Development Finance Assessment for Cook Islands

Leveraging finance for sustainable development

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Acronyms

ADB	Asian Development Bank
AIIB	Asian Infrastructure Investment Bank
CIIC	Cook Islands Investment Commission
DBR	Doing Business Report
DFA	Development Financial Assessment
EDS 2030	Economic Development Strategy 2030
ERP	Economic Response Plan

ERR	Economic Recovery Roadmap
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HYEFU	Half-Year Economic and Fiscal Update
IMF TAR	IMF Technical Assistance Report
MFEM	Ministry of Finance and Economic Management
MTEC	Medium Term Expenditure Ceiling
MTFF	Medium Term Financial Framework
MTFS	Medium Term Financial Strategy
NIIP	National Infrastructure Investment Plan
NSDA	National Sustainable Development Agenda (NSDA) 2020+
ODA	Official Development Aid
OECD/DAC	Organization for Economic Co-operation and Development / Development
OOF	Other Official Flows
Pa Enua	Outer islands
PAC	Public Accounts Committee
PDA	Private Development Assistance
PEFA	Public Expenditure and Financial Accountability
PPD	Public Private Dialogue
PPP	Public Private Partnership
PSD	Private Sector Development
ROE	Return on equity
SOE	State Owned Enterprise
UNDP	United Nations Development Programme
WB	The World Bank
WDI	World Development Indicators
VAT	Value Added Tax

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Foreword

Over the past decade, the Cook Islands economy has established a solid track record of economic growth which resulted in the country graduating to high income status in 2020. Underpinning these achievements has been the Cook Islands National Sustainable Development Plans which sets out the overarching strategy for accelerating sustainable development and creating opportunities for all and outlining key policy priorities that Government is pursuing to achieve. This has been succeeded by the Te Ara Akapapa'anga Nui - the National Sustainable Development Agenda (NSDA) 2020+ developed in 2021 which gives an extended 100 year overview which privileges Akapapa'anga as a core towards attaining Turanga Memeitaki (well-being) for all. It is a living framework that will guide the Cook Islands into the future.

However, the nation faces significant challenges to sustainable development, such as, a narrow economic base that is highly dependent on tourism sector and is susceptible to external shocks, reliant on imports for consumption, capacity constraints for sustained economic growth, and vulnerability to climate changes and natural disasters. Like many large ocean countries in the region, it requires significant investment and financing to address these challenges and achieve SDGs and national sustainable development goals. This is especially the case in times of the global pandemic and post-pandemic recovery.

The United Nations Development Programme (UNDP) assisted the Cook Islands Government to commission this Development Finance Assessment (DFA) to take forward policy and institutional reforms to enable more integrated management of a broader set of finance flows to support the implementation of Cook Islands national priorities and the SDGs.

The DFA takes into account the social, economic and environmental dimensions of development and it analyses the role that different development finance flows play for or against well-being and sustainable development considering these dimensions.

More importantly, the effective implementation of the necessary reforms in this DFA is important, to well-manage finance flows for marco-socio economic stability and sustainable developments for the Cook Islands.

Hon. Mark Brown
Minister of Finance

Executive Summary

This Development Finance Assessment (DFA) is part of the effort to develop and implement an INFF in the Cook Islands where the overall objective is to provide an overview of existing development finance flows in the Cook Islands and the institutional arrangements utilised to finance the delivery of national development goals and priorities to identify how to more effectively address challenges and leverage opportunities for funding of the Cook Island's development objectives and the SDGs.

The global pandemic hit the Cook Islands hard. It resulted in the virtual shut down of the Cook Islands' tourism industry, which accounted for nearly two-thirds of the country's GDP before COVID, leading to the economy contracting by 5.9% in 2020 and 29% further in 2021, with the expectation that it will only return to its pre-COVID level by 2025. Moreover, its fiscal balances turned into deficits of 10.3% of GDP in 2020 and 29.4% in FY2021. This increased the Cook Islands' debt level from about 16.7% of GDP in FY2019 to 38.9% in FY2021 and is projected to increase further to 43.8% in 2022. So the big question that the DFA seeks to answer is how to mobilise resources to finance a sustainable and equitable recovery post-COVID 19.

This DFA, from the lens of the Integrated National Financing Framework (INFF), examined The Cook Islands' current development financing landscape; analyzed the current and future financial resources available to meet Cook Islands' financial demand for its national development and achieving its SDG goals; evaluated the policy and institutional frameworks governing these financial resources, including financing strategy, monitoring and review, and governance and coordination mechanisms; and made recommendations on improving the Cook Islands' financing frameworks and proposed a roadmap for implementing INFF in the Cook Islands. This report is developed based on desk review, consultation with public and private sector stakeholders, and independent research.

The DFA has identified many opportunities to improve the Cook Islands' INFF that govern the development finance available to the Cook Islands, including the overarching financing framework, M&E framework, governance and coordination mechanisms. Many of these opportunities for reforms are interrelated. For example, Land tenure reforms are related to Foreign Direct Investment, financial sector development, promoting MSME development, etc. At the same time, Foreign Direct Investment links to PPP development, private sector development and investment, and SOE reforms. PFM reforms are also related to development financing, etc. Therefore, an integrated approach to these opportunities has emerged as a top priority in the DFA, while the INFF will serve as a useful instrument to direct and facilitate the reforms in the identified areas.

This integrated approach should be long-term (2021-2030) and receive ample technical and financial support from development partners to learn from international best practices and to support the Cook Islands in developing its capacity to implement these identified reforms. Considering the integrated and long term nature of these reforms, strong leadership and/or institutional mechanism are required to ensure continuity and systematic improvement in generating the desired results. Strong leadership, a long-term and systematic approach, sufficient international funding, and quality technical support are all critical.

Although integrated, implementing all these reforms will be a significant challenge for the Cook Islands Government due to limited government capacity and some reforms taking a longer time. Another recommendation emerging from the DFA is the prioritization and sequencing of these reforms, compatible with the EDS 2030 and NSDA 2020+ programming cycles. Initial reforms could focus on addressing the significant weaknesses detected by the DFA and other studies, such as PEFA 2021, IMF TAR, EDS 2030, etc.

The following table presents the main findings by INFF building blocks, together with the main recommendations. The actions listed below may require systemic reforms and involve a wide variety of areas, from public administration to good governance and the strengthening of the management capacity of the central government and line ministries.

Implementing them all at once will be a big challenge. Therefore, the government should consider the prioritization of these policy areas and develop a realistic roadmap of interventions based on the outcomes of this assessment and other government priorities. Implementing the prioritized agenda will require leadership and coordination from the highest levels of the government.

INFF Bloc	Thematic Areas	Findings and Issues	Recommendations
Financing strategy	Aligning the budget with the national plan and SDGs	• The Cook Islands have endorsed the UN proposed 2030 Agenda and SDGs, the principles of which have long been the underlying principles of the Cook Islands' national development strategies • However, SDGs goals and targets have only been inexplicitly integrated into the national plans • The Cook Islands has not explicitly considered the affordability, cost and financial resources needed to achieve National development strategies and SDGs	• Integrate SDG targets and indicators explicitly into EDS 2030, NSDA 2020+, sectoral strategies and plans, and M&E frameworks • Estimate the finance requirement for implementing the national strategy and achieving development goals
	Establishing an overall financing strategy	• The Cook Islands has a well-performed Medium Term Fiscal Framework, • The Cook Islands could improve its MTEC and its Medium-Tem Budgeting	• Improve its MTEC by analyzing why forecasts deviate from previous years' forecasts and why actual revenues and expenditures deviate from forecasts • Improve the Medium-Tem Budget by presenting the actual revenues and expenditures for the budget year before the last budget year to evaluate agency revenue and expenditure outturns
	Improving Financing policies for specific financial flows	<u>Tax and non-Tax Revenue policy</u> • The Cook Islands have a relatively higher tax revenue to GDP ratio and may have little space to increase its overall tax level • Non-Tax revenue typically accounts for around 15% of government revenue income • However, the Cook Islands does not have an explicit and consistent policy on how best to mobilize non-tax revenue	<u>Tax and non-Tax Revenue policy</u> • Develop various SOPs to strengthen tax administration and tax compliance • Conduct a Tax Administration Diagnostic Assessment, with the objectives of exploring the relative strengths and weaknesses of tax administration systems, processes, and institutions and identifying opportunities for improving the effectiveness and efficiency of tax administration • Establish consistent non-tax revenue policy and procedures
		<u>Development Cooperation</u> • The Cook Islands has achieved a high level of country leadership and development cooperation, with donors' objectives aligned with national development strategies • Nearly all development cooperation are recorded in the budget and use national institutions and procedures for budget implementation and financial reporting • However, the Cook Islands faces Capacity constraints and challenges in M&E of development cooperation execution	<u>Development Cooperation</u> • Develop SOPs to minimize the impacts of high staff turnover and to enhance government agency capacity development; • Coordinate M&E activities among DCD, implementing agencies, and development partners • Conduct regular reviews of ODA programmes to determine the bottlenecks in delivery • Strengthen the involvement of the private sector in development cooperation through public-private dialogue and public-private partnership

INFF Bloc	Thematic Areas	Findings and Issues	Recommendations
		External Debt • The Cook Islands has increased its level of external debt significantly since the outbreak of COVID19 • It has not had a Debt Policy yet. The government has used fiscal rules within MTFS in managing external debt	External Debt • Develop a Medium-Term Debt Management Strategy to guide the government's debt management decisions and operations in the medium term. The Cook Islands has developed one, which is to be published soon • Build its capacity to strengthen its debt management, make more informed decisions about borrowing and related costs and risks, manage debts prudently, and be mindful of the potential rise in debt service responsibility • Explore options and opportunities to undertake infrastructure development in partnership with the private sector
		Foreign Direct Investment • The Cook Islands has a low foreign direct investment • Several factors constrain FDI in the Cook Islands, including o Lack of a clear and well-defined strategy to provide an overall direction, o Restrictive regulatory framework for Foreign Direct Investment; o Lengthy foreign investment approval process; o Difficulty in land access due to the customary land tenure system; o employing migrant workers; o unfavourable investment climate	Foreign Direct Investment • Develop a clear and well-defined investment strategy, including a National Policy Statement on Investment, a comprehensive Investment Strategy, an Investment Promotion Strategy, and Sectoral investment strategies and implementation plans, to provide an overall direction for investment, with specific targets and means to attract and facilitate investment, particularly foreign direct investment • Review the current investment regulatory framework, identify barriers to investment, identify priority areas of reforms to facilitate and promote investment, and set out a plan for investment policy reforms with options and priorities and an action plan with a concrete timeline • Improve Cook Islands' investment climate, including physical and digital connectivity, land access, finance access, access to infrastructure, supply of skilled labour, fair competition, etc.
		Remittance and Diaspora • The Cook Islands has a large diaspora population • However, the Cook Islands is not dependent on remittances • The Cook Islands could utilize the financial and human capital resources of the Cook Islands diaspora	Remittance and Diaspora • Offer financial products or incentives for diasporas to invest in their home country • Encourage investment and utilising human capital and business network from the diasporas to develop the Cook Islands • Promote the Cook Islands as a

INFF Bloc	Thematic Areas	Findings and Issues	Recommendations
			place for working holidays to the younger diaspora (e.g. after finishing high school or university summer holidays)
		Public Private Partnership • The EDS 2030 has proposed to explore the potential for using Public Private Partnerships (PPPs) to deliver public services and/ or assets cost-effectively • However, the Cook Islands lacks PPP-related laws and regulatory frameworks • Stringent investment legislation may constrain the involvement of foreign investment in PPP; • Inadequate private and public sector capacity in dealing with the complex Public-Private Partnership deals	Public Private Partnership • Develop and enforce a Public Private Partnership Policy and establish a related regulatory framework. The Government is finalising a draft PPP policy and reviewing necessary legislative adjustments to enable its implementation • Review and reform the current investment regulatory framework to facilitate the engagement of foreign investment in PPP; • Develop or enhance the private and public sector capacity in dealing with complex Public-Private Partnership deals • Develop a list of candidate projects for PPP
	Improving the domestic financial system	• The Cook Islands' financial sector is comparatively shallow. Domestic private sector credit as a percentage of GDP is significantly lower than the world and regional averages • Several structural issues limit the development of the Cook Islands' domestic financial system and hence its ability to develop the economy, including - the high cost of domestic credit, - creditor protection, - using land as collateral for borrowing, - weak domestic financial infrastructures, and - lack of competition	• Review the current situation of the financial sector • Explore sustainable, structurally sound long-term mechanisms to bring down the cost of credit, including o Better integration with the New Zealand banking system, o Atomization of the current payment systems and improving the payment system efficiency, o Resolving competition issues within the banking sector and making it more competitive, o Introducing bankruptcy laws to facilitate financially troubled businesses to restructure their finances, o Establishing concessional financing instruments for SMEs and start-ups, etc. o Reforming the land tenure system; o Explore opportunities for using other types of assets as collaterals
	Improving business enabling environment and Promoting Private development sector	• The Private Sector accounted for 69% of the Cook Islands' Employment; • The private sector, particularly the tourism sector, has been hit the hardest by COVID19	• Conduct a comprehensive review of its current business environment, identifying factors constraining private sector development, identifying priority areas of reforms to facilitate and promote

INFF Bloc	Thematic Areas	Findings and Issues	Recommendations
		• The recovery and further development of the private sector have been constrained by uncertain economic prospects and an unfavourable business environment, including o labour shortage, o weak physical and digital infrastructure, o difficulties in land access o high cost of accessing finance, o the dominance of SOEs in key sectors, and o high cost of doing business in general	private sector investment, and setting out a plan for policy reforms and action plans with a concrete timeline • Develop an integrated program for private sector development, linking the establishment of a business enabling environment with SOE reform, improving labour supply, implementing PPI, promoting FDI, land tenure reform, and developing the domestic financial system • Continue SOE reforms and establish appropriate competition policy and regulatory frameworks, to ensure fair competition and create a level playing ground for private businesses • Liberalize sectors dominated by SOEs, making them accessible to private businesses, and making SOEs and private businesses subject to the same market regulations
	Reforming the current Land Tenure system and facilitating land access	• Land tenure, including access to land and limitations on using it as collateral for loans, has been a recurring theme in this DFA	• Review the current land tenure system and explore new and innovative land tenure systems to ensure equitable and efficient access to land as well as productive use of land o One option is to delineate land ownership and the rights to land use and promote the establishment of various types of land trusts, which pool lands or land shares together and manage lands on behalf of landowners o Another option is to set up a publicly accessible “land bank”, with clearly delineated ownership and valuation on land and real estate, available for investment projects in the forms of a lease, rental or equity purposes; develop a master plan for the use of these lands; develop appropriate mechanisms for land allocation to ensure efficient land use, and develop related infrastructure facilities for these lands
	Improving Labour supply	• Decreasing population size and shortage of labour constrain the Cook islands’ development.	• Implement policies to increase labour force participation rates, particularly female labour force participation rates;

INFF Bloc	Thematic Areas	Findings and Issues	Recommendations
			• Promote education and vocational training to upskill its labour force • Encourage investment and the utilisation of human capital and business network from the diasporas to develop the Cook Islands • Promote the Cook Islands as a place for working holidays to the young people, including younger • Facilitate the employment of foreign workers to fill gaps in the labour force • Formalise/expand short-term work programs with other Pacific Island nations • Conduct a labour market survey and population study to develop targeted solutions to this gap
M&E	Strengthening the M&E system to monitor and provide evidence-based support for financing for development	• The Cook Islands has established an M&E framework monitoring the implementation of EDS 2030 and NSDA 2020+ • However, many aspects of the M&E framework are not fully in place yet and may affect its effectiveness	• Improve the effective monitoring and evaluation of public finance activities, including o Rolling out its FMIS, o Systematically tracking information on actual budget allocation and service delivery; o Tracking SDG budgeting and implementation; o Improving the audit and parliament scrutiny of government half-year and annual financial reports • Improve the monitoring and evaluation of private sector activities through conducting business surveys or generating the private sector data from business registration and taxation records • Improve the monitoring and evaluation of development cooperation through more coordinated M&E activities of the government, line ministries, and development partners • **Conduct a data mapping exercise** to identify the currently available data sources and institutional settings and identify any data and institutional gaps for establishing baselines and monitoring national development
			• Then, **develop a strategy to address the gaps and to ensure the implementation of monitor-**

INFF Bloc	Thematic Areas	Findings and Issues	Recommendations
			ing and evaluation at both the national level and the sector level.
Improving Governance and coordination	Ensuring leadership and institutional coherence through integrated planning and budgeting process	• The budgeting and planning are shaped by national development strategy (such as NSDA 2020+, EDS 2030, NSDP, MTFF, and NIIP • However, the government faces challenges in M&E, dialogue and accountability, and capacity constraints	• Strengthen the M&E system and establish an effective public sector performance management system • Improve dialogue and accountability mechanism between the government with the private sector, the general public, and the parliament; • Improve the capacity constraints faced by the governments, parliament, private sectors, and NGOs
	Improving the effectiveness of Development Cooperation	• The Cook Islands has achieved country ownership of development cooperation projects, o almost all development cooperation is adequately recorded in the government budget, o nearly all development cooperation uses national procedures for budget execution and financial reporting, and o relies on the national procurement system • Issues with coordination and M&E of development cooperation; • The Cook Islands could explore new sources of development finance	• Better coordination between DCD, line ministries, and development partners to improve the predictability of development assistance; • Improve M&E of development cooperation through joint M&E activities of DCD, line ministries, and development partners; • Explore new sources of development finance, such as climate finance, and develop candidate projects
	Building an enabling environment for accountability and dialogue	• The Cook Islands has established a framework for dialogue and accountability through dialogue between government and the general public, between government and private sector participants, between government and development partners, and through the public's scrutiny of the government's decisions and actions • However, there are issues with dialogue and accountability, including weak external scrutiny and audit, weak accounting and reporting, and weak parliamentary scrutiny of the budget	• Update the Parliament standing orders on budget formulation and approval to require referral to the PAC after the first reading. The update has been completed • **Improve the effectiveness of the Parliament's scrutiny** by enhancing the parliament's capacity to conduct budget analysis and scrutinise budget and budget execution reports • **Establish an effective review and independent audit mechanism and enhance** the independence and capacity of the Cook Island Audit Office • **Establish robust and efficient monitoring, evaluation and learning system** • **Provide creditable, comprehensive and transparent information to civil society and the private sector**

INFF Bloc	Thematic Areas	Findings and Issues	Recommendations
			• **Set up a formal mechanism to stimulate multi- stakeholder participation for policy implementation and multi-stakeholder policy dialogue**

1. Introduction

1.1 Introduction of DFA

1.1.1 Purpose of DFA

The Sustainable Development Goals (SDGs) are the most ambitious development endeavour humankind has ever attempted. The SDGs aim to achieve by 2030 sustainable development in its three dimensions-economic, social and environmental while ensuring that no one is left behind. It calls for concerted action by all countries to promote prosperity while protecting the planet.

To achieve the development goals and targets set in national development plans and to achieve the SDG goals by 2030, countries face significant challenges in financing the achievement of SDGs and their national development goals. Globally, UNCTAD (2014) found that a total of $5-7 trillion is needed annually to implement SDGs, with the investment gap being $2.5 trillion for developing countries. In addition to additional financial resources, achieving SDGs also requires sound diagnosis, effective planning, and effective and efficient implementation. Otherwise, it risks placing scarce resources on low-priority, low-impact areas.

The challenges in financing SDGs and development, in general, have become more evident and pressing in times of the Global Pandemic, which has delivered a severe blow to the global economy, leading many countries to an economic crisis and recession since March 2020. The need to recover and build better in times of the Global Pandemic call even more for effective and efficient domestic resource mobilisation.

To address this challenge, United Nations, in its Addis Ababa Action Agenda (AAAA), has called for countries to establish Integrated National Financing Frameworks (INFFs) as an instrument to facilitate the mobilisation of all available finance, public and private, domestic and foreign, and the exploration of new and innovative finance in supporting governments' efforts in achieving SDGs and National Development Goals.

INFF is a set of integrated and holistic policy and institutional frameworks that a government can utilise to mobilise effectively and efficiently all available development finances from public and private, domestic and international sources for achieving SDGs and national development goals. Integrated national financing frameworks can help governments bring together policies and institutions within a more integrated, holistic approach to financing for sustainable development.

The Cook Islands has made its commitment to achieving SDGs by 2030. It has also set up its own Economic Development Strategy (EDS) 2030 with the vision to build a dynamic, prosperous, and inclusive future for Cook Islanders that is in harmony with the Cook Islands' culture and environment.

In achieving SDGs and its national development goals, the Cook Islands, a small island economy that has recently graduated from being a middle-income developing country, faces significant challenges to sustainable development, such as a narrow economic base, highly dependent on the tourism sector that is susceptible to external shocks, reliant on imports for consumption goods, capacity constraints (including shortage of skilled labour, inadequate infrastructure investment, insufficient private investment, etc.) for sustained economic growth, and vulnerable to climate changes and natural disasters. Like many small island countries in the region, it requires significant investment and financing to address these challenges and achieve SDGs and national development goals. This is especially the case in times of global pandemic and post-pandemic recovery.

The Cook Islands has felt the full force of economic and social impacts of COVID and the associated containment measures. The global pandemic has shut down the Cook Islands' tourism industry, which accounted for nearly two-thirds of the Cook Islands' GDP before COVID. According to estimates from ADB, Cook Island's economy contracted by 5.9% in 2020 and 29% further in 2021 and will only return to its pre-COVID level by 2025.

Against increased finance requirement arising from increased health care requirements and COVID relief effort, a contracted economy lead to reduced financial flows available, consequently widening the financing gap in moving forward the Sustainable Development Agenda and national development goals. According to ADB estimates, the Cook Islands' fiscal balances turn into deficits of 10.3% and 29.4% of GDP in 2020 and FY2021, respectively. Its debt level increased from 16.7% of GDP in FY2019 to 38.9% in FY2021 and is projected to increase to 43.8% in 2022.

How to mobilise resources to address the financing and liquidity needs arising from COVID-19 and finance a sustainable, equitable recovery is a challenge faced by many Pacific small island countries. In June 2020, the UNDP Samoa Multi- Country Office secured funding from the SDG Fund in assisting Samoa, Niue, and the Cook Islands to develop and implement Integrated National Financing Frameworks (INFF) for financing post-COVID recovery and accelerating SDG Progress in the three countries.

This Development Finance Assessment (DFA) is part of the effort to develop and implement an INFF in the Cook Islands. DFA is a tool to fulfil the Assessment and Diagnostic function of the INFF and initiates the inception phase of INFF. The overall objective of the current DFA is to provide an overview of existing development finance flows in the Cook Islands and the institutional arrangements utilised to finance achieving national development goals and priorities.

1.1.2 Integrated National Financing Framework

INFF is a set of integrated and holistic policy and institutional frameworks that a government can utilise to mobilise effectively and efficiently all available development finances from public and private, domestic and international sources for achieving SDGs and national development goals. Integrated national financing frameworks can help governments bring together existing policies and institutions within a more integrated, holistic approach to mobilise financing for sustainable development.

Figure 1. Financing Landscape

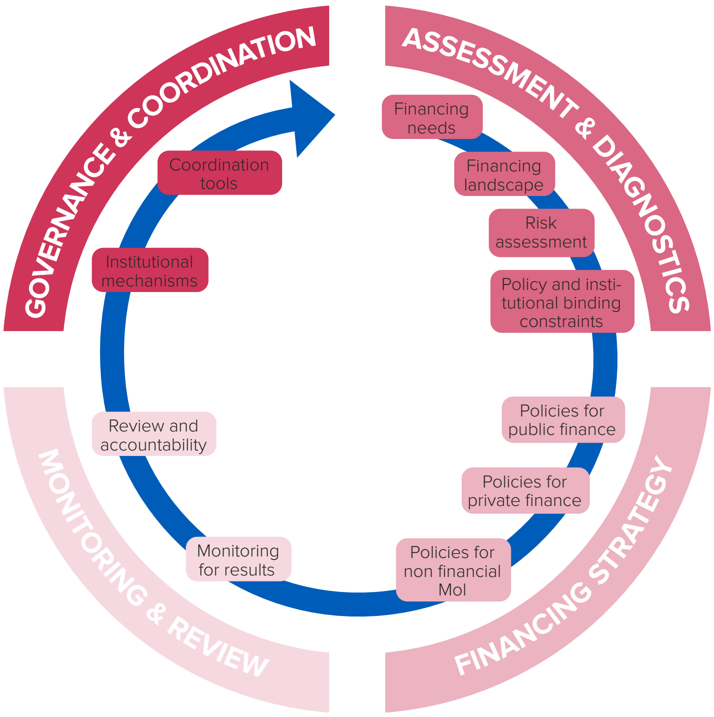
Financing Landscape				
	Public Finance	**Private Finance**	**Philanthropy Finance**	**Public Private Finance**
Domestic Finance	Government finance • Tax revenue (direct and indirect) • Non-tax revenue • Public debt (loans, sovereign bonds) Public entities • Revenue and dividend • Investment and expenditure • Government transfer Public finance usage	Domestic private finance • Private investment • Credit to the private sector • Bonds and equity market Private finance usage	Philanthropy finance • Foundations • NGOs • CSOs Philanthropy finance usage	Public-private finance • PPPs • Blended finance Usage
Interna-tional Finance	Development cooperation • ODA • Other official flows • South-south cooperation Development cooperation usage	International private finance • FDI • Portfolio invest ment • Illicit finance International private finance usage	International NGO finance • Foundations • NGOs • CSOs Usage	

Source: UNDP

INFF includes four building blocks, (i) assessments and diagnostics; (ii) financing strategy; (iii) monitoring and review; and (iv) governance and coordination. The building block of **assess-ments and diagnostics** involves examining the current situation of a country's INFF, identifying any improvement opportunities, and recommending INFF reform map.

The second building block, **financing strategy**, sits at the heart of the INFF and provides a strategic framework detailing the Government will implement an integrated, public and private approach to financing the priorities articulated in a development plan.

Figure 2. Building Block of INFF



Source: UNDP

The third building block, **Monitoring and Review of financing and financing policies**, is essential for the functioning of an integrated national financing framework that can support building forward better. This involves regularly examining how financing needs, trends, risks and constraints are evolving, how public and private financing policies are performing and identifying opportunities for improvement.

The fourth building block, **governance and coordination**, provides an institutional framework to manage and operate the INFF and strengthen engagement between Government and non-state stakeholders. Figure 2 demonstrates the four blocking blocks of INFF.

Several Pacific Islands Countries are in the process of establishing or preparing to establish their INFFS. For example, the Solomon Islands set up an Integrated National Financing Framework (INFF) in 2018. However, the implementation and effectiveness of this framework of this framework are yet to be seen. Fiji, Samoa, and Vanuatu are conducting their Development Finance Assessments at the moment, which will form the base for establishing INFF in the two countries.

1.1.3 Structure of the report

This report comprises four parts. Part one will explain the purpose of the current Development Finance Assessment (DFA), introduce DFA as a tool to fulfil the Assessment and Diagnostic function of the INFF and initiates the inception phase of INFF. It also briefly summarizes Cook Island's social and economic situations and challenges.

