR) circulated in January 1999.⁷ The PCR noted that while the original targets had been met, medium- to long-term work was still required to see the ERP through to a successful conclusion. Several important achievements were mentioned: (i) significant reduction in government expenditure through downsizing of ministries and the number of public servants; (ii) passage of key legislation establishing principles of fiscal responsibility, improved accountability, and transparency to be followed by heads of departments and the Government; (iii) significant progress toward improved public expenditure management in respect of specification of outputs and associated performance indicators; (iv) creation of substantial and effective public participation in the reform process; (v) improved governance, especially with respect to the key principles of predictability, transparency, and participation, as evidenced by such institutions as the National Development Council (NDC) and the Office of Public Expenditure Review Committee and Audit (PERCA); (vi) considerable progress in debt restructuring; and (vii) a business environment that was much more conducive to private-sector investment.

⁴ Other major reforms completed prior to ADB loan approval included (i) reduction of ministries from 52 to 22; (ii) approval of "user pay" policy; (iii) approval of Finance and Economic Management Act (the MFEM Act), Public Service Act, and Public Expenditure Review Committee and Audit Act; (iv) introduction of accrual accounting, "generally accepted accounting principles," and output-based budgeting based on identified strategic result areas; (v) corporatization of airport and port authorities; and (vi) creation of transition service to assist displaced public servants.

⁵ TA 2650-COO: *Management of the Cook Islands Development Bank and Business Ventures Development*, for \$740,000, approved on 26 September 1996 but cancelled in July 1998 upon the request of the Government; and TA 2651-COO: *Institutional Support to the Development Investment Board*, for \$251,000, approved on 26 September 1996.

⁶ TA 2750-COO: *Strengthening Institutional Capacity for FEM (Phase II)*, for \$600,000, approved on 27 January 1997.

⁷ Based on a three-level rating system of generally successful, partly successful and unsuccessful.

8. Although many policy reforms had been implemented, several issues still needed to be addressed. The fiscal situation in the Cook Islands remained fragile, underlining the importance of further efforts to improve public expenditure management. Further expenditure cuts were essential to achieve fiscal balance. The sustainability of complex budgeting systems, which relied heavily on grant TAs, was questionable. The shift to output-based budgeting and accrual accounting needed to take into account local resource and capacity constraints. While the TAs were effective in dealing with the crisis, they failed to establish sustainable local capacities for economic management.

9. There were serious questions regarding the feasibility of devolving delivery of basic services and certain political processes to local levels. Given the small population of the country, it might be inappropriate to introduce several layers of government, as it would result in additional public expenditure burden. Proper attention to regulatory requirements was essential when privatizing state-owned enterprises (SOEs) as privately controlled monopolies were created, which were more difficult to manage.⁸

F. Operations Evaluation

10. An Operations Evaluation Mission (OEM) visited the Cook Islands in August–September 2001 to evaluate the performance of the ERP. The OEM held discussions with representatives of various national and local government agencies, private sector organizations and enterprises, commercial banks, and bilateral funding agencies. The OEM assessment focused on the (i) relevance, effectiveness, and sustainability of the ERP; (ii) its economic and social impact; (iii) subsequent actions taken to continue and sustain reforms and the capacity of the Government to do so; (iv) quality of implementation including fulfillment of conditionalities, extent of capacity building, use of loan proceeds, and continued government commitment; (v) adequacy of measures taken to mitigate the negative impacts; and (vi) degree to which the ERP met the primary immediate objectives of promoting a more self-reliant society led by a competitive and growth-oriented private sector, less dependent on but more effectively serviced by a smaller, more efficient government. A draft program performance audit report was circulated to the Government and ADB staff concerned for review. Their comments were considered when finalizing the report.

II. IMPLEMENTATION PERFORMANCE

A. Effectiveness of Design

11. The ERP was designed in collaboration with New Zealand Overseas Development Assistance (NZODA), the Pacific Financial Technical Assistance Center, and the Economic and Social Commission for Asia and the Pacific/Pacific Operations Center. Businessmen, trade unionists, government officials, and representatives of the wider community participated in the design process. External funding agencies offered their support to the ERP and agreed to continue to coordinate their contributions, with ADB taking the lead role.

12. The design and implementation of the ERP provides a useful template for the execution of policy-based programs in ADB's Pacific developing member countries. An ADB-financed study identified in 1995 the impending financial crisis and need for reform, and provided a firm

⁸ Similar findings were also reported by two additional studies of the ERP including *An Economic Evaluation of the Cook Islands Economic Restructuring Program* prepared by an ADB staff consultant in October 1998, and the *Cook Islands 2001 Economic Report: Policies for Progress*, financed by ADB.

basis for program design.⁹ While the policy matrix contained 122 conditions and may be criticized as cumbersome, the ERP covered a wide area of both public sector restructuring and reform of the environment for private sector development. Although the list of conditions may well have benefited from simplification and more careful specification, it covered all the major areas essential to the successful implementation of an economic reform program. In this, the framework developed was a job well done. In addition, a number of reforms were completed prior to ADB loan approval (para. 5 and footnote 4).

13. Critical to the successful implementation of the ERP was the participatory nature of the reform process, which was established between the private and public sectors, nongovernment organizations, and community groups. Establishment of this process was supported through the key role played by individuals, including individuals supported through ADB TAs and NZODA, in advocacy and effective communication of a clear and simple vision of the reforms needed. Equally important was the clear support by a “champion” from within the Cook Island leadership—in this case from the highest levels of government.

B. Policy Reform Measures

14. The ERP was dominated in form and substance by measures involving public sector reforms and promoting private sector growth. The following section therefore concentrates on these two areas. The reforms related to social equity and environmental sustainability are covered in paras. 52, 53, and 60, and in relevant sections of Appendix 1.

1. Public Sector Reform

a. Redefine the Role of Government

15. The immediate requirement was to define and adopt an appropriate role of government. The ERP emphasized five key ingredients: (i) downsizing government, (ii) privatization and corporatization of government activities, (iii) devolution, (iv) communication and consultation with the private sector and civil society, and (v) strengthening of the policy functions of the Government. Government expenditure had reached high and unsustainable levels representing over 50% of gross domestic product (GDP) before the reforms and public servants represented about 60% of the paid labor force. From a level of 3,205 in April 1996, employment in the Government was reduced to 1,319 by May 1999, or by almost 60%, surpassing the reduction target of 1,500 by nearly 400 employees. While the numbers are small in magnitude, the percentage reduction must be one of the highest achieved in any restructuring program in the world. Since the completion of the ERP, there has been some slippage in maintaining the achievements made and, by June 2002, the number of public servants is estimated to have risen to 1,667. While the ERP design emphasized downsizing, there was no definition or framework developed to determine an appropriate size of the public sector and guide fiscal policy once the target reduction had been achieved. It was thus not surprising, without any policy guidelines in place, that numbers gradually increased once the economy stabilized, growth returned, and revenues expanded permitting expansion in public expenditure.

16. Critically important in defining the role of the Government and for the successful implementation of the ERP was to strengthen policy-making capacity and responsibilities. While the function of policy formulation was specified as a measurable indicator and policy measures

⁹ ADB. 1995. *Cook Islands: Economic Performance, Issues and Strategy*. Manila; conducted under TA 5543-REG: *Economic Policy Analysis in the Pacific*, for \$400,000, approved on 27 August 1993.

completed for heads of ministries (HOMs), no office or institution has been specifically delegated this responsibility. In particular, the capacity of MFEM to formulate fiscal and economic policy remains weak despite the two FEM TAs (paras. 1 and 6). While political commitment is clearly necessary, a capacity to analyze and formulate policy is also required. The lack of capacity has inhibited maintaining reform momentum, especially since circumstances have changed, requiring modification in or development of new policy directions. Key to the reform process was dissemination of information and development of participatory forum to establish a wide ownership for the program. The reform agenda was published,¹⁰ and numerous meetings and retreats were held with the community and private sector. NDC was established comprising business, nongovernment organizations, traditional leaders, and church officials to provide a focal point for national-level consultation. However, these successes were not sustained: NDC failed to be institutionalized and is now defunct. Briefings on the reform agenda to the public are rare, and with the lack of an institutionalized policy capacity and frequent turnover in government,¹¹ communication with the public is at a low level. On the positive side there is an active press, which engenders an ongoing and lively debate.

17. An important element in the redefinition and restructuring of government was privatization and corporatization of activities more appropriately undertaken by the private sector. Significant achievements were made, although not without controversy, involving lack of transparency and failure to establish an appropriate regulatory framework (para. 30). Devolution of government functions to local councils and the outer islands played an important role in the design of the ERP, but has proved overambitious and impractical. Most local bodies were unprepared and received little capacity-building assistance to effectively manage public services. After the initial decentralization of many services, education, health, the police, and agriculture have all now been returned to the central Government.

b. Ensure Fiscal Responsibility

18. Return of the Cook Island economy to financial and macroeconomic stability was the first of the three-pronged strategy of the ERP, and in the short run, the most important. The ERP defined seven strategies to achieve stabilization: cost cutting, revenue mobilization through increased user charges and tax reform, debt restructuring and formulation of a prudential debt strategy, establishment of reserves to provide a buffer against adverse factors, and better monitoring of fiscal risks. While operating balance¹² was not achieved in FY1997/98 and FY1998/99, although stipulated as a second tranche condition, operating and overall surpluses were recorded in the subsequent 3 years through FY2001/02. The series of measures instigated through the ERP, including downsizing of the public service, fiscal compression, and tax reform, led to the successful return of financial stability. After 2 years of negative growth in 1997 and 1998, the economy experienced strong growth of 5.8%, 9.8%, and 3.0% in 1999, 2000, and 2001, respectively. However, although restoration of prudential fiscal management had been achieved at the time of the PCR, this outcome has become eroded with a lack of clear definition of the objectives of fiscal policy or well-defined medium-term fiscal framework. Although the MFEM Act incorporates many principles of sound economic and financial management, it fails to establish a framework for determining an appropriate cost and size of government in the medium-term. Fiscal responsibility is defined according to whether the debt position is at prudential levels. In case debt is above prudential levels, the Government must maintain

¹⁰ Path to Recovery—The Reform Agenda, July 1996.

¹¹ Since the elections in late 1999, four different coalition governments have held power.

¹² Definitions of operating and overall balance according to the revised Government Finance Statistics (International Monetary Fund, 2001).

operating expenses within revenues. If the debt position is favorable, Government must establish a buffer reserve against adverse factors.¹³

19. While these definitions helped restore fiscal responsibility after the financial crisis in the mid-1990s, they have failed to provide a broad basis for the development of fiscal policy subsequently as the fiscal situation returned to normal. With the return of high rates of economic growth in 1999 and subsequent strong growth in revenues, expenditures in the absence of any other guiding principles grew in proportion. From a level of 31% of GDP in the ERP period (FY1996/97 through FY1998/99), operating expenses have grown to 35% for FY2002/03 (Table A3.1 in Appendix 3). Although payroll costs grew during the period matching the expansion in GDP, the major expansion was in outlays on goods and services. While still maintaining operating balance by the time of the OEM and FY2002/03 budget, the lack of government restraint led to an overall small deficit of 0.5% of GDP for the first time since the introduction of the reforms. Given that, up to the time of the FY2002/03 budget, debt had been reducing but was still considered to be above prudent levels, the definition of fiscal responsibility in the MFEM act had failed to constrain the rapid growth in public expenditures or provide any guidelines as to what an appropriate level of government expenditure should be. While it is clear the ERP played a key role in returning the Cook Island economy to financial stability, it did not provide a basis for developing sound fiscal management in the medium term after the crisis had been resolved.

20. Following on the need to restore fiscal balance, restructuring the unsustainable level of external debt was the second key objective in returning the Cook Islands' economy to financial stability. In September 1998, an agreement, chaired by ADB as "honest broker," was reached in Manila between the Government and three creditor nations (Italy, Nauru, and New Zealand) to restructure the nation's external debt.¹⁴ Favorable terms were agreed so that a debt to GDP ratio of 139% in FY1997/98 was reduced to 60% by FY2002/03. In terms of debt service, the ratio to exports of goods and services (including tourism) improved from 9% to the comfortable level of 3% over the same period, with debt service representing 7% of government revenue in FY2002/03. As a result of the favorable debt restructuring conditions, the Cook Islands now fall in the category of a low indebted nation. In addition to debt restructuring, the ERP specified formulation of a comprehensive external debt management strategy. The Manila Agreement called for definition of prudential financial ratios to be agreed with ADB before the Cook Islands undertook new commercial borrowing. Since the Cook Islands have not until this time¹⁵ considered any new commercial borrowing, prudential guidelines have not been established and neither has any comprehensive debt strategy evolved. This issue is intimately intertwined with defining fiscal responsibility, and a medium-term fiscal framework, all of which have yet to be established.

21. As part of restoring fiscal balance and a viable external debt position, the ERP called for increase in user charges and reduction in subsidies. Performance has been mixed. The SOE sector generally operates at full cost recovery, but the targets set for the health sector have not been met. Comprehensive reform of the tax system was successfully implemented (para. 29), but a buffer reserve against adverse factors affecting fiscal balance has not been established (such a reserve is only required under the MFEM act after a prudential debt situation was

¹³ Once prudential levels of external debt have been attained, the MFEM act provides no provision to limit borrowing to finance operational deficits.

¹⁴ Agreement with France according to the principles outlined in the Manila Agreement has yet to be reached, although efforts are ongoing and discussions are currently underway.

¹⁵ The Cook Islands is currently considering engaging in commercial borrowing to fund port and airport extensions and has requested ADB to assist in determining prudential financial ratios as required by the Manila Agreement.

attained). The Government has built up substantial reserves, partly from past surpluses, for repayment of debts including debts on-lent to SOEs. However, in the FY2002/03 budget, surpluses have been programmed as a source of funds to finance the overall projected deficit.

c. Ensure Effective Financial and Economic Management

22. A series of strategies and measures were included in the Program to ensure sound economic management and governance. In accordance with the general principles of the New Zealand model of governance adopted by the Cook Islands, the Government is required to submit a statement of policy before the budget, submit a statement of the fiscal strategy with the budget, and prepare yearly, half-yearly, and pre-election fiscal updates. All of this is diligently complied with. However, while fiscal transparency has been achieved through the budget process in the narrow sense of presenting all the numbers, data on a Government Finance Statistics (GFS)¹⁶ basis indicating standard measures of fiscal balance is not presented. While the reported data is voluminous, the lack of clarity hinders assessment of the true underlying fiscal position.¹⁷ The same problem is encountered with respect to the ERP requirement to improve the availability of audited financial information. While the financial statements remain outdated, the latest completed report being for FY1998/99, the information is not presented on a GFS basis or with enough detail to produce GFS accounts. Nevertheless, production of the consolidated accounts of the Government, including central Government, and local and outer island administrations, with the SOE accounts has been an important achievement.