Part two examines the development financing landscape in the Cook Islands, analyzing the current and future financial resources available to meet the Cook Islands' financial demand for its development and achieving its SDG goals. These financial flows covered in the report are shown in Figure 1.

Part three will examine the policy and institutional frameworks governing these financial flows, including financing strategy, monitoring and review, and governance and coordination mechanisms.

Part four makes recommendations on improving the Cook Islands' financing frameworks and proposes a roadmap for implementing INFF in the Cook Islands.

1.2 Cook Islands' Economic and Social Situation

1.2.1 A summary of the Cook Islands' economic and social situation

The Cook Islands is a large ocean Pacific Island country, with a land area of 240 KM2 spread across 15 islands and an exclusive economic zone area of 1.9 million KM2. It is a self-governing island country in free association with New Zealand. The resident population is around 15 thousand[1], of which approximately 72% live on the largest island, Rarotonga, and 28% live on Pa Enua (Outer Islands). Cook Islanders are citizens of New Zealand and have the right to live and work in New Zealand, which many do. Similar to many other Pacific small island countries, the Cook Islands faces challenges, such as a small domestic market, remoteness and isolation from the centre of global economic activities, high transportation costs, reliance on a limited range of economic activities, and vulnerability to various social and economic shocks and climate change, etc. Table 1 presents some of the Cook Islands' key social and economic indicators.

Table 1. Main social and economic indicators in most recent data (2019-2021)

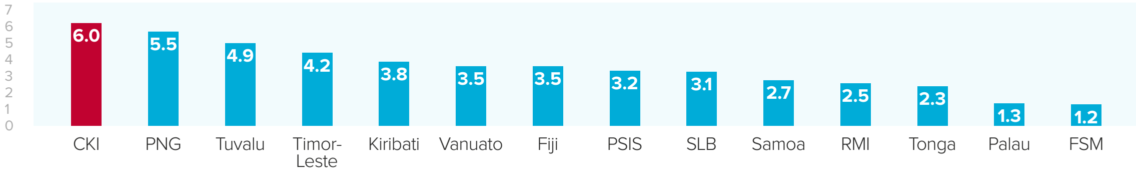
Main indicators	Value
Resident population in December 2021 (preliminary result from 2021 Census)	14,961
Labour force participation rate (% of the working-age population aged 15 and over) in 2019	70.4
GDP (Current NZ$ Million) in 2021	431.3
GDP per capita (current NZT$) in 2021	$24,123 (US$17,354)
Average GDP Growth (%), 2014-2019	6%
GDP growth (%) in 2021	-26%
Public Revenue (% of GDP) in 2021	39.0
Public expenditure (% of GDP) in 2021	72.8
Net Public debt (as % of GDP) in 2021	44.0%
Foreign direct investment (% of GDP) in 2019	0.12
Trade (import and export) (as % of GDP) in 2019	40%
Unemployment rate (% of the labour force 2019)	1.3 (reported to have risen in 2020)

Source: MFEM and ADB Key Indicators

From 2014 until the COVID-19 outbreak, the Cook Islands experienced strong economic growth. Between 2014 and 2019, its GDP grew at an average of 6.0% annually, the highest among all Pacific Small Islands States (see Figure 3).

[1] This is the preliminary result from the 2021 Census. See also MEFM estimate in MEFM Census 2021 Updates, https://mfem.gov.ck/statistics/census-and-surveys/census/267-census-2021/1160-census-of-population-dwellings-2014?showall=&start=2

Figure 3. Annual Average GDP Growth (%) in Pacific Small Islands States, 2014-2019



Source: WDI and MFEM

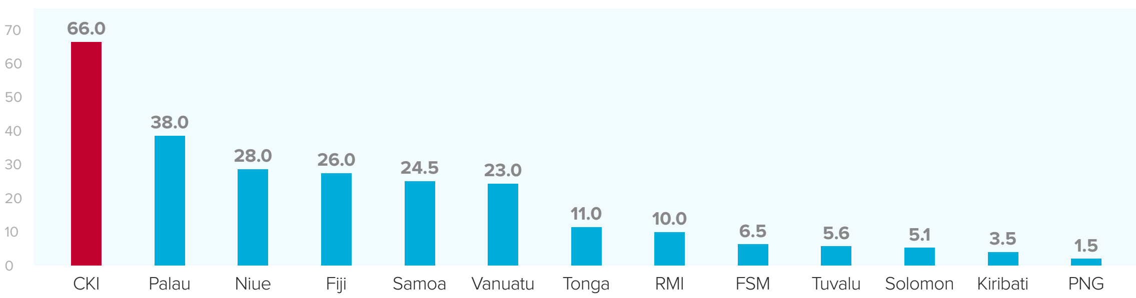
GDP peaked at NZ$575.4 million in 2019 (US$402 million)[2], and its GDP per capita reached NZ$24,446 (US$18,767), which is more than four times of regional average (US$4270) and second only to Palau (US$42755).

The rapid growth is mainly driven by increasing tourist arrivals and high levels of public and private capital investment. It has delivered tangible national income benefits, with the Cook Islands graduating to the high-income country status from 1 January 2020[3]. However, during the growth period, the Cook Islands was capacity constrained, including inadequate infrastructure investment, difficulty in land access, and labour shortage[4].

The Cook Islands' economy is service based, with relatively small industrial and primary sectors. In 2021, the service sector accounted for 87.4% of GDP[5], similar to other Pacific island countries, on par with many developed countries, and essentially unchanged from before COVID-19 (88.4% in 2019)[6]. Manufacturing, mining and construction accounted for around 10% of GDP in 2021, while primary industries (agriculture and fisheries) accounted for only 2.7%.

Like many other Pacific island countries, tourism has been important in developing the economy. Before COVID-19, the Cook Islands were one of the most tourist-dependent economies in the world[7] and the most tourist-dependent economies in the region (see Figure 4). The tourism sector accounted for an estimated 66% of its GDP in 2019, the highest in the region, and employment in tourism accounted for about 34% of the country's total workforce in 2016[8]. High reliance on the tourism sector makes the economy vulnerable to external shocks, such as the outbreak of COVID-19 and restrictions on international travel, which effectively "wiped out" the sector. At the same time, the Cook Islands has gradually faced lots of competition for tourism from other similar economies in the region.

Figure 4. Tourism Receipt (% of GDP), 2019



Source: Pacific Tourism Organisation. 2020. Annual Review of Visitor Arrivals Report as cited in PSDI Pacific Tourism Sector Snapshot, Country Profiles

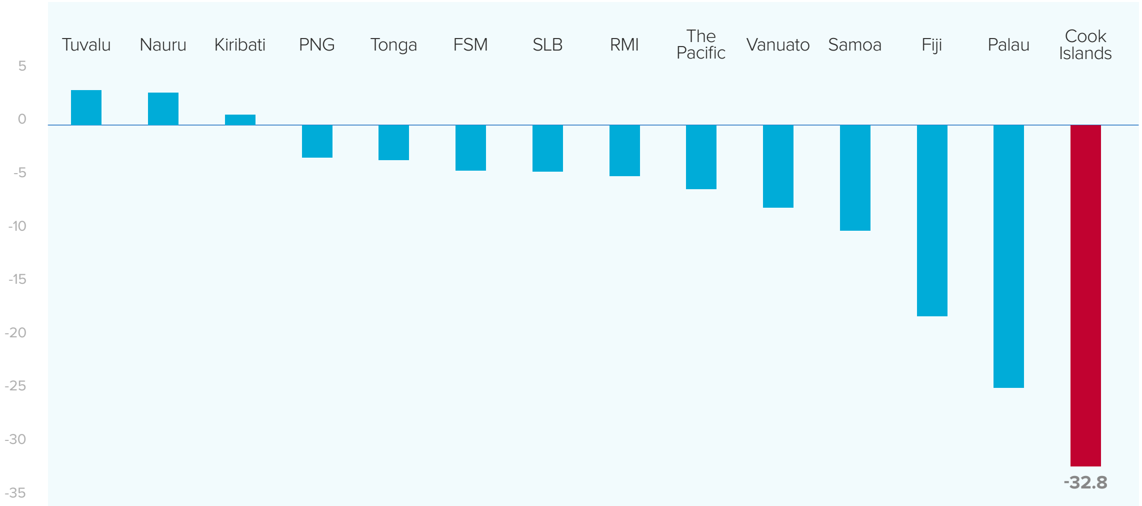
[2] MFEM, GDP-Statistics-Tables_2021
[3] https://blogs.worldbank.org/opendata/new-world-bank-country-classifications-income-level-2021-2022 As of July 2021 the threshold for high income was US$12,695. The recent fall in GDP saw quarterly GDP per capita drop close to this threshold.
[4] IMF, Cook Islands Technical Assistant Report, August 2020
[5] MFEM, GDP-Statistics-Tables_2021
[6] ADB Key Indicators 2021
[7] https://www.aiib.org/en/projects/details/2020/approved/Cook-Islands-COVID-19-Active-Response-and-Economic-Support-Program.html
[8] PSDI (Pacific Private Sector Development Initiative), 2021, PACIFIC TOURISM SECTOR SNAPSHOT: Cook Islands

In 2019, visitor arrivals were 171,550, most of whom came from New Zealand (61%) or Australia (13%)[9], while the remaining 26% came from the USA, EUROPE and the rest of the world.

The Cook Islands relies on imports for manufactured products, including food, due to its limited manufacturing capacity, making it vulnerable to supply chains and international trade disruptions caused by external shocks, such as the COVID19 pandemic. In 2019, imports accounted for 36% of its GDP. Most imports are sourced from or via New Zealand.

The global outbreak of COVID-19 and the associated containment measures have hit the Cook Islands harder than most nations. The restrictions on international travel led to a significant decline in the tourism-related sectors (lost revenue is approximately $1M per day).[10] This has caused considerable loss of employment and damage to the economy. The Cook Islands' GDP contracted 5.2% in 2020 and contracted 29% further in 2021 (ADB, 2022)[11], nearly a third lower than that in 2019 (see Figure 5), the lowest among all Pacific Small Island countries. Consequently, The Cook Islands faces significant challenges in recovering from COVID damage, creating and accelerating resilient and sustainable economic growth post-COVID.

Figure 5. Cumulative GDP growth (%), 2019-2021



Source: Asian Development Outlook 2022

It is predicted that the economy will start to recover from 2022, with GDP forecasted to grow by 9.1% in 2022 (ADB, 2022), and the economy will return to pre-COVID-19 levels at around 2025. The Cook Islands has a very high vaccination rate (over 96%) and has opened its border to vaccinated New Zealanders since January and Australian since April 2022. It plans to open its border to the rest of the world from May.[12, 13]

The collapse in tourism and the contraction in the economy have led to a decline in tax revenues of 7 percent in FY20 and a further expected decline of almost 40 percent in FY21. However, public expenditure has increased due to increased finance required to prepare for the Pandemic and to support emergency response and economic recovery. Public expenditures rose temporarily from 36 percent of GDP in FY19 to over 70 percent in FY21. As a result, the

[9] Cook Islands | New Zealand Ministry of Foreign Affairs and Trade (mfat.govt.nz)
[10] Limited tourism from New Zealand resumed in May 2021 but ended due to the Delta outbreak reaching New Zealand.
[11] ADB, Asian Development Outlook 2022, https://data.adb.org/dataset/gdp-growth-asia-and-pacific-asian-development-outlook
[12] WHO, 2 November 2021, https://covid19.who.int/region/wpro/country/ck
[13] https://covid19.gov.ck/

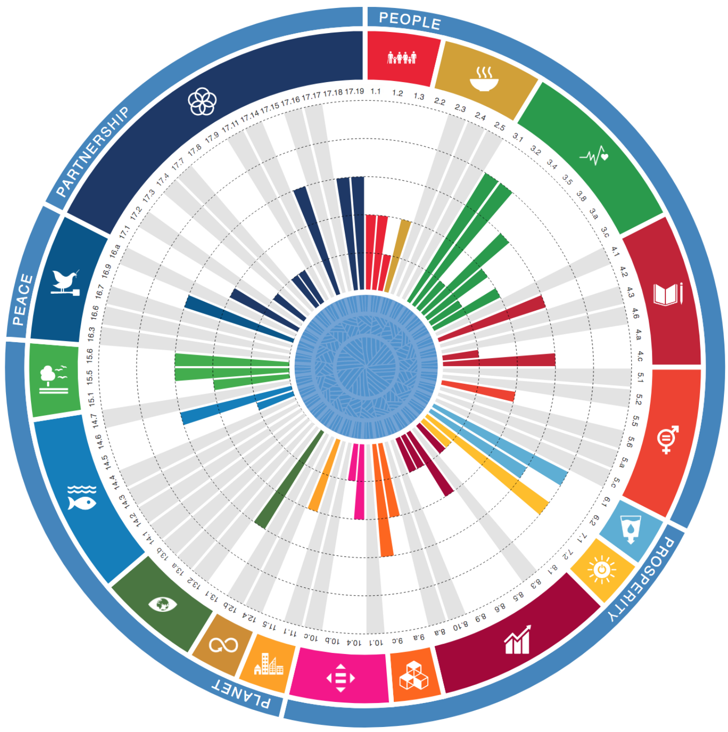
fiscal balance turned from a surplus of 5.4% GDP in 2019 to a deficit of 2.4 percent in 2020 and a projected deficit of 30% GDP or more in 2021[14].

The Cook Islands' public debt level was relatively low before COVID-19. At less than 30% of GDP before COVID-19, the public debt level had been within the Government's prudential limits and was projected to decline further[15]. However, the fiscal drain of current deficits due to COVID-19 has seen the public debt to GDP ratio rising to 44% of GDP in 2021, with forecasts of further increases. Debt levels have exceeded the government's previous hard target, which poses challenges for the government to manage debt sustainability.

The Cook Islands has a relatively low level of investment. The Cook Island's Gross Fixed Capital Formation is estimated to be around 12% of its GDP, and its FDI is estimated to be approximately 0.12% of its GDP in 2019, which are lower than those in New Zealand and regional leaders, such as Fiji, Vanuatu, etc. one reason for the relatively low level of investment is the rigid regulatory framework. The overall regulatory environment in the Cook Islands has been described as not conducive to business and international investment. This includes issues around access to land, the high cost of domestic finance, restrictions on FDI, and administrative 'red tape'. The newly developed ERR has proposed programmes specifically to address these issues.

These obstacles make it difficult to start businesses and invest. These barriers also reduce competition, leading to inefficiencies, reduced economic development, and higher prices. Consequently, the level of private investment in the Cook Islands is insufficient to overcome capacity constraints on growth. Most (if not all) industries, including tourist accommodation, are "Reserved Investment Areas" and are only open to foreign investment via an exemption. This and other restrictions have limited private sector investment to primarily being funded domestically.

Figure 6. The Cook Islands' SDG Progress Wheel



Source: SPC Pacific Data Hub

[14] ADB Pacific Economic Monitor
[15] IMF, 2020, IMF Staff Technical Assistance Report

The Cook Islands has a relatively high level of human capital development. Schooling is compulsory to age 16 and is observed in practice. The Cook Islands use the New Zealand secondary system, with around half of students continuing to the final year (approximately age 18).[16] The Cook Islands is not included in the Human Development Report 2020, but available data suggest it has a high level of human development. However, due to rapid economic growth, emigration of Cook Islanders, and relative restrictive immigration policy[17], labour shortage, particularly skilled labour, has become a significant issue for private sector businesses.

The Cook Islands has a high level of social development as well and has made its commitment to SDGs and the 2030 Agenda. While it has made good progress in some aspects of SDGs, it is still lagging in other aspects. For example, the SPC's SDG progress wheel shows that the Cook Islands has already achieved several SDG targets, such as reducing maternal mortality and infant mortality rates, accessing safe and affordable drinking water for all, etc. On the other hand, it has only made minimal achievements in some targets, such as reducing the number of people living in poverty by half, and strengthening the prevention and treatment of substance abuse.

1.2.2 Challenges facing the Cook Islands

In light of the Cook Islands' past social and economic development and the current difficulties brought about by the Global Pandemic, the Cook Islands' EDS 2030 and NSDA 2020+ have identified the following challenges faced by the Cook Islands in achieving its development visions:

- Realising the NSDA 2020+ vision of Turanga Memeitaki- wellbeing for all.
- **Balancing the quantity and quality of economic growth.** While the Cook Islands has achieved strong economic growth during the past few years, it also faces challenges that may have the potential to threaten the long-term sustainability of the Cook Islands economy, such as waste and sanitation management and inequitable access to the benefits of economic growth. Dealing with these challenges and ensuring environmentally sustainable development requires balancing the quantity and quality of economic growth.
- **Transforming the economy into a more complex, diversified, and dynamic economy, facilitating private sector lead growth in non-tourism sectors.** The economy is highly dependent on tourism, especially tourists from Australia and New Zealand. This presents ongoing risks that global events or natural disasters impacting tourism would significantly impact the Cook Islands economy.
- **Addressing capacity and business environment constraints to strong economic growth, including shortage of labour and skilled labour, housing shortage, and infrastructure deficit restrictive investment regime.**

  Before COVID-19, economic growth was constrained by labour and infrastructure capacity. The IMF Technical Assistance Report (IMF TAR) considered that the economy had reached and probably exceeded its potential growth rate.[18] While this is no longer a short-term issue in times of COVID, it is likely to remerge in the future, particularly if the economic recovery is stronger than anticipated and/or if there is a reduction in the labour force. At the same time, the regulatory environment in the Cook Islands has been described as not conducive to business and international investment and constraining economic growth.

[16] http://www.education.gov.ck/wp-content/uploads/2021/06/2020-Education-Statistics-Report.pdf
[17] For example, Work Permits are normally valid for one year. Entry and work permits may be extended on application for up to two (2) further one-year periods
[18] IMF, Cook Islands Technical Assistant Report, August 2020

- Possible **long-term population and labour force decline** due to emigration and declining birth rates. This presents issues around the size of the future labour force and how to support an ageing population (e.g. health care, social support). The UN projects a slight decline in population by 2030.
- **Addressing capacity constraints of public sector institutions.** Given the limited population size, there is limited technical capacity within relevant agencies to take on new initiatives and deliver public services.
- **Addressing inequitable sharing of the benefits of economic growth across regions and all walks of society.** The Cook Islands has reduced the population living below the minimum liveable income from 11 percent in 2016 to 8 per cent in 2018. However, there is still marked inequality across regions, in particular between Rarotonga and the Pa Enua[19].
- **Adapt to climate changes and enhance resilience to climate change and disasters.** The Cook Islands is vulnerable to natural disasters, which have become more frequent and caused more damage.
- In times of Global Pandemic, the Cook Islands faces the challenges of recovering from the aftermath of COVID-19 and building back better.

1.3 Financing challenges and Financing solutions

To address these challenges, the Cook Islands, similar to many Pacific Islands countries, faces challenges of mobilizing existing financial resources and exploring new resources to meet their development financing requirements. This is especially the case in times of COVID-19 when the economy contracted and financial flows reduced, while finance required arising from COVID-19 response and ensuring a sustainable, equitable recovery have increased.

Similar to other Pacific Island countries, substantial additional domestic revenues may be possible from sources such as fisheries, tourism, natural resource extraction, (possibly) deep-sea mining, and innovative ‘green’ or conservation fees, among other areas.

At the same time, taxation system reforms could improve tax compliance and revenue collection. Improving tax audits can reduce illicit capital flows. Refining tax incentives for investment can enhance their effectiveness and minimise revenue loss. Tax exemptions and incentives for investors result in considerable losses in revenues, yet it is not always clear that they are effective in attracting investment. Sovereign Wealth Funds also represent a potential source of development finance, especially for infrastructure investment.

Public sector reform can improve the effectiveness and efficiency of overall public expenditures, especially in key public areas, such as health, education and public administration. SOE reforms could improve SOE efficiency, redirect state subsidies to activities with positive externalities, and facilitate the entry of private sector investment.

Private sector development has been identified as a key priority for many Pacific Small Island Countries. However, private sector investment and credits to the private sector in many Pacific Island countries are still low. How to attract private sector investment and improve the private sector access to finance remain challenges for many countries. Remittance is the primary source of private finance in many Pacific Islands countries. Leveraging Diaspora wealth and channelling remittance for development are yet to be fully explored.

Even with improved domestic resource mobilisation, development assistance will remain critical to most Pacific SIDS to enable them to not only deliver adequate public services but also to invest in critical infrastructure and to plan for and adapt to climate change. Development assistance can be used more strategically to leverage or ‘crowd-in’ finance from the private sector, especially in infrastructure or in other sectors where there are expected economic returns.

Utilising innovative financing mechanisms and instruments, such as blended finance, green finance, and impact investment, to name a few, can maximise the benefits of available financial resources.

All these issues are interrelated and call for holistic and integrated solutions. INFF will play a critical role in this regard. It can help facilitate the development of holistic and integrated solutions and provide a holistic and integrated perspective in seeking solutions for development financing. This report will evaluate the Cook Islands’ national financing framework from the lens of INFF and explore the opportunities to establish an INFF in the Cook Islands.

2. Cook Islands' Financing Landscape

This section will examine the Cook Islands' financing landscape, examining the trends, sources, and usages of different development finance flows. These development finance flows originate broadly from four sources:

- Domestic - private: gross domestic savings as well as the increased credit from the domestic financial market due to the deepening of the financial market;
- Domestic - public: tax revenues and other public revenues;
- International - private: remittance, foreign direct investment (FDI) and portfolio investment, philanthropic finance as well as borrowing from international capital markets; and
- International - public: Official Development Assistance (ODA), Other Official Flows (OOF) and South-South Cooperation (SSC).

2.1 Public Finance

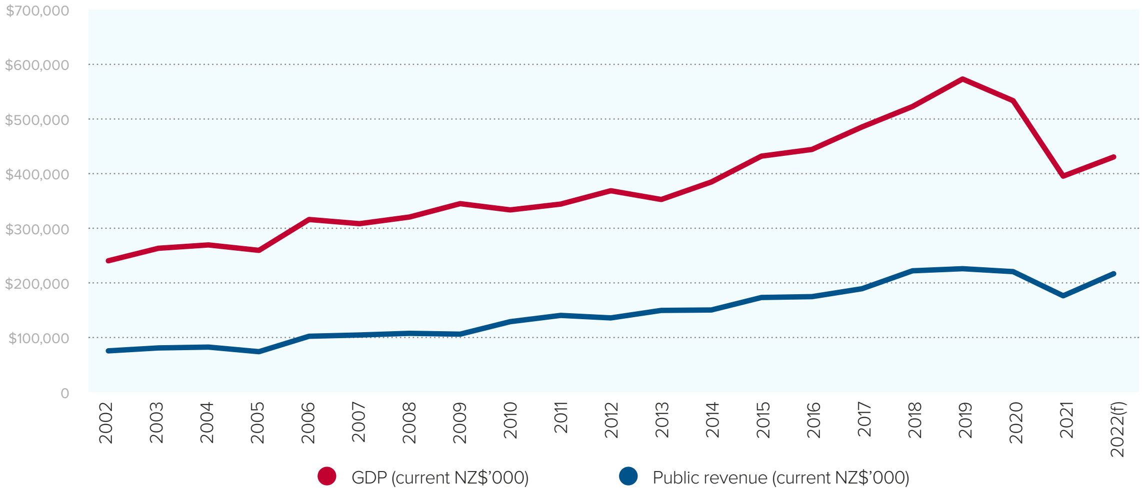
This section looks at the Cook Islands government's public finance, including public revenues, expenses and debt financing.

2.1.1 Public revenue

2.1.1.1 Public revenue has been increasing in value yet has been stable at around 40% of its GDP

The Cook Islands' public revenue in recent years generally follows the trend of GDP, as seen in Figure 7, particularly during the period up until 2019, when the economy was growing. From 2009 to 2019, public revenue has more than doubled, having increased from NZ$105 million in 2009 to NZ$225 million in 2019. However, the closure of the international borders and the shutdown of the tourism sector due to COVID have resulted in a significant fall in public revenue, which dropped from NZ$225M in 2019 to NZ$175.6M in 2021, a 22% contraction. It is expected that the public revenue will start to recover from 2022 and increase by 8.8% in 2022 to reach NZ$216.4M.

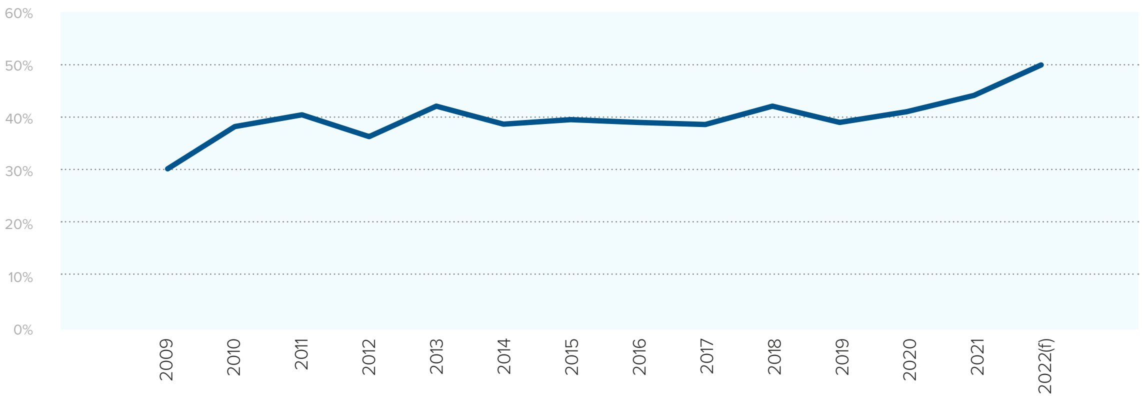
Figure 7. Public revenue and GDP (current NZ$ '000), 2002-2022(f)



Source: MFEM and ADB

For the decade 2010 to 2019, public revenue stabilized at around 40% of GDP with only limited variations due to variations in grants received. However, since 2020, the impacts of COVID-19 saw the ratio of public revenue to GDP rise to 44.4% for 2020 and is forecasted to be more than 50% of GDP in 2022. This increase in public revenue to GDP ratio is due to the increase in grants, in the form of budget support, from development partners supporting the Cook Islands' effort in COVID response and post-COVID recovery.

Figure 8. Public revenue as % of GDP, 2010-2022(f)

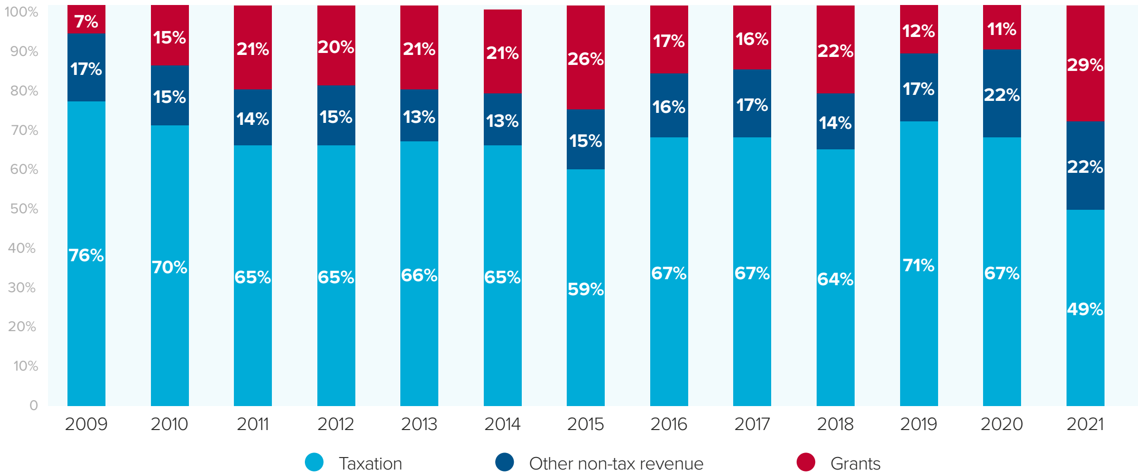


Source: MFEM and ADB

2.1.1.2 Sources of public revenue

The Cook Islands' public revenue comes from taxation (e.g. income and company tax, sales tax), non-tax revenue (e.g. sales by government entities, fines, fees for international financial licenses, fishing licences), and development assistance grants. Figure 9 shows the split of public revenue by sources over time.

Figure 9. Distribution of Public revenue (% of Public Revenue), 2010-2022(f)

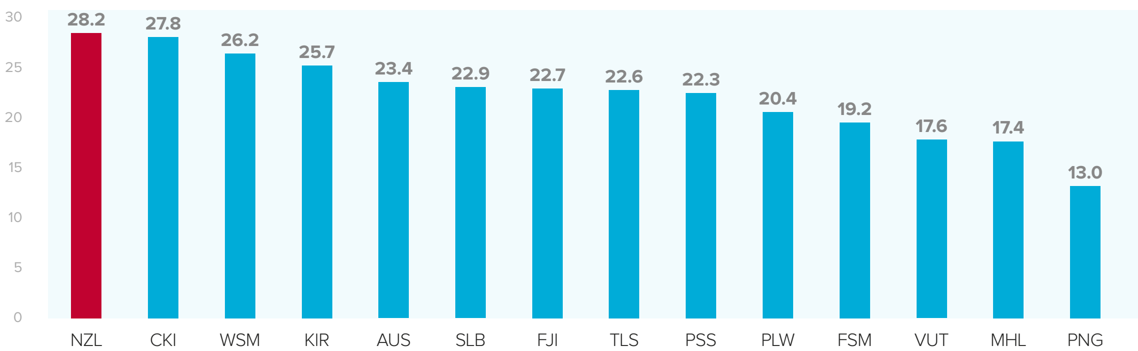


Source: MFEM and ADB

Taxation revenue was the primary source of public revenue and represented two-thirds of public revenue from 2011 to 2019 (an average of 66%). The other sources of public revenue are non-tax revenue, averaging 15%, and grants, averaging around 20%. Taxation revenue broadly comes from three types of taxes, taxes on goods and services, taxes on international trade and transactions, and taxes on individual and corporate income, profits, and capital gains. Tax on goods and services is the largest source of tax revenue, accounting for more than 50% of total taxation revenue since 2014, when the Cook Islands increased the VAT from 12.5% to 15%.

Compared with others in the region, the Cook Islands' tax mobilisation (tax revenue to GDP ratio) is high. In 2019, the Cook Islands' tax revenue to GDP ratio, at 27.8%, was slightly lower than that in New Zealand (28.2%) and higher than those in the rest of other Pacific Small Island countries. This suggests that there is little space for the Cook Islands to raise taxes.

Figure 10. Tax revenue (% of GDP) in selected Pacific Small Islands States, 2019



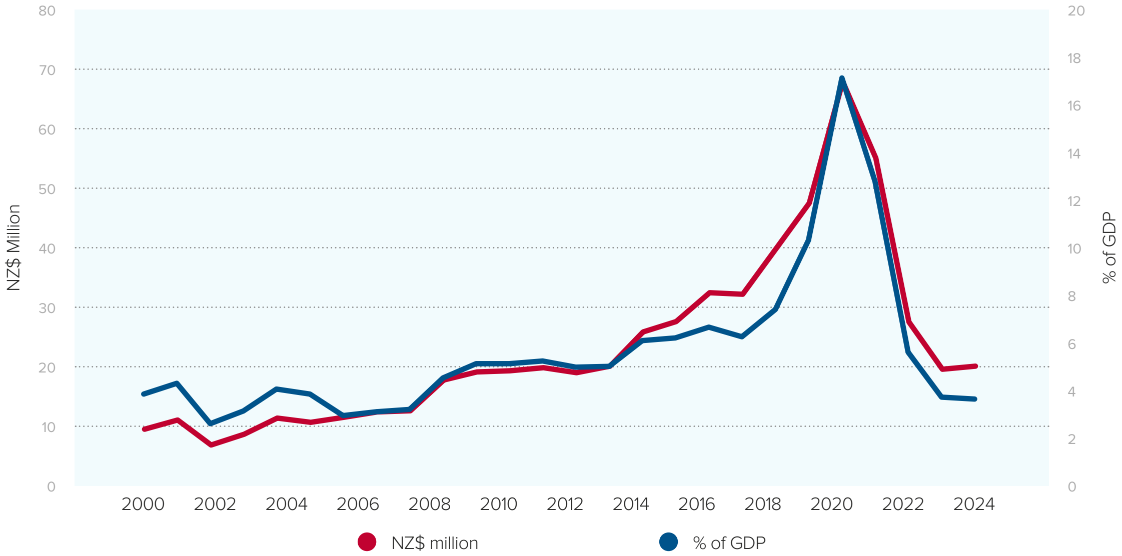
Source: WDI and ADB

COVID-19 has dealt a blow to the Cook Island economy, with economic activity contracted and tax revenue reduced significantly. In FY2019/20, tax revenue reduced by 7.3% compared with that in FY2018/19; in FY2020/21, tax revenue reduced by 42% compared with that in FY2019/20. As a result, tax revenue in FY2020/21 was only 54% of that in FY2018/19. To counter this impact, the New Zealand Aid Program has provided a total of NZ$35.1 million to the government of the

Cook Islands in the form of budget support in FY2020/21. NZAID has confirmed to provide another NZ$30 million for FY2021/22.[20] The increased budget support and ODA grants have, to some extent, compensated for the loss of tax revenues.

Non-Tax revenue mainly comes from property income, sales of goods and services, fees, fines, penalties, and forfeits. Non-tax revenue has been increasing in terms of both monetary value and percentage of GDP. Between 2000 and 2019, non-tax revenue increased from NZ$9.4 million and 3.8% of GDP in 2000 to NZ$47.5 million and NZ$47.5 million and 10.3% of GDP in 2019. It is estimated that Non-Tax will peak at NZ$68 million in 2021 and decline gradually to around NZ$20 million by 2025 due to the end date of the current Core Sector Support agreement with New Zealand.

Figure 11. Non-Tax revenue (% of GDP), 2010-2020



Source: MFEM and ADB

Looking into the future, as the Cook Islands' economy is gradually recovering from COVID-19, tax revenue will also gradually recover, although it is likely to return to its 2019 level before 2025. At the same time, other factors, which will be discussed in more detail in later sections, may have impacts on the Cook Islands' public revenue as well, including:

- Grants from development partners will not likely be affected by the graduation from ODA[21]. As the majority of the grants to the Cook Islands are from non-ODA sources. The Cook Islands' primary development partners have indicated they will continue to provide funding or will provide funding through channels other than ODA, such as bilateral agreements[22].
- However, non-tax revenue is likely to reduce significantly from 2021. The government needs to find new sources to make up for the reduction in non-Tax revenue from 2021. Furthermore, fishing revenue accounts for a significant proportion of non-Tax revenue. Climatic conditions may impact the stability of this revenue.

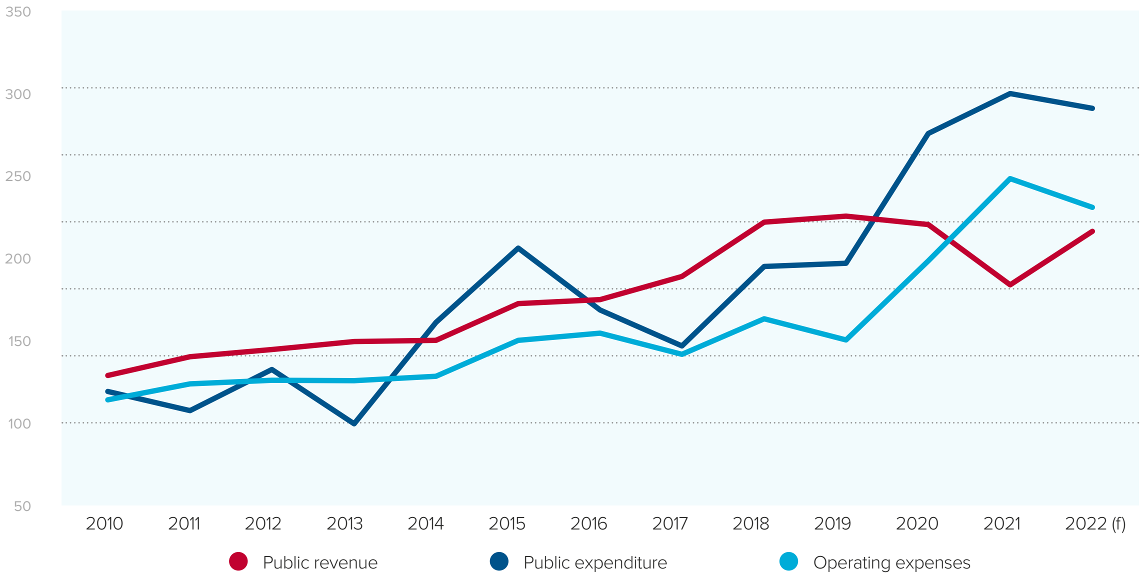
[20] https://covid19policy.adb.org/index.php/policy-measures/COO, MFEM
[21] Bertram, Geoff, 2016, Implications of the Cook Islands' Graduation from Development Assistance Committee (DAC) Eligibility, http://www.mfem.gov.ck/images/documents/DCD_Docs/Development-Resources/Implications_of_the_CKI_Graduation_from_DAC_Eligibility.pdf
[22] Stakeholder consultation

2.1.2 Public expenditure

2.1.2.1 Public expenditure has increased significantly since COVID19

Public expenditure has increased over time, increasing from NZ$121M in 2014 to $277M in 2021. Since the outbreak of COVID-19, public expenditure has increased significantly. This reflects the need for the government to support businesses, employment and livelihoods and maintain economic capability. The Government's COVID-19 Economic Response Plan has a value of NZ$61 million, covering the 2019/20 and 2020/21 financial years and including funds carried forward into 2021/22. The Government has also sought to maintain the ability to undertake further fiscal intervention in the longer term.[23]

Figure 12. Public Expenditure and Public Revenue (NZ$ Million), 2010-2022

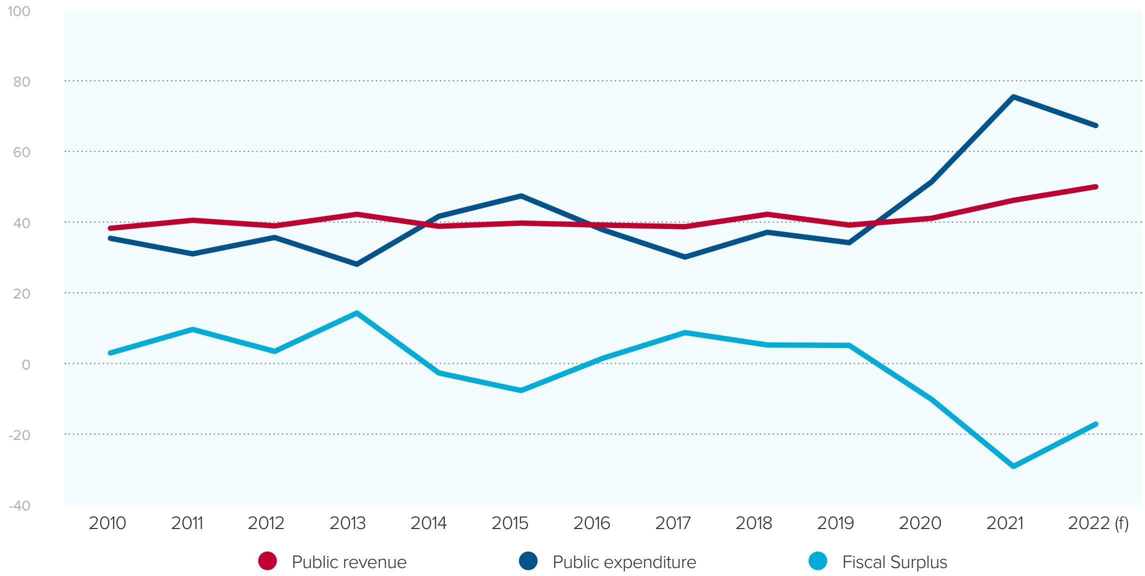


Source: MFEM and ADB

As a percentage of GDP, public expenditure fluctuated around 35% of GDP between 2010 and 2019, while public revenue stabilised at about 40% of GDP. The public expenditure to GDP ratio is higher than 40% in only two (2014 and 2015) of the ten-year period. However, since the outbreak of COVID in 2020, public expenditure increased significantly to 75.7% of GDP due to the significant increase in public expenditure and the reduction in GDP. As a result, the fiscal balance shifted from a surplus of 5% of GDP in 2019 to a deficit of 29.4% of GDP in 2021.

[23] http://www.mfem.gov.ck/images/MFEM_Documents/COVID-19/Cook_Islands_Economic_Response_to_COVID-19.pdf

Figure 13. Public Expenditure and Public Revenue (% of GDP), 2014-2022



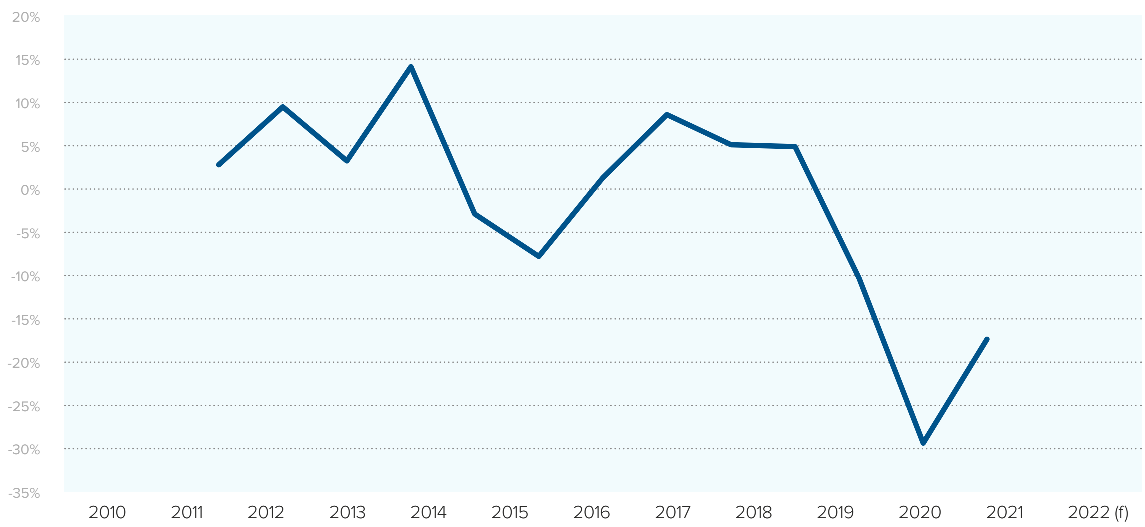
Source: MFEM and ADB

Most of the public expenditure is allocated for operating expenses, with operating expenses accounting for an average of 80% of the public expenditure and capital investment accounting for about 20%.

Figure 14 shows the effect of these trends on the fiscal deficit (net). From 2010 to 2019, the Cook Islands only had a fiscal deficit in 2014 (-3% of GDP) and 2015 (-8% of GDP). Between 2016 and 2019, the Cook Islands had three consecutive years of fiscal surpluses. Loss of public revenue and expansion of public expenditure due to COVID-19 have resulted in fiscal deficits of 10% and 29% GDP in 2020 and 2021 respectively.

It is expected that the fiscal situation will start to improve from 2022 onwards. However, surpluses are expected to return only in the medium term, depending on a substantial return of tourists.

Figure 14. Fiscal surplus/deficit (% of GDP), 2010-2022 (f)



Source: MFEM and ADB

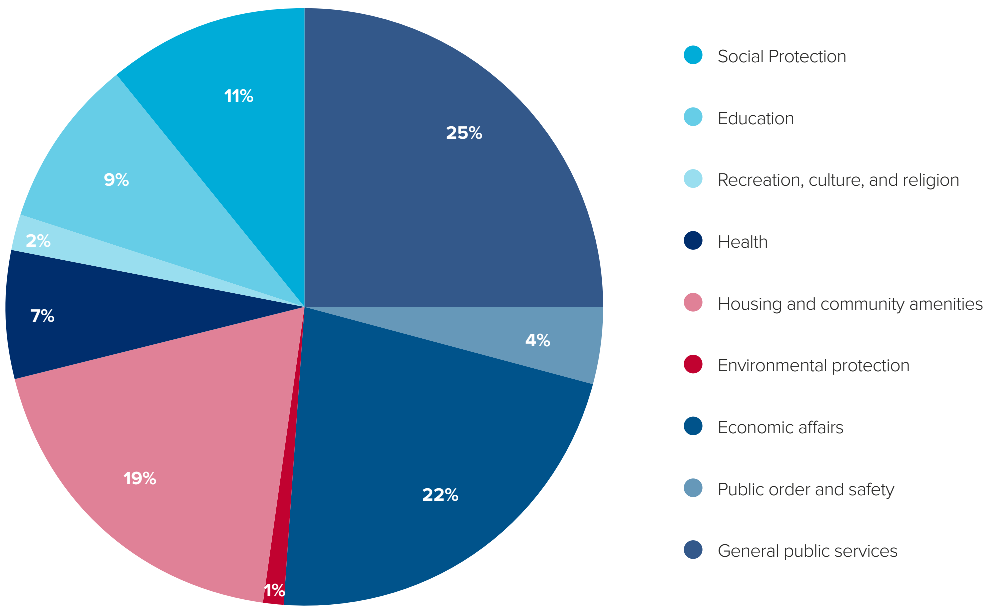
2.1.2.2 Use of public expenditure

Historically, public expenditure focuses on General public services, Economic Affairs, and housing and community amenities. Figure 15 shows the distribution of public expenditure by function before COVID-19 in 2019. It shows that General public services accounted for 25% of public expenditure, economic affairs accounted for 22%, housing and community amenities accounted for 19%, and social protection accounted for 11%. These are followed by expenditure on education, 9%; expenditure on health, 7%; expenditure on public order and safety, 4%.

While this demonstrates the distribution of public expenditure by functions, it is not clear to what extent this distribution aligns with the SDG financing needs, especially financing needs of the cross-cutting issues, such as gender and climate. Currently, the Cook Islands does not have an SDG costing and does not have an SDG budgeting mechanism in place yet. The Cook Islands may consider conducting SDG costing, incorporating SDG budgeting into the budget process, and conducting SDG budget analysis.

Over time, there has been a significant increase in the public expenditure allocated to housing and community amenities. In 2013, housing and community amenities accounted for only 0.1% of the public expenditure; by 2019, this had increased to 19%. Housing and community amenities has been consistently the third largest expenditure areas in the FY2019/20, FY2020/21, and FY2021/22 budgets.

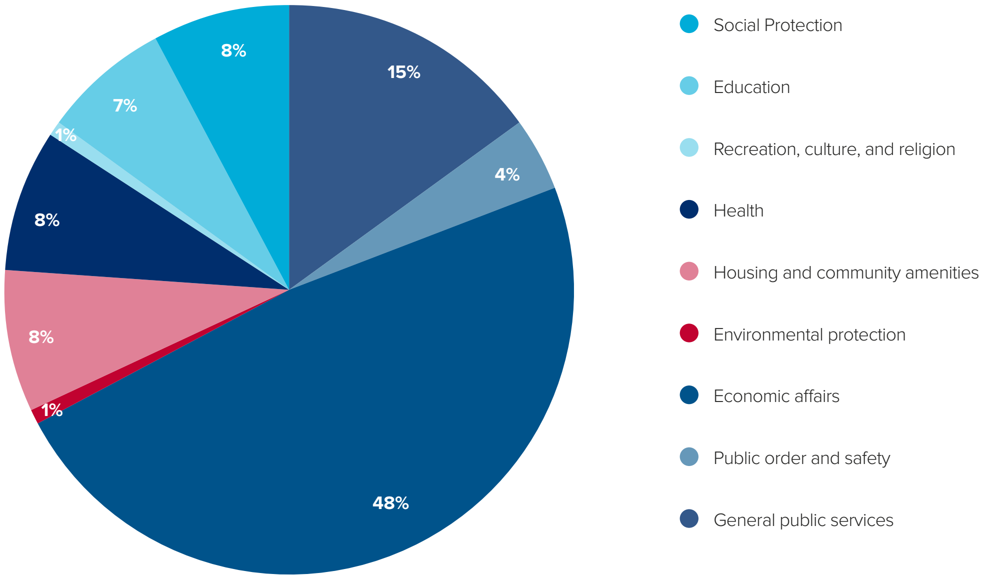
Figure 15. Distribution (%) of Public Expenditure by function in 2019



Source: MFEM

Since the outbreak of COVID-19, the Cook Islands has significantly increased its expenditure on economic affairs. In 2020, economic affairs accounted for 48% of public expenditure. Particularly, the government's expenditure on General economic, commercial, and labour affairs accounted for 71% of the government's expenditures on economic affairs or a third of the total government expenditure. This reflects the Government's increased effort to support businesses, employment and livelihoods and maintain the economic capability in the face of COVID-19. This trend is likely to continue into 2022.

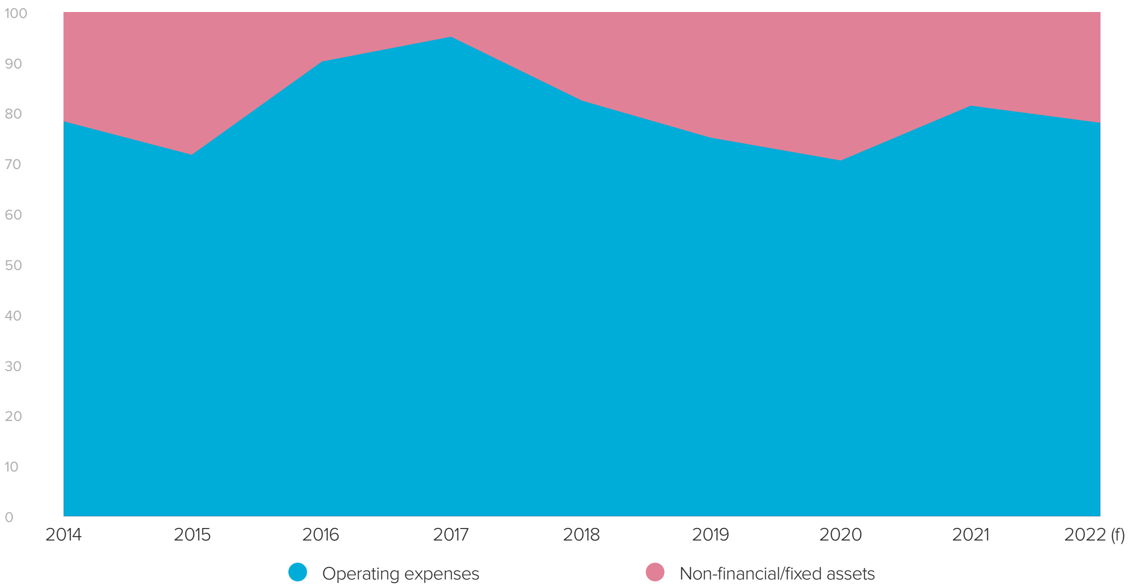
Figure 16. Distribution (%) of Public Expenditure by function in 2020



Source: MFEM

Most of the Cook Islands' public expenditure is allocated for the government operating expenditure, as illustrated below in Figure 17. Over the last five years, government operating expenses accounted for an average of around 80% of public expenditure, while capital investment accounted for an average of 20%. However, in 2016 and 2017, less than 10% of public expenditure was allocated for capital expenditure, as many public infrastructure investments are funded by development funding, which is variable and one-off in nature.

Figure 17. Operating Expenses vs Capital expenditure (% of public expenditure), 2014-2022(f)



Source: MFEM and ADB

The government's operating expenditure focuses on the compensation of employees, use of goods and services, and social benefits, accounting for 38%, 27%, and 14% of the government's operating expenditures, respectively, in 2019. Together, they accounted for nearly 80% of the government's operating expenditure in 2019. Since COVID-19, the government has significantly increased its expenditure on goods and services due to the appropriation of the COVID-19 Economic Response Plan fund. As a result, expenditure on goods and services more than doubled between 2019 and 2021, with expenditure on goods and services increased from NZ$52.4 million in 2019 to NZ$129.4 million in 2021, and its share in total public expenditure increased from 27% in 2019 to 51% in 2021. This high level of expenditure on goods and services is short-term only and will come back to normal when the funding for ERP comes to an end.

During Cook Island's current economic downturn, public capital works as a counter-cyclical tool to help sustain the economy and develop infrastructure for future growth. Cook Island government ERR report estimates that the upper limit of public capital works is around $NZ40M per annum. However, this has implications for public debt, which will be discussed next.

2.1.3 Public debt

2.1.3.1 Public borrowing has increased significantly since COVID19

Public debt has played a prominent role in the Cook Islands over the last decades. In the 1990s, the Cook Islands experienced a debt crisis that saw external debt of approximately 140% of GDP. This led to assistance from creditor governments and development banks, along with the introduction of fiscal safeguards.

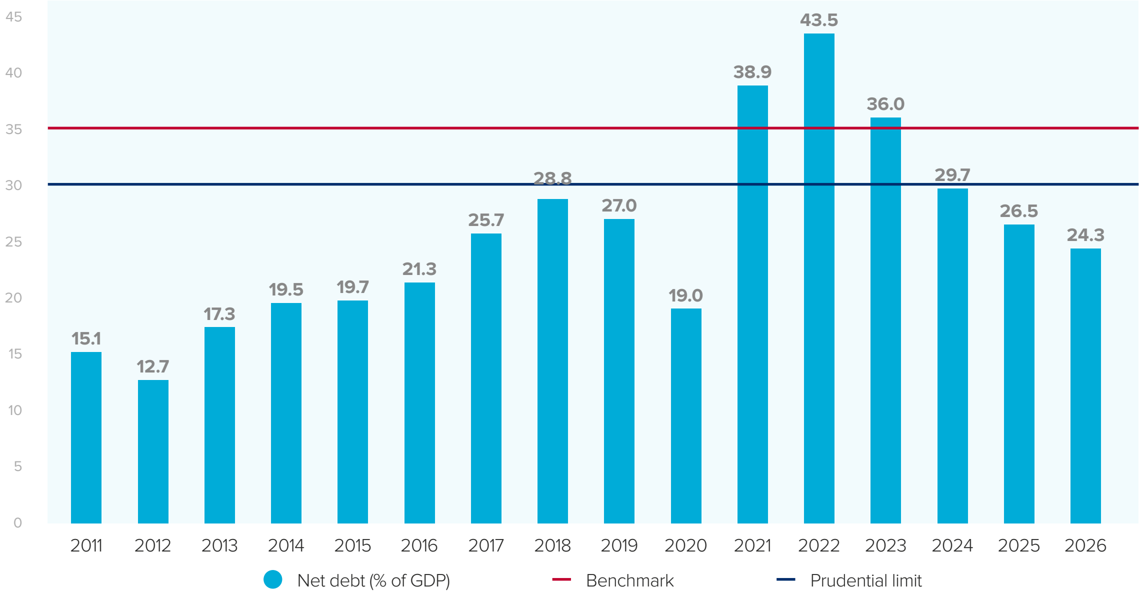
The Cook Islands' MTFS set up the fiscal rule that net public debt should not exceed a soft cap of 30 percent of GDP and cannot exceed a hard cap of 35 percent of GDP. However, an exit clause permits a breach of the caps in the event of a natural disaster, a state of emergency, or an economic shock that leads to an expected contraction in GDP of 2% or more. In 2021, a soft net debt cap of 55% GDP and a hard cap of 65% GDP have been established to facilitate the Government's effort to utilise debt funding to strengthen its response to the economic crisis. The change is expected to be permanent, pending a further review of the entire MTFF as economic and fiscal conditions evolve.