23. In line with the New Zealand model of governance, the Cook Islands adopted performance budgeting, management, and full accrual accounting. The introduction of new budget and accounting procedures stretched capacity and government resources at a time when the public service was downsizing and skilled manpower was in short supply. Accrual accounting required preparation of profit and loss statements, and balance sheets, and identification of the full cost of the provision of public services including capital charges. While the feasibility of the introduction of accrual accounting in such a small economy was originally questioned, the system is now in place and has been institutionalized. However, the changes in accounting procedures took time to introduce with many departments needing to outsource bookkeeping and accounting functions. Reporting to MFEM was frequently delayed although ministries now report within the month. Timely reporting, however, remains a problem in the outer islands administrations. Consolidation of information is hindered by the use of a variety of different financial management accounting systems and lack of adoption of a uniform system, which a small country like the Cook Islands with limited skills can ill afford. To improve the situation and build capacity, the budget division within MFEM now conducts regular training and mentoring sessions with ministries and outer island administrations.

24. The annual budget is prepared on a performance basis, and outputs are listed along with the Appropriation Bill. Greater detail is provided in Part II of the budget, which contains information on departmental work plans, expected results, and measurable quantifiable indicators of performance. However, outputs and the performance indicators require considerable further development before they can serve as a meaningful basis for public sector management, and the system currently in place would be best described as program budgeting. At present, no regular reporting is undertaken on output delivery and associated cost. Indeed the financial management accounting systems in use do not have this capability. Therefore, it is

¹⁶ Government Finance Statistics (International Monetary Fund, 2001).

¹⁷ Considerable time was spent by the OEM to establish the debt capacity of the Cook Islands in setting up a trial GFS account to determine the actual fiscal position.

not possible to measure productivity or changes in the efficiency of service delivery. Audit of output delivery is required under the PERCA Act, but PERCA does not presently carry out this function. While the desirability of the introduction of performance budgeting may be questioned in small economies with limited capacity to fulfill the additional monitoring and reporting requirements, the widespread belief was expressed to the OEM that performance budgeting was desirable and warranted greater development and resourcing. However, until the new system lives up to the expectations the downside remains that in the effort to reformat budgets according to outputs that are neither monitored nor costed, critical fiscal information on inputs such as expenditures on wages or goods and services is not reported.¹⁸

25. An important second tranche condition was the completion of a draft medium-term Public Sector Investment Program (PSIP). The Cook Islands Investment strategy was approved by cabinet in July 1997, but has not been subsequently extended, developed, or institutionalized. Indeed the current officials in MFEM were unaware of its existence or the function of the PSIP process. The New Zealand model of governance adopted by the Cook Islands does not identify a separate PSIP process, assuming it is incorporated into the annual medium-term fiscal framework. However, in the developing country context where capital and development programming takes on a special significance, the explicit identification and selection of projects through a holistic approach is required to ensure that development projects are selected according to government policy priorities and partisan or political influences are kept to a minimum.

26. As an element of fiscal transparency, the ERP specified regular and independent reviews of public finances. This requirement was fulfilled by the passage of the PERCA act. Since passage of the act in 1996, PERCA has commissioned regular independent reviews: 20 in FY1997/98, 15 in FY1998/99, and 23 in FY1999/2000. However, while these reports are presented to Parliament, there has been little debate and no action has been forthcoming.

d. Improve Public Sector Management and Efficiency

27. An important element of public sector reform and relationship between ministers and HOMs was the incorporation of a purchaser-provider model in the delivery of government services. Under the arrangements, HOMs enter into performance agreements with ministers to deliver specified outputs at an agreed cost. The role of the HOM is to manage the ministry in the most efficient way and he/she is given freedom to optimally deploy resources under his or her control, but subject to both the MFEM and Public Service Commission (PSC) laws, the latter requiring HOMs to act according to “good employer” principles.¹⁹ The day-to-day operation of ministries resides with the HOM, while the minister is responsible for the development of policy, outputs, and measurement of performance. In this way, political interference in the running of the ministry and hiring of employees is minimized. Initially, the introduction of the new system was reported as one of the major achievements of the ERP with examples of HOMs refusing to agree to ministerial requests because of lack of output specification in the budget and provision

¹⁸ The annual budget estimates provide no information by major input source, such as wages, goods, and services, and it is not possible to identify the major sources of growth in public expenditures. The OEM had to carry out a special exercise to estimate the growth in the wage bill to supplement the detail provided in MFEM’s regular reporting in order to evaluate fiscal developments.

¹⁹ Based on the New Zealand model, this means that every HOM is required to follow a personnel policy that contains provisions promoting fair and proper treatment of employees in all aspects of their employment. This includes providing good and safe working conditions, equal employment opportunities, promotion of the principles of the Treaty of Waitangi, impartial selection procedures, and opportunities for employee personal development.

of associated funding. However, the OEM's discussions with HOMs indicated that this relationship was being eroded with the system reverting to more direct ministerial involvement in the running of ministries. As part of the ERP measures and conditions under the performance agreements, HOMs are required to report on the delivery of outputs semiannually to PSC. Depending on performance, HOMs are eligible for bonus. However, while HOMs provide reports, these are not actively assessed or used by PSC as a monitoring tool, largely due to lack of PSC staff capable of carrying out the function.

2. Promoting Private Sector Growth

a. Promote Public Confidence in Reform Program

28. Successful implementation of economic reforms requires community participation and confidence in the Government's commitment to reform. The ERP called for public release of the "Path to Recovery" and a demonstrated commitment to the principles outlined. The five-point program specified asset sales, debt repayment, restoration of liquidity and investment, resumption of private sector growth, and establishment of a \$100 million reserve for investment in the social sectors. Except for the last point, this has been achieved. There was a highly participatory relationship among the Government, private sector, and community groups. However, the view was expressed to the OEM that emphasis was laid more on rectifying the immediate fiscal and debt crisis, and less on the long-term need for structural reform. Since the ERP completion in 1999, the participatory approach has all but ceased. With four different coalition governments holding power since the last election, the lack of political stability has impeded maintaining the reform momentum. During the last budget statement, the Minister of Finance expressed his regrets at the lack of consultation with community representatives prior to the publication of the budget policy statement since the new coalition had only just assumed office.

b. Improve the Environment for Competitive, Private Sector-Led Growth

29. This critical element of the ERP targeted tax reform, privatization, and reform of laws hindering market efficiency. Extensive reform of the tax system with amendments to the turnover tax, income tax simplification, and reduction of import levies was specified as a second tranche condition. The tax reform was more comprehensive than envisaged: the turnover tax was abolished and replaced with value-added tax (VAT), income taxes were streamlined, and the number of different import levy bands was reduced. The tax reform was perhaps one of the most successful of the ERP. In addition to the introduction of a broad-based non-distortionary system supporting private sector growth, it resulted in buoyant revenue collections underpinning the return of fiscal stability. Less successful has been the reduction or elimination of protective distortionary import taxes (levies). While the tax reform did introduce an element of streamlining into the import tax regime, a large number of different bands and rates remain (Table A3.2 in Appendix 3).

30. The ERP included a wide-ranging privatization program with emphasis on establishment of transparent and contestable guidelines, and a strategy to enable the Cook Islanders to participate in the process. While many entities were corporatized, privatized, or terminated (Table A3.3 in Appendix 3), the process was not always transparent. Most notably, the main resort in the Cook Islands, the Rarotonga Hotel, was transferred to a local businessman on very favorable terms, while substantially higher offers from foreign investors were turned down (Appendix 4). To be able to proceed with the sale, the Government had to clear a mortgage on

the property first. For this purpose, because of the lack of funds at the time, the Government had to sell 20% of its 60% share in the Cook Islands Telecom to the other partner, Telecom New Zealand, thus creating a private sector monopoly. In addition to the Rarotonga Hotel, the Broadcasting Corporation, Printing Office, Aitutaki Lagoon Resort, and Rapae Hotel were all sold to the private sector. The Te Aponga Uira, the Cook Island power utility, was slated for divestment, but sale was never effected. The Vaimaanga Hotel, funded through Italian sources with the debt subsequently restructured as part of the Manila Agreement, was never completed and the lease returned to the landowner due to lack of payment. The Housing Authority was dissolved.

31. There is no doubt the privatization program, however lacking in transparency and contestability, played a key role in revitalizing and returning the economy to a path of economic growth, particularly in the tourism industry. However, the ERP design did not go much beyond identifying a list of candidates and executing the privatization process in a rush to get the economy back on track. Little attention was paid to whether privatization was the most suitable form of transformation, or to the establishment of a regulatory and monitoring regime once the process was complete. The Cook Islands Investment Corporation has been given the responsibility to manage government assets, but does little more than collect and consolidate accounts. No analysis of performance is conducted and there is no regulation of prices in the case of monopolies either private or public. While privatization of the Te Aponga Uira was originally envisaged, its corporatization as a public utility probably better serves the country. The sale of Telecom shares resulted in the creation of a private sector monopoly, which is not subject to regulation and not required to publish financial statements. While the transformation of the SOE sector has freed the Government from the need to subsidize inefficient industries and supported financial stabilization in the short term, the lack of monitoring and regulation is not in the public interest.

32. An important ingredient of the ERP was removal of distortionary laws that impeded market efficiency. In particular, amendments were proposed to remove requirements for premium rates for unsocial work hours, progressively deregulate the labor market, and repeal the Control of Prices Act. None of these requirements were acted on. However, inefficient bureaucracy and policing has resulted in a price control regime that is largely ineffective.

c. Facilitate Access to Capital Through an Efficient Financial Sector

33. An important part of the ERP reforms to enhance the efficiency of capital markets was a series of initiatives designed to improve the operation of the Cook Islands Savings Bank (CISB) and the Cook Islands Development Bank (CIDB). To some extent, the merger of the two institutions into the Bank of the Cook Islands (BCI) altered the ground rules upon which original reforms were intended to be based. However, many of the measures remain at issue and the jury is still out on whether the merger has or will contribute to capital market development. The ERP called for improvement to the cash handling arrangements of CISB, repayment of the Government's debt to CISB, and operation of CISB on a commercial basis. While many irregularities existed in outer island cash handling, these have now been rectified, and as part of BCI, the savings bank functions now operate on a commercial basis. However, the intended liquidation of the Government's debt to CISB has not taken place with approximately NZ\$3 million still outstanding. The ERP made provision for CIDB to mobilize domestic savings through taking deposits, and BCI now offers a full range of savings, checking, and term deposits. However, BCI is not regulated, there is no deposit insurance, and the conflicting interests of development banking and depositors remain a serious concern.

34. With no central bank, the conduct of monetary policy (limited to the financial operations of the Government) resides with MFEM. At the time of the financial crisis, the Government was a net debtor to the banking system effectively crowding out the private sector. The ERP called for repaying local creditors and reducing demands on the local banking system. With the use of counterpart funds generated by the program loan, local creditors were repaid. The improvements in fiscal policy resulted in a change from the Government being a net debtor of NZ\$8 million in FY1994/95 to becoming a net creditor of NZ\$20 million in FY2001/02 (Table A3.4 in Appendix 3).²⁰ The ERP specified the need for strengthening the awareness of the Government of the implications of fiscal policy on the financial sector, and required regular quarterly meetings and consultations with the commercial banks. MFEM does meet regularly with the banks, but its institutional capacity is weak to adequately design and implement those areas of monetary policy that come under its influence.

d. Simplify Access to Land

35. There was wide consultation on land issues, but these failed to result in simplification of the land tenure system as required under the ERP, in any case an ambitious target. As in most Pacific Island economies, the land tenure system and access to land are significant constraints on development, and the Cook Islands is no exception. Land holding is owned through tradition and family, and cannot be alienated. However, long-term leasing is possible and leasehold mortgages have been an accepted form of collateral to the commercial banks to secure loans, thus providing a source of finance to developers and enabling productive land to be brought into economic use.²¹ Land trust managements arrangements have improved and the law was modified in 1996 to require unclaimed rents to be publicized. After a statutory period, remaining amounts are transferred to the Land Trust Reserve for public use. A land title database has been designed with significant progress being made on data entry with a target completion date of 2004 for all registrations.

e. Facilitate Foreign and Domestic Investment by the Private Sector

36. Critical to the successful implementation of the ERP was the development of an environment conducive for foreign investment. An important second tranche condition was the enactment of the Development Investment Act, which would create the Development Investment Board (DIB) and clarify its role. This was accomplished in 1996. Prior to the ERP, the Monetary Board (effectively cabinet) executed the functions of foreign investment licensing but in an ad hoc and non-transparent way. The Monetary Board was subsequently abolished. It is clear that liberalization of foreign investment during the recovery period played an important role in reinvigorating the economy. However, by the time of ERP completion, a clear understanding and execution of government policy toward foreign investment was becoming muddled. A new investment code was drafted as required by the ERP, but the cabinet failed to adopt it. DIB has thus been operating without clear policy guidelines. Its history has been controversial. In 2001, the whole DIB was dismissed following the granting of license to a foreign investor in a technical area, which conflicted with the interests of a local investor who

²⁰ The strength of the Government's current position is of some concern to the banking community as a decision to invest off shore to attract a higher yield or deterioration in fiscal policy could lead to a reduction in liquidity. With the excess liquidity in the system matching the Government's deposits, any change in government policy would force the local banks either to borrow off shore at higher cost or reduce domestic credit, either of which would lead to an increase in domestic lending interest rates.

²¹ However, while access to land is not a constraint to the Cook Islanders within their home island, access to land in other locations, particularly for outer islanders wishing to take up business or agricultural opportunities on the main island of Rarotonga, is effectively restricted.

had failed to receive financing from local sources. In 2002, the DIB chairman resigned following the failure to grant a license to a foreign investor for tourism development in the outer islands, explicitly an area in which the Government supported foreign direct investment (FDI). While there was a clear need to attract foreign investment during the economic recovery period, now that the economy has returned to good health, many local businesses are questioning the policy of attracting foreign competitors. It is clear that the current environment lacks transparency and runs counter to the ERP objectives of liberalizing FDI.

C. Program Management

1. Disbursement and Procurement

37. The first loan tranche of \$3.0 million was released in October 1996, 4 days after loan effectiveness. An imprest account was expeditiously opened with an Australian commercial bank in the Cook Islands. The second tranche of about \$1.8 million²² was disbursed in September 1997, about 2 months after the target date. Loan proceeds were fully liquidated by 31 December 1997, the original closing date of the loan. Disbursement was based on reimbursement for any goods imported up to 180 days of loan effectiveness, other than those included in a negative list. Actual goods financed consisted primarily of aviation fuel and other oil products.²³

2. Performance of ADB and the Executing Agency

38. MFEM was the Executing Agency for the ERP. Given the scope, breadth, and complexity of the 122 program measures, combined with the severity of the fiscal crisis at hand, and the high turnover of MFEM staff induced by the crisis, MFEM's performance during the 3-year program period was highly satisfactory. MFEM demonstrated strong support for the ERP, which was backstopped by equally strong support by the Office of the Prime Minister. NZODA-financed expatriate staff in key MFEM positions played a significant role in effective implementation of reforms.

39. ADB's response to the Government's crisis was timely and appropriate. The 1995 economic report on the Cook Islands (footnote 9), which presented a comprehensive analysis of the economy, helped identify the forthcoming crisis and provided an analytical basis for policy dialogue and decision making for the eventual program design. ADB also played a major role in coordinating the contribution of other external funding agencies to the ERP through its efforts to organize consultative group meetings in 1996 and 1997. Continuation of active policy dialogue and support of the ERP waned after release of the second tranche in September 1997, although ADB's role as an honest broker in the Manila Agreement of 1998 had a substantial positive impact on the Cook Islands' international debt problems that were beyond the scope of the ERP to address. The long delay in proceeding with the third phase of the FEM capacity building TA program²⁴ has likely had an impact on the continued weaknesses within MFEM and the Government's ability to sustain progress in economic reforms. Overall, ADB's performance is rated satisfactory.