For the ten years before COVID-19, the Cook Islands' net crown debt to GDP ratio had been below the soft cap. While the ratio had been increasing from 15.1% of GDP in 2011 to 28.8%, it started to decrease in 2018. By June 2020, the net crown debt had fallen to 19% of GDP, and the net outstanding crown debt was estimated to be NZ$108 million.

Since the outbreak of COVID-19, the Cook Islands has taken on new loans to finance the government's Economic Response Plan (ERP) and fund a counter cyclical policy to support the economy, which has significantly increased its level of public debt. In November and December 2020, the Cook Islands took on loans from ADB and AIIB's COVID-19 Pandemic Response Option (CPRO), valued at NZ$58 million. In 2021, the Cook Islands was approved to take on loans valued at NZ$85.3 million from ADB's Economic Recovery Program and Disaster Resilience Program. These new loans have more than doubled the public debt. By June 2022, the Cook Islands' gross debt is expected to reach NZ$228.29 million[24][25].

[24] MFEM 2021-25 Budget Book
[25] This includes a number of projects which are assumed to be debt funded and may not go ahead in the current form

Figure 18. Net crown debt to GDP (%), 2011-2026(f)



Source: MFEM

Combined with the fall in GDP, the net debt to GDP ratio is expected to reach 43.5% at the end of 2021/22. This would significantly exceed the previous hard cap, as shown in Figure 18. The level of public debt over the next few years is expected to decrease. However, this will likely be dependent on the recovery of tourism. The later/slower tourism recovers, the greater the fiscal deficits and the longer the net debt ratio will stay above the benchmark ratio.

The net public debt servicing outflows are forecast to increase from the current NZ$10.9M (7.1% of public revenue) to NZ$15.7M in 2024/25 (12.1% of public revenue) and NZ$29.9 million in 2030/31.

The large increase in debt, and the servicing this requires for some of the loans with shorter terms, is a key challenge for the Cook Islands. Debt servicing costs are forecasted to increase to $30 million by the end of this decade. That is approximately 16 percent of the total revenue. This is three times the current debt servicing costs, and with the current reduced economy, debt servicing will demand a significant chunk of the public revenue. This will severely impact the Cook Islands' capacity to invest in, let alone to maintain, its infrastructure and will dampen the attempts to fast-track economic growth. It will hamper the Cook Islands' efforts to meet mounting social obligations as prosperity levels drop.

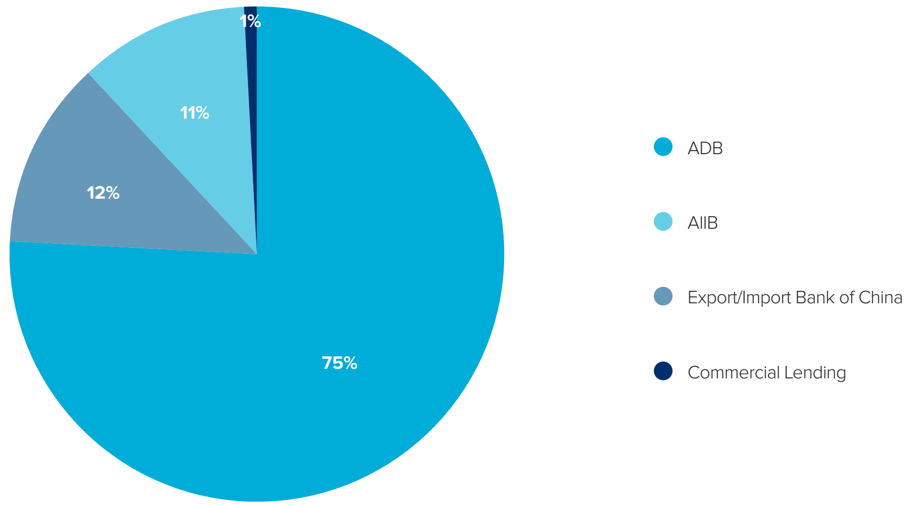
2.1.3.2 Sources of public borrowings

The Cook Islands' public debt has been funded mainly externally through a mixture of multilateral and bilateral loans. The main external creditors are ADB, AIIB, and the Export and Import banks of China. The Cook Islands entered into two loans in 2020, which reportedly have concessional interest rates of around 1.5%, namely:

- An ADB loan of US$20 million (NZ$30,490,000) for budget support.
- An additional loan of US$20 million by the Asian Infrastructure Investment Bank. This loan is part of the bank's COVID-19 Crisis Recovery Facility and is co-financed with ADB and the New Zealand Agency for International Development (NZAID).

ADB has approved two other loans in 2021, valued at NZ$85.3 million, for the Cook Islands to access ADB's Economic Recovery Program and Disaster Resilience Program. By June 2022, ADB will hold 75% of Cook Islands' public debt, while AIIB holding 12% and the Export/Import Bank of China at 11%. These debts will be held in a mixture of SDR[26] (8%), NZ$ (42%), Chinese RMB (10%) and US$ (40%, which is a significant increase from 2019).[27]

Figure 19. Public debt by lenders (June 2022)



Source: MFEM

Most (83%) of the debt is directly held by the Crown, with the remainder (17%) held by SOEs. The two main SOE loans are to Avaroa Cable Limited for $18.3 million and the Ports Authority for $16.9 million.

2.1.3.3 Future issues for public borrowings and development

The increased debt level makes it increasingly important for the Cook Islands to have low interest rates. While interest rates are currently low and the Cook Island has concessional loans, there will be long-term benefits from maintaining discussion with development partners to keep the rates low or to extend the grace period and be aware of the potential downside risks.

A major risk is unfavourable movements in foreign currency. This could impact interest payments and refinancing when the debts mature over time. The risk to the Cook Islands would be a devaluation of the NZ$ relative to the other currencies its external debt is issued in (e.g. US$). This would increase the debt ratio to GDP and the cost of servicing debt and limit Cook Islands' ability to fund future development investments. For example, a 10% depreciation in the value of the NZ$ against relevant foreign currencies would increase the gross debt by an estimated $10.5M (as of December 2021) million and annual servicing costs by NZ$0.6 million.[28]

The government has taken steps to deal with this risk, with both the new $55m loan and a contingency loan from ADB (also ADB) denominated in NZD to mitigate this risk. However, with an increasing level of gross public debt and potentially new loans denominated in US$, the impact of such a devaluation in the future would be greater.

[26] The special drawing rights (SDR) is an international reserve asset created by the IMF. The value of the SDR is based on a basket of five currencies including the US$ and RMB.
[27] MFEM 2012-25 Budget Book
[28] MEFM Half Year Economic and Fiscal Update 2021/22

The level of public debt in the Cook Islands is closely related to infrastructure development. Much of infrastructure development is funded by development loans. The debt caps can limit the level of public investment. Consequently, investment projects need to be prioritised. The government may consider the following options in funding the future development investment, all of which will be closely related to SOE reform:

- Exploring mechanisms to engage the private sector, including FDI, in funding for development investment or managing development projects, such as via PPP
- Exploring mechanisms to enable private sector players to contribute to public funded and managed infrastructure that they benefit from. For example, In New Zealand, property developers are often required to pay directly or contribute to upgrades to infrastructure resulting from their development projects (e.g. building an access road, paying for new roadside cabinets for an electricity network). This issue may be particularly relevant to large FDI funded projects, which may both make greater demands for developing public infrastructure and be funded by investors able to pay their share of the development costs.
- Considering new ways for the users of future public developments to contribute to the servicing of the debts that funded the developments. For example, by having a levy on rental cars to contribute to serving loans for road improvements.[29]
- Privatizing some SOEs to fund infrastructure investment and/or to pay off government debt. Such sales could see the new owners funding the future development of these entities. Related options include selling or leasing some government buildings.

2.1.4 SOEs

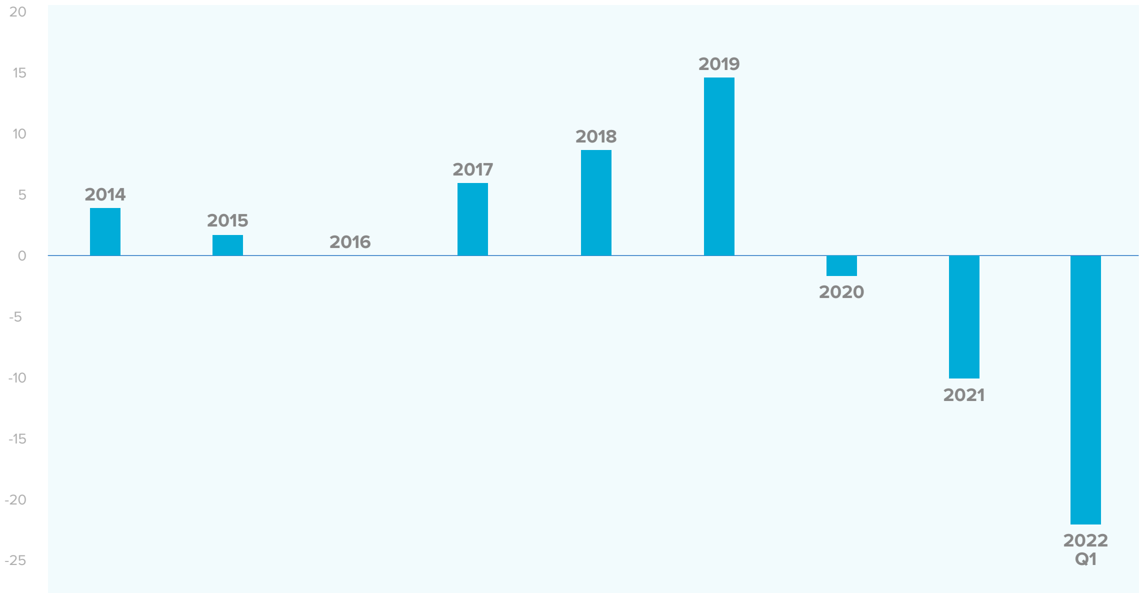
The Cook Islands Government has seven State-owned Enterprises (SOEs) under the management of the Cook Islands Investment Corporation (CIIC). They are:

- Airport Authority of the Cook Islands,
- Bank of the Cook Islands,
- The Cook Islands Ports Authority,
- Te Aponga Uira (electricity utility in Rarotonga),
- Te Mana Uira (electricity utility in Aitutaki),
- To Tatou Vai Limited (water and sanitation), and
- Avaroa Cable Limited (Manatua cable project).

These SOEs provide services in electricity, water and sanitation, international telecommunications cable, retail banking, seaport and airports. SOEs, in general, have relatively weaker financial performance, with a return on equity (ROE) below the cost of capital and less than what comparable private sector firms would be expected to deliver. Figure 20 shows the aggregated SOE gross profit margin, calculated based on the Government Consolidated Financial Reports. It shows that the aggregated SOE gross profit margin was less than 5% in 3 of the six years between 2014 and 2019. Since the COVID outbreak, SOEs' gross profit margin has been significantly affected, dropping to a negative 22% in the first quarter of the 2022 financial year.

[29] For example, Queensland Australia charges a A$6.50 per day levy on rental cars.

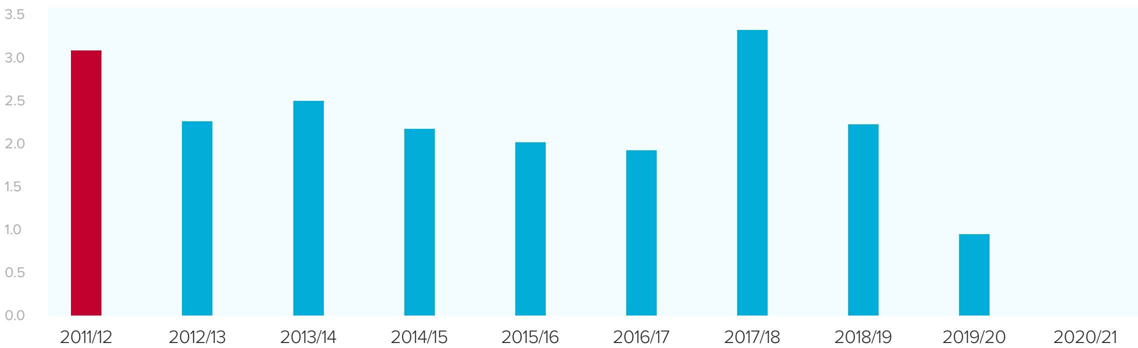
Figure 20. SOE Gross Profit Margin (% of revenue), 2014-2022 Q1



Source: MFEM

SOEs' dividends to the government tend to decline over time. Figure 21 shows SOEs' dividends to the government between 2011 and 2021. The two spikes in 2011/12 and 2017/18 are due to one-off payments from Te Aponga Uira (in 2011/12) and Bluesky (2017/18). Excluding these one-off payments, SOEs' dividend to the government has been declining. In fact, several SOEs have never paid any dividends to the government over this period. None of the SOEs paid any dividends in 2020/21, and none is expected to pay any dividends by 2024/25, except BCI and Telecom Cook Islands[30].

Figure 21. SOEs' dividend to the Crown (NZ$ million), 2011/12-2020/21



Source: MFEM

The key risks associated with SOEs are weak financial performance and/ or excessive borrowing that can result in the Government having to guarantee or potentially restructure the SOEs debt, often at a substantial budgetary cost. Poor performance may result from a range of factors, including:

[30] Cook Islands Government, Budget Estimates 2021-2025

- Exogenous shocks (unexpected or unpredictable events outside the country's control that can severely impact the economy) – for example, earthquakes or tsunamis;
- Lack of incentive to be competitive; and
- Government requirements to undertake community obligations.

The Cook Islands Government has put in place a range of measures to mitigate SOE fiscal risk. These include:

- Placing all SOEs under the CIIC umbrella, one of its principal objectives is to be the efficient, profitable and professional management of SOEs;
- Ensuring that SOE debt falls under the broader Government debt ceiling target and new debts undergo a Debt Sustainability Analysis before approval, as required by the Loan Repayment Fund (LRF) Act 2014; and
- Providing for a portion of SOE debt repayments in the Loan Reserve Fund[31].

ADB has facilitated a gap analysis of the SOE portfolio in the Cook Islands[32], which reviewed the financial performance of SOEs and the legislative, governance and monitoring frameworks in place. The ADB analysis identified high priority areas for change, including:

- Adopting an overarching SOE policy to guide the implementation of reforms;
- Adopting the primary obligation of operating as successful businesses for all SOEs and hence as the principle behind all SOE board decisions.
- Community service obligations should only be undertaken by SOEs if specifically directed by the Government and fully funded by the government (either through cash payment, reduced profit or dividend targets) to ensure the ongoing financial viability of SOEs.

SOEs typically concentrate in the utility and infrastructure sectors, where they enjoy monopoly or quasi-monopoly rights. This often results in poor service delivery and high costs, which are a source of inefficiency that affects the overall competitiveness of the economy. SOEs, such as the Airport Authority of the Cook Islands, the Cook Islands Ports Authority, Te Aponga Uira (electricity utility in Rarotonga), To Tatou Vai Limited (water and sanitation), and Avaroa Cable Limited (Manatua cable project), are monopoly providers of core infrastructure services (power, water, airport, port, telecommunication) and the level and quality of the services they provide are vital for the development of private businesses and the economy as a whole. For example, TAU's electricity prices for both commercial and larger residential users are among the highest in the Pacific Island countries[33].

2.1.5 Illicit financial flows

Illicit financial flows are money that is "illegally earned, transferred or used" (UNECA, 2015). The money, somewhere at its origin, movement, or use, break laws and hence is considered illicit (Reuter, 2012; Baker, 2005; Kar, 2011). According to UNECA (2015), IFF can be classified broadly into three main forms: the proceeds from commercial tax evasion, trade misinvoicing and abusive transfer pricing; the proceeds from criminal activities, including the drug trade, human

[31] Loan Reserve Fund is a fund established in 2014 under the Cook Islands Loan Repayment Fund Act 2014. The money held in the fund is used only to pay off government debt.
[32] ADB, Sector Assessment: Public Sector Management, https://www.adb.org/sites/default/files/linked-documents/42503-023-coo-ssa.pdf
[33] Pacific Public Utilities Benchmarking Report 2019 Financial Year, https://www.ppa.org.fj/wp-content/uploads/2020/12/2019-FY-Benchmarking- Report.pdf

trafficking, illegal arms dealing, and smuggling of contraband; and the proceeds from bribery and theft by corrupt government officials.

According to the evaluation conducted by the Asia Pacific Group on Money Laundering (APG), the Cook Islands has developed an anti-money laundering system. The Cook Islands has enacted broad anti-money laundering and counter- terrorist financing laws and has a Financial Intelligence Unit and a system for reporting suspicious transactions. Cook Islands has been a member of APG since 2001 and has been reviewed several times.[34]

In 2015 and 2016, the Cook Islands joined two major international bodies that address offshore tax evasion (Multilateral Convention on Mutual Administrative Assistance in Tax Matters and Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information). In 2018, the Cook Islands Government agreed to amend legislation to tax the profits of international companies and join the Inclusive Framework of the OECD's Base Erosion and Profit Shifting project. The Cook Islands has also enacted the International Companies (Removal of Tax Exemption) Amendment Act 2019, which abolished tax exemptions for international companies on 17 December 2019 and is to be fully enacted from January 2022.

The Cook Islands Financial Intelligence Unit (CIFIU), established in 2003, was mandated by Cabinet to coordinate the implementation of the Cook Islands anti-money laundering and countering the financing of terrorism (AML/CFT) regime. CIFIU collects, analyses and disseminates financial information and intelligence on suspected money laundering, the financing of terrorist activities and other serious offences to the appropriate domestic and international authorities. CIFIU is also tasked with regulating and compliance examinations of all registered Reporting Institutions in the Cook Islands as stipulated by the Financial Transaction Reporting Act 2017 (FTRA).

2.2 Private Finance

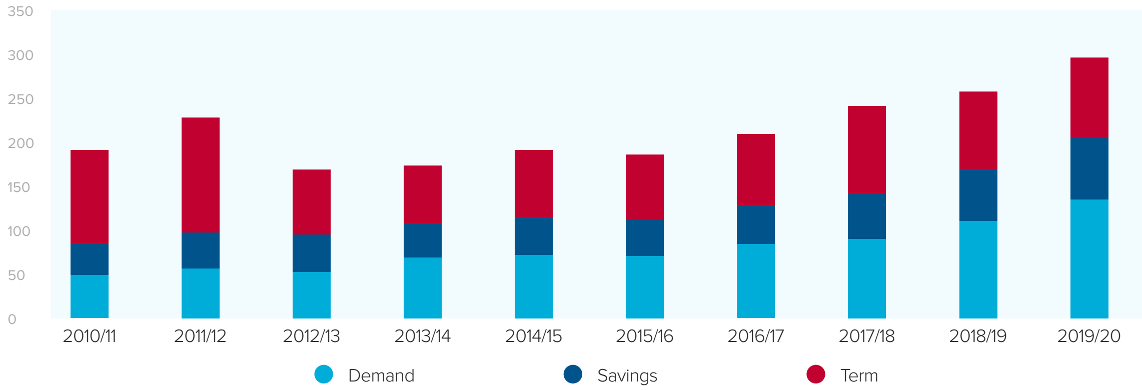
2.2.1 Private savings

International differences in domestic savings rates among major industrial countries have corresponded to almost equal differences in domestic investment rates (Feldstein and Horioka, 1980). Domestic saving provides a stable, low-cost, and low-risk source of financing for investment when compared with, for example, international private capital flows (UNECA, 2015). This is especially the case for developing countries (Aghion et al., 2006). Mobilizing domestic savings is an important goal in developing financial systems.

The Cook Islands has a relatively high domestic gross saving rate (Bertram, 2016). The Cook Islands have seen increasing levels of accumulated domestic savings since June 2012, leading to a peak of NZ$297.38M in June 2020 (see Figure 22) and equivalent to 68% of GDP in 2019/20. Since then, domestic savings have started to fall. By March 2021, it fell by 10.5% to NZ$266 million. The fall could have been more significant without the ERP fiscal stimulus (e.g. wage subsidies) package.

[34] http://www.apgml.org/members-and-observers/members/details.aspx?m=5c63cd37-73a2-4a45-aac3-f6e5b8ec0594

Figure 22. Bank Deposits (NZ$ Million), 2010/11-2019/20



Source: MFEM

However, a significant percentage of domestic savings flow offshore, funding private investments in the destination countries, which could be invested locally if appropriate incentives and mechanisms be established.

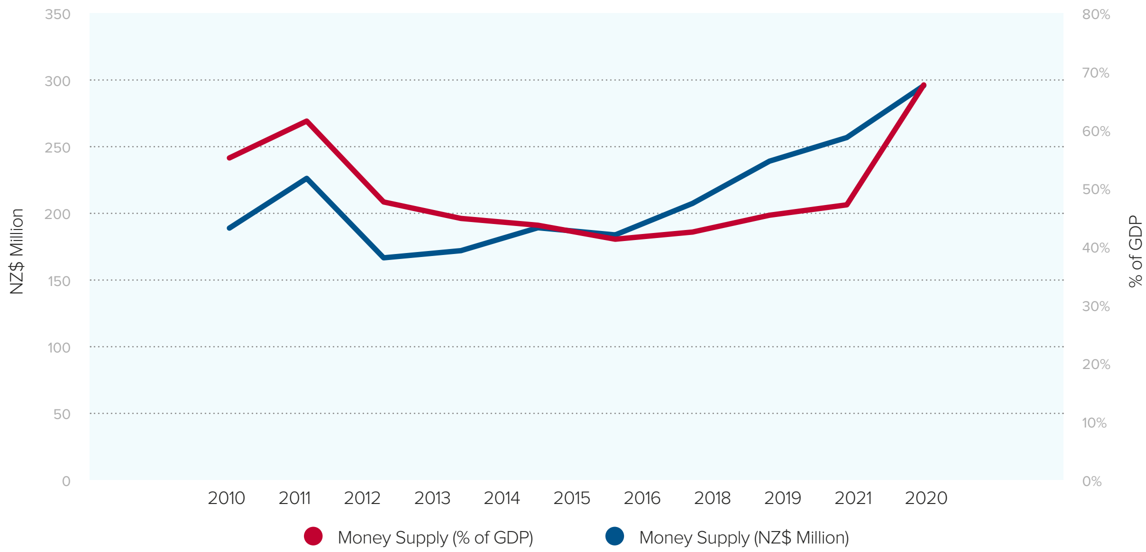
2.2.2 Domestic Credit to the Private sector

Domestic finance, particularly domestic private finance, is mobilized by the domestic financial system to meet the financing needs of the private sector.

2.2.2.1 Depth of Financial sector: Money supply

Since 2010, the Cook Islands' financial depth may have declined. Figure 23 shows ratios of money supply, broad money (M3), to GDP between 2011 and 2020. It shows that the volume of money supply has been increasing since 2013, while the ratio of the money supply to GDP has stabilised at around 50%. In 2020, the ratio of the money supply to GDP rose to 68%, likely due to the increase in money supply arising from the COVID response and recovery effort combined with the loss of GDP due to COVID.

Figure 23. Money Supply (Broad Money, M3), 2011-2020

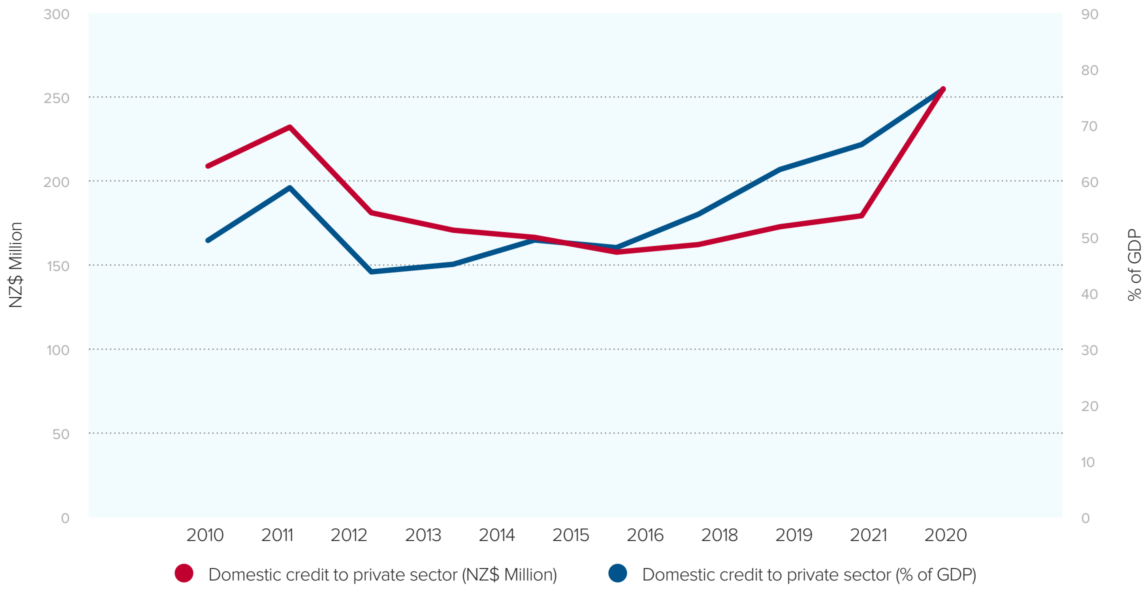


Source: MFEM

2.2.2.2 Depth of financial sector: Domestic credit to the private sector

Since 2010, Domestic credit provided by the financial sector to the private sector as a percentage of GDP has been declining. Figure 24 presents the volume of domestic credit to the private sector provided by banks and its percentage as in GDP. It shows that the domestic credit to the private sector provided by the financial sector as a percentage of GDP has declined from 80% in 2011 to 42% in 2019, a reduction of 74 percentage points. Meanwhile, the value of domestic credit to the private sector declined from NZ$259 million in 2011 to NZ$229 million in 2016 and remained at around NZ$230 million between 2016 and 2019.

Figure 24. Domestic Credit to the private sector by banks, 2011-2020



Source: MFEM

As we have seen from Figure 24, domestic credit to the private sector by the financial sector has been declining in monetary value and its percentage as in GDP. Over the ten-year period between 2011 and 2020, the percentage of domestic credit to the private sector as a percentage of GDP has dropped by nearly 40 percentage points. A number of reasons may explain this decline, including low usage of bank credits due to high lending interest rates, businesses using favourable economic conditions to pay off loans early or refinance, businesses bypassing the local credit market to access credit from mainland New Zealand banks, etc. It may be worthwhile to investigate what has caused the decline. Access to adequate finance with ease will be a critical factor for promoting private sector development.

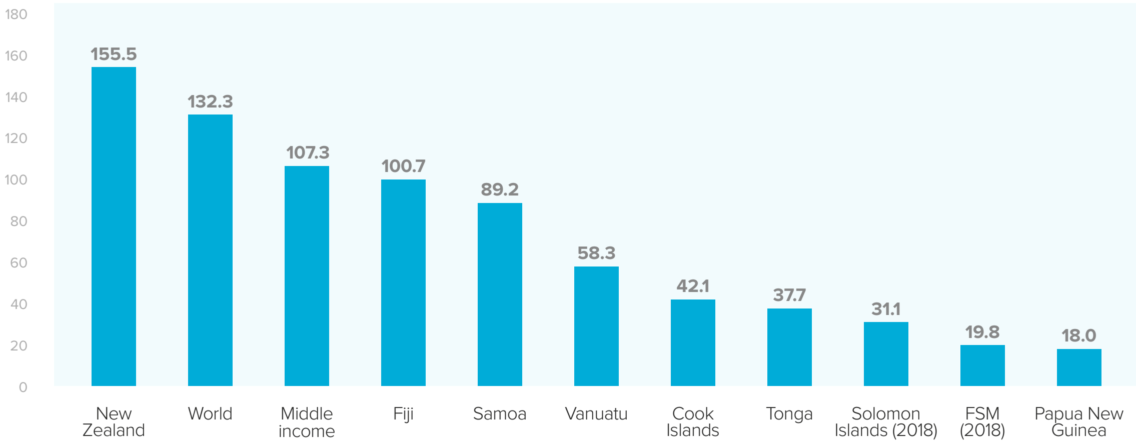
In 2020, the private sector borrowed more, which may be a response to the reduced cash flows associated with the fall in GDP. Furthermore, many tourist accommodation providers may take this opportunity to refurbish their premises and consequently increase their demand for credit.[35] This saw domestic private sector credit increase by 3% (year on year) to $235.8M.

The depth of the Cook Islands' financial sector is shallow when compared globally. The level of credit to the private sector in the Cook Islands, measured as the ratio of private sector credit to GDP at 42% in 2019 (see Figure 25), is lower than the world average (132%), middle-income country average (107.3%), the Pacific Island country average (78%), Caribbean Small Country aver-

[35] EDS 2030

age(46%), and is only 27% of that in New Zealand. Even when compared regionally, the depth of the Cook Islands' financial sector is still shallow, lower than Fiji (100.7%), Samoa (89.2%), and Vanuatu (58.3%). This may suggest that the Cook Islands has the potential to improve its financial depth.

Figure 25. Domestic Credit to Private Sector (% of GDP) in selected Pacific Island Countries, 2019

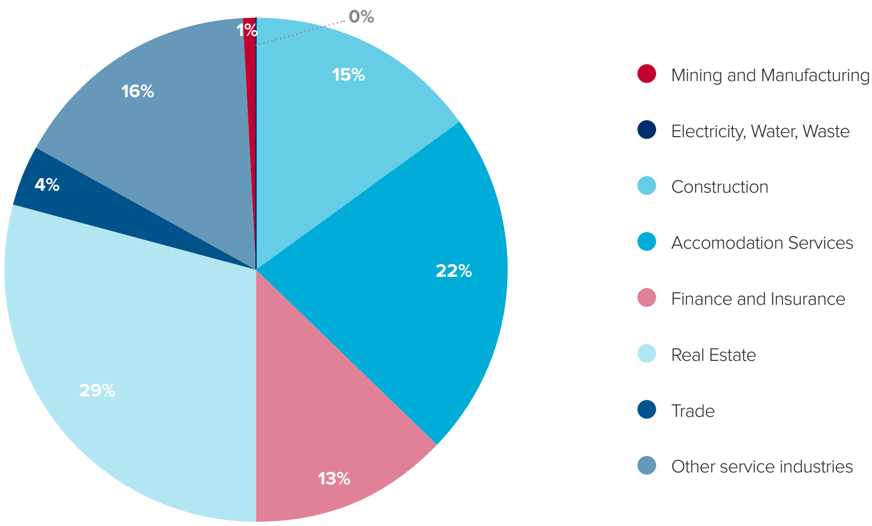


Source: WDI, MFEM, and Central Bank of Samoa

2.2.2.3 Usage of domestic credit

Domestic credits were mainly channelled to the construction, real estate, accommodation, finance and insurance sector. Figure 26 shows the distribution of domestic private sector credit by sector. It shows that real estate, including private housing, accounted for 29% of the domestic credit, accommodation services accounted for 22%, the building and construction sector accounted for 15%, and the finance and insurance sector accounted for 13%.

Figure 26. Distribution of Domestic Credit by sectors (% of total), 2020



Source: MFEM

On the other hand, manufacturing accounted for only 1.2% of the domestic credit, agriculture and fishery accounted for only 0.2%, and transportation accounted for only 2.3%. Some tourism-related sectors accounted for only a small proportion of the domestic credit, such as tourism agents and tour operators (0.8%) and restaurants (1.1%). A low level of domestic credit access may indicate the lack of investment in these sectors, even after allowing for the relatively lower levels of capital required for some activities.

2.2.3 Remittances and Diaspora

Like many small Pacific Island nations, the Cook Islands has a large diaspora. Approximately 80,000 people, who identify with the Cook Islands, live in New Zealand and around 22,000 in Australia. These numbers exceed the resident population of the Cook Islands by a factor of 6.

Unlike some small Pacific Island nations, the Cook Islands is not dependent on remittances from its diaspora or the wages its nationals earn from overseas seasonal work. Due to relatively high income and low unemployment, its residents do not need to rely on remittances from relatives to meet their basic needs. Furthermore, as New Zealand citizens, Cook Islanders can live and work in New Zealand and Australia. This gives them the ability to access desirable permanent jobs overseas.

For the Cook Islands, remittances are often outbound as foreign workers send money home. The 2019 balance of payments report noted that foreign workers' remittances transferred to families abroad (e.g. Asia) make up the bulk of secondary income debit. Outbound private remittance payments increased from $2.5M in 2011 to a peak of $6M in 2019 and were around $4.1M between 2017 and 2019.

2.2.4 Foreign Direct Investment is low

The Cook Islands' English-speaking and educated workforce, popularity as a tourist destination, and tropical climate offer advantages to focused investors. However, the country's distance from major markets affects the cost of imports and exports.

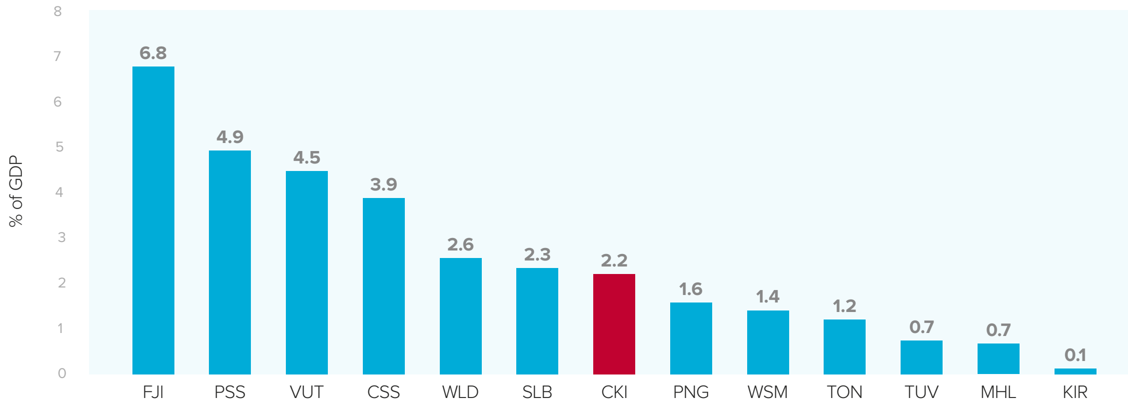
The Cook Islands also has a well-developed infrastructure, including reasonably priced transport infrastructure, an international airport capable of handling commercial jet aircraft, relatively well-performed telecommunications (with recent new investment in international submarine cable and over 80% of mobile penetration), water supply, and electricity networks that facilitate trade and investment. Furthermore, it has a stable financial environment with single-digit inflation and a recent history of balanced budgets, boosting investors' confidence.

However, the Cook Islands' existing foreign investment environment is not particularly welcoming for potential foreign investors, with a broad range of restrictions and barriers to FDI. This has been noted by both international organisations and the government. ADB characterised the FDI regime as 'slow, discretionary, dependent on outdated laws, and discourage[ing] foreign investment'.[36] The Cook Island's ERR has recommended 'attracting foreign investment that will benefit the Cook Islands' as a focus area. The IMF recommended investment policy reforms, noting 'reforming the investment code to open up traditionally closed areas of the economy to foreign investment could help lead to diversification of economic activity'.[37]

The Cook Islands has a relatively low level of FDI. Between 2015 and 2019, the Cook Islands' FDI amounts to 2.2% of its GDP annually (see Figure 27). This is lower than the world average of 2.6% and lags far behind the regional leaders Fiji (6.8%) and Vanuatu (4.5%), and the Caribbean (3.9%).

[36] ADB (2015). The Cook Islands: Stronger investment climate for sustainable growth. Asian Development Bank; IMF (2019) IMF Mission to the Cook Islands – Concluding Statement. International Monetary Fund, April 2019, 2020: p21.
[37] IMF, 2020: p 22.

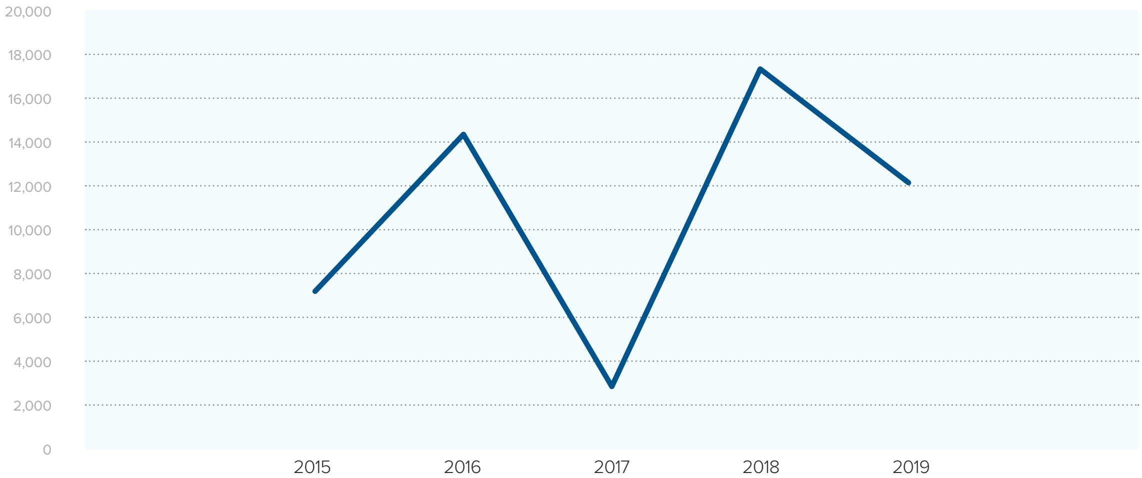
Figure 27. Average annual FDI to GDP Ratio (%) in Pacific Island Countries, 2015-2019



Source: The World Bank

FDI inflow has been volatile (see Figure 28). FDI inflows were higher in 2016 (NZ$14.3M) and 2018 (NZ$17.4M), with a notably lower level in 2017 (NZ$2.8M).

Figure 28. Total FDI (NZ$ '000) from 2015 to 2019



Source: ADB

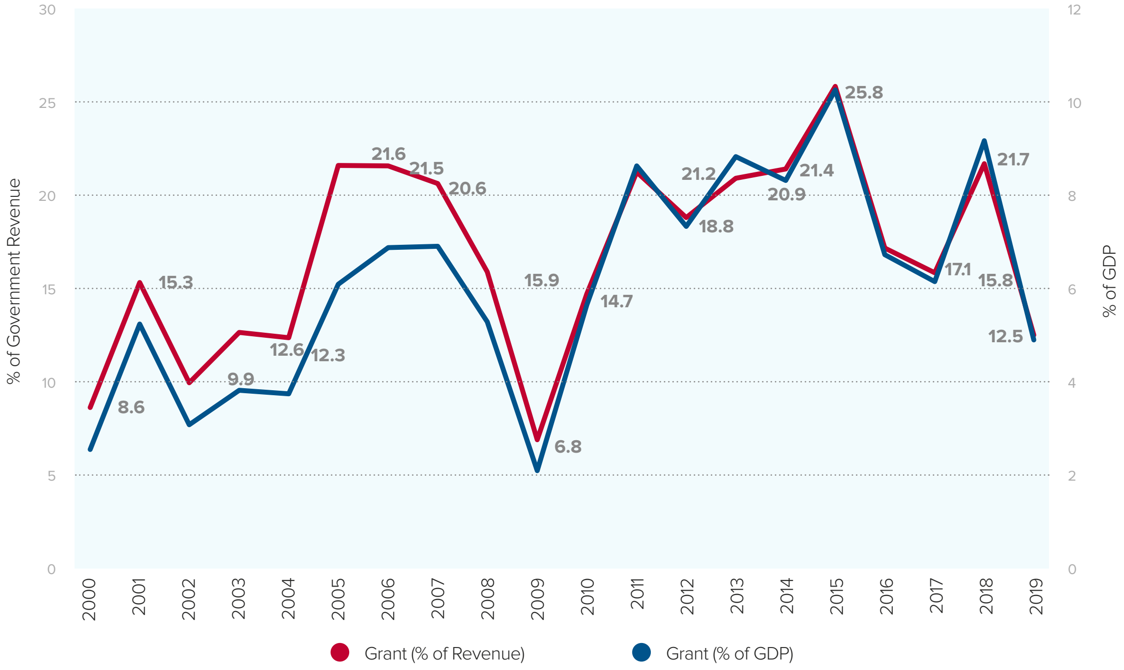
Limited public information is available on where FDI in the Cook Islands originates or is distributed. The Australian government has stated that Australia has $18M in investment in the Cook Islands but did not provide a separate figure for FDI. Another main source of FDI is New Zealand, given its close ties.

2.3 Development assistance

2.3.1 Development assistance accounts for around 20% of public revenue

Development assistance to the Cook Islands, including mainly official development assistance (ODA), concession loans, and South-South Development Cooperation, has played an important role in the Cook Islands' public finance and the economy as a whole. Figure 29 presents development assistance, which the Cook Islands Government has received in grants, as a percentage of GDP and public revenue. It shows that between 2011 and 2019, development assistance accounted for an average of around 20% of government revenue and was equivalent to an average of 8% of GDP. Concession loans have been used to support infrastructure upgrades and investment. Since the COVID outbreak, the Cook Islands have received an even higher level of development assistance for government budget support and emergency response and economic recovery efforts.

Figure 29. Grant as % of GDP and Government Revenue[38], 2000-2019



Source: ADB Key Indicators

New Zealand is the Cook Islands' largest donor of grants and the ADB the largest lender. Other main donors and lenders include Australia, China, the EU and AIIB.

Since 1 January 2020, the Cook Islands has graduated to a developed nation, according to OECD's classification. This is a significant achievement for the nation, being the first Pacific Island nation or territory to graduate since 2000. As a result, the Cook Islands will no longer be eligible for official development assistance through the OECD's Development Assistance Committee (DAC) and will need to restructure its financial arrangements accordingly. It is expected that key donors will continue to provide funding in the foreseeable future[39].

In light of the graduation from ODA and the ongoing uncertainty of non-ODA development grants, the Cook Islands government may need to:

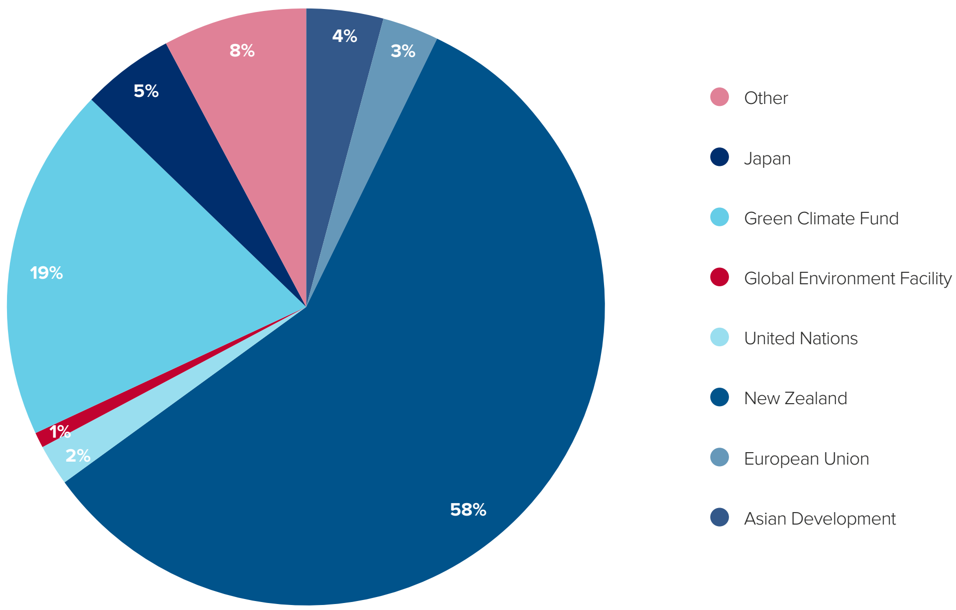
- Identify which priority programs may lose development financial support.
- Seek alternative ways for development assistance to fund shortfalls and other priority programmes (e.g. identify new donors whose priorities align with the Cook Island's development needs, increase the Cook Islands' access to funds available for fighting climate change (such as GCF, Adaptation Fund, debt for climate swaps).

[38] Grant figure for 2019 may be incomplete.
[39] For example, New Zealand expects to continue its two main activities for the coming three years and most likely beyond: 1) NZ's Core Sector Support programme focused on strengthening key sectors (health, education and tourism and public sector strengthening); and 2) the Infrastructure Trust Fund. ADB will continue to

2.3.2 Sources of development assistance

Most of the Cook Islands' development assistance comes from New Zealand (58% for the 2021/22 ODA budget, as shown in Figure 30). Other development partners include Australia (reported at 16% in the past), China (13% between 2011 and 2016 per Lowy Institute data), the EU, Japan, India, Green Climate Fund and ADB.

Figure 30. Cook Islands 'ODA' budget 2021/22



Source: MFEM

2.3.3 Official Development Assistance (ODA)

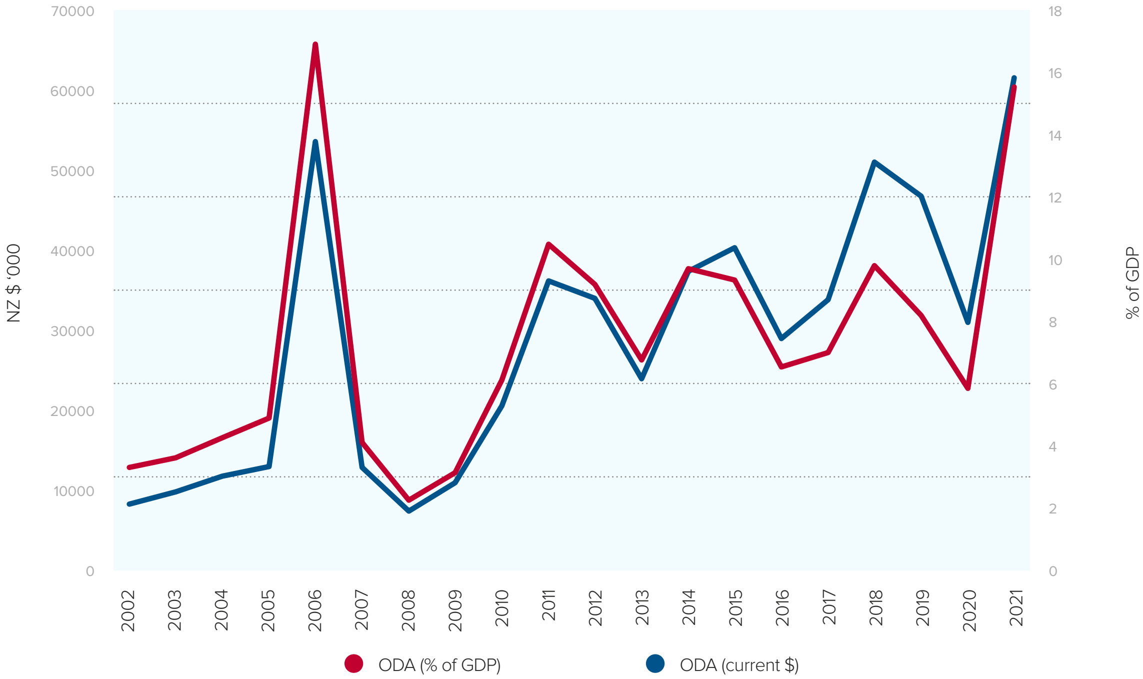
OECD defines ODA as those flows to countries and territories on the DAC List of ODA recipients (www.oecd.org/dac/stats/daclist) and to multilateral development institutions, which are:

- Provided by official agencies, including state and local governments, or by their executive agencies; and
- Each transaction of which:
    - o is administered with the promotion of the economic development and welfare of developing countries as its primary objective; and
    - o is concessional in nature and conveys a grant element of at least 25 per cent.

2.3.3.1 ODA fluctuated at 8% of GDP

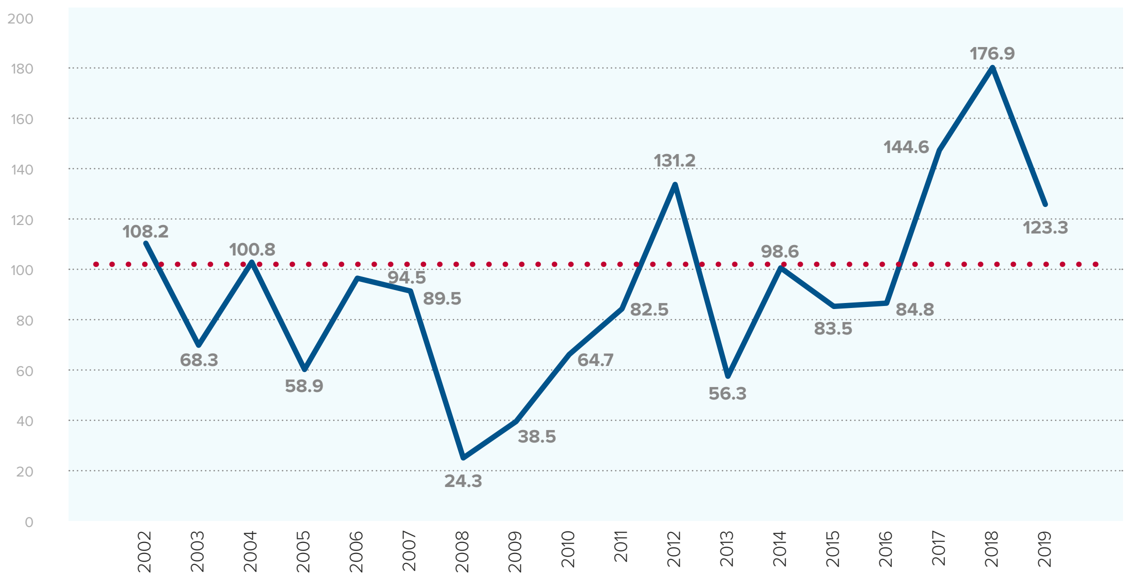
From 2008 until 2019, ODA increased both in absolute terms and as a percentage of GDP (see Figure 31). In absolute terms, it increased from $6.6M in 2008 to $46.5m in 2019. As the percentage of GDP, ODA increased from 2% in 2008 to 10.4% in 2011 and fluctuated at around 8% between 2011 and 2019.

Figure 31. ODA received, 2002-2021



Source: OECD for 2002-2019, MFEM for 2020-2021

Figure 32. ODA Disbursement Commitment Ratio (%), 2002-2019



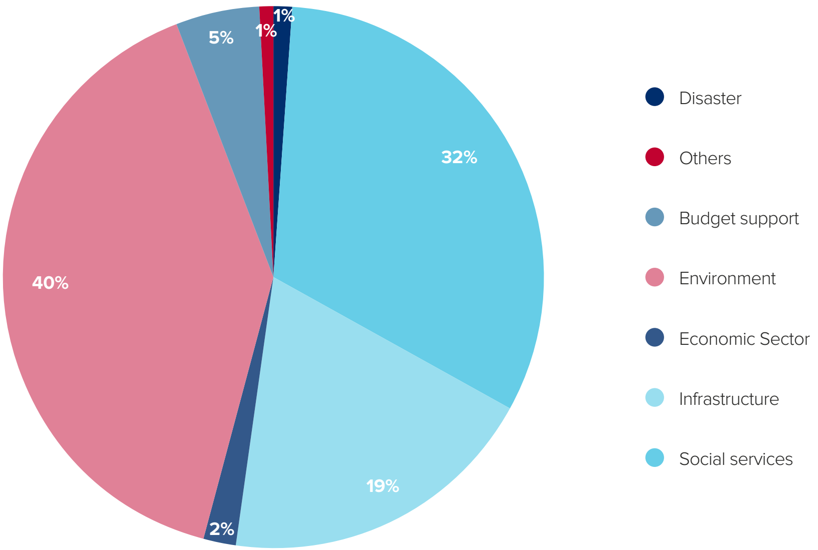
Source: OECD for 2002-2019

Figure 32 presents the ODA disbursement to commitment ratio between 2002 and 2019. The disbursement of ODA tends to deviate significantly from the ODA commitment e.g., in 2019, ODA disbursement is 76.9% higher than the ODA commitment; in 2008, ODA disbursement was only 24.3% of ODA commitment. While grants, including ODA, account for an average of 20% of public revenue, significant disbursement deviation from the commitment impacts the government's budget reliability and implementation.

2.3.3.2 Usage of official development assistance (ODA) (see Figure 33)

Between 2015 and 2019, the distribution of ODA focused mainly on environment and multi-sector aid, climate change, social services, and economic infrastructure investment. Between 2015 and 2019, 40% of ODA was channelled to the environment, climate change and multisector aid, 32% to social services, including education, health, governance, water supply and sanitation, population policies and reproductive health, 19% to infrastructure building, including transport, storage, and communication, energy, banking and business services, and 5% to Budget support.