²² Due to the change in the value of the SDR after loan approval, the effective loan amount was reduced from \$5.0 million to \$4.83 million.

²³ The OEM was unable to locate any audit report on the ERP in ADB's records. Records contained liquidation documents representing about \$2.3 million out of the total loan amount of \$4.8 million.

²⁴ TA 3815-COO: *Improving Corporate Management in Government Services*, for \$250,000, approved on 19 December 2001. Consultants have not been fielded, and the TA is expected to be reformulated.

3. Effectiveness of Technical Assistance

a. Strengthening Institutional Capacity for Financial and Economic Management

40. The first FEM TA was approved in October 1995 (footnote 2), about 11 months prior to approval of the ERP, and the second in January 1997 (footnote 6), about 4 months after approval of the ERP. The TAs constituted the first and second phase of a comprehensive 3-year program for strengthening the capacity of MFEM in macroeconomic analysis, planning, and policy formulation. While they were generally effective in assisting the Government in dealing with the financial crisis, and maintaining support for the ERP, they failed to establish sustainable local capabilities for economic management. With the notable exception of the statistics office of MFEM, there is still considerable reliance on expatriate inputs. The quality of recruited international consultants was not consistently high, and incompatibility problems between consultants were reported to be a hindering factor. The demands on senior staff and consultants during the crisis, and assisting with the development of the systems and procedures required for implementing reforms, did not permit a sustained focus on staff development and other capacity building objectives. The loss and high turnover of senior MFEM staff, as well as staff from other major ministries, also adversely affected the capacity building efforts.

41. The consultants for the first FEM TA were reportedly responsible for preparing the draft PSIP, and comprehensive policy and strategy statements for tourism, agriculture, and marine resources (all second tranche release conditions). The three strategy statements were designed to provide a policy framework to enhance the sectors' competitiveness and harness their growth potential through institutional and policy reforms. Although the progress report for the release of the second tranche and the PCR indicated that all four documents had been completed and approved by the Cabinet in July 1997, current government staff, a number of whom served already at that time, are unaware of these documents. Assuming the documents were finalized and endorsed by the Cabinet, it is clear they were of little use or relevance to the Government or for follow-up action by ADB on their recommendations.²⁵ Overall, the two FEM TAs are rated partly successful.

b. Institutional Support to the Development Investment Board

42. This TA was attached to the ERP loan (footnote 5). Its objective was to enable the newly established DIB to become quickly operational and effective in its investment promotion and trade marketing. The start of the TA was delayed by 1 year pending selection of DIB's first chief executive and supporting staff. The 9 person-months of consulting services provided over a 6-month period were highly successful in getting DIB "up and running." Systems, procedures, and databases were established, a corporate plan was prepared, trade missions were undertaken, a website was developed, and staff received good on-the-job training. However, given the relatively young and unskilled staff, and turnover of chief executives, TA inputs were insufficient to firmly establish DIB as an effective promoter of international trade and FDI. Failure to enact a new investment code (second tranche condition) has also affected transparency in FDI policy and hindered DIB effectiveness.²⁶

²⁵ Upon return of the OEM to Manila, the consultant for the second FEM TA was able to provide electronic versions of the three draft strategy papers, none of which met ADB standards to justify compliance with the second tranche conditionalities.

²⁶ A visit to DIB's website in November 2002 is revealing. For the topics of Doing Business, Investment Opportunities, and Investment Code, the visitor is informed that these areas are "currently under construction."

43. A secondary TA objective was to make DIB a one-stop shop for foreign investors. While DIB claims to facilitate one-stop shopping, any foreign investor would require separate approvals from the Department of Immigration, Health, Conservation, Customs, Power Authority, Building Controller, Liquor Licensing Authority, and Tourism, among others. Overall, the TA is rated partly successful.

c. Management of Business Ventures Development by the Cook Islands Development Bank

44. This TA was also attached to the ERP loan (footnote 5). However, the Government requested its cancellation (eventually approved by ADB in July 1998), based on the decision to privatize CIDB. In 2001, the operations of CIDB were combined with those of the financially distressed CISB to create BCI. Privatization has not occurred and is no longer under active discussion.

III. PROGRAM RESULTS

A. Performance Indicators

45. The report and recommendation of the President for the ERP specified an extensive number of performance monitoring indicators covering the 3-year program period in the areas of fiscal parameters (25) and ratios (9), external sector performance (6), private sector development (9), and social impact (7).²⁷ Active monitoring of the indicators by ADB with reference to the ERP was done consistently on a quarterly basis, but only during the first year after loan approval (until the release of the second tranche). Detailed statistical data reflecting fiscal, economic, and social conditions prior to, during, and after the ERP are given in Appendix 3. Highlights for major indicators are discussed in the following sections.

B. Impact of Policies

1. Macroeconomic Impact

46. The major impact of the ERP was macroeconomic stabilization and return to high rates of economic growth in the post-reform era. In the 4 years to FY1997/98, the economy contracted by a negative 2.9% per annum. In FY1998/99 and the following year, GDP grew by 5.8% and 9.9%, respectively. In FY2000/01, revised estimates of GDP would indicate that the rate of growth slackened as the economy neared capacity and inflation jumped to 8.7%, but overall the economy still recorded a healthy 3.0% growth.²⁸ While the tourism sector suffered after the 11 September 2001 attacks in the United States, from the downturn in international travel, and the termination of a charter carrier from Canada, the economy was largely stagnant in FY2001/02 as inflation returned to normal. However, there are signs that these disruptions are over and there is every reason to anticipate the economy will record a good performance in FY2002/03. Behind the impressive growth figures was the successful implementation of the ERP. A participatory approach was adopted bringing together the Government, the private sector, and community groups. The realization that reform was unavoidable led to a collective

²⁷ Most of the monitoring indicators, with the exception of those for monitoring social impact, had annual targets/projections covering FY1996/97–FY1998/99.

²⁸ OEM estimate based on lower inflation estimates and smaller negative growth rates for agriculture, utilities, and public administration sectors. The Government estimates the growth at a negative 3.3%.

decision to take firm action and “bite the bullet.” This resulted in the implementation of painful reforms, which underpinned the return to economic stability and growth.

47. Most important to the economic recovery was the mix of reforms in the public sector and in improvements to the environment for private sector growth. The fiscal situation was stabilized through a three-tiered approach: (i) fiscal compression, (ii) tax reform, and (iii) debt restructuring. The reduction in public servants at the start of the reform period had an immediate impact on cost-cutting impact bringing the deficit under control. In the medium term, the introduction of VAT established a broad-based non-distortionary tax, which led to considerable buoyancy in tax collections, and allowed a reduction and restructuring of income and corporate taxes. The restructuring of the external debt situation and accord achieved under the Manila Agreement established a viable external position and return of international respectability. Coupled together, the three key fiscal policies reestablished macroeconomic stability and laid the foundation for subsequent economic recovery.

48. The return of economic growth was facilitated by progress in three critical areas of private sector reform, namely, privatization, FDI, and domestic resource mobilization. While the process of privatization was not transacted in the most transparent fashion, key facilities in the tourism sector was placed under private sector control, permitting the rapid increase in visitor arrivals between 1998 and 2001 averaging 14% per annum. The Government’s policy towards FDI at the time of the OEM’s visit was under a hiatus, but there is no doubt that the liberal regime that existed during the ERP underpinned the return of economic growth. Finally, the generation of a fiscal surplus in FY1999/2000 to FY2001/02 led to the net credit position of the Government with the domestic banking system improving by about NZ\$28 million. This significant change from crowding out the private sector through government borrowing to crowding it in enabled a rapid expansion in credit to the private sector supporting growth in tourism and the economy. In sum, the impact of the ERP on the macroeconomy was dramatic and led to the return of financial stability and economic recovery.

49. Although declining in economic importance since the early 1980s, two thirds of all Cook Island families are still engaged in some agricultural activity. Prior to the ERP, the Ministry of Agriculture maintained a national extension division and provided many of the services required by the agriculture sector including input supply, cultivation services, and the provision of planting material. Following the FY1996/97 ERP budget cuts, the number of staff in the ministry fell from 270 to 70. The extension division was closed, and its functions partly taken over by research division. However, there is no formal link from Rarotonga to the agricultural officers on the outer islands which restricts their ability to obtain up-to-date information on crops or technology. Most other services were largely withdrawn, apart from the provision of limited planting material. Exports of fruits and vegetables, almost exclusively paw paw (papaya) products to New Zealand, dropped from NZ\$1.70 million in 1996 to NZ\$0.25 million in 2001. Conversely food imports totaled about NZ\$22.9 million in 2001, an almost 40% increase for the same period.

2. Institutional Impact

50. In attempting to adopt the New Zealand model of governance, the Cook Islands embarked on a far reaching and ambitious program of institutional reforms. The new system of governance was embodied in the three important pieces of legislation: the MFEM, PERCA, and PSC acts. The institutional reforms had far reaching consequences, transforming a weak system of governance into one that contained the central pieces of a system of good governance. It is clear that the reformed system played a critical role in not only redefining the role of government, but also in establishing fiscal responsibility and underpinning economic

recovery. However, while a new system is in place, considerable work remains before it can be said to be fully operational. In the MFEM Act, fiscal responsibility is poorly defined, and the financial accounts are not presented according to internationally accepted standards (i.e., GFS) that would enable transparent analysis of the fiscal position. While accrual accounting has now largely been institutionalized, there remains much work to be done in the area of output budgeting and performance management before the system is working as designed. Lastly, the relationship between HOMs and ministers, while institutionalized through the purchaser-provider model, is being undermined in the current uncertain political climate.

51. In the financial sector, the merger of CISB with CIBD into BCI improved the provision of banking services in the outer islands and provided the newly merged institution with a new source of funds, namely deposits. However, the merger also created a conflict between the interest of depositors and objectives of development banking, and it is uncertain as to whether BCI will make a critical contribution to financial intermediation in the Cook Islands. The foreign investment regime remains in hiatus. The ERP helped institutionalize DIB, which played a role in economic recovery. However, DIB embodies an “old style” approach to FDI, which is neither transparent nor consistent, and encourages ad hoc decision-making. Finally, while significant institutional changes were made through privatization, particularly in the tourism sector, they focused on fiscal strengthening, and the ERP did not provide a framework for SOE regulation or monitoring.

C. Social Protection

52. The most far-reaching and adverse impact of the ERP was in the emigration that ensued from the public sector downsizing. The final results of the 2001 population census are yet to be finalized, but preliminary figures, which include non-residents,²⁹ indicate that while the population of Rarotonga has grown since 1996 by 1.7%, the population of the outer islands fell from 9,312 to 5,821, which is equivalent to an average 9.4% decrease per year. The large reduction in the public service staff from 3,205 in 1996 to 1,319 in 1999 was implemented with a disproportionate impact on the outer islands. The ERP was designed on the basis that a significant percentage of displaced people would be relocated to the private sector in agriculture, fisheries, and tourism. However, faced with little alternative to public sector employment in the outer islands, and given the rights to New Zealand citizenship and residence, the population voted with their feet and got on the first plane. It would appear that the design of the ERP failed to anticipate the emigration of a large part of the Cook Islands’ population to such an extent that the very viability of the remote and very small outer islands has been seriously compromised. Given the lack of alternative employment activities in the outer islands, New Zealand’s more lucrative employment opportunities and higher quality of social services, combined with full rights of access to New Zealand by all Cook Islanders, and a long history of Polynesia migration, it is surprising that the program design failed to fully anticipate this major consequence.³⁰

D. Environmental Protection

53. Climate, topography, vegetation, reefs, and lagoons are the Cook Islands’ major natural assets that make the country a popular tourist destination and allow a pleasant lifestyle for most

²⁹ Non-residents include both tourists and Cook Islanders whose center of living lies outside the Cook Islands.

³⁰ The ERP did not have any direct adverse impact on the indigenous peoples that could trigger ADB’s *Policy on Indigenous Peoples*.

Cook Islanders. According to the 2001 economic report (footnote 9), solid waste disposal,³¹ sewage treatment, ribbon development along the coastal strip (Rarotonga), reef and lagoon management, and sand and coral mining (particularly in the outer islands) raise serious environmental concerns, which have changed little or worsened during the 1990s, and potentially threaten the tourism industry in the longer term. The ERP policy matrix contained three provisions directly related to the environment. The first was to define annual sustainable catch quotas for the fishing industry, which had already been an ongoing activity of the Forum Fisheries Agency (FFA).³² As no foreign fishing vessels were issued licenses in 2000, 2001, or 2002, and sustainable catch is estimated to be many times the capacity of the local industry, the quotas have not had much practical importance. The second condition required the Government to develop community awareness through media and public discussion. This resulted in a weekly environment column in the local newspaper prepared by the Environmental Service. The third condition called for the introduction of environmental impact assessments for development proposals. However, this had already been a requirement incorporated in the 1995 Rarotonga Environmental Act (but not applicable to the outer islands). Guidelines issued as part of the ERP to cover the entire country had no legislative backing. Overall, because of the concentration on economic and public sector reforms, the ERP had little positive or negative environmental impact, although the reduction in Environmental Service staff from 19 to 6 and the high turnover of management effectively reduced the capacity to manage environmental issues. A consultation process is underway to finalize the proposed National Environment Act that will replace the Rarotonga Environmental Act. Among others, the new act will give island councils the authority to develop appropriate local regulations for environmental management.³³

E. Counterpart Funds

54. At appraisal, it was proposed that \$4.0 million in counterpart funds be utilized for the retirement of the Government's short-term liabilities,³⁴ and \$1.0 million for the promotion of private business through the Business Ventures Development Corporation that was to be established under the CIDB-related TA (footnote 5), and for equity injection in CIDB. Some of the funds were used for the first purpose (actual amounts were not provided to the PCR mission or the OEM); but no funds were used for the second and third purposes due to the plan to privatize CIDB, and the cancellation of the Business Ventures Development Corporation proposal. Counterpart funds were then reportedly used for general budgetary support and refurbishment of the Rarotongan Hotel.

F. Sustainability

55. It is clear that the Cook Islands have reached a turning point in their development. The macroeconomy has been stabilized and economic growth has returned. Important institutional change has been achieved. Indeed, the right foundations for long-term development and economic growth are in place. However, in the uncertain political climate that has ensued from four coalition governments since 1999, the reform momentum has been eroded, and the

³¹ The solid waste problem is being addressed by Loan 1832-COO(SF): *Waste Management Project*, for \$2.2 million, approved on 17 July 2001.

³² FFA was established in 1979 in response to the member countries' desire to promote regional cooperation and coordination in respect of fisheries issues and their concern to secure maximum benefits from the living marine resources of the region, in particular the highly migratory species. FFA members include 14 Pacific Island countries, plus Australia and New Zealand.