Figure 33. Distribution of ODA (% of ODA received) by sector, 2015-2019



Source: OECD CRS

Over time, the allocation of ODA has shifted gradually away from social services and towards infrastructure and environment services.

Table 2. Distribution of ODA by sector (% of Total ODA), 2005-2019

	2002-2019 (%)	2005-2009 (%)	2010-2014 (%)	2015-2019 (%)
Social services (↓)	39.1	45.4	39.8	32.3
Education (↓)	16.4	22.8	16.9	10.9
Health (↓)	3.9	5.5	2.8	2.2
Water Supply & Sanitation (↑)	9.4	3.6	7.9	14.2
Governance (↓)	7.7	11.6	10.0	3.8
Infrastructure (↑↓)	17.1	1.3	25.4	18.7
Economic Sector (↑↓)	7.3	6.9	14.6	1.7
Environment and Multisector(↑)	22.7	9.3	10.4	40.3
Budget support and assistance	2.0	0.0	0.0	5.0
Debt Relief	7.3	38.7	0.0	0.0
Disaster	4.6	2.9	9.6	1.5
Grand Total (US$ million)	**333.3**	**63.3**	**118.6**	**135.5**

Source: OECD CRS

Between 2015 and 2019, social services accounted for nearly 32 of the ODA received, 13 percentage points lower than that between 2005 and 2009. However, the share of ODA channelled to water and sanitation increased from 3.6% of total ODA received between 2005 and 2009 to 14.2% between 2015 and 2019, driven mainly by the Te Mato Vai project. The environment sector accounted for 40% of total ODA between 2015 and 2019, 31 percentage points higher than between 2005 and 2009. For the same period, infrastructure accounted for 19% of the total ODA, 17 percentage points higher than 2005-2009, but dropped from 25.4% between 2010 and 2014.

Development assistance has recently included budget support, social services, infrastructure, and economic services. Some of the most recent significant projects include:[40]

- New Zealand contributed NZD$15 million (US$10 million) in funding towards the Manatua Cable, which will bring reliable, high-speed internet to the Cook Islands. It connected the Cook Islands to Samoa and French Polynesia and became operational in 2020.
- New Zealand contributed US$17M to the Renewable Energy (Northern Group) project
- Perhaps mention GCF's 12m RE Project here as well
- New Zealand contributed US$16.5M to the Cook Islands' Water Partnership programme and Sanitation Upgrade
- Programme since 2013
- New Zealand committed US$26 million for Core Sector support and US$7.6M to Infrastructure Trust Fund;
- UNDP and Adaption Foundation US$3.7M and US$4.7M aid for strengthening the Islands' resilience to Climate Change.

According to MFEM, approximately $38.5M of development assistance did not proceed due to the current travel restrictions or reprioritisation.[41]

2.3.4 South-South Cooperation (SSC)

South-South Cooperation is the exchange of resources, technology, and knowledge between developing countries. Around the globe, South-South Cooperation has increased significantly. In 2013, South-South cooperation exceeded US$20 Billion and amounted to more than 10% of global ODA. However, data on South-South cooperation is incomplete, so development cooperation flows by government providers outside the DAC are likely to be underestimated. In particular, SSC provides advice and training and may not be included in formal economic statistics.

China is the largest government provider of such development cooperation to the Cook Islands. The Governments of the Cook Islands and China have signed various agreements on economic and technical cooperation. According to data from Lowy Institute, between 2009 and 2019, China provided a total of US$56.75 million worth of grants to the Cook Islands, in addition to low interest loans of US$3.4 million. Since 2016, China has significantly increased its development assistance to the Cook Islands and has surpassed Australia and become the Cook Islands' second largest grant provider after New Zealand. China's development assistance to the Cook Islands is mainly in grants and focuses on infrastructure construction. Some of the most significant projects include:

[40] Australia also provided a used patrol boat in 2015, and plans to provide another in 2022. This is for maritime surveillance of the Cook Islands' large Exclusive Economic Zone (EEZ).
[41] MFEM, 2020-25 Budget Book page 242

Table 3. China's development priority projects to the Cook Islands (between 2013 and 2019)

Objective	Project	Value	Types of aid
Marine Resource Development	Pearl Farming Equipment	NZ$2.1 million	Goods
Agricultural Development	Agriculture Equipment	US$1.23 million	Capital
Improved Water Quality and Access	Northern Group Roofing	NZ$1.5 million	Capital
Improve Transport infrastructure	Airport Upgrade - Atiu	NZ$3.9 million	Capital
Robust Construction	Chinese Building Repairs	NZ$0.8 million	Service
Capacity Building in the Infrastructure sector	Outer Islands Heavy Machinery - Stage 1 & Stage 2	NZ$11 million	Capital
Improving education facility	APII NIKAO School Rebuild	NZ$14.58 million	Capital
Upgrading public building	Upgrading Court House	US$3.05 million	Capital
Improving Education facility	Construction of a New 500 Pupil Primary School	US$10.59 million	Capital
Upgrade Public building	Public building upgrades	US2.78 million	Capital

Source: NSDA 2020+ and SDGs

In addition to SSC projects with China, the Cook Islands participates in other South-South cooperation projects, targeting small Pacific Island nations[42] and focusing on capacity building and knowledge sharing. Recent examples of South-South Cooperation on capacity building and knowledge sharing that the Cook Islands has participated in include:

- Enhancing the adaptive human and technological capacities for disaster preparedness and recovery in Pacific Island countries (India through India-UNDP).
- Advice to smaller Pacific Island states on improving aviation safety, security and air navigation, supported by several countries (e.g. Australia, Singapore, and China).
- Participating in the 2019 to 2022 Pacific Regional Policy Dialogue on Climate Mobility Program supported by United Nations Trust Fund for Human Security (UNTFHS).
- A network facilitating collaboration to strengthen national civil registration and vital statistics systems. 2.3.5 Other official flows (OOF) and public development assistance post-ODA

Other Official Flows (OOFs) are flows from developed countries to aid recipients, which do not meet the conditions for eligibility as ODA because they either are not primarily aimed at development or have a grant element of less than 25 per cent (OECD, 2008). The bulk of the Cook Islands' OOF is concessionary loans from ADB, which will be discussed in the public debt section.

The graduation from ODA will only have a small impact on the Cook Islands' development assistance flows. Cook Island's traditional aid partners have indicated they intend to continue providing development support following the Cook Islands' graduation from ODA in 2020. For example, Australia has allocated $8 million over four years in non-ODA funding ($2 million per year over four years from 2020-21). Australia considers that this will assist the Cook Islands to remain engaged in key regional activities, including the PACER Plus trade agreement, and support its economic resilience.[43] Australia has noted this non-ODA assistance to the Cook Islands will support engagement in Australian-led regional initiatives.

[42] Good Practices in South-South and Triangular Cooperation for Sustainable Development in SIDS UNDP 2021 https://www.unsouthsouth.org/wp-content/uploads/2021/07/WEB-UNOSSC-SIDS-Good-Practices.pdf
[43] https://www.dfat.gov.au/geo/cook-islands/cook-islands-country-brief

New Zealand's aid to the Cook Islands will not be affected by the graduation. New Zealand sees its current development priorities for the Cook Islands as:[44]

- Support the Cook Islands to maintain effective self-governance for a sustainable economy and improved well- being, including for Pa Enua (outer islands).
- A climate resilient and environmentally sustainable Cook Islands.
- New Zealand and the Cook Islands have a mutually beneficial and regional relationship

New Zealand is currently providing development support, including:

- Te Mato Vai, a partnership between New Zealand, the Cook Islands, and China to deliver safe drinking water.
- General budget support in response to COVID-19.
- Support for public services (health and education) and tourism.
- Initial investment of $12M into the Cook Islands Infrastructure Fund in December 2019.
- Medical specialists and vaccinations in response to the COVID-19 pandemic.[45]

While the Cook Islands is not eligible for ADB's grants, ADB can still support the Cook Islands with OCR only loans and technical assistance. In 2020, ADB provided the Cook Islands' government with a US$20 million loan to help reduce the adverse social and economic impacts of COVID-19. On 2 November 2021, ADB announced that it would help the Cook Islands prepare for the return of tourists through a $2 million grant from the Japan Fund for Poverty Reduction, financed by the Government of Japan. The grant project will extend the Rarotonga Airport terminal building to improve coronavirus disease (COVID-19) screening and physical distancing, upgrade a health facility to provide hospital-like services and install a medical waste treatment system.[46]

While the Cook Islands' traditional development partners have indicated they will continue to provide support, there is uncertainty about the size of the future financial flows.[47], which can be attributable to several factors:

- Aid, by nature, can be volatile. For example, aid may increase in response to natural disasters or emergencies, while aid tied to projects is time bound.
- One-off grants for infrastructure development can represent a noticeable share of development assistance (and GDP) due to the Cook Islands being a small nation.
- Future development in the Cook Islands may mean donors see less need to provide financial support.
- Donor priorities may change, leading to changes in the level of development assistance and how development assistance is directed (e.g. health in response to COVID or infrastructure development).
- Current travel restrictions prevent some projects from proceeding.

[44] NZ Foreign Affairs and Trade: Our Development Cooperation with Cook Islands
[45] https://www.rnz.co.nz/international/pacific-news/442482/nz-rolls-out-more-covid-19-support-for-the-pacific
[46] https://www.adb.org/news/2-million-adb-grant-japan-boost-tourism-cook-islands
[47] MFEM's 2021-25 Budget Book, page 90 has decreasing forecasts for ODA funding for 2022 to 2025. The actual amounts could be higher, because not all future development assistance has been committed to.

2.3.6 Other types of development assistance

2.3.6.1 International Philanthropy and Impact Investment

Private Development Assistance (PDA) and impact investment are growth areas internationally. They are also on the rise in the Pacific, though finance from these sources remains small overall (and data is weak). The majority of them are US- based and target mainly Health and poverty reduction.

Due to the low global traceability for PDA, it is hard to quantify the actual scale of the aid received from these sources. For example, many Australian and New Zealand NGOs provide aid to the Pacific, and the Cook Islands likely receives some of this aid.

2.3.6.2 Domestic Philanthropy and Impact Investment

The Cook Islands has a tradition of supporting family and community and local giving. Domestic philanthropic activities comprise private giving, Civil Society Organisations (CSOs) and faith groups, and corporate social responsibility. The Cook Islands has a number of formal and informal NGOs working on a broad range of areas, including health, education, youth, disability, and the environment. One example is that churches operate five schools and provide education services to a significant proportion of school students. Another example is the Cook Foundation, a grant making trust that brings together a number of estates, trusts, funds and foundations with similar objectives to benefit the Cook Islanders and other island communities.[48]

CSR is a relatively new concept in the Pacific; there is a general awareness of corporate social responsibility among foreign and local companies. Some Cook Islands businesses have started to adopt corporate social responsibility practices. For example, the tourism industry has introduced the Mana Tiaki Eco Certification Scheme to enable it to work towards its commitment to sustainable tourism.[49]

The Cook Islands Government may encourage and facilitate NGOs' and Faith Groups' participation in and contribution to sustainable and inclusive economic growth, education, health, social service delivery, religion and culture, communication and environmental sustainability.

[48] https://cookfoundation.org/
[49] https://trctourism.com/cook-islands-steps-up-its-commitment-to-sustainability/

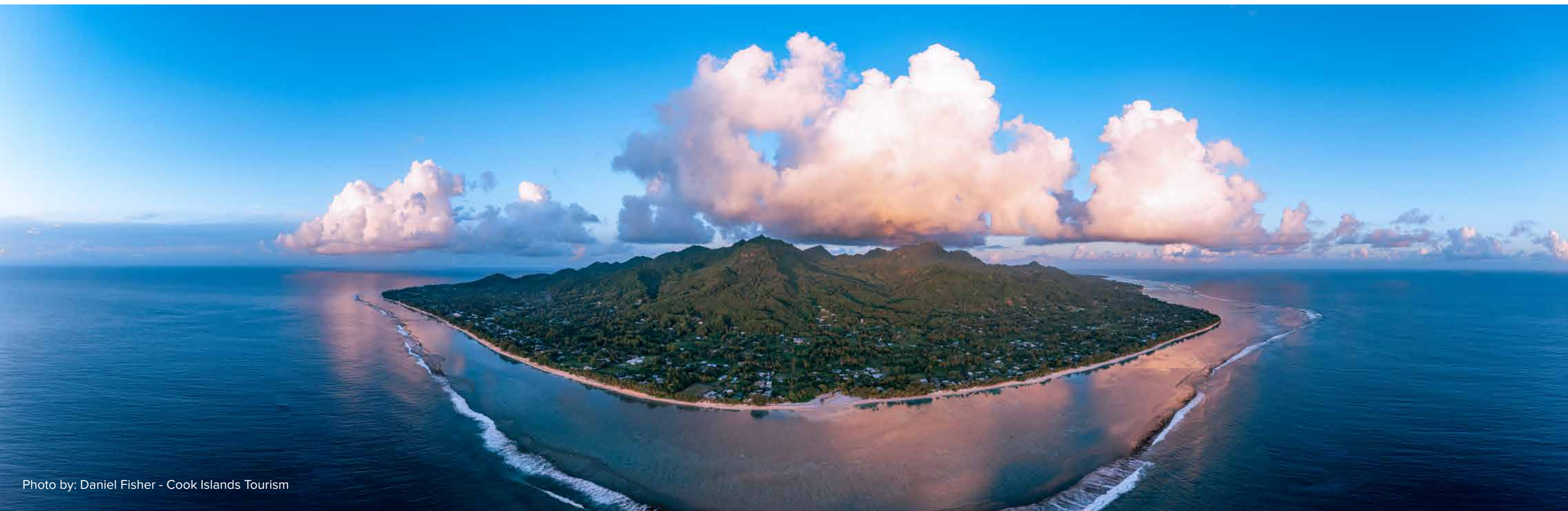


Photo by: Daniel Fisher - Cook Islands Tourism

3. Financing Strategy and Institutional Frameworks

This part will examine the policy and institutional frameworks governing these financial flows, including financing strategy, monitoring and review, and governance and coordination mechanisms.

3.1 Financing strategy

The financing strategy sits at the heart of the INFF. It provides a strategic framework detailing how the government will implement an integrated approach to mobilise, invest and influence public and private financing from both domestic and international sources to finance the priorities articulated in a development plan.

This section will discuss the financing strategies that are in place to mobilize public and private finance from both domestic and international sources to finance Cook Islands' development and SDGs.

3.1.1 Aligning the budget with the national plan and SDGs

The Cook Islands have endorsed the UN proposed 2030 Agenda and SDGs, the principles of which have long been the underlying principles of Cook Islands' national development strategies. However, SDGs goals and targets have only been inexplicitly integrated into the national plans. The Cook Islands has not explicitly considered the affordability, cost and financial resources needed to achieve National development strategies and SDGs. The cost of the national development strategies and SDGs will be crucial in helping the Cook Islands meet its SDG commitment.

3.1.1.1 Te Ara Akapapa'anga Nui - National Sustainable Development Agenda 2020+

In 2016, the Cook Islands developed the National Sustainable Development Plan 2016-2020, which included 16 national development goals and incorporated the 17 SDGs. In 2021, as the country has graduated to become a developed country and is coping with the impacts of the Global Pandemic, the Cook Islands has developed a National Sustainable Development Agenda 2020+ (NSDA) through an extensive consultation and research process. At the heart of NSDA is the 100+ year Roadmap – a living framework that will guide the Cook Islands into the future.

The formulation of Te Ara Akapapa'anga Nui- National Sustainable Development Agenda (NSDA) 2020+ takes an extended outlook over 100 years and prioritises a generational scale. This period will be interspersed with short to medium-term plans that will be adjusted as "our Nation" and "our people" continue to evolve. This is planned at 5 and 25-year intervals. These planning periods align with the philosophy and practice of 'Akapapa'anga: the use and importance of genealogical legacies to and for the Cook Islands and its people. The Cook Islands has developed Te Ara Akapapa'anga Nuia- National Sustainable Development Agenda 2020+ (NSDA) through an extensive consultation and research.

The NSDA 2020+ sets up a holistic vision of wellbeing where each person attains, at its most basic, a state of being comfortable, healthy, and happy. It has made pledges on 15 aspects of

Cook Islands' social, economic, and environmental life, including "Our wellbeing as our focus", "Our ocean and environment", "our health", "Our vibrant languages and dialects", "Our cultural heritage and history", "Our identity", "Our governance", "Our Responsibility", "Our empowerment", "Our dignity", "Our Prosperity", "Our knowledge and innovation", "Our connectedness", "Our Security", and "Our resilience and preparedness". All these pledges are consistent with the 2030 Agenda and SDGs.

Table 4. Mapping of NSDA 2020+ and SDGs

NSDA 2020+	SDGs
Our Wellbeing	SDG 1 (No Poverty), 2 (Zero Hunger), SDG 4 (Quality education), SDG 8 (Decent Work and Economic Growth), SDG 5 (Gender Equality)
Our Ocean and Environment	SDG 14 (Life below water) and SDG 15 (Life on Land)
Our Health,	SDG 3 (Good health and Well-being)
Our vibrant languages and dialects,	SDG 4 (Quality education),
Our Cultural Heritage and History	SDG 11 (Sustainable Cities and Communities)
Our Identity	
Our Governance,	SDG 16 (Peace, Justice, and Strong Institution)
Our Responsibility	SDG 1 (No Poverty), SDG 5 (Gender Equality)
Our Empowerment	SDG 4 (Quality education), SDG 11 (Sustainable Cities and Communities)
Our Dignity	SDG 1 (No Poverty), SDG 5 (Gender Equality), SDG 17 (Partnerships for the Goals)
Our Prosperity	SDG 4 (Quality education), SDG 8 (Decent Work and Economic Growth)
Our Knowledge and Innovation	SDG 9 (Industry, Innovation, and Infrastructure)
Our connectedness,	SDG 9 (Industry, Innovation, and Infrastructure), SDG 17 (Partnerships for the Goals)
Our Security	SDG 16 (Peace, Justice, and Strong Institution)
Our resilience and preparedness	SDG 13 (Climate Action)

Source: NSDA 2020+ and SDGs

To achieve this vision and realize these pledges, NSDA 2020+ has set up six (6) targets for the next 25 years, including:

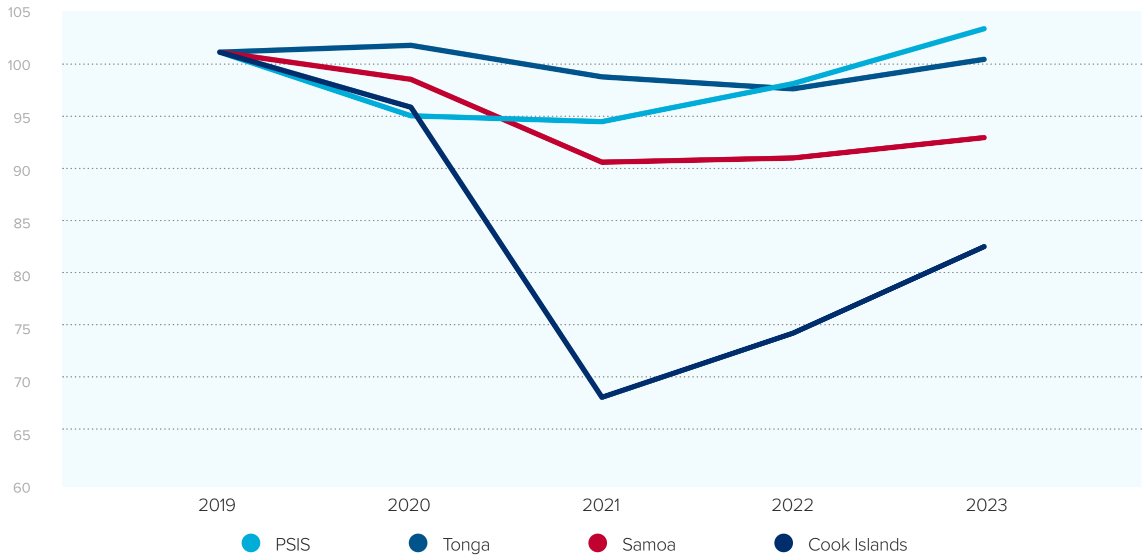
- Golden standard of well-being achieved
- Food import free- getting to below 5% of 2020 imports of the following products (vegetables, fruits, root crops, livestock or crops & meat).
- NCD reduction- reducing the 2020 NCD rates by 25% of 2020 levels.
- Zero waste -is a set of principles focused on waste prevention that encourages the redesign of resource life cycles
- so that all products are reused. The ultimate goal is for no solid waste to be sent to landfills, incinerators or the ocean.
- Reo Maori Vitality – Reo Maori as a language in daily use for (50%) of "our" Tamariki
- Net Zero- means a Nation that is removing as much anthropogenic emission from the atmosphere as it's putting in.

There are also identified projects under each pledge area for consideration over this 25-year generational plan. A set of short-term wellbeing indicators and targets for the next five years have also been established.

3.1.1.2 COVID-19 Economic Recovery Roadmap

The Cook Islands has been affected by the COVID-19 pandemic worse than other small Pacific Islands, such as Samoa and Tonga and is among the worse economically impacted in the world.[50] In particular, the closure of the border to tourism meant the impact was also relatively quick. Figure 34 demonstrates the effects of COVID-19 on GDP in selected Pacific Island countries. It shows that Cook Islands' GDP in FY2021 was more than 30% lower than in 2019.

Figure 34. Impact of COVID-19 on GDP for Pacific island nations (2019=100)



Source: ADB Asia Development Outlook 2022

In response to the economic fallout, the Cook Islands' government has implemented the Economic Response Plan (ERP) from April 2020 to June 2021, with a total budget of NZ$137 million. This plan sought to protect livelihoods, help businesses remain in business, and invest in infrastructure. By 30 June 2021, around 72% ($69.5 million) of the ERP has been implemented to support business viability through business and sole trader grants and Training and Wage subsidies.[51]

Recognising that it could not fund the ERP indefinitely and that economic recovery would be gradual, the Government developed a COVID-19 Economic Recovery Roadmap (ERR). ERR seeks to facilitate recovery by focusing on:

- Reducing the **cost of borrowing** (lowering interest rates for private sector borrowers)
- Managing **the burden of public debt**
- Infrastructure investment
- Reducing barriers to competition and business
- Productivity growth
- Improved public sector efficiency
- Growing the labour force and preventing depopulation
- Attracting foreign investment that will benefit the Cook Islands.

[50] Cook Islands Government, Covid-19 Economic Roadmap, May 2021
[51] MFEM 2021-25 Budget Book, page 10

3.1.1.3 Economic Development Strategy 2030

In 2021, the Cook Islands government published its Economic Development Strategy 2030 (EDS 2030). It recognises that economic development will not be sustainable without addressing relevant social and environmental challenges. The recommendations in the EDS 2030 address issues beyond recovering from the effects of COVID-19 and loss of tourist revenue and Table 5 below presents a summary of its objectives and focus areas. Many of its specific recommendations overlap with the COVID-19 ERR. As it is a recent document, it is too early to comment on progress to date.

Table 5. Mapping of EDS 2030 objectives and focus areas with SDGs

Objective	SDGs	Key focus areas	Measuring progress
1: Improving equity & access for all	SDG 1 (No Poverty), SDG 2 (Zero Hunger), SDG 4 (Quality education), SDG 5 (Gender Equality), SDG 8 (Decent Work and Economic Growth)	Improving equity across the Cook Islands through: • improving the welfare system; • better access to land and housing; and • minimum wage reform A more equitable Pa Enua through: • reducing the cost of living; • improving shipping and air services; • better telecommunication, health, education and small business services	• 2% annual real GDP growth rate on average • 2% growth in real median income per year • Fiscal management in compliance with Medium-term Fiscal Strategy • Increase visitor numbers to pre-COVID- 19 levels • Increase international visitor average daily expenditure • Reduce commercial electricity bills • Maintain business confidence
2: Transforming our economy	SDG 9 (Industry, Innovation, and Infrastructure) SDG 16 (Peace, Justice, and Strong Institution) SDG 17 (Partnerships for the Goals)	Transforming our economy by: • Increase real economic growth in non-tourism related industries • fostering innovation; • improving competition and market efficiency; • improving the delivery of Government services; • fostering our creative and cultural industries; • capitalising on new economic opportunities	• Increase real economic growth in non- tourism related industries • Increase the proportion of international arrivals from markets other than New Zealand and Australia • Reduce internet data costs • Improve the internet penetration rate • Improve the mobile penetration rate • Improve government productivity
3: Developing our people & culture	SDG 4 (Quality education), SDG 8 (Decent Work and Economic Growth)	Developing our people and culture by: • increasing our population; • increasing our labour force participation rates; • increasing our skills base; • building on the quality of our schools; • valuing the contribution of our culture, traditions and community values; • ensuring a productive workforce	• Increase the Cook Islands population • Increase the female labour force participation rate to 70% by 2030 • Meet national Year 4 & 8 English & Maori literacy rate targets • Meet Pa Enua Year 3 & 8 numeracy rate targets • Meet NCEA achievement targets • Increase the number of vocational qualifications • Increase the percentage of the population with vocational or tertiary qualifications
4: Investing in our Islands	SDG 7 (Clean and Affordable Energy) SDG 8 (Decent Work and Economic Growth) SDG 9 (Industry, Innovation, and Infrastructure)	Promoting investment in the Cook Islands by: • ensuring a stable macroeconomic setting; • investing in essential infrastructure; • maintaining an attractive business environment;	• 2% annual real GDP growth rate on average • 2% growth in real median income per year • Fiscal management in compliance with Medium Term Fiscal Strategy • Increase visitor numbers to pre-COVID- 19 levels

		• broadening our economic base; and • facilitating greater local content in business and industry	• Increase international visitor average daily expenditure • Reduce commercial electricity bills • Maintain business confidence
5: Greening our economy	SDG 6 (Clean Water and Sanitation) SDG 7 (Affordable and Clean Energy) SDG 13 (Climate Action)	Greening our economy by: • improving our eco-efficiency so we grow while using fewer resources and generating fewer emissions; • preparing for climate change to mitigate the economic and social risks of a more extreme climate; • having economic recovery plans in place to respond in the event of a natural disaster; • improving the management of solid and liquid waste that is a direct by-product of our economic growth; and • introducing better & more efficient ways of regulating the sustainable use of our environmental resources	• Increase the percentage of electricity Generation from renewable energy • Increase energy use efficiency • Increase the recycling rate to 75% by 2030 • Increase the percentage of properties with approved sanitation systems to 85% by 2030 • Increase the area under wetlands each year

Source: EDS 2030 and DFA Team

3.1.2 Overall financing strategy

In 2018, the government developed its Medium-term Fiscal Framework (MTFF), which has been implemented since FY2019/20. MTFF comprises three interlinked elements, Medium-term Fiscal Strategy (MTFS), Medium-term Expenditure Ceilings (MTEC), and Medium-Term Budget. This is demonstrated in Figure 35.

MTFS forms the basis of MTFF and seeks to ensure sound fiscal and economic management to deliver fiscally sustainable budgets and fiscal planning. It sets out the Government's fiscal commitments over the medium-term, including four basic fiscal responsibility rules, establishing reserve funds for economic downturns, natural disasters, and future generations, and a Government expenditure profile guided by the economic context. The MTFS also includes a strategy to increase revenue without increasing the tax burden through a better tax administration and enforcement of tax legislation.

The MTFS is based on the following principles:

- Investing in infrastructure that will ensure the sustainability of economic growth and the resilience of the economy to climate change;
- Increasing revenue over the medium-term without increasing the tax burden on society, through economic growth and by ensuring that tax legislation is enforced in an equitable manner;
- Focusing the efforts of Government Departments on core deliverables and limiting the expansion of new programmes and costs.

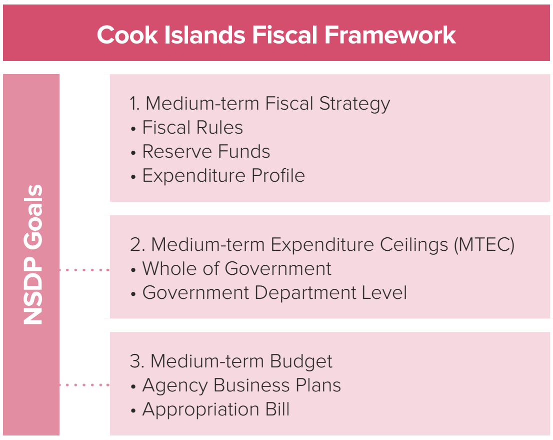
The four basic fiscal rules within MTFS include:

- Net public debt should not exceed a soft cap of 30% of GDP and cannot exceed a hard cap of 35% of GDP.
- The fiscal balance cannot fall below a deficit of 1.9 percent of GDP.[52]

- Budgeted expenditure cannot grow by more than 4% year-on-year in nominal terms.[53]
- The equivalent of 3 months of operating expenditure should be held in cash reserves. This is to respond to the short-term costs of economic shocks or natural disasters.

The MTFS includes an 'Exit Clause' that allows for a temporary departure from the fiscal rules in the event of a natural disaster and the declaration of a state of emergency or a severe economic shock that leads to an expected contraction in GDP of 2% or more to enable a Government stimulus response to boost the economy.

Figure 35. Cook Islands Medium Term Fiscal Framework



Source: Cook Islands Budget Estimates 2021/22

MTFS has been implemented since 2019/20. However, the sudden economic decline in 2020 triggered the exit clauses in MTFS. This allowed the government to take on higher debt levels, as it implemented a new fiscal policy to support the economy. The deviation from Fiscal Framework parameters requires the government consequently re-establish a new medium-term fiscal strategy to ensure fiscal consolidation and long-term sustainability. In 2021, the Medium Term Fiscal Framework was revised, and a new set of fiscal rules were established as interim measures to enable the Government to utilise debt funding to strengthen its response to the economic crisis, necessary for the implementation of the ERR and economic stimulus measures – including ERP-type business support- and to continue to support core government functions until revenue recovers. The newly established fiscal rules include:

- **Cash Reserves Rule:** the equivalent of 3 months of operating expenditure must be held in liquid assets at any one time (estimated to be approximately $60 million).
    - o Within the Cash Reserves Rule, an emergency level of cash reserves (that is, the level below which the ability of the Government to meet its obligations is at risk) has been determined to be equal to one month of expenditure, which is rounded to $20 million
- **Investment Rule:** the Government shall commit that any additional borrowing, once the debt has reached 55 per cent of GDP, be for capital investment and/or targeted GDP stimulus purposes.
- **Operating Expenditure Rule**: baseline budgeted operating expenditure cannot grow by more than 2 per cent or the average of the past two years' growth in the Consumer Price Index (CPI) year-on-year.

[52] The fiscal balance rule provide some buffer to respond to economic downturns or natural disasters.
[53] This rate is roughly in line with the nominal growth of Cook Island GDP over the last decade. Hence this could be seen as a conservative rule.

- **Net Debt Rule:** the net debt should not exceed a soft cap of 55 per cent of Gross Domestic Product (GDP) and cannot exceed a hard cap of 65 per cent of GDP.

MTFS also includes the establishment of a Stabilization Account to accumulate excess cash balances (above four months of operating expenditure) in periods of strong economic growth (nominal growth of 4 percent and above) to be used for additional debt repayments and to cover operational and capital expenditure during periods of economic contraction (defined as real economic growth lower than 1 percent per year).

Medium-term Expenditure Ceilings (MTEC's) is a set of the whole of Government and government department medium-term expenditure ceilings for four years, developed based on MTFS, Agency capacity requirements, and National Sustainable Development Plan.

Medium-term Budget – Agency business plans that reflect individual ceilings, along with revenue and economic forecasts, are used to prepare the medium-term budget – the appropriation estimates for the budget year and forecasts for three forward or outer years. Additionally, the Medium-Term Budget for agencies also presents the estimated actuals of revenues and expenditures for the previous budget year.

The Cook Islands has a well performed Medium Term Fiscal Framework, reflected by excellent scores on three PEFA pillars, B+ for PI-14 (Macroeconomic and Fiscal Reporting), A for PI-15 (Fiscal Strategy) and FPI-16 (Medium Term Perspective in Expenditure Budgeting). The Cook Islands could improve its MTEC by analyzing forecasts that deviate from previous years' forecasts and why actual revenues and expenditures deviate from forecasts. At the same time, the Cook Islands could improve the Medium-Tem Budget by presenting the actual revenues and expenditures as well for the budget year before the last budget year to evaluate agency revenue and expenditure outturns.

3.1.3 Financing policies for specific financial flows

Building on and consistent with the overarching financing strategy, policies for each type of financing can guide how resources are mobilized and harnessed to achieve development goals. The Cook Islands has many policies governing the mobilization and use of different types of finance, including tax policies, expenditure policies, development cooperation, and investment policy for both domestic and foreign investment.

3.1.3.1 Tax and non-tax policies

Cook Islands' taxation mainly includes income tax, company tax, withholding tax, value-added tax, import levies, and departure tax. In the 2019/20 financial year, tax revenues accounted for 65.5 percent of government revenue and was equivalent to nearly 28% of GDP, which is on par with New Zealand and higher than the majority of the Pacific Small Island countries. Consequently, the Cook Islands may have little space to increase its overall tax level. The MTFS stresses the need to increase revenue without increasing the tax burden through a better tax administration and enforcement of tax legislation.

The International Companies (Removal of Tax Exemption) Amendment Act 2019 abolished tax exemptions for international companies on 17 December 2019, which is to be fully enacted from January 2022. The new tax obligations require International companies registered in the Cook Islands to assess their Cook Islands taxable income for each income year, calculate any tax to pay, file company tax returns (including NIL returns along with financial statements), and make any payments to Revenue Management Division (RMD). The Income Tax rate for International Companies is 20%, the same as a resident company. Together with other measures, such as improving taxation transparency, etc., the Cook Islands has successfully removed itself from the EU tax haven "Grey list" since 2020.

Taxing international companies in the Cook Islands will likely lead to the contraction of the international financial services industry with a direct effect on growth and tax revenue. The IMF estimated that removing tax exemption would lead to a one-off decline in GDP of between 2.1 and 2.6 percent, and a decline in tax revenue of about NZ$3.5 to NZ$4.1 million annually

However, being removed from the EU tax haven blacklist has reputational benefits for the Cook Islands, facilitating international payment to the Cook Islands, providing incentives for international businesses to invest in the Cook Islands, enhancing Cook Islands' ability to access funds from international markets, and improving international banks' correspondent banking relationship with domestic banks in the Cook Islands.

The Cook Islands has gradually automated some Revenue Management's tax administration processes. It launched the Cook Islands online ETax in 2015, which allows taxpayers to easily comply with their tax obligations by making their tax records readily accessible and providing the ability for taxpayers to file and pay their returns and make tax payments electronically. The ETax system has streamlined processes and enhanced tax compliance.

Tax compliance is still an issue. For example, the Tax arrears peaked at $30 million in FY2020. The PEFA 2021 scored a D for the collection of gross tax arrears, with 92% of arrears being older than one year[54]. The fully enacting of the International Companies (Removal of Tax Exemption) Amendment Act 2019 since 2022 will also pose challenges for tax compliance. Improving tax compliance will assist the recovery of the fiscal position.

Supported by PFTAC, the Cook Islands is developing various SOPs to strengthen tax administration. It is suggested that the Cook Islands conduct a Tax Administration Diagnostic Assessment as well, with the objectives of exploring the relative strengths and weaknesses in tax administration systems, processes, and institutions and identifying opportunities for improving the effectiveness and efficiency of tax administration.

Non-tax revenue policies. While non-tax revenue, including interest received, SOE dividend, administration fees, etc., typically accounts for around 15% of government revenue income, the Cook Islands does not have an explicit policy on how best to mobilize non-tax revenue. For example, the MTFS establishes a Sovereign Wealth Fund to capture revenues expected in the future from seabed minerals harvesting, which is an appropriate intergenerational savings vehicle for revenues from an exhaustible natural resource.

Cook Islands' fishing fees have similar characteristics as mining fees. Fish stocks may exhaust or move away from Cook Islands' exclusive economic zone. Fishing fees are also volatile, depending on where the fish is. Consequently, The Cook Islands may consider establishing a fund, similar to the Sovereign Wealth Fund, to capture the revenue from fishing fees and dedicate the usage of the fund to fishery-related activities.

3.1.3.2 Development Cooperation

The Cook Islands approved its Development Partners policy in 2015. This Policy addresses the management of total official support for development in the Cook Islands, including climate finance, South-South cooperation, as well as traditional ODA, which includes grants, loans and technical assistance provided by OECD countries, and seeks to make effective use of aid to achieve national development priorities. Development partners covered in the policy comprise governments, civil society, the private sector, regional, multilateral and international development agencies, faith-based and philanthropic organisations, etc.

The policy sets out how the Cook Islands intends to coordinate development partnerships and relationships to achieve national development outcomes. The policy is developed based on the following principles:

- Relevant and aligned to national development priorities
- Fostering accountable partnerships between stakeholders
- Efficient and well managed
- Effective and well-coordinated
- Sustainable and equitable
- Improve the capacity of the Cook Islands to become self-reliant

[54] PEFA 2021

The policy aims to achieve:

- Engagement: effective engagements of development partners, the Cook Islands Government, private sector, civil society, traditional leaders, and Pa Enua;
- Coordination: effective coordination of development support;
- Alignment: official development support aligned to the existing policy suite and national priorities;
- Implementation – Delivering Development Outcomes;
- Effective Reporting and Evaluation.

The Ministry of Foreign Affairs & Immigration ("MFAI") manages the government's relationship with other countries, including broader economic issues. The Development Coordination Division ("DCD") of the Ministry of Finance and Economic Management (MFEM) is responsible for many of the operational aspects, such as technical level changes to development projects. It is the contact for traditional development partners. Individual ministries and other government agencies have a 'lead' responsibility for the daily implementation of development projects relating to their mandates, as well as the responsibility of monitoring and evaluating program or project progress and performance.

3.1.3.3 External debt

The Cook Islands does not have an explicit debt management policy. The government has used fiscal rules within MTFS in managing external debt. Development partners have used compliance with fiscal rules as conditions for approving new loans and extending existing loans.

The Cook Islands government also has a stabilization fund to make additional debt repayments in periods of strong economic growth or to cover operational and capital expenditure during periods of economic contraction.

The Cook Islands regularly releases official, publicly available reports on the status of its debt profile and loan repayment reserves, which constitutes part of the quarterly report on Government financial results. It may be worthwhile to conduct regular debt risk and sustainability analysis.

The sharp rise in debt to GDP ratio since the outbreak of COVID-19 has demonstrated the impacts of natural disasters or external shocks on the Cook Islands' economy and its debt level. Consequently, the usual debt management measures should be complemented by mitigating disaster risks and adverse economic shocks. Establishing an emergency trust fund and securing disaster-contingent financing from the Pacific Catastrophe Risk Assessment and Financing Initiative and development partners are measures the Cook Islands is taking to mitigate the adverse impacts of national disasters.

Debt financing will be critical for financing major projects, accelerating post-COVID recovery, and achieving sustained and inclusive growth. The Cook Islands may consider developing a Medium Term Debt Management Strategy to guide the government's debt management decisions and operations in the medium term. Effective debt management can help strike a balance between funding the government's needs with sustainable debt levels. At the same time, the Cook Islands may consider building its capacity to strengthen its debt management and make more informed decisions about borrowing and related costs and risks.

3.1.3.4 Foreign Direct Investment

Foreign direct investment will also help the Cook Islands diversify growth and make it more sustainable. It can also facilitate the transfer of technology and know-how to the Cook Islands and allow it to promote its products and services more widely in international markets. Foreign direct investment is also a way for the Cook Islands to integrate with the world economy, achieve economic growth, and recover better from COVID.

Policy framework

Domestic and foreign investment in the Cook Islands is governed by the Development Investment Act 1995-1996, the Development Investment Regulations 1996 and the Development Investment Code Order 2003. Both the ERR and EDS have identified promoting domestic and foreign investment as a national priority.

The Business Trade Investment Board has been established with the task of implementing these regulations to promote trade, investment and business in the Cook Islands, promote and monitor foreign investments, and encourage the participation of Cook Islanders in trade investment and business. An online Business One Stop Shop has been established for business registration, tax registration, applying and renewing permits and licences, business banking, business advisory, etc.

There are various incentives for investment promotion, such as concession of tariff protection, import duty and levy concessions, tax concessions through accelerated depreciation, allowance for counterpart training and recruitment of Cook Islanders from overseas.

However, the Cook Islands has yet to design a clear and well-defined strategy to provide an overall direction, with specific targets and means to attract and facilitate investment, particularly foreign direct investment. A well-designed investment strategy typically comprises a national policy statement on investment, a comprehensive investment strategy, an investment promotion strategy, and Sectoral investment strategies and implementation plans. The Cook Islands has developed a National Infrastructure Investment Plan 2021, which outlines the Cook Islands' priorities and plans for major infrastructure over the next ten years.

Furthermore, there are significant constraints to foreign direct investment in the Cook Islands. The Development Investment Act:

- Requires all foreign organisations to obtain approval first. This requires providing business plans, character references, and other documentation.
- Restricts the scope of FDI. Most significant (if not all) sectors are "Reserved Investment Areas" and are only open to foreign investment via exemptions. This includes tourist accommodation, rental cars, fish and food processing, film, retail and hospitality.
- Allows exemptions if specific criteria are met, including:
    - There is a demonstrable demand for that activity;
    - No Cook Islander is currently carrying on business in that activity.
    - Existing Cook Islands enterprises do not have the resources to carry out the specific project (e.g. specialised construction project).
    - The foreign enterprise is a joint venture involving Cook Islanders (the greater the ownership and participation by Cook Islanders, the more likely it is to obtain approval).

The Foreign Investment approval process is complicated and lengthy. For example, a foreign investor needs to provide more than ten different documents and take around three weeks to register and get their business approved. Some documents, such as the Police Check form from the home country, require international correspondence, and other documents, such as reference letters from lawyer, banker, and accountant, may be difficult to get before a business has been set up and in operation[55]. The approval process is not transparent. After approval, foreign businesses also face the challenges of applying for work permits (visas), business registration, tax registration, etc. The process of issuing a work permit is problematic. The Cook Islands may consider integrating foreign investment approval into the Business One Stop Shop framework. The process for foreign businesses exiting the Cook Islands market is also complicated in that they can only sell to other foreign investors unless there are no suitable citizen buyers.

Issues with land tenures also affect investment. The Cook Islands land tenure system is primarily native freehold title, which cannot be sold outright, with increasing fragmentation of ownership as all children equally inherit their parents' land ownership rights. The Leases Restrictions Act does not allow freehold ownership of land, and leasehold is permitted for a maximum period of 60 years, with the consent of landowners, subject to approval by the Committee established under the Act. The Committee's principal function is to regulate leasehold to people other than Cook Islanders and permanent residents. The leasehold process can be lengthy, complicated, and costly, and is exacerbated by significant absentee land ownership due to substantial outward migration. Long-term access to suitable land is important to many FDI as larger investments often require large and/or favourably located sites (e.g. a processing plant being close to a port, 4-star resort being on beachfront) and require more than five years to make a payback.

The Asian Development Bank has criticised the Cook Islands regime, characterising it as unwelcoming, 'slow, discretionary, dependent on outdated laws, and discourage[ing] foreign investment'. The International Monetary Fund recommends changes, noting that 'reforming the investment code to open up traditionally closed areas of the economy to foreign investment could help to diversify economic activities.

These restrictions have been noted in the ERR as 'too-strongly biased against foreign investment across the board' and contributing to the private investment being lower than 'optimal'. The ERR proposed reforms but considers that some areas still need to be reserved for local activity only. The EDS 2030 proposed a review of the foreign investment framework in 2022 to assess if the current framework is fit for its purposes.[56] It also proposed to review the current land tenure system to ensure equitable and efficient access to land.

In addition to regulatory constraints and land tenure issues, there are other factors affecting foreign investors' investment in the Cook Islands as well, including small population and economy size, long distance from major global markets, weak physical and digital connectivity, weak financial infrastructure, labour shortage, vulnerability to environmental and economic shocks, etc. While physical constraints, such as small population size and long distance from major global markets, will persist, the Cook Islands could improve its general investment climate to facilitate foreign investment.

[55] Business Trade Investment Board, Foreign Investment, https://btib.gov.ck/foreign-investment/foreign-direct-investment/
[56] Action 4.8 of EDS 2030

Implications for FDI funded development

Fish and food processing and other commercial investment

The restriction on FDI includes fish and food processing industries. Larger modern processing facilities can improve productivity and produce higher grades of products efficiently. This could reduce the need for imported products and possibly increase export earnings. However, developing a modern processing facility requires significant investment. Allowing FDI could improve the performance of the sector.

Accommodation and Other Tourism

The restrictions on foreign ownership of land and tourist accommodation favour local investors. This may lead to new accommodation being of a scale and quality level more suited to local investors (a desk review suggests this may be the case).

Larger resorts can offer a range of premium facilities such as luxury pools, multiple dining options, etc., but require significant long-term investment and access to sizeable land areas. Such developments also need funding at a level beyond most Cook Island investors could afford and hence suit FDI. Larger resorts are likely to increase the appeal of the Cook Islands to higher spending tourists from outside the region, facilitated by the marketing effort of international hotel groups. Regulations also prohibit foreign ownership of rental car operations, cinemas, tourist tour operations and eco-tours and retail services that serve tourists.

Hotels, resorts, rental cars, tour buses and boats, and retail can impact tourists' perceptions of a destination. Lack of premium options may reduce tourist spending and even see potential tourists choose to holiday elsewhere. Upgrading these sectors may require significant investment and technology know-how.

This DFA considers that:

- New investment in tourism is required if the Cook Islands is to
    - Achieve its goals of increasing tourist spending and, in particular, attracting more high-end tourists from outside Australia and New Zealand.
    - Remain competitive against other Pacific Islands neighbours, with new and/or upgraded premium resorts. For example, Samoa has five or so new luxury resorts and two recently upgraded Sheraton group properties.[57]
- FDI could assist in developing tourism, particularly for premium tourist accommodation.
- FDI is more likely if there are reforms around land access. Facilitating employment of foreign workers may also support FDI (which will facilitate skill transfer to Cook Islanders).

3.1.3.5 Remittance and Diaspora

Although not reliant on remittances from the diaspora, the Cook Islands has a large diaspora population. The Cook Island EDS 2030 identifies overseas Cook Islanders as a source of workers to fill labour and, in particular, skill gaps. It proposes action to help attract them to the Cook Islands, including facilitating repayment of New Zealand student loans. While many diasporas

[57] https://www.newshub.co.nz/home/travel/2021/10/five-stunning-new-luxury-samoan-resorts-open-ahead-of-international-tourism- restart.html

may return, it is unlikely they will meet all of Cook Island's long-term labour needs. Reasons for this conclusion are:

- Depopulation due to low population growth. UN predicts a slight fall in Cook Island's population by 2030.
- In addition to possible depopulation, the Cook Islands has an ageing population. This may reflect decreasing birth rates (smaller families), increased longevity, and migration of younger adults to New Zealand and Australia. An ageing population will see fewer working-age people and possibly more people leaving the workforce to care for ageing relatives, given Cook Islands' culture. These will contribute to future labour shortages.
- New Zealand and Australia both have strong economies with higher average incomes and present many opportunities for younger Cook Islanders to migrate;
- Foreign-born Cook Islanders may have less connection to the Cook Islands than their parents and hence be less inclined to migrate to the Cook Islands.

The EDS 2030 proposes to improve public health (e.g. obesity levels) and infrastructure (e.g. telecommunications), which may enhance labour force productivity and make the Cook Islands more attractive to overseas Cook Islanders.

The EDS 2030 also proposes to draw on the financial resources, human capital, and business networks of the diaspora and establish a coordinated network of the diaspora to facilitate Cook Islanders abroad to contribute to the economic development of the Cook Islands.

Measures to encourage their participation could include:

- Offering financial products or incentives for diasporas to invest in their home country.
- **Encouraging investment and utilisation of** human capital and business network **from the diasporas** to develop the Cook Islands. To fully leverage this opportunity, the Cook Islands should implement reforms to encourage and facilitate private investments.

At the same time, to meet long-term labour needs, the Cook Islands may consider:

- Implementing policies to increase labour force participation rates, particularly female labour force participation rates. EDS 2030 include policies seeking to address this, such as regulating early child care, improving old-age care, and introducing after-school programs to allow both parents of young children to work.
- Promoting education and vocational training to upskill its labour force. EDS 2030 has proposed policies to address this, including establishing a domestic student loan scheme.
- Promoting the Cook Islands as a place for working holidays to the younger diaspora (e.g. after finishing high school or university summer holidays). This could be marketed as an opportunity to understand your culture better, visit extended family, and earn money to pay for your tertiary education. The idea of young people working and travelling overseas is well established in New Zealand and Australia. The younger workers will require little in terms of costly social services.
- Facilitating the employment of foreign workers to fill gaps in the labour force. This could be achieved with a combination of long-term immigration and shorter-term work visas.
- Formalising/expanding short-term work programs with other Pacific Island nations. Reasons for this include the higher wages in the Cook Islands would be attractive to many Pacific peo-

ple, access to English- speaking workers, shared cultural values, and that these workers could deliver a Pacific experience for tourism.

- Conducting a labour market survey and population study to develop targeted solutions to this gap.

3.1.3.6 Public Private Partnerships

Public-private partnerships (PPPs) are agreements between the public and private sectors to provide assets and/or services such as power, water, transportation, education, and health (ADB, 2008). PPPs allocate risks and returns between the partners and create efficiency incentives for the service provider by linking payments to specific performance criteria (ADB, 2008).

There exist several PPP models, with varying degrees of private sector participation and responsibility, ranging from service contracts, management contracts, lease contracts, concessions, and build-own-lease or build-operate-transfer to partial private ownership (World Bank PPPIRC website).

The Cook Islands have yet to implement any significant Public-Private Partnerships (PPPs). However, the Cook Islands have already engaged private sector players in the delivery of many development projects, such as renewable energy and climate-related projects, demonstrating the potential and benefits of involving private sector players.

As the Cook Islands has graduated from being a developing country into a developed country, the government will need to broaden its market for where it receives funding. Although concessional loans and grants are still accessible, private sector financing through PPPs has gradually become a more attractive option. PPP can drive development that would otherwise be out of reach of the government's financial capacity. In contrast to borrowing from offshore institutions, using locally based PPPs for development retains the revenue in the local economy and builds local capacity across investment areas. PPP can also be utilized for SOE reforms and improving public service delivery.

The EDS 2030 has proposed to explore the potential for using Public Private Partnerships (PPPs) to deliver public services and/ or assets cost-effectively. To this end, the Government is finalising a draft Public Private Partnership Policy and reviewing necessary legislative adjustments to enable its implementation.

In implementing PPP, the Cook Islands may face the following challenges:

- Inadequate private and public sector capacity in dealing with the complex Public-Private Partnership deals.
- Stringent investment legislation may constrain the involvement of foreign investment in PPP;
- Lack of PPP related laws and regulatory frameworks.

3.1.4 Public Finance Management System Performance

The latest Public Expenditure and Financial Accountability Assessment (PEFA), conducted in 2021, concluded that "Overall, there have been significant improvements since the last assessment both at the policy and activity level" for the Cook Islands' PFM system.

The PEFA noted progress in budget credibility, budget documentation, managing extra-budgetary resources, debt management, macroeconomic and fiscal forecasting, fiscal strategy formulation, revenue accounting and cash management. However, Cook Islands' PFM underperformed in some areas.

Cook Island's PFM scored A or B in 15 of 31 indicators assessed, reflecting strong performance, and scored C for six indicators, reflecting baseline performance, and D for the remaining ten indicators, reflecting weak performance.

In general, the Cook Islands' PFM underperformed in many areas. The 2021 PEFA scored either C or D for 16 indicators, reflecting baseline or weak performance. The report highlights the following issues that need further development:

Table 6. PEFA rating for Cook Islands' PFM 2021 (colours match PEFA)

PEFA Rating	Indicator number	Indicator
A	PI-5	Budget documentation
	PI-6	Central government operations outside financial reports
	PI-7	Transfers to subnational governments
	PI-13	Debt management
	PI-15	Fiscal strategy
	PI-16	Medium-term perspective in expenditure budgeting
B+	PI-2	Expenditure composition outturn
	PI-14	Macroeconomic and fiscal forecasting
	PI-20	Accounting for revenue
B	PI-1	Aggregate expenditure outturn
	PI-4	Budget classification
	PI-9	Public access to fiscal information
	PI-17	Budget preparation process
	PI-21	Predictability of in-year resource allocation
	PI-25	Internal controls on non-salary expenditure
C+	PI-3	Revenue Outrun
	PI-8	Performance information for service delivery
	PI-19	Revenue administration
	PI-26	Internal audit
C	PI-10	Fiscal risk reporting
	PI-11	Public Investment Management
D+	PI-12	Public Asset management
	PI-18	Legistlative scrutiny of budgets
	PI-22	Expenditure arrears
	PI-23	Payroll controls
	PI-27	Financial data integrity
	PI-28	In-year budget reports
	PI-29	Annual financial reports
	PI-30	External Audit
D	PI-24	Procurement management
	PI-31	Legislative scrutiny of audit reports

Source: Cook Islands PEFA 2021

- **Pillar I Budget reliability.** The Cook Islands scored C+ for one of the three indicators under this pillar: PI-3 (Revenue outturn). The main issue is that:
    - o Budgeted revenue forecasts appear to be systematically too conservative and should be improved in the future. The low predictability of international aid may contribute to the revenue outturn exceeding the budget forecasts.
- **Pillar II: Transparency of public finances.** The Cook Islands scored well for this pillar. It scored C+ for one of the pillar's five indicators: PI-8 (Performance information for service delivery). The main issues include that:
    - o The Cook Islands' budget does not systematically track or present information on service delivery.
    - o There is no performance evaluation for service delivery on an ongoing basis.
    - o Need for some specific quantitative measures of service delivery.
- **Pillar III: Management of assets and liabilities.** The Cook Islands scored C or D in three of this pillar's four indicators. It scored C in PI-10 (Fiscal risk reporting) and PI-11 (Public investment management), and D+ in PI-12 (Public asset management). The main issues in this pillar include:
    - o The CIIC annual financial statement did not provide data on individual institutions and did not meet the goal of reporting within nine months of the end of the fiscal year.
    - o The finances of Pa Enua (outer island) governments, incorporated in the Quarterly Financial reports, are not shown separately.
    - o Economic analyses are conducted to assess some major investment projects and should be done for all major projects.
    - o Recurrent expenditures for public assets are generally not in budget projections
    - o The Auditor has questions about the record-keeping and asset inventories used to establish values for the annual reports.
- **Pillar IV: Policy-based fiscal strategy and budgeting.** The Cook Islands scored favourably for four of five indicators in this pillar. It scored D+ for PI-18 (Legislative scrutiny of budgets). The main issues under this pillar include:
    - o For the last two fiscal years, 2019/20 and 2020/21, the budget was submitted to the legislature less than a month before the new financial year took effect.
    - o Issues around the legislative procedure for budget scrutiny, including not reviewing the economic and fiscal policy on the first reading.
- **Pillar V: Predictability and control in budget execution.** The Cook Islands scored C or D in five of the eight indicators. It scored C+ for PI-19 (Revenue administration and PI-26 (Internal audit); scored D+ for PI-22 (Expenditure arrears) and PI-23 (Payroll controls), and scored D for PI-24 (Procurement management). The main issues include:
    - o No data is available on actual audits and investigations undertaken against plans.
    - o Tax revenue arrears of $29.3 million, 92% of which were older than one year.
    - o No inventory of bank accounts (including balances) is maintained systematically to ascertain the quantum of idle and unremunerated funds sitting in the various accounts. No sweeping or pooling of funds is undertaken.