³³ ADB. 2002. *Cook Islands 2001 Economic Report: Policies for Progress*. Manila.

³⁴ Government's total short-term liabilities were estimated at NZ\$50 million (\$34.5 million) as of June 1996, of which about NZ\$13.8 million (\$9.5 million) were arrears to domestic creditors and deferred wage payments.

institutional structure is not as robust as it was at the time of the ERP completion. In particular, the failure to maintain the participatory approach developed during the reform period has impeded policy making. The purchaser-provider relationship between HOMs and ministers is being eroded by political interference in the day-to-day running of the government business. The budget authorized for FY2002/03 is the first one showing a deficit since the crisis. Lastly, the adverse policy environment with respect to FDI may undermine economic growth potential for the future. While the Cook Islands have made very significant progress since the financial crisis of the mid-1990s, long-term sustainability is not ensured and the reform program needs revitalization if eventual success is to be assured.

G. Overall Impact

56. The ERP's goals of achieving recovery and sustainable growth through major macroeconomic structural reforms, and promoting private sector-led growth were highly relevant to addressing the financial crisis facing the Cook Islands. The ERP has been a major achievement for the Government. The major reduction of the public sector and the generally sound policy framework progressively put in place provide a good foundation for long-term growth. At the same time, substantial improvements have been made in the transparency and accountability of government and in community participation. However, as is inevitable in any reform process, it is clear at hindsight that there would have been better ways to pursue some components of the reform. It would have been useful to have worked from a clearer idea of the form of government ultimately sought and to consciously manage a more gradual adjustment. There was also a tendency to focus on the adoption of unnecessarily complicated management tools rather than finding simpler, short-term solutions.

57. Despite the rather ambitious scope of the ERP, the Government has completed and sustained most of the agreed reform measures. Of the 122 measures, about 23 were partially completed, not completed, or completed but not sustained. Significantly, 10 major legislative acts were signed into law (9 during and 1 after the program period) and implemented in the areas of balanced budgets (Appropriation Act), income and value-added taxes (two acts), superannuation scheme (approved in 2000), offshore financial services, devolution (Vaka Act), fiscal and economic management (MFEM Act), public expenditure review committee and audit (PERCA Act), public service (PSC Act), and creation of DIB.

58. Measures to achieve the objective of macroeconomic stability were the most successful, although there are some signs of slipping back to imprudent fiscal behavior. The strong growth of the private sector during the period indicates the second objective has been substantively achieved, particularly in terms of tourism growth and the overall growth of the black pearl industry.³⁵ However, the private sector has expressed serious concerns about the growing shortage of skilled workers, the perceived insufficient government action on long-term human resource development, and the lack of political reforms needed for the stability of the longer-term economic reform process and fiscal stability. The recent lack of transparency on FDI could also affect long-term private sector growth prospects.

59. Measures in agriculture and fisheries were not very successful and growth in these sectors has been disappointing. This has significant economic and social effects on many from the lower income groups, particularly in the outer islands that have fewer economic options. The recent potential prospects for long-line fishing could yield a substantial economic boon, but

³⁵ Notwithstanding major disease problems and falling black pearl prices.

require the resolution of a number of issues (capital, marketing facilities and information, training, technical expertise, and industry knowledge).

60. Achievement of the third objective—mitigation of social costs resulting from the loss of civil service jobs and the rise in emigration—has been the least successful. Although emigration has been ongoing for many years, it is generally agreed that the ERP accelerated emigration from the outer islands to Rarotonga and overseas, and from Rarotonga to overseas. Emigration had serious effects on the social fabric of communities, particularly in the outer islands. Also, health and education sectors suffered and continue to get inadequate resources. Adverse changes in important social indicators were observed early in ERP implementation, but these have recently returned to near pre-ERP levels.³⁶ The NZODA-financed Transition Services and Community Action Program (NZ\$5 million) provided much-needed financial and technical assistance to retrenched government staff and other affected persons, but effectively operated only in FY1996/97. Neither agricultural policies/programs designed to attract retrenched staff, nor the strong growth of the private sector have been able to effectively stem continuing emigration, particularly of the young and skilled, or to attract overseas Cook Islanders to return.

IV. KEY ISSUES FOR THE FUTURE

61. The single most important issue for the Cook Islands at this time is whether to reinvigorate the reform program embarked on initially to restore macroeconomic and financial stability, but with longer-term objectives of restructuring the public sector and improving the environment for private sector development. The financial crisis was successfully overcome and the basic fiscal position is sound, notwithstanding the present signs of weakness in the design of the FY2002/03 budget. An important turning point has been reached as to whether to allow the slide in the progress of reform or complete an unfinished program. The best way to reactivate the reforms would be through a nationwide economic summit and reestablishment of the participatory process initiated in FY1996/97. A briefing on the initial objectives of the reforms, the progress achieved, the work left undone, and areas in which there has been erosion would be a good starting point. Without such a deliberate attempt to restore the reform initiative, and in face of the current lack of political cohesion, there is a significant risk that the important advances made by the Cook Islands may be lost.

62. More specifically there is need to reopen the debate about the appropriate objectives of fiscal policy with respect to the appropriate size and cost of government (rather than simply allowing revenue collections to determine the level of expenditure), and the optimal size of the public service and the level of growth allowed in salaries and/or staff numbers as the economy and population change. Having determined an appropriate size of government, a tax policy can be set accordingly. While the Cook Islands have established a modern tax system, the remaining import taxes, excluding those on spirits and tobacco, would be well abolished. There is a need to determine an appropriate external debt policy. This work has already commenced with ADB support, but it needs wider discussion and refinement. In the absence of a central bank to support fiscal policy in the short term, there is a need to determine a suitable buffer level of reserves to absorb shortfalls in revenues. Finally, the current definition of fiscal responsibility in the MFEM Act is weak. A suitable approach would be to incorporate the above objectives into a broader definition of fiscal reasonability through an adequately flexible system.

63. The Cook Islands have adopted the New Zealand model of governance, but the purchaser-provider relationship between ministers and HOMs has weakened. In order to

³⁶ Cook Islands social indicators are still the highest compared to all South Pacific countries.

maintain the principles of good governance and avoidance of political interference in the day-to-day execution of government business, this relationship needs restoration. An output-based budgeting system was introduced, but this has gone little further than budget reformatting and the system is not used in performance management. If it is to be effectively deployed, considerable further resourcing is required. New financial management systems will need to be introduced that allow monitoring of outputs to be recorded with associated cost, not just at the broad level of output defined in the Cook Islands (which is more akin to program budgeting), but at the detailed quantitative indicator level. Staff will have to be recruited and trained in measuring and recording the indicators. Lastly, annual performance audits will need to be undertaken, and acted on, just as the financial statements are currently prepared annually.

64. The foreign investment regime remains in a hiatus. The current situation does not support the long-run growth in the economy. While the participation of local investors is an important objective, it is also important to balance it with sharpening the competitive spirits of the private sector. Too frequently, the critics of FDI are local investors who wish to limit competition and see competition as a threat rather than an opportunity for opening up new markets. However, whichever path the Cook Islands decide to take, it is important to install a transparent regime that is not subject to ad hoc decisions made behind closed doors.

65. Finally, an important issue for the future is to complete and extend the reforms started in the SOE sector. The ERP emphasized privatization, which made a valuable contribution to reducing the cost of government and reinvigorating the private sector. However, since completion of the ERP, activity in the area has halted. While much progress was made, there remain areas still under public control that would benefit from transformation whether within the Government or outside. There is no regulatory environment or monitoring of the sector to safeguard the interests of the public or to provide information to the Government on SOE performance.

V. CONCLUSIONS

A. Overall Assessment

66. **Relevance.** The overall goal of the ERP was to reduce the Government's domination of the economy and create an outward-looking and competitive economy led by a growth-oriented private sector. The ERP as implemented was consistent with the Government's plan for reviving the economy and the ADB's strategy for the Cook Islands. The depth of analytical study combined with a highly participatory process involving the Government, the private sector and major external funding agencies ensured a sound design and strong country ownership of reforms. Overall, based on the rationale of the ERP and soundness of its design at appraisal and currently, the ERP is assessed as highly relevant.

67. **Efficacy.** Over 80% of the 122 ERP measures were implemented or substantially completed. Major reforms to downsize government staff by almost 60% and increase civil service productivity, and passage of key legislative reform measures were completed shortly before loan approval. In all, 10 significant legislative acts were passed and implemented. The second tranche was released 1 year after loan approval, only 2 months behind schedule. The ERP was crucial for the effective and expeditious resolution of the Government's fiscal crisis. Key legislation established principles of fiscal responsibility, and improved accountability and transparency. Tax reforms that reduced distortions were embraced by the private sector. Effective implementation of tax reforms induced major improvements in compliance, added significantly to total collection in a sustained manner, and resulted in major progress to

achieving fiscal balance. The Government's domestic debt was eliminated and significant cash surpluses generated. Good progress was also achieved on the corporatization and privatization of SOEs, and cost recovery of public services, particularly electricity. Major long-term debt restructuring has been achieved and debt service capacity is no longer a major issue. Notwithstanding the ERP's achievements, the reform agenda remains unfinished in such areas as the privatization program, a truly foreign investment-friendly environment, the quality of outputs produced by the public sector and effective monitoring of those outputs, further reductions in the size of government, removal/reduction of tariffs and price controls, more effective and affordable local government, and public service planning and management. On balance, the ERP is assessed as efficacious in terms of achieving its stated reforms.

68. **Efficiency.** The ERP and assistance from other external funding agencies played a major role in reducing the severity of the economic downturn in the 1996–1998 period, returning the country to macroeconomic stability, and inducing relatively strong economic growth led by the private rather than public sector, particularly tourism, retail and wholesale trade, black pearl production, and financial services. Agriculture and fisheries were also targeted to growth, but reforms in these areas were ineffective and/or poorly implemented, resulting in negative real growth in these sectors. Significant government deposits with local commercial banks have become a major source of liquidity, such that the improved fiscal position has gone from crowding out the private sector prior to the ERP to crowding it in during the past 4 years. The ERP objective of mitigating social impacts of Government downsizing was not achieved. The robust growth of the private sector was to be the primary source of employment for retrenched government employees, but the lag effect between reforms and private sector response was too long. This, combined with the ease and incentives for Cook Islanders to leave the country, led to accelerated emigration, particularly from the outer islands. A number of social indicators worsened during the first few years of the ERP but over the past 4 years have, in general, returned to the pre-crisis levels, which are the highest among the Pacific Island countries. Ironically, although emigration has exacerbated the problem of skilled workers and entrepreneurs, and, to a degree, affected the social fabric of the Cook Island culture, particularly in the outer islands, it also has acted as a relief valve for keeping social service costs to reasonable levels. Also, notwithstanding the inherent difficulty of establishing a counterfactual scenario, given the declining condition of the economy and unsustainable fiscal imbalances prior to the ERP, it is quite likely the emigration would have increased even more, and social indicators declined, in the absence of a reform program. Overall, the ERP is assessed as efficient in achieving its primary objectives.

69. **Sustainability.** While almost all major reforms remain in place after a period of 5 years, macroeconomic stability remains fragile. A major positive factor is the debt restructuring brought about by the Manila Agreement which, based on international benchmarks, would rate the Cook Islands as a lowly indebted country. However, government spending increases have recently outpaced revenue growth and again budget deficits loom on the horizon. The strength of the economy rests largely on the fortunes of the tourism and black pearl industries, which are highly subject to exogenous factors outside the control of the Cook Islands. The thriving offshore financial services sector has experienced rapid growth, but the country remains on the list of noncompliant countries by money-laundering agencies. A new foreign investment code has yet to be implemented, and guidelines for FDI are not fully transparent. The Government appears to remain committed to the New Zealand model of performance-based contracts and results-oriented public management introduced under the ERP. However, there are serious questions whether the model is well-suited for developing Pacific Island countries, and, even on the assumption that it is, whether pre-conditions exist today in the Cook Islands for the model to be

successfully implemented.³⁷ Although public participation was a key to strong ownership of the ERP, the local media, among others, indicate that poor transparency and accountability in Government are significant issues again. One of the most important ERP changes has been the separation of roles between ministers and HOMs along the lines of the purchaser-provider model, giving HOMs operational discretion and control, and the contractual obligation to produce agreed outputs for an agreed level of funding. However, there are strong indications that ministers are again becoming involved at the operational level, which introduces bias to government expenditures toward political agendas rather than community needs, as well as weakens controls on budget overruns. There are signs that a degree of “reform fatigue” has set in. With the immediate economic crisis over and the economy growing, although the reform agenda is unfinished, the political costs of further reforms must be weighed against the political benefits. The government responsible for implementing the ERP was voted out of office in 1999, and four coalition governments have been formed since (without elections). In short, whether the ERP’s achievements will be sustained is primarily a question of political reform—whether behavior and culture of the executive and legislative branches of the government can be permanently changed. An active open media, a politically active and educated population, and a solid government framework created by the ERP from which to build on suggests guarded optimism. The ERP is assessed as likely to be sustained.

70. **Institutional Development.** The impacts of the legislative reforms, introduction of the New Zealand Model of government management, and the devolution process on improving an enabling environment in the country are covered above. In addition, institutional skill levels and capacity building were key objectives of the two FEM-related TAs. However, the major disruptions resulting from the government downsizing, combined with the exodus of skilled government staff in the wake of the economic downturn, made formal capacity building difficult. The immediacy of the fiscal crisis and the required assistance for implementing the ERP necessarily dominated the work of the consultants. In general, the uninterrupted emigration of skilled people and the inability to attract overseas Cook Islanders back home before, during, and after the ERP have resulted in chronic problems in filling skilled positions in both the private and public sectors. Notable exceptions have been the improved capability of the Cook Island’s Statistics Office and the initial operating capacity of the DIB. Using expatriates to fill key positions made a significant contribution to the successful implementation of the ERP, but this long-term practice, common throughout the Pacific Island countries, also likely affected the sense of urgency to develop and exploit skilled local expertise. On balance, the ERP’s institutional development and other impacts are rated as moderate.

71. On the whole, based on all the major achievements and some shortcomings, the ERP is rated successful.

B. Performance of ADB and the Executing Agency

72. The ERP was designed in accordance with the strategies of the Government and ADB. With full support from the Office of the Prime Minister, MFEM demonstrated strong ownership. Given the severity of the financial crisis and the ambitious scope of the ERP, MFEM’s performance during the program period was highly satisfactory. ADB’s response to the Government’s crisis was timely, effective, and appropriate. ADB also played a major role in coordinating the contribution of other external funding agencies and brokering the 1998 Manila

³⁷ An analysis of the suitability of the New Zealand model for developing countries is given in Schick, Allen, “Why Most Developing Countries Should Not Try New Zealand Reforms.” *The World Bank Research Observer*, Vol. 13, No. 1 (February 1998), pp. 123–131.

Agreement. The delayed implementation of the third phase of the FEM capacity building TA program (footnote 24) has likely affected progress on economic reforms following the immediate resolution of the crisis. Overall, the performance of ADB was satisfactory.

C. Key Lessons Learned

73. An important lesson to be learned is the time required for the effective implementation of a wide-ranging reform program such as adopted in the Cook Islands. The original design envisaged that the reforms would be completed within the timeframe of the ERP itself, i.e., within 3 years. This was unrealistic. While the fiscal and macroeconomic stabilization was achieved within the period, the more far-reaching structural reforms were only partially completed. Coupled with the short timeframe, the lack of follow-up support by ADB may be responsible for the loss of reform momentum the Cook Islands is currently experiencing. ADB's country program included long-term TA policy support for MFEM, but it is only now that reactivating the delayed third-phase TA (footnote 24) is considered. While political instability has contributed to the current lack of direction in policy, the failure to provide and sustain expert advice and capacity building to maintain the reform momentum has also been an important factor.

74. At the policy level, the ERP clearly demonstrates that the introduction of VAT can be successfully achieved in the small island economies of the Pacific, provided there is sufficient planning and preparation. This has long been a question open to debate. The imposition of a simple regime with one unified rate, and limited number of VAT-registered taxpayers, supported through capacity building, has provided the model. The introduction of a modern tax regime of income taxes coupled with a broad-based consumption tax has provided a buoyant and non-distortionary environment for private sector development.

75. The Cook Islands provides another case of uncertainty affecting the future use of output-based budgeting and performance management. Introduced 5 years ago, the New Zealand system is currently used for little more than reformatting of the budget. The system has contributed to the lack of attention devoted to fiscal management and the basic costs of providing public services. Nevertheless, most public servants, in the Cook Islands as elsewhere in the Pacific, remain convinced that this is the right direction to move. Significantly more resources and capacity building would be needed if this conviction is to become anything more than a distant ideal.

76. Other lessons learned from the implementation of the ERP highlight (i) the importance of effective coordination with key external aid agencies at the early stage of design; (ii) an overall vision of how the public sector should look and perform in the long term, an associated set of goals and means, and an implementation plan with a timetable; (iii) the use of simple solutions rather than sophisticated and resource-intensive tools and systems; and (iv) detailed specification of outputs, and key performance indicators to measure outputs and impacts.

D. Follow-Up Actions

77. The most urgent action is to reactivate the third phase in FEM capacity building TA program (footnote 24) and give consideration to a fourth phase in a concerted long-term effort to consolidate and reinvigorate the reform process. The follow-up actions, which could be initiated through the TA, include

- (i) organizing an economic summit, with strong representation from the public and private sectors and civil society, to identify and build ownership for the major reform objectives that require action;
- (ii) redefining fiscal responsibility by providing policy guidelines on the size of government, external debt policy, fiscal stance (size of deficit), and level of government reserves;
- (iii) revising the Government's financial statements by introducing the GFS system of the International Monetary Fund, and ensuring reporting required in the MFEM act;
- (iv) approving and promulgating the long-delayed new foreign investment code to ensure a simplified and transparent foreign investment regime that promotes competition and high-quality private sector investment consistent with the country's development goals, yet sensitive to its unique culture and environment;
- (v) establishing an active government body with responsibilities for monitoring performance and regulation to continue the transformation process of the SOE sector;
- (vi) developing a formal PSIP process;
- (vii) facilitating parliamentary debate and action on PERCA's independent reviews of public finances; and
- (viii) abolishing the remaining import levies, replacing with excises, levies for the usual "sin" commodities (spirits and tobacco), which represent 55% of the yield from import taxes, and compensating for the shortfall through increases in VAT. This would not only establish a tax regime free of distortions but also support the Cook Islands' accession to the World Trade Organization and other regional trade agreements.

PROGRAM MATRIX

Overall objective: The national Economic Restructuring Program (ERP) seeks to facilitate the transition of the Cook Islands economy from one in which the public sector is dominant, productivity is low, and market signals are weak, to one which is led by a competitive and growth-oriented private sector. The overall objective is to achieve economic recovery and sustainable growth while ensuring that the negative economic, social, and environmental effects of the reform and restructuring process are mitigated to the maximum extent possible.

Policy Areas and Objectives: (A)			Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002			
Public Sector Reform	Strategy	Measures to be Taken							
			1. Redefine role of Government (emphasize regulatory functions).	1.1 Downsize the Government	Sharply reduce the number of public service employees in accordance with budget limits and based on heads of ministries' (HOMs) assessment of staff needs: expected reduction of public service by 55–60% of its full-time equivalent level in May 1996	End Sep 1996	At least 1,500 public servants entering the transition process	Completed on schedule. Staff numbers cut from 3,153 in Mar 1996 to 1,427 in Jul 1997. Number in Oct 1998 is 1,341.	As of 31 Aug 2000, staff numbers increased to 1,482, and to 1,667 at the start of FY2002/03. The total cost of wages, salary, and employee contributions dropped from NZ\$39,901 in FY1994/95 to an estimated NZ\$30,477 for FY2002/03, a decrease of 23.6%.
				1.2 Strengthen policy functions	Include policy-related responsibilities and skills in public service job specifications	End Sep 1996	Copies of job specifications lodged at Public Service Commission (PSC)	Completed for HOMs	Completed for HOMs
					Provide technical assistance (TA) to ministries with key policy formulation roles	Ongoing	TA requests and deliveries	Completed	TA 2424-COO from FY1995/97, TA 2750-COO from FY1997/2000, and TA 3815-COO approved Dec 2001
				1.3 Devolve selected powers and responsibilities to local communities	Enact revisions to Local Government Act to enable devolution of greater power to local councils (Vaka councils)	Mid Dec 1996	Law enacted	Completed. Vaka Act passed 27 May 1997	Completed. Vaka Act applicable only to Rarotonga. Effective devolution, particularly in outer islands, not achieved. Island councils and administrations unprepared for devolution.
		Conduct public awareness campaign to explain reasons and implications of Local Government Act revisions	End Feb 1997	Meetings at villages, Vakas, and islands; media exposure	Completed. Meetings held in November 1996	Completed.			

Policy Areas and Objectives: (A) Public Sector Reform	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
	1.4 Commercialize, corporatize, and privatize state trading activities	See B. "Promoting Private Sector Growth"				
	1.5 Communicate and consult with interest groups and public at large	Publish "Path to Recovery—The Reform Agenda"	End Jul 1996	Availability to the public on all islands	Completed	Completed.
		Monthly press releases and televised briefings by the Prime Minister on the progress of reform and related matters of public concern	End Jul 1996 (and monthly)	Media appearances and press releases	Completed and intermittent	Downward trend in frequency of Prime Minister briefings to the public for past 3 years
		Create formal consultation mechanism embracing business, labor, traditional, and community groups	End Sep 1996	Start of formal consultative process	Completed. National Development Council formed and ongoing	National Development Council now defunct and not replaced by any other formal participatory body. Ad hoc committees have replaced this function. ^a
2. Ensure fiscal responsibility	2.1 Cut costs to meet budgetary crisis	Keep the operational budget for FY1996/97, FY1997/98, and FY1998/99 within statutory requirements of the Fiscal and Economic Management (FEM) Act to achieve balanced budget (operational budget excludes extraordinary costs associated with the transition, debt servicing, and debt liquidation).	End Jul 1996	Appropriation Act	Completed in the sense that budget appropriations for FY1996/97 and FY1997/98 complied with the conditionality. There is noncompliance in the FY1998/99 budget, and deficits were actually recorded in FY1996/97 and FY1997/98. Asset sales are funding current expenditure.	Same as project completion report for FY1996/97–FY1997/98. Fiscal discipline has been maintained. Small budget surpluses have been generated for the past 4 fiscal years, inclusive of NZ\$9.0 million reserved for payment of Asian Development Bank (ADB) and French loans. Expenditure growth since FY1999/2000 has mirrored buoyant revenue growth, however, fiscal stability is fragile.
			End Jul 1997 Second tranche condition^b	Appropriation Act		
			End Jul 1998	Appropriation Act		

^a The Government has indicated its intention to reintroduce formal consultations in the financial statement of the FY2002/03 budget estimates.

^b Second tranche conditions are highlighted in bold.

Policy Areas and Objectives: (A) Public Sector Reform	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
	2.2 Increase user charges and reduce subsidies	Selectively increase user charges for health services to recover 5–10% of all Ministry of Health's costs in FY1997/98	End Jun 1997	Reduced net budget for FY1997/98	Reported as substantially complete in progress report Aug 1997	Partially complied. NZ\$158,000 collected in newly introduced user fees in FY1996/97 compared to expenditures of NZ\$3.6 million, excluding health services for outer islands. In FY2001/02, fees were NZ\$155,000 out of a total budget of NZ\$6.8 million.
		Progressively transfer responsibility for non-personnel and non-capital costs to school committees	1 Jul 1998	Reduced net budget for FY1998/99	Completed	Completed. It is reported that since the completion of the ADB Education Project (1999), all school committees maintain non-personnel and noncapital costs through island and Vaka councils
		Remove government provision for school buses in Rarotonga	End Dec 1996	Reduced net budget for FY1997/98	Completed	Completed. After being dropped from the budget in FY1996/97, this cost has never been reintroduced. The local bus company offers special weekly rates for school children.
		Introduce full cost recovery for non-Crown mandated services	1 Jul 1997		Completed according to progress report Aug 1997	Non-Crown services are an unknown term to the present Government. State-owned enterprises (SOEs) generally operate on a full cost recovery basis. Public water, waste management, and some sewerage services remain subsidized.
	2.3 Mobilize revenue	Comprehensively reform tax system (see "Promoting Private Sector Growth")	Mid Dec 1996	New legislation	Completed. New income tax and value-added tax acts effective Jul 1997	Completed. Tax reform very effectively implemented.

Policy Areas and Objectives: (A) Public Sector Reform	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Combine Inland Revenue and Customs Departments, followed by capacity strengthening (with TA and equipment)	Jul 1996	New Ministry of Finance and Economic Management (MFEM) structure	Completed in Jul 1996. The New Zealand Official Development Assistance (NZODA) provided TA.	Completed
	2.4 Manage immediate debt crisis	Negotiate with long- and short-term creditors to accommodate financial constraints in accordance with debt management strategy (with NZODA TA)		Agreements with creditors in respect of current liabilities	Completed Aug 1998 with ADB acting as honest broker	Aug 1998 negotiations reduced external debt by more than 25%. Repayment schedules have been extended and interest rates substantially reduced on average.
		Review Parliamentarians' Superannuation scheme	End Jun 1997	New legislation	Under action with officials' committee formed to draw up proposals	Old scheme unresolved and remains a continued significant budgetary burden (unfounded NZ\$525,000/year). Proposal under review to bring all retired and retiring MPs under the new National Superannuation Fund (2001).
	2.5 Adopt prudent borrowing and debt management policies	Formulate comprehensive strategy for debt management including target debt ratios	Mid Oct 1996	Report from MFEM	Completed but there is a question mark over sustained implementation.	ADB-assisted debt negotiations in 1998 resulted in major debt restructuring. After a period of restraint, Government is now undertaking an analysis of external borrowing capacity, including target debt ratios.
		Establish transparent and contestable guidelines for divestment of state assets	End Jul 1996	Cabinet approval	Completed in Feb 1996 with the establishment of the Privatization Committee, but observance of the guidelines has been an issue. Subsequent sale of Rarotonga Hotel lacked transparency and contestability.	Completed in Feb 1996. However, the Public Expenditure Review and Audit Committee (PERCA) reported irregularities in the divestment of the Rarotongan and Rapae Hotels.

Policy Areas and Objectives: (A) Public Sector Reform	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Proceeds from sale of selected state assets to be applied to debt retirement	Ongoing	Number of value and sales	Completed and ongoing	Completed. Proceeds used for debt reduction and budgetary financing requirements in FY1996/97 and FY1997/98.
	2.6 Create buffer against factors adversely affecting Crown's net worth	Establish by an Act of Parliament a Sustainable Development Reserves Fund	Mid Mar 1997		Redundant. Prudent balance sheet management mandated by MFEM Act.	Not completed. MFEM Act requires build up of special reserves after debt levels have reached prudential levels. ^c
		Create reserves from budget surpluses, after application to liquidating current liabilities and ensuring proper maintenance of capital assets	1998 onward	Government balance sheet	Incomplete	There has been a significant build-up of cash reserves for debt repayment, working capital, and other budgetary purposes (estimated at NZ\$20 million).
	2.7 Monitor fiscal risks	Identify and estimate major risks Contingent liabilities Uninsured cyclone damage to state assets Notes and coins held by nonresidents Foreign exchange risks to Government	Mid 1997	Reports	Completed according to Aug 1997 progress report. MFEM Act mandates use of generally accepted accounting principles	Completed.
3. Ensure effective financial and economic management	3.1 Publish Government's economic, financial, and fiscal policies	Publish Economic and Financial Policy Statement	31 Mar 1997 (and each year)	Document available to public	Completed	Completed and continued.
		Completed first draft of medium-term Public Sector Investment Program acceptable to ADB	End Feb 1997 Second tranche condition		Completed in a formal sense, but not effectively ongoing. No integration into the budget process	Completed for FY1997/98, but not effectively ongoing. No integration into the budget process. ^d
		Publish Budget Policy Statement		Document available to public	Completed	Completed and continued.

^c Bank currently establishing debt capacity of the Cook Islands, and preliminary analysis indicates debt has attained a prudent level.

^d Government indicated establishment of a comprehensive PSIP process would assist investment programming.

Policy Areas and Objectives: (A) Public Sector Reform	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Submission of Fiscal Strategy Report to Parliament, together with Appropriation Bill	31 Mar 1997 (and each year)	Document tabled in Parliament	Completed	Completed and continued.
		Submit Current Year Fiscal Update to Parliament	7 Jul 1996 (and each year)	Document tabled in Parliament	Completed	Completed and continued.
		Public Half-Yearly Economic and Fiscal Update	30 Jun 1997 (and each year)	Document available to public	Completed	Completed and continued.
		Public Pre-Election Economic and Fiscal Update- Within 14 days of announcing a General Election	31 Dec 1996 (and each year)	Document available to public	Mandatory under MFEM Act if an early election is called	Completed and continued.
	3.2 Reform budgeting and accounting processes	Monitor adherence to budget	Ongoing	Actual expenditure against budgeted expenditure and outputs	Ongoing, but with delays in reporting by ministries	All ministries now report monthly, but outer island administrations have difficulty meeting requirement.
Monitor and update Strategic Result Areas		FY1997/98 and ongoing	Completed and ongoing, with need to shift focus from inputs to outputs		Strategic goals defined in budget policy statement. Although budget specifies outputs, performance monitoring is weak, and performance audits are not undertaken as required in the PERCA Act.	
Introduce capital charges against departmental budgets for use of public assets to produce outputs		1 Jul 1997	Inclusion in FY1997/98 budget	Completed	Completed. Depreciation reserves used to finance capital expenditure.	
		Training HOMs and accounting cadres to develop capacity to comply with new requirements and standards	End Jun 1997	Full compliance	Completed. NZODA TA. But most ministries have outsourced the accounting task because of its complexity	Completed. NZODA TA. While most ministries and outer island administrations have outsourced the accounting task and institutional capacity remains weak, MFEM is now conducting regular training and mentoring.

Policy Areas and Objectives: (A) Public Sector Reform	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
	3.3 Improve financial information	Prepare and present comprehensive financial statements	End Jul 1996	Availability of statements	1996–97 statements now presented to parliament; 1997–98 substantially complete and expected to be presented to the next sessions of parliament	Audited statements considerably delayed. Latest statement available is for 1999. ^e
	3.4 Make independent review of public finances	Form PERCA	End Sep 1996	Announcement of membership by Queen's Representative in Executive Council	Completed. PERCA Act passed July 1996. PERCA committee operational July 1997	Completed. PERCA Act passed in July 1996. PERCA committee operational July 1997. While independent reviews regularly done, there has been no debate in Parliament of action taken.
4. Improve public sector management and efficiency	4.1 Empower HOMs to manage and delegate; with accountability	Draft National Human Resource Development Plan (public and private sectors)	Mid Dec 1996	Completed report	Completed with ADB TA. Plan approved by Cabinet July 1997	Completed with ADB TA. According to Human Resources Department (HRD) the 1997 document was national human resources development policy framework for the Cook Islands.
		Decide on implementation of main recommendations of HRD Plan	End Mar 1997	Cabinet minutes	Completed as immediately above	This document has guided the work effort of the HRD division with PSC from 1997 up to the establishment of the HRD Department in April 2001.
		Develop skills of senior public service managers to enable them to fulfill their new contractual obligations under the Public Service Act	Ongoing	Input: number, duration, and attendance at skill development sessions Output: enhanced departmental efficiency	Ongoing with NZODA assistance	Diploma in Public Sector Management short course instituted as a stop gap measure for upscaling quickly (temporary for 2 years). Other training programs were also implemented to address the training needs of the public service, private sector, and the outer islands.

^e Government indicated audit for FY1999/2000 is being finalized while audits for FY2000/01 and FY2001/02 will be prepared concurrently.

Policy Areas and Objectives: (A) Public Sector Reform	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Monitor senior manager's performance in accordance with performance agreements required by the MFEM Act and PERCA Act	Mid Dec 1996 (and half-yearly)	Regular PSC reviews and ad hoc PERCA reviews	Reported in Aug 1997 progress report as complete and ongoing, but effective implementation is constrained by PSC staff limitations	Continued assistance through TA 3815-COO (2001) and planned New Zealand Aid for International Development (NZ Aid) assistance HOM reporting to PSC not effectively undertaken or used as a monitoring tool.

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
1. Promote public confidence in Reform Program	1.1 Improve public confidence in government commitment to implementation of Reform Agenda	Endorsement and public release of <i>Path to Recovery</i> documented by the Government	Mid Jul 1996	Community to support the ERP	Completed in terms of document release	Completed.
		Demonstrated adherence by Government to <i>Path to Recovery</i> , and to reporting requirements of the MFEM Act	Ongoing		Ongoing. Five-point economic strategy announced in September 1996	Partially completed. Four new governments since 1999 reduced momentum for reforms. Reporting requirements generally adhered to.
2. Improve environment for competitive, private sector-led growth	2.1 Reform present high cost, inequitable, and distortionary tax structure	Enact amendments to Income Tax and Turnover Tax Acts addressing the need to broaden the tax base, reduce the number of taxes, reduce average income tax rates, eliminate tax on taxes, allow immediate deductibility of new capital expenditure, eliminate double tax on dividends, reduce import levies and partially replace with turnover tax, and reduce the number of taxpayers required to submit returns.	Mid Dec 1996 Second tranche condition	Tax Act enacted	Substantially completed. Income Tax Act 1997 and Value-Added Tax Act 1997 passed on 10 June 1997, effective 1 July 1997. Review of import levies yet to take place.	Turnover Tax efficiently replaced with Value-added Tax, which led to substantial buoyancy in government revenues, and contributed to fiscal stability and private sector growth. Income tax changes significant for high-income groups.
				Promulgation of guidelines	Review of import levies now subject of a draft Cabinet submission	Import levies substantially unchanged. Minimum taxable income level raised from NZ\$6,000 to NZ\$10,000 starting in 2003.
	2.2 Improve competitive environment and resource productivity through wide-ranging privatization program	MFEM to establish guidelines for transparent and contestable privatization process	End Aug 1996		Completed. See A.2.5.2 above	Same condition as A2.5.2.
		Develop policy and strategy to enable Cook Islanders to meaningfully participate in the privatization process	End Oct 1996		Completed and ongoing as per August 1997 progress report. Leasehold land returned to landowners as the basis of equity.	Completed. (See A.2.5.2)

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Complete corporatization and board reconstitution for privatization candidates	End Dec 1996	Promulgation of Guidelines	Completed as per Aug 1997 progress report. Cabinet removed all SOE board directors in 1996 and Privatization Committee began tendering process.	Completed.
		Divest Rarotongan Resort Hotel, Broadcasting Corporation, Printing Office, Aitutaki Lagoon Resort Hotel, and Rapae Hotel	Mid Dec 1996	Cabinet review/decision	Completed except for Rapae Hotel. Rarotongan Resort sale contentious (A2.5)	Completed. Rapae Hotel privatized in 2001. According to PERCA report, Rarotongan Resort sold to chairman of Privatization Committee reportedly under highly favorable terms, and significant loss of revenue to the Government based on another responsive offer (see A2.5).
		Consider alternative shareholding arrangements for Telecom Cook Islands and associated companies with view to realizing cash flow without divesting control	End Dec 1996	Sales concluded	Completed for Telecom. Government retains 40% after divesting 20% of its shareholding.	New Zealand Telecom purchased additional 20% share for NZ\$3.0 million, and now has a controlling 60% interest. No regulatory body in place to oversee telecom rate structure.
		Divest Te Aponga Uira including outer island power utilities within overall Government privatization policy/strategies	End Mar 1997	Cabinet decision	Incomplete	Incomplete. Outer island assets turned over to outer island councils in some cases. Te Aponga Uira has been established as an SOE, but there are no plans for divestiture in Rarotonga.
		Divest Vaimaanga Hotel	Mid Dec 1996	Cabinet decision	Incomplete	Completed in 2000. Handed over to local landowner due to lack of payment of lease. Hotel building assets have only salvage value. Outstanding government debt as of 1999 was NZ\$49 million. Loan denominated in German DM.

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Dissolve Housing Corporation	Early Mar 1997	Sale concluded	Complete. Subject of PERCA report	Completed, although asset status unclear.
		Periodic review by Privatization Committee for additional privatization candidates	Mid May 1997 (and half-yearly)	Corporation dissolved	Ongoing	No other candidates proposed for privatization, except for Shipping Registry, which was privatized in FY2000/01.
	2.3 Identify and address outdated laws, regulations, and practices that inhibit private sector initiatives.	Amend Industrial and Labor Ordinance to remove requirements for premium rates for unsocial work hours, and progressively introduce measures to deregulate the labor market	End Apr 1997	Cabinet decision	Incomplete	Incomplete. Private sector indicated disincentive effect of current restrictive labor laws. ^f
		Review marine safety and other regulations relating to large domestic vessels to promote interisland shipping	End Jun 1997	Cabinet decision	Incomplete	Incomplete
		Formulate proposals for deregulation of interisland shipping	End Aug 1997	Cabinet decision	Incomplete	Incomplete
		Review policy on importation and sale of liquor	End Jun 1997		Completed	Completed
		Repeal Control of Prices Act	End Dec 1997	Cabinet decision	Incomplete	Incomplete. Price (margin) control remains in effect, although Tribunal is defunct and law ineffectively administered.
3. Facilitate access to capital through an efficient financial sector	3.1 Improve efficiency and market orientation of Cook Islands Savings Bank (CISB) following separation of CISB and treasury functions.	Formalize arrangements for (i) arms length outer islands cash handling services between CISB and Treasury; (ii) agreed repayment schedule for outstanding treasury liabilities, including payment of market-	End Jul 1996		Completed according to Aug 1997 progress report. Decision to privatize taken in Sep 1996. However, there has been no progress on sale. The financial	Operating guidelines and procedures partially improved. However, CISB's merger with Cook Islands Development Bank (CIDB) in 2001 (see below) indicated significant accounting irregularities.

^f An Employment Relations Bill to replace the existing legislation is being finalized for presentation to Parliament. However, it is not planned to ameliorate the existing weakness.

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		related interest, and (iii) CISB to operate on a commercial basis, with freedom to manage assets accordingly			position of CISB is still to be clarified.	
		Decision on future for CISB/CIDB functions. Alternatives include merger with CIDB, privatization, contract commercial bank to provide services	End Oct 1996	Cabinet decision cited	For the time being, the Cook Islands Investment Corporation has put CISB in the too-hard basket.	CISB and CIDB merged in 2001 and renamed Bank of the Cook Islands (BCI). BCI has yet to establish itself as a sound and viable entity due to development versus commercial objectives, resources, and commercial capacity.
	3.2 Strengthen government awareness of financial sector and savings mobilization issues	Institute quarterly meetings between banks and MFEM	End Jul 1996	Minutes of meetings	Completed and ongoing on an ad hoc basis	Completed and ongoing on an annual basis plus other meetings as needed.
		Undertake review identifying banking sector issues and data for ongoing monitoring	End Nov 1996		Reported as completed in August 1997 progress report	Reported as completed in August 1997 progress report.
	3.3 Constrain government demands on savings by FEM Act, requiring transparent fiscal strategy on balanced budget principles	As part of overall arrears repayment, Government to repay arrears to domestic creditors totaling \$7 million: repay initial \$6 million and complete full repayment	Mid Dec 1996 End Jul 1997	Lower levels of government arrears	Status unclear. See A2.4.1.	Completed. Government arrears to domestic creditors eliminated. No longer a fiscal issue. The growth in government cash balances (NZ\$20 million) as of March 2002 has provided significant liquidity to the local banking system.
	3.4 CIDB to utilize domestic savings as funding source, within limit of prudential constraints	CIDB to explore potential for issue of medium term securities on domestic market to better match asset-liability maturity profile	Jun 1998		Incomplete. Awaiting outcome of privatization decision due in December 1998	Incomplete. Asset-liability maturity profile still an issue. Domestic savings being mobilized through a full range of savings, checking, and term deposit accounts.

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
	3.5 External grant and loan funding sought by CIDB to complement domestic resources	Additional NZODA grant funding supporting "transition" arrangements, to be managed by CIDB, for productive investments	End Jun 1996 onwards		Completed	Completed. NZODA Transition Service lending program terminated after 3 years
4. Improve access to business advice	4.1 Government to subsidize provision of business advisory services to small business	Transition Service to recruit two staff to provide business advice to displaced public servants over 3 years from July 1996	End Jul 1996 (recruitment)		Completed	Some services were replaced by the Small Business Enterprise Center (SBEC) in 2000.
		CIDB to provide institutional support and training to Transition Ministry to facilitate initial delivery of advisory services to displaced public servants	Jul-Sep 1996		Completed	Completed
		CIDB to formulate program of identified deliverable business advisory services, with related budget, to be met under present CIDB operational plan	End Aug 1996		Redundant	Redundant
		Based on above, MFEM to identify need for additional advisory services warranted under public funding. Identified need will be specified, and subject to open competitive tender			Completed. Services mainstreamed	Completed. Services mainstreamed
	4.2 Strengthen CIDB capabilities to play leading role in identification, formulation, and structuring of new project proposals	Fielding Adviser through external TA	End Sep 1996	Increased CIDB lending	Completed	Completed (excluded from September 1997 ADB Progress Report for Second Tranche Release)

Policy Areas and Objectives: (B) Promoting Private Sector Growth		Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
5. Simplify access to land	5.1 Following broad local consultation, introduce simplified land tenure system that balances landowner concerns with commercial development needs	Widest possible public consultation being undertaken on report through Parliamentary Select Committee hearings	End Aug 1996		Completed	Completed	
		Formalize land trust management arrangements and create comprehensive land ownership database	End Mar 1997		Completed insofar as computer hardware was purchased. Status unknown.	Incomplete. Law changed in 1996 to allow unclaimed rents to be transferred to Land Trust Reserve. Although land trust management has yet to be effected, land title database has been established with data entry ongoing.	
		Enact legislation to simplify land tenure system	End Mar 1998	Enacted	Incomplete. A very ambitious conditionality	Incomplete.	
6. Facilitate foreign and domestic investment by the private sector	6.1 Rationalize and reallocate promotional regulatory, licensing, and policy formulation functions of Monetary Board and MFEM, as part of revised focus on investment promotion	Clarify role and functions of Development Investment Board (DIB) in light of pending tax reform. Amend DIB draft legislation and Investment Code with the aim of liberalizing, simplifying, and reducing use of discretionary powers in processing of investment applications, and export promotion	End Jul 1996		Incomplete. Board effectively operational October 1997. New Investment Code yet to be prepared	Incomplete. Board effectively operational October 1997. However, new Investment Code remains to be adopted, discretionary powers remain in effect, and reserved investment areas are extensive. Instances of discrimination against foreign applicants have been reported (who have met code criteria), even in cases where there is no local interest.	
		Enact Act establishing DIB	End Sep 1996 Second tranche condition	Development Investment Act enacted Gazette Notice, and DIB operational	Completed. Act passed September 1996	Completed.	
		Combine residual Monetary Board Services with Prime Minister's Office	End Nov 1996		Completed	Monetary Board abolished	

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
7. Develop agriculture	7.1 Redefine the role and functions of the Ministry of Agriculture (MOA)	Complete comprehensive policy and strategy statement for agriculture development	End Nov 1996 Second tranche condition	Report		Completed according to Sep 1997 ADB Progress Report for Second Tranche Release. MOA could not produce report or was aware of its existence. If prepared, did not guide future programs or policy.
		Continue further rationalization of the role of MOA	Mid Mar 1997	Cabinet decision specifying the role of Government in agriculture and the institutional structure		Export orientation of MOA not effective. Agriculture exports followed a major decreasing trend.
	7.2 Cut costs of MOA and increase staff productivity	Downsizing already completed			Completed	Completed. MOA budget cut from NZ\$1.6 million in FY1996/97 to NZ\$0.77 million in FY1997/98. Current budget is NZ\$1.48 million. Staff levels reduced from 234 in March 1996 to 46 in July 1997 and 36 in June 2001 (staff in Atiu cut from 18 to 2 but have now been increased back to 7 in 2002). In a 1997 NZODA survey of MOA staff, 60% indicated service improved, 40% indicated a decline.
	7.3 Promote agricultural exports	Implement transparent grading system for all major agricultural export goods	Early Sep 1996	Completion of grading system materials	Completed	Completed. However, exports declined from NZ\$1.3 million in 1996 to NZ\$0.25 million in 2001.
	7.4 Corporatize/ privatize for efficiency gain	Corporatize the following MOA assets and associated facilities: Avana abattoir	Mar 1997	Made separate accounting entity for each unit	Completed	Retained by Government but operations turned over to Rarotonga Pig Producers Federation
		Mitiaro coconut processing plant	Mar 1997	Facility sold or its operation put out to tender	Abandoned	Abandoned

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Aitutaki coffee bean dehydrating service	Sep 1997		Completed	Abandoned
		MOA machinery maintenance unit at Arorangi	Sep 1997		Completed	Land given back to owner – used for Noni fruit processing
		Pawpaw seedling production facility at Arorangi	Sep 1997		Completed	Land given back to owner
		Privatize and operate under license the following MOA assets and associated facilities: Hot air treatment plant	Jul 1996		Completed	Retained by Government but operations turned over to Rarotonga Nita Growers Association.
		Aitutaki banana dehydrator	Sep 1996			Closed
8. Develop marine resources sector	8.1 Redefine the role of the Ministry of Marine Resources (MMR)	Complete comprehensive policy and strategy statement for development of marine resources	End Nov 1996 Second tranche condition	Report	Completed. State of implementation unclear	Completed according to September 1997 ADB Progress Report for Second Tranche Release. MMR could not produce report nor was aware of existence. If prepared, did not guide future programs or policy
		Continue further rationalization of the role of MMR	Mid Mar 1997	Cabinet decision specifying the role of the Government in the marine resources sector and the institutional structure for carrying out this role	Completed.	Completed. MMR budget cut from NZ\$1.7 in FY1996/97 to NZ\$1.4 million in FY1997/98. Current budget is NZ\$1.2 million. Staff levels reduced from 96 in March 1996 to 46 in July 1997 and still 46 in June 2001. In a 1997 NZODA survey of MMR staff, 93% indicated service improved. Marine Masterplan under development with NZAID assistance.

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
	8.2 Create transparent guidelines for resource exploitation	Provide industry with MMR-defined annual sustainable catch quotas for tuna (all commercial species), swordfish, and billfish	Early Jul 1997	Annual sustainable catch quotas defined	Completed	Completed
		Define annual catch quota for Trochus for all islands and coordinate harvests	Early Jul 1997	Annual sustainable catch quotas defined and harvests coordinated	Completed	Completed
	8.3 Increase government revenue, efficiency of resource utilization	Complete analysis of alternatives for exploiting offshore fisheries and make recommendations	Early Jul 1997	Report of analysis of alternatives for offshore fisheries development	Completed	Completed
	8.4 Corporatize or privatize for efficiency gain	Corporatize marine research station at Penryhn and all associated non-monitoring activities	End Jul 1999	Facility's non-monitoring activities made a separate accounting entity	Reported as completed in Aug 1997 progress report—station 'in the process of being shutdown'	Completed
9. Develop tourism	9.1 Redefine the role and functions of Ministry of Transport and Tourism	Complete comprehensive policy and strategy statement for tourism development	End Nov 1996 Second tranche condition	Report	Ongoing	Completed July 1997. Strategy now based on FY2002/03 Cook Islands Tourism Corporation (CITC) Corporate Strategy.
		Continue further rationalization of the role of the Ministry of Transport and Tourism	Mid Mar 1997	Cabinet decision specifying the role of Government in the tourism sector and the institution structure for carrying out this role	Completed	Budget for the Cook Island Tourism Authority is currently NZ\$3.1 million for FY2002/03. Staff levels were 20 in June 2001.
	9.2 Corporatize for efficiency gain, increased cost recovery, and application of user-pays principle	Corporatize the Cook Islands Tourism Authority information center on Rarotonga and the Hospitality and Tourism Training Center (HTTC)	Early Dec 1996	Facility made a separate accounting entity	Bill passed December 1998	Cook Islands Tourism Marketing Corporation established in 1999, and new Tourism Corporation Bill 2002 will formalize shift from a purely marketing organization to one with responsibilities for

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		Formulate proposal for joint government-industry financing for external marketing	Mid Oct 1996		Delayed pending corporatization	policy formulation, planning, human resources development and training, destination product development, and accreditation.
		Undertake consultations with industry on proposal	Mid Jan 1997	Consultations undertaken		Industry has financed about 25–30% of CITC's operating budget since 1998.
		Finalize scheme	End Jul 1997	Scheme formulated		
		Reflect Government's contribution in FY1997/98 budget		Commitment reflected in FY1997/98 budget		
	9.3 Encourage a wider range of tourism-related services relying more on market forces and less on regulation	Disband the General Licensing Authority and dissolve its functions	Early Aug 1996	Bill dissolving General Licensing Authority passed	Completed	Completed
		Put into place a system of voluntary standards and rating for all tourism facilities	Early Jul 1996	Report for voluntary standards monitoring completed	Completed	Completed
	9.4 Increase efficiency of government-provided external marketing in generating tourist revenue	Establish an ongoing facility for monitoring demand for tourist services and major changes in tourist arrival profiles	Early Nov 1996	Existence of monitoring facility	Completed. Visitor arrival forms and quality assurance survey prepared	Completed and ongoing by CITC.
10. Develop other productive sectors	10.1 Develop offshore financial services	Revise legislation governing offshore financial services in the Cook Islands to clarify purpose and objectives for such services	Early Sep 1996	Law enacted	Completed. November 1996	Completed. Offshore financial services have had dramatic growth. Money-laundering issues raised by international bodies are to be addressed through the establishment of the Money-Laundering Authority and a substantial increase in the allocation of the Commissioner for Offshore Services.

Policy Areas and Objectives: (B) Promoting Private Sector Growth	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
	10.2 Develop culture-, arts-, and craft-related industries	Encourage and support community groups to formulate proposals and business plans for viable business ventures that are culture-, arts-, and craft-related	Early Jul 1997	Number of funding proposals to CIDB	Complete and ongoing according to August 1997 progress report—no data on indicators	Complete and ongoing according to August 1997 progress report—no data on indicators
	10.3 Develop the music industry	Facilitate and encourage the development of local music industry and their exports	Early Jul 1997	Number of recordings produced	Complete and ongoing according to August 1997 progress report—no data on indicators	Complete and ongoing according to August 1997 progress report—no data on indicators

Policy Areas and Objectives: (C) Social Equity and Sustainability	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
1. Protect and support vulnerable groups	1.1 Assist displaced public servants adjust to their new socioeconomic environment	Contracting in of specialist staff and implementation of the program components	From early Jul 1996	Numbers of clients using service	Completed according to August 1997 progress report—no data on indicators	Completed. The Transition Services and Community Action Program, financed by NZODA, was effective for 1 year (NZ\$4.98 million). Some services were replaced by the SBEC in 2000.
		Contract out selected services provided within government departments such as cleaning, security, to private operators	End Sep 1996	Target: 20 contracts	Complete and ongoing according to August 1997 progress report—no data on indicators	Incomplete. Selected services mentioned were dropped from ministry budgets but not necessarily replaced by private operators on a long-term basis. During period of economy recovery to date, trend has been to reemploy these positions back into the government service.
		Encourage “buddy” system in local communities whereby people established in business help those starting out	From Jul 1996	100 businesses started	Complete and ongoing according to August 1997 progress report—no data on indicators	SBEC has developed a mentoring program and continues to provide business advisory support to small businesses starting up. Also DIB has been proactive in facilitating small operators through joint marketing program with Ministry of Internal Affairs and SBEC.
	1.2 Mobilize community support and strengthen community capacity to take responsibility for members' well-being	Make local communities responsible for management of government funds allocated for social services. New legislation to restore powers to local organizations is being drafted	Jul 1997	Legislation	Completed (cf. A1.3.1)	Legislation enacting the Vaka Councils on Rarotonga passed in 1997 (amended in 1998 Rarotonga Local Government Act) The outer islands Local Government Act of 1987 was abolished in 1999. Social Services essentially recentralized through new

Policy Areas and Objectives: (C) Social Equity and Sustainability	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
						Officer of the Minister of Outer Islands Administrations 2000.
		Facilitate simplified short-term agricultural lease arrangements for outer islanders resident on Rarotonga.	End Mar 1997	30 hectares made available by landowners	Abandoned—not regarded as a problem	Incomplete. Implementation precluded by entrenched land tenure issues.
		Where possible, make selected Crown Lands available for short-term agricultural leases	End Mar 1997	20 hectares leased (target)	Abandoned—not regarded as a problem	Incomplete. Same as above
	1.3 Empower local representative bodies to decide their own development priorities	Legally decentralize a large measure of political and economic power to Vaka and Island Councils and, where appropriate, to village-level bodies	Mid Dec 1996 Second tranche condition	“Vaka Law” enacted	Completed (cf. A.1.3.1). Concern that funds have been devolved before mechanisms were in place to ensure accountability and effective delivery of services	Incomplete. Current political climate not conducive for devolution, and Vaka and Island Councils are not prepared for responsibility in most cases. Current practice is for Vaka councils to file monthly reports to the Ministry of Internal Affairs, who forward to MFEM for reimbursement.
	1.4 Make local bodies responsible for the maintenance of social infrastructure	Allocate government funds for the material costs of school/clinic and other social infrastructure maintenance to local government bodies, which will be responsible for labor inputs	End Jul 1998	“Vaka Law” enacted	Completed through the Budget and Vaka councils, though there is doubt about the extent and adequacy of resource transfer (cf. A.1.3.1)	Completed. Vaka councils reportedly have over the last two years set up maintenance programs for clinics, and other social infrastructure, and have worked with their people and Government to maintain these.
2. Ensure environmentally sustainable socioeconomic development	2.1 Maximize employment opportunities by aligning skills with the needs of the economy	Carry out a comprehensive national training needs assessment to identify and prioritize needs in line with strategic objectives. This will underscore the planned Human Resource Development	Jun 1997	Assessment completed and published	Incomplete	Incomplete. However, NZAID has recently completed a draft comprehensive training needs assessment.
		Realign school curricula, principally to equip school leavers with marketable skills in the	Jun 1998	Full realignment of all secondary school curricula to those of	Completed and ongoing	A Cook Islands Certificate of Employment Skills was introduced in 2001, and in

Policy Areas and Objectives: (C) Social Equity and Sustainability	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
		developing Cook Islands economy		New Zealand's (NZ), with local adaptation		2002 NZ School Certificate will be replaced by the NZ Certificate in Educational Achievement
		Corporatize HTTC facility to ensure maximum use	End Jun 1997	Sale completed	Incomplete	Incomplete. HTTC was transferred to CITC during the ERP. CITC indicated resources and facilities presently are inadequate to meet industry needs.
	2.2 Remove constraints to labor mobility	Formulate and implement policy for retirement savings plan open to private and public sector workers	End Sep 1997	Retirement Plan enacted	Officials' committee working on this	Incomplete. However, the Cook Islands' Superannuation Scheme was started in 2001 for public servants, and public enterprise staff now participate. Private sector expected to join in 2003.
	2.3 Protect the Cook Islands environment as a heritage and asset	Develop community awareness through public discussion and through the media	From Jul 1997	Media exposure	Ongoing	Completed and ongoing. Proposed changes to environment legislation are discussed with the community at length
		Introduce Environmental Impact Assessment (EIA) for development proposals	End Jul 1997	Regulations and guidelines for project proponents and appraisers published	Completed	Completed. Under the Rarotonga Environment Act 94/95, EIA is a condition of specific types of development. Quality of EIAs unknown, but resources are generally insufficient.
3. Mainstream gender issues into development planning	3.1 Policies and organizational structure for representation of women's concerns	Integrate women's issues into government policies and planning	Ongoing	Visibility of women's issues in policy and planning documents	Ongoing	Completed and ongoing. Under the PSC Act, the principle of 'good employer' opportunities for women to seek employment in high level positions became visible.

Policy Areas and Objectives: (C) Social Equity and Sustainability	Strategy	Measures to be Taken	Target Date for Completion	Measurable Indicators	Status of Program Implementation 1998	Status at Evaluation 2002
	3.2 Ensure equal employment opportunities	Fair and impartial appointments to the reduced number of public service posts as required by the Act	End Sep 1996	Zero complaints to be justified	Ongoing	The principle of non-discrimination on the basis of sex is enshrined in the Constitution. There are no government practices or policies that intentionally discriminate against women. However, there is no legislation, with sanctions, preventing discrimination against women. There are no guidelines or rules, tribunals, or other institutions to ensure that there is in fact no discrimination against women and there is no mechanism in place for identifying such discrimination.

PUBLIC SECTOR REFORM: A CHRONOLOGY OF EVENTS

April 1995: The Cook Islands reverted to the New Zealand dollar following a period of mismanagement of the Cook Islands currency and a simultaneous decline in economic activity resulting in large part from a decline in the tourism sector.

June 1995: The Cook Islands and the Asian Development Bank (ADB) signed a Memorandum of Understanding (MOU) that recognized the urgent need for improved economic management and the need for technical assistance (TA) to respond to the fiscal-cum-financial crisis that was imminent in the Cook Islands. This MOU led to the design of a TA in collaboration with the New Zealand Official Development Assistance (NZODA), the Pacific Financial Technical Assistance Center, and the Economic and Social Commission for Asia and the Pacific/Pacific Operations Center.

October 1995: TA 2424-COO approved for \$892,000. The overall goal was to improve financial and economic management in the newly established Ministry of Finance and Economic Management (MFEM). The objectives were to develop a fully functional financial and economic management system within the Government and improve institutional capacity to undertake strategic planning and macroeconomic policy formulation; budget preparation, management, and monitoring; policy formulation and administration for revenue mobilization; the effectiveness of aid coordination; and the preparation and dissemination of financial and economic statistical information.

January–March 1996: A NZODA-funded Financial Secretary arrived in January and the ADB-funded financial and economic management team (FEM 1) arrived in March. Unfortunately, even with the June 1995 MOU in place, poor financial management systems, inadequate analytical capacity, and a delayed response from the political leadership resulted in a rapid deterioration of the financial and economic crisis.

March 1996: The first National Retreat was held at the Rarotongan Beach Resort. The participants represented government, business, traditional leaders, and the community at large. They reviewed an assessment of the country's economic and financial situation that identified the imminent onset of a government liquidity crisis and, in the absence of immediate structural reforms, the potential for government insolvency. The immediate concern was the inability of the Government to meet either its domestic or international financial commitments through to the end of FY1995/96. This important event also led to the drafting of the document *Path to Recovery—Reform Agenda*. In the wake of this meeting, a range of emergency measures were implemented to address the Government's cash crisis including large cuts in non-personnel expenditures and suspension of most international travel by government officials; elimination of 10 assistant ministerial positions; elimination of most overseas diplomatic posts; 15% across-the-board pay cut for parliamentarians and public servants, effective 1 March 1996; and further reduction by 50% of salaries for May and June, although this amount was repaid in December.

May 1996: "*Path to Recovery—Reform Agenda*" adopted by Cabinet. This document outlined the broad elements of what came to be known as the Economic Reform Program (ERP). The ERP defined a new role for government—essentially that the dominant role of the public sector be reduced in order to release resources to the other sectors. At the same time, the Government would be responsible for creating an enabling environment to encourage private sector investment, outward-oriented growth, and employment creation. Specific elements of the ERP included public sector downsizing, reform of the leading productive sectors, and support for social equity issues.

June 1996: The first donors' Consultative Group Meeting (CGM) in Suva, Fiji. The meeting was chaired by ADB and provided an opportunity for the Government to present reform plans to address the financial and economic crisis. The *Path to Recovery-Reform Agenda* was the lead document, together with other technical papers prepared with the assistance of the FEM 1 team. The ERP matrix—which became the formal reform monitoring tool—was developed in the wake of this first CGM. Included in the commitments at the time were (i) an intention to reduce the number of ministries and departments from 52 to 22 effective July 1996; (ii) the adoption of output-based budgeting combined with delegation of increased authority to department heads through performance contracts; (iii) plans to sell off state-owned enterprises; (iv) plans to encourage private sector activity by improving access to land and capital and enhancing the policy environment for investors; and (v) encouragement of foreign investment and removal of constraints to investment in the key growth areas of tourism, agriculture, and marine resources.

June and July 1996: Adoption of Public Sector Reform legislation was a priority and three important institutional innovations were created in these 2 months: the Public Service Act, the Public Expenditure Review Committee and Audit Act, and the MFEM Act.

July 1996: Public service layoffs began at the start of FY1996/97 with the closure of the Cook Islands Nursing School and with voluntary redundancies and retirements followed by forced redundancies in August and September. Teachers were released at the end of the school year in December 1996.

September 1996: ADB approved a loan for the ERP in the amount of \$5 million. Attached to the concessional program loan were two TAs: \$740,000 for the Cook Islands Development Bank and \$251,000 to the newly established Development Investment Board.

January 1997: Another TA was approved (FEM 2, TA 2750-COO).

April 1997: The first fully developed output-based budget was formulated with a reform-focused budget policy statement based on the Government's "Five-Point Plan."

July 1997: Another National Retreat was held to assess reform progress in advance of the second donors' CGM, which was hosted by ADB in Noumea, New Caledonia. The purpose of this CGM was for the Government to present the results of the ERP to date.

November 1997: A third National Retreat was held to assess reform progress to date. The retreat resulted in a general commitment to continue the ERP despite the obvious and negative short-run impacts of the public service downsizing. Particular emphasis was placed on accelerating the Government's stalled privatization program. Participants identified the need for a follow-up meeting to discuss roles and responsibilities of private sector enterprises in the reform program.

April 1998: The Development Investment Board hosted the first "Private Sector Advance" as a follow-up to requests made in the November 1997 National Retreat.

September 1998: Manila Debt Negotiations were hosted by ADB from 9 to 17 September 1998. ADB played the role of honest broker. ADB effectively took the role of the Paris Club for debt relief negotiations with developing countries. The Paris Club procedures were generally followed. Although the Government of France did not sign on to the negotiated agreement, the

other three major official creditors did. A starting debt level to Italy, Nauru, and New Zealand of over \$125 million was reduced through negotiation to less than \$70 million.

June 1999: Elections were called and the Government of the Prime Minister, Sir Geoffrey Henry (Cook Islands Party), failed to win a majority of seats. A coalition of the Cook Islands Party and the New Alliance Party (plus independents) formed the Government with Dr. Joe Williams as Prime Minister. This Government lasted until November when the coalition collapsed.

November 1999: A new coalition was formed between the Democratic Alliance Party and the New Alliance Party (plus independents) under Prime Minister Dr. Terepa'i Maoate. Subsequently, two more coalition governments have held the reigns of political power up to the present time.

November 2000–February 2001: At the request of the Government, ADB fielded a team of economic consultants to prepare the *Cook Islands 2001 Economic Report: Policies for Progress*. A concluding Economic Policy Forum was hosted by the Government in February and led to the bulk of the policy recommendations included in this report.

May 2001: The Government hosted the Consultative Forum on Accountability and Transparency for Leaders of the Cook Islands, which was supported by the United Nations Development Programme. The result of the forum was the development of an action plan for the implementation of the Forum Economic Ministerial Meeting Accountability Principles.

June 2001: The Government and ADB hosted the third CGM in Rarotonga. The Government reviewed the country's performance, some 5 years on, in the ongoing reform process and reiterated its commitment to continued reforms. The external aid community was broadly supportive of Cook Islands reform efforts to date and pledged support for specific elements of the Government's reform program.

December 2001: ADB approved Finance and Economic Management TA (Phase 3) for \$250,000. TA consultants have yet to be fielded and TA reformulation is under discussion with the Government.

KEY INDICATORS

Table A3.1: Government Finance—Balances and Indicators

Item	1996/97	1997/98	1998/99	1999/00	2000/01 ^a	2001/02 ^a	2002/03 ^b
Revenue (NZ\$ million)	57.4	55.6	50.3	59.4	78.3	78.9	84.0
Expense (NZ\$ million)	52.8	56.8	52.5	56.1	71.3	75.3	81.2
Operating Balance (NZ\$ million)	4.6	(1.2)	(2.3)	3.4	7.0	3.6	2.8
Net Lending/Borrowing (NZ\$ million)	—	—	1.8	4.9	3.8	0.2	(1.6)
Overall Balance (NZ\$ million)	—	—	0.8	4.0	6.7	1.8	(1.1)
Revenue (less aid) to GDP (%)	31.7	31.1	29.4	31.7	36.1	35.8	36.5
Expense (less aid) to GDP (%)	29.4	32.6	31.1	30.8	32.3	33.9	35.1
Compensation of Employees to GDP (%)	16.5	16.4	14.8	14.2	13.7	14.4	15.0
Use of Goods and Services to GDP (%)	6.0	7.1	9.2	9.4	10.4	11.2	10.3
Operating Balance to GDP (%)	3.2	(0.8)	(1.5)	2.0	3.8	1.9	1.4
Overall Balance to GDP (%)	0.0	0.0	0.5	2.3	3.7	0.9	(0.5)

— = not available, GDP = gross domestic product.

^a Estimate.

^b Budget.

Note: Data presented according to Government Finance Statistics (International Monetary Fund, 2001).

Data not available due to transition to full accrual accounting in 1996/97 and 1997/98.

Source: Ministry of Finance and Economic Management Annual Audited Financial Statements and Budget Estimates.

Table A3.2: Summary of Import Levies by Levy Bands, 1999 and 2000
(NZ\$)

Levy Band	Levy (%)	Number of Coded items (SITC)	1999 Collections	2000 Collections	2-Year Avg. Collections	2-Year Avg. Share (%)
1	0	11	267,121	348,112	307,617	3.4
2	5	129	267,121	348,112	307,617	3.4
3	10	1,117	4,272,618	4,950,981	4,611,799	50.9
4	15	10	1,357,350	952,937	1,155,143	12.8
5	18	1	5,540	22,070	13,805	0.2
6	20	58	389,345	517,610	453,477	5.0
7	25	86	964,211	1,486,162	1,225,187	13.5
8	30	15	404,219	149,889	277,054	3.1
9	40	10	231,023	201,950	216,486	2.4
10	45	1	4,500	—	2,250	0.0
11	50	17	31,119	68,185	49,652	0.5
12	55	2	1,540	4,386	2,963	0.0
13	75	11	5,126	8,456	6,791	0.1
14	80	8	359,497	429,187	394,342	4.4
15	100	8	7,882	25,426	16,654	0.2
16	120	8	6,000	23,333	14,666	0.2
17	125	1	875	375	625	0.0
18	150	1	3,000	—	1,500	0.0
	Total	1,494	8,578,087	9,537,171	9,057,629	100.0
Memo items:	Petroleum, oil, fuel products		1,708,832	1,708,013	1,708,422	18.9
	Alcohol products		822,824	1,455,223	1,139,023	12.6
	Tobacco products		1,323,034	894,190	1,108,612	12.2

Source: Ministry of Finance and Economic Management, Revenue Management Division and Cook Islands Statistics.

**Table A3.3: Government Enterprises and Commercial Activities,
Pre- and Post-Reform**

Government Enterprise	Current Status
Telecom Cook Islands Ltd—60% of shares owned by the Government; remainder by Telecom New Zealand	Telecom—now 40 % of shares owned by the Government (20% of shares sold for \$ 3 million)
Te Aponga Uira o Tumu-te-Varovaro (power utility)	Corporatized; improved financial status based on full cost recovery.
Cook Islands Airport Authority	No change; to be transformed via management contract.
Waterfront Commission	Corporatized—Port Authority
Cook Islands Tourist Authority	Corporatized—now Cook Islands Tourism Corporation
Cook Islands Development Bank/ Cook Islands Savings Bank	Merged into the Bank of the Cook Islands.
Shipping Registry	Privatized.
Cook Islands Health Board	Terminated.
Cook Islands Broadcasting Corporation	Privatized.
Cook Islands National Shipping	Managed by CIIC.
Cultural Center	No change; managed by the Ministry of Cultural Affairs.
Workers' Compensation Fund	No change; managed by the Ministry of Finance and Economic Management.
Aitutaki Lagoon Hotel Ltd.	Privatized through sale to foreign investor group.
Avaiki Nui Development Ltd. (owns St. Helens Hospital Property Ltd., New Zealand)	Managed by CIIC.
Cook Islands International Airlines, Ltd.	Terminated.
Cook Islands Property Corporation, (owns the Rapae Hotel and Banana Court Ltd.)	Managed by CIIC.
Ecil Ltd. (a holding company for the Sheraton Hotel Project and VIP Services Ltd.)	Privatized through hand-over to local landowner (due to lack of payment of lease).
Kia Orana Foods Corporation Ltd.	Privatized.
Rarotongan Hotel Company Ltd.	Privatized through sale to local investor.
Cook Islands Housing Corporation	Managed by CIIC.
Banana Court Limited	Managed by CIIC.
Blue Pacific Laundry	Privatized.
Women's Handicraft Center	Privatized; managed by a nongovernment organization.

Table A3.3 continued

Government Enterprise	Current Status
Ammunition Sales	Terminated.
Bulk Stores	Terminated.
Currency: Overseas and Local Sales	Managed by Post Office.
Outer Island Electricity Services	Mostly handed over to outer island administrations.
Fuel Depot, Supplies and Services	Privatized.
Joinery	Privatized.
Lighterage Services	Devolved to outer island administrations.
Liquor Supplies Store	Privatized.
Mechanical Workshop	Terminated.
Ngatipa Stores	Privatized.
Government Printing Office	Privatized.
Quarry: Rarotonga	Privatized.
Rapae Cottage Hotel	Privatized.

CIIC = Cook Islands Investment Corporation.

Table A3.4: Banking Survey
(NZ\$ million)

Date	Net Foreign Assets ^a	Net Domestic Credit ^b	Claims On			Deposits			Other Items (net) ^d	Capital Account	
			Government (net)	Public Enterpr.	Private Sector	Liquid Liabilities ^c	Demand	Savings			Term
30 Jun 1995	(12.2)	56.9	8.0	8.7	40.2	47.3	8.5	14.9	23.9	10.3	7.7
30 Jun 1996	(4.8)	54.6	3.8	7.8	43.0	46.9	9.3	13.9	23.6	6.2	9.1
30 Jun 1997	16.3	46.9	(1.9)	6.5	42.3	61.6	20.8	16.1	24.7	7.9	9.5
30 Jun 1998	17.8	50.4	(1.6)	3.3	48.7	69.1	19.6	16.6	33.0	9.7	8.8
30 Jun 1999	26.3	56.8	(0.8)	2.3	55.3	80.6	21.4	15.7	43.5	8.4	11.0
30 Jun 2000	28.6	59.8	(7.3)	1.8	65.2	84.5	24.9	18.9	40.7	12.7	16.6
30 Jun 2001	39.0	60.0	(16.9)	1.2	75.6	96.7	28.5	23.3	44.8	14.5	16.8
30 Jun 2002	36.2	74.4	(20.1)	0.9	93.6	99.8	30.9	23.7	45.2	12.4	13.2

^a Net foreign assets include gross foreign assets less foreign liabilities.

^b Net domestic credit represents net lending to government, gross lending to public enterprises and the private sector.

^c Liquid liabilities represent total demand, savings, and term deposits of the public enterprises and private sector.

^d Other items (net) represents all other assets and liabilities of the financial institutions including capital.

Source: Banking Survey, Cook Islands Statistics Office.

THE SALE OF THE RAROTONGAN HOTEL

1. The Government advertised the proposed sale of the Rarotongan Hotel in April 1996. Four bids were received, with a bid by an Australian company for NZ\$6 million recommended by the sales agent. The Government pursued an offer for NZ\$8.4 million by a Hawaiian company but the company subsequently withdrew the offer. Although the bid by the Australian company was still available, in November, the Government entered into an agreement with the locally-owned Rarotongan Resort Hotel Limited (RRHL) to sell the hotel for NZ\$3.25 million. The chairman of the Government's Privatization Committee owned controlling interest in RRHL. The purchase price was not to be paid immediately, with payment instead dependent on the availability of 'net distributable reserves' within RRHL. A decision on whether adequate net distributable reserves existed was to be made by RRHL's accounting advisors who would have considerable discretion to control whether they were adequate.
2. In November 1996, the Prime Minister's office announced the sale to RRHL. However the transaction was still incomplete in August 1997. At that time, an offer of NZ\$6 million was received from an Asian businessman. The Government advised that the hotel could be purchased for \$12 million and the negotiations came to an end. The Government then sought to finalize the sale to RRHL.
3. The transfer of title to RRHL had been delayed by a mortgage held by the Government of Nauru. This mortgage was cleared in August 1997 by the use of proceeds of the sale of a 20% stake in Telecom (Cook Islands) Limited to Telecom (New Zealand) Limited. In May 1997, the Government had commenced a refurbishment of the hotel to ready it for the 1997 Forum meeting. This and other operating costs, totaling NZ\$2 million, were funded by an Australia and New Zealand Bank loan and from the public account.
4. Title to the hotel was transferred to RRHL in September 1997. Among other measures, the final agreement put a 10-year cap on the repayment of the NZ\$3.25 million purchase price, required RRHL to repay the refurbishment cost plus interest after 1 year, and required the management of the hotel by an international operator within 12 weeks of the completion of sale (to replace an original requirement that a management agreement be entered into with Outrigger Hotels and Resorts). No money was paid upon sale (a NZ\$100,000 'deposit' had been refunded in April) nor was interest on the NZ\$3.25 million allowed for.
5. Key conclusions reached by the Public Expenditure Review Committee and Audit included the following:
 - (i) The impending Forum meeting and the inability to quickly dispose of the Nauru mortgage both had a detrimental effect on the sale price.
 - (ii) The hotel should not have been advertised with the prospect of a 60-year lease without that having being negotiated with the landowners (the lease had 34 years to run).
 - (iii) Consideration should have been given to re-advertising the hotel for sale once the partial or complete upgrade was in place.
 - (iv) The economic recovery objectives set out in the five-point plan were not met. Instead, the Government incurred considerable expense and waived potential

revenue in agreeing to the sale in the form that it did. No money was received at the time the hotel was sold.

- (v) Adequate accounting advice was not sought.
- (vi) Part of the NZ\$2 million was spent unlawfully (because it had not been appropriated according to the conditions of the Ministry of Finance and Economic Management Act).
- (vii) Details of the sale were well advanced before the endorsement of the sales agent was gained by the Government (which was subsequently found by the Public Expenditure Review Committee and Audit to have been based on a misunderstanding of the sale process and conditions).
- (viii) A better financial return from the sale of the hotel could have been achieved.
- (ix) The Government cannot claim that the transaction was carried out in “fully arms length, transparent, and contestable manner” in accordance with its stated objectives.¹

¹ Taken from *An Economic Evaluation of the Cook Islands Economic Restructuring Program* prepared by an ADB staff consultant in October 1998. Information is based on *Public Expenditure Review Committee Report to Parliament on the Review of the Sale of the Rarotongan Resort Hotel*, Cook Islands, December 1997.