- o The FMIS is only partially rolled out (approximately 20% of entities), so comprehensive system-generated data (e.g. arrears) and analysis is unavailable.
- o The last payroll audit was in 2015/16. Hence there is a risk of systematic issues and anomalies (e.g. ghost workers).
- o Difficulties for interested parties to monitor procurements awarded due to incomplete data being published.

• **Pillar VI: Accounting and reporting.** The Cook Islands scored D+ on all three indicators, PI-27 (Financial data integrity), PI-28 (In-year budget reports), and PI-29 (Annual financial reports). The main issues under this pillar include:

- o Large unreconciled balances in most active bank accounts and suspense accounts were not cleared by year-end.
- o Timing of in-year budget reports, including quarterly reports, was only available three to four months after the period ended.
- o Financial reports are late and submitted for audit more than 12 months after the financial year for the last three completed fiscal years.

• **Pillar VII: External scrutiny and audit.** The Cook Islands scored D+ for PI-30 (External Audit) and D for PI-31 (Legislative scrutiny of audit reports). The main issues include:

- o The Audit Office has not submitted annual audit reports to Parliament for 2015-19.
- o There is no evidence that Parliament scrutinized the reports from the Audit Office or acted on the recommendations of the last audit report.

3.1.5 Improving the domestic financial system

3.1.5.1 Domestic financial system to mobilize private finance

The financial sector is considered a catalyst for economic growth and development. However, the financial sector in the Cook Islands provides relatively low levels of credit and has been identified as facing some long-term structural issues that restrict credit.[58]

The Cook Islands' domestic financial system includes financial institutions (e.g. banks and insurance companies), financial markets, and financial instruments. A well-developed financial system can support economic development by providing incentives to save and channelling those savings to productive activities. The development of the local private sector depends on its ability to secure appropriate and affordable finance to start and expand businesses.

The Cook Islands' financial system comprises about thirty financial entities, including domestic and international banks, a superannuation fund, insurers, captive insurers, trustee companies, and money changing and remittance businesses.

Two commercial banks are foreign-owned, the ANZ Banking Group Limited (ANZ) and Bank of South Pacific (BSP) Limited, and have a combined market share of more than 80%. The Bank of the Cook Islands (BCI) Limited is owned by the Government and operates on all islands, and processes government subsidies, child benefit and pension payments, and government salaries. As a result, the number of Cook Islanders with access to a bank account is very high.

[58] For example the IMF TAR.

An additional domestic bank, Capital Security Bank (CSB), is an onshore commercial bank specialising in providing trust and wealth management services. It provides services to the Cook Islands offshore international financial services industry that was established in the 1980s.

The Cook Islands National Superannuation Fund (CINSF) is a compulsory superannuation scheme. It covers all people working in the Cook Islands, who contribute 5% of their salary to the fund. The Fund is designed to provide members with a means to save for retirement. The fund is currently entirely invested overseas. However, the Cook Islands National Superannuation Act 20 allows for 20% of the fund invested within the Cook Islands. As such, there is an opportunity for CINSF to play an important role in developing the domestic financial market for financing development projects.

The Cook Islands established its Credit Bureau in 2017 and set up a collateral registry (Personal Property Securities Register) in 2019. These should help banks assess and manage loan risks. Some commentators suggest that this should be integrated with New Zealand's credit bureaus to be more effective.

Insurance can provide individuals and businesses with funds needed to recover from accidents (e.g. fire destroying a commercial premise) and natural disasters. Insurance claim payments allow for new development to replace lost assets. Cook Islands' insurance sector comprises five insurance companies (all external to the Cook Islands or a subsidiary of a New Zealand insurer) plus insurance intermediaries, brokers and captive insurers.

Limited data is available on the insurance sector in the Cook Islands, possibly partly due to the major insurance companies based offshore.

Cook Islands' financial market is in its infant stage. It does not have equity, corporate bond market, or stock exchange and has no locally-based companies listed in regional stock exchanges, such as SPX or NZX.

3.1.5.2 Financial Institutions

The Financial Supervisory Commission (FSC) supervises financial intuitions in the Cook Islands. It administers 15 pieces of legislation. Its accountabilities include:

- Licensing all financial institutions being banks, insurers (including captives), money-changing and remittance businesses and trustee companies.
- Operating the Registry of International & Foreign Companies, Limited Liability Companies, International Trusts, International Partnerships and Foundations.
- Administering risk-based supervision of the financial sector, including risk identification and assessment, risk rating and supervisory action planning (which it has performed).

MFEM is responsible for collecting and publishing statistics about the economy, including the financial services sector.

The Cook Islands do not have a central bank and is in a monetary union with New Zealand. Without a central bank, the Financial Supervisory Commission serves as the primary regulator of the finance sector. Meanwhile, the Financial Services Development Authority, established in 2009, is tasked with promoting the industry and its long-term development.

3.1.5.3 Issues and gaps with the financial system

Compared internationally, Cook Islands' banking sector is less efficient with issues including the high lending deposit spread and associated high cost of credit. These are likely factors for the Cook Islands' relative low level of private credit. Land access and tenure is also an issue for the private finance.

High borrowing cost

Banks in the Cook Islands tend to have higher lending interest rates. The 2021 ERR report included several comparisons and noted that the Cook Islands had noticeably higher interest rates than New Zealand despite being a realm of New Zealand. The ERR report stated:

> 'high rates of borrowing are not unusual across the Pacific, though the Cook Islands still appears to have a higher cost than some comparable countries. For example, in Niue, which is also a Realm country, mortgages are available at 5 per cent, whereas in the Cooks, this is over 2.5 percentage points higher. American Samoa also lacks the ability to increase the supply of currency to lower costs, yet has borrowing costs around 1 percentage point lower than the Cook Islands'

Figure 36 list the lending rates cited in the Cook Islands' ERR. It shows that the Cook Islands' mortgage rate of 7.69- 8.53% is higher than those in most Pacific Island countries and is more than 5 percentage points higher than that in New Zealand. The lending rates for owner-occupied housing loans, as reported in MFEM's banking statistics, range between 8.25-9.0% in 2019/20, which is even higher than those reported in the ERR report.

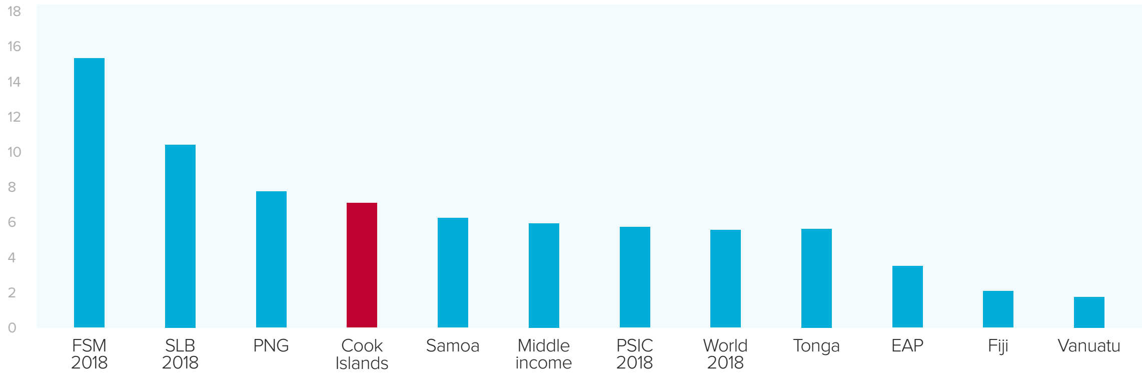
Figure 36. Lending rates in selected Pacific Island Countries

Country	Type of credit	Rate (range)	Own currency?
Cook Islands	Mortage rates	7.69% – 8.53%	No – Nzd
Cook Islands	Business credit	7.66% – 8.57%	No – Nzd
Samoa	Commercial bank leading rate	8.50%	Yes
American Samoa	Home loans variable	6.79%	No – USD
Fiji	Lending interest rate	6.03%	Yes
Vanuatu	Lending interest rate	2.00%	Yes
Solomon Islands	Lending interest rate	10.75%	Yes
Papua New Guinea	Lending interest rate	8.65%	Yes
Palau	First home owner loan	8.00%	No – USD
Tonga	Lending interest rate	8.07%	Yes
Tonga	Home loans variable	8.65%	Yes
FSM	Commercial bank leading rate	7.60%	No – USD
FSM	Business credit	15.70%	No – USD
Guam	Mortage rates	2.75%	No – USD
Niue	Mortage rates	5.00%	No – USD
Niue	Business credit	7.5% – 9%	No – USD
New Zealand	Home ownership	2.49%	Yes

Source: ERR

Several reasons may explain the high lending interest rates, including low bank efficiency and lack of competition. An indicator measuring bank efficiency is the bank lending deposit spread. Figure 37 shows the bank lending and deposit spread for selected countries in 2019. It indicates that Cook Island's bank lending deposit spread is higher than Vanuatu, Fiji, Tonga, the Pacific Small Island countries' average, and the World average.

Figure 37. Bank Lending and Deposit Spread (%) in selected countries[59], 2019



Source: WDI and MFEM

This higher lending interest and high spread may result from limited competition among banks in lending to the private sector and hamper the effectiveness of monetary policy transmission through a credit channel. One sign of limited competition is the lack of variations in lending and deposit rates for many years. Table 7 shows the interest rates from three commercial banks, ANZ, BSP, and BCI. It shows that both deposit rates and lending rates from these three banks have remained the same for many years.

Table 7. Interest Rates, 2015-2020

	Fixed Term Deposit Rate (3 months)			Housing loans for owner- occupied			Business Loan base rate		
	ANZ	BSP	BCI	ANZ	BSP	BCI	ANZ	BSP	BCI
2015/16	3.27	3.25	3.30	9.50	9.50	8.25	9.50	9.50	7.70
2016/17	3.10	3.25	3.25	9.50	9.50	8.25	9.50	9.50	7.70
2017/18	2.40	3.25	3.25	9.50	9.50	8.25	9.50	9.50	7.70
2018/19	2.40	3.25	3.25	9.50	9.50	8.25	9.50	9.50	7.70
2019/20	1.20	3.25	3.25	9.00	8.25	8.25	10.00	9.50	7.70
2020/21									

Source: MFEM

Issues with land as collateral

Another impediment for individuals and small businesses to accessing development finance is the difficulty of using the land as collateral. This is compounded by restrictions on foreign land ownership, which reduces the pool of available buyers in the case of loan defaults, thus the amounts banks may be willing to lend against land.

[59] ANZ is the largest bank in the Cook Islands. In here, we use ANZ's lending deposit spread as a proxy for the Cook Islands' lending deposit spread.

The lack of bankruptcy provisions in the Cook Islands also contributes to the weak collateral framework (ADB, 2013). The government has promised to assess options to introduce bankruptcy laws to address issues around dealing with debtors' assets and allowing financially troubled businesses (e.g. insolvency or under administration) to restructure their finances.[60] Bankruptcy legislation is common in developed nations to protect creditors, including banks and employees. Such legislation helps reduce ongoing losses (which can harm other businesses) and redeploys economic resources to better uses.

Unfavourable banking infrastructure

Other challenges related to bank infrastructure include the lack of an automated clearance system and weak internet connectivity, which increases costs and restricts the speed and quality of financial services.

The development and adoption of Fintech and digital payment may provide a mechanism for small businesses to access the global market. However, the Cook Islands faces a challenge in developing Fintech and digital payment. Many larger internet payment gateways, such as PayPal, don't recognize the Cook Islands as a jurisdiction they can transact with. Banks in the Cook Islands are trying to develop their internet payment gateway. However, this process has been delayed.

Lack of credit information hinders banks from providing credits to the private sector. The recent introduction of a local credit bureau and a collateral registry should help consolidate information about borrowers. However, some market participants suggest integrating it with New Zealand credit bureaus to be more effective.

Financial soundness

The IMF TAR noted that financial soundness indicators present a favourable overall risk profile for the Cook Islands banking sector but noted several recommendations and other issues, including the lack of an automated bank clearance system. It proposed memorandums of understanding with the parents of foreign (owned) banks to manage risks (such as natural disasters and bank failure) and to have contingency plans in case of a banking crisis.

On an international level, there is increasing global agreement and public pressure to address the problems of tax havens. In October 2021, 136 countries set a minimum global tax rate of 15% for big companies and sought to make it harder to avoid taxation. New Zealand and Australia were both signatories of this agreement.

The implications for the Cook Islands are that its international financial services industry is unlikely to grow and may contract. This could lead to reductions in GDP and the government's tax revenue. It would also mean that the FSC risks losing some of its fee revenue from the international financial service industry.

3.1.6 Private sector development

Private sector development is a key driver for the Cook Islands to recover from the damage of the Global Pandemic, diversify its economy, and achieve its shared vision of "building a dynamic, prosperous, and inclusive economic future for Cook Islanders". The business environment, defined as the interplay of policy, legal, institutional, regulatory and physical conditions that facilitate business

[60] EDS 2030 page 80.

activities, impacts private sector development by affecting the cost of doing business (transaction costs) and consequently influencing the incentives of private enterprises to invest. This affects their survival and expansion and their level of employment, trade, investment and growth.

Currently, the private sector accounts for 69% of Cook Islands' employment. Tourism-related businesses, including accommodation, visitor activities, restaurants, etc., account for most private businesses and 65% of GDP. The Cook Islands Tourism Industry Council is the leading representative body for the tourism industry, with support from the Chamber of Commerce.

The global pandemic and the border closure to international tourists have impacted the private sector the hardest, particularly the tourism sector. According to the Pacific Business Monitor, by November 2021, 94% of Cook Islands' businesses were negatively affected, of which 83% were significantly affected. The Cook Islands Business Confidence Index reports show that 27% and 21% of the businesses surveyed closed their businesses in 2020 and 2021, respectively, and 66% and 39% of businesses' revenue declined by more than 50% in 2020 and 2021, respectively. Businesses face significant challenges of uncertain economic prospects, surviving the current economic situation, and how to recover from.

The recovery and further development of the private sector have been constrained by several factors, including uncertain economic prospects, Labour shortage, weak infrastructure, high cost of doing business, such as difficulties in land access and high cost of accessing finance, etc.

Uncertain economic prospects constrain business activities. According to the most recent 2021 Business Confidence survey, 84% of the businesses surveyed cited "general economic uncertainty" as their main short-term concern, and 48% cited "Building an economically resilient business operation" as their main long-term concern. With the gradual opening of the Cook Islands to international tourists, businesses will gradually ease their concerns about short-term uncertainties, which will boost business confidence.

Labour shortage has long been constraining Cook Island's economy. Before Covid, the Business Confidence Surveys constantly identified inadequate human resources as the top challenge for businesses in the next five years[61]. Businesses find it particularly difficult to recruit staff with suitable qualifications and skills. This shortage is, to a large extent, due to the local labor supply can't meet the labor demand arising from rapid economic growth. This labor shortage is generally filled by foreign workers.

Since Covid, especially since January 2021, there has been an exodus of Cook Islanders and Expat workers to New Zealand, made possible by one-way quarantine-free travel. This has exacerbated labor shortages and may have a lasting impact on the Cook Islands' sustainability. Many businesses cannot source labor locally or from traditional labor markets in the immediate term because of border closures. To address immediate labor shortages, the government will promote labor mobility by allowing migrant workers to seek alternative employment beyond their visa-sponsoring employer.

Historically, Cook Island's migrant worker policy is cumbersome for businesses to recruit migrant workers despite labor shortage. The process regulating the issue of work permits lacks transparency and is time consuming. The Work permit, however, can entail an immigrant worker a maximum of six years of right working in the Cook Islands. After that, the immigrant worker has

[61] Cook Islands Business Survey and Confidence Index, 2018 and 2019

to leave the country. This may lead to the forced loss of human capital and institutional knowledge that immigrant workers have accumulated.

The government has approved a new immigration bill to improve transparency around visa categories and approvals for migrant labor, alleviate longer-term labor shortages, and codify migrant worker protections. Recently, the government has further eased the regulation on migrant workers, including relaxing health checks for workers wanting to come in from Australia or New Zealand, allowing for secondary employment, removing the requirement for repatriation by the employer, waiver on bonds and approving short term work permits of up to six months for persons with specific skills.

The government may consider further relaxing immigration regulation, removing the restrictions on the maximum years of working restriction and reducing the minimum years required for permanent residency application, and making it easier for businesses to bring in and maintain migrant workers.

Infrastructure, particularly infrastructure services quality and sustainability, continues to be a challenge for businesses. For example, Cook Islands' electricity price for commercial users is among the highest in the region. Internet penetration rate, at 54%[62], is still low compared with the developed country average (85% in 2019), suggesting inadequate infrastructure or services, high prices, and low access. Despite the recent completion of the Manatua One Polynesia submarine cable, improved service delivery remains hindered by limited regulation and oversight, and limited competition. This hinders investment in information technology, retail opportunities in tourism, and e-commerce. Liner shipping connectivity, including inter-island connectivity, remains low and has not improved since 2012[63]. Air connectivity, including both domestic and international air connectivity, remains low, ranking 176th out of 219 countries around the globe[64]. There are also issues with roads, water supply, sanitation, waste management, etc.[65] Furthermore, many of the infrastructures are state owned with monopoly or near monopoly statuses, which provides limited incentives for them to improve service efficiency and quality.

The NIIP, developed with assistance from the Pacific Region Infrastructure Facility, will assist in identifying future projects, together with their maintenance, and integrating them into the budget. The government needs to implement appropriate regulations over these services or open the market for competition in some sectors. The enactment of the Telecommunications Act 2019 and supporting regulations will promote competition in the sector, improve service delivery, and reduce costs to businesses. The government is in the process of drafting Utility Regulation Policies. The government has already established an independent Competition and Regulatory Authority (CRA) to oversee monopoly pricing, administer licensing, and ensure competition. However, it is not yet fully operationalized and is only regulating the telecommunication sector currently.

Businesses also face high costs of doing business. Business registration services and registering security over movable assets are cumbersome, especially for foreign investment. Access to land is both costly, complicated, and lengthy. Costs of access to credit (see section 3.1.5) is high. Enforcing contracts and protecting minority investors are problematic, and resolving bankruptcy is difficult as there is no bankruptcy law. All these raise the cost of doing business and pose challenges to businesses.

[62] "Digital 2021: The Cook Islands", Datareportal, https://datareportal.com/reports/digital-2021-cook-islands
[63] Liner shipping connectivity index, UNCTAD
[64] Air Connectivity Index, IATA, https://www.iata.org/en/iata-repository/publications/economic-reports/air-connectivity-measuring-the- connections-that-drive-economic-growth/
[65] EDS 2021-2030

3.2 M&E Framework

Effective and efficient monitoring and evaluation (M&E) is an integrated part of INFF implementation. M&E is used to monitor the allocation, disbursement and movements of various financial flows, the progress of programmes funded by these financial flows, and to evaluate their outcomes. It helps ensure that the allocation of financial flows aligns with national development priorities and that the execution of these financial flows achieves their intended objectives.

There are many components to an effective M&E system. Finance tracking systems capture information on the allocation and usage of resources. Performance monitoring systems capture information on development results and the progress toward the national development plan and SDGs. Evaluation systems evaluate both the project or program implementation and impacts. The quality of these systems and the ability to connect information between them will determine the extent of a clear picture of the program (or project) impacts and efficiency.

The Cook Islands has an M&E system in place, with the Cook Islands Statistics Office (CISO), within the Ministry of Finance and Economic Management (MFEM), taking on the primary responsibility of collecting, compiling, and analysing national social, economic, and environmental statistics.

Cook Islands has included in its EDS 2030 a set of indicators under each key objective. NSDA 2020+ has also set up a set of wellbeing indicators and targets for the five years up to 2025 to monitor the progress towards achieving Cook Islands' development goals. However, neither EDS 2030 nor NSDA 2020+ has set up the baselines, and neither of them has established quantitative targets for most of these indicators. Cook Islands is yet to establish an explicit M&E system to monitor the progress of these indicators. Only a limited number of indicators are reported in the annual budget.

The Cook Islands has made its commitment to SDGs and the 2030 Agenda. However, it has only implicitly integrated SDG targets and indicators into EDS 2030 and NSDA 2020+. There is no explicit national system to monitor Cook Islands' progress towards achieving SDGs and no instruments or platforms, such as SDG dashboard, etc., to disseminate information on SDG achievements. There is limited data available on Cook Islands' SDG progress. The Cook Islands has not conducted a VNR report yet recover from the damages caused by the Global Pandemic.

At the sector level, some sectors have also set up performance measurement systems. For example, the education sector, in its Education Master Plan 2008-2023, defined a set of qualitative and quantitative targets to achieve and has a system to measure sectoral performance. The health sector has 129 indicators from the National Sustainable Development Plan, Sustainable Development Goals, the Healthy Islands Vision, and WHO Core Global Health Indicators. Some of these indicators are expected to be presented in the Annual Statistical Bulletin and are used to compile reports to the Office of the Public Service Commissioner, Office of the Prime Minister, the Minister of Health, key development partners, etc. However, the data for these 129 indicators are not available online.

The Cook Islands started to roll out a centralised Financial Management Information System (FMIS) in 2016/17 to capture information on the allocation and usage of resources, requiring all government payments and receipts to go through a single Treasury account. However, the

FMIS is only partially rolled out (approximately 20% of entities) until now[66]. Consequently, comprehensive system-generated data (e.g. arrears) and analysis are unavailable. For financial data generated, there are data integrity issues, with large unreconciled balances in most active bank accounts and suspense accounts balances not being cleared by year-end.

The Cook Islands' budget has incorporated medium-term perspectives with budget forecasts for the forthcoming four years at national and sectoral levels. However, it does not systematically track or present information on actual budget allocation and service delivery and has no performance evaluation for service delivery on an ongoing basis[67]. Furthermore, the Cook Islands does not have an explicit SDG budgeting mechanism. Consequently, it is difficult to assess the allocation of the budget to SDGs and its contribution to SDG progress, especially for cross-cutting thematic areas such as gender equality or climate change.

The timing of the in-year budget and financial reports tends to be late, which may hamper the effectiveness of the parliament's scrutiny of budget execution. For example, the in-year budget reports, including quarterly reports, were only available three to four months after the period ended. Financial reports were late and submitted for audit more than 12 months after the financial year.

While DCD within MFEM coordinates and manages all donor resources in the Cook Islands by integrating official development cooperation into the national budget, the implementing agencies, including government agencies and development partners, have a 'lead' responsibility for the daily implementation of development projects relating to their mandates as well as the responsibility of monitoring and evaluating of program or project progress and performance. As a result, DCD may not have a complete picture of the progress and impacts of incumbent projects and may be unable to identify the constraints to project implementation. It is suggested that Government consider a full review of its ODA programmes to determine the bottlenecks in delivery.

The monitoring of private sector activities is weak and needs to be improved. For example, the Cook Islands has not conducted a comprehensive business survey yet. There are no up-to-date estimations on business activities, such as the number of private businesses, their contribution to the economy, etc.

External scrutiny and audit are weak in the Cook Islands. The PEFA 2021 found that the Audit Office does not submit audited reports to the Parliament, and the Parliament does not scrutinize the Audit report.

3.3 Governance and coordination

Achieving Cook Islands' NSDA 2020+, EDS 2030, the SDG 2030 Agenda, and NSDP require substantial investments from the public sector, private sector, and development partners. One of the key objectives of the INFF is to help countries raise resources by Mobilising the available financial flows, generating more of them, and maximising the contributions of these financial flows to achieving policy objectives requires an integrated approach to financing. This entails a policy framework, partnerships, and collaboration that promote contributions from different types of financing according to their specific characteristics.

[66] Cook Islands PEFA 2021
[67] Cook Islands PEFA 2021

As sustainable development principles have long underpinned Cook Islands' development strategies and SDGs have been inexplicitly integrated into national development strategies, Government has a critical role in instigating an integrated approach to financing Cook Islands' national development and its efforts to achieve SDGs. The way it invests its resources, the partnerships and collaboration it builds across sectors, and the policy environment it develops have a powerful influence on how other actors operate and invest their resources.

At the foundation of the government's approach to financing for Cook Islands' national development as well as SDG achievement is the planning process and the policies that govern different types of financing. This includes but exceeds the budget, incorporating policies towards the private sector, development partners, and other actors.

This section of the DFA looks at the systems that are in place to align the planning and budgeting processes and coordinate across policies toward other types of financing.

3.3.1 Institutional frameworks and leadership: integrated planning and budgeting

The Cook Islands' government implements its fiscal policies through the Ministry of Finance and Economic Management (MFEM), which is responsible for a broad range of economic and fiscal duties and administers a range of legislation. The Ministry of Finance and Economic Management (MFEM) Act and related regulations provide the legislative framework for the budget process.

The budget is shaped by national development strategy (such as NSDA 2020+, EDS 2030, NSDP), the MTFF, and NIIP. While the NSDA 2020+, EDS 2030, and NSDP determine the national development targets and priorities, the MTFF determines the level of revenue available and baseline budget resource allocation in the medium term (four financial years), and NIIP determines the financing requirements for priority infrastructure projects in the long term (10 years). Sector plans, such as Education Master Plan 2008-2023 and National Health Strategic Plan 2017-2021, also play an important role in determining sectoral development priorities and funding requirements.

The budget process consists of four primary stages: budget preparation, budget approval, budget implementation, and budget oversight. This section will focus on the first two stages, budget preparation and budget approval. The two other stages, budget and programme execution and budget and programme oversight, are also important in that the budget and programme execution implement what the national budget intents to achieve. The budget oversight tracks the effectiveness and efficiency of the budget execution and provides feedback on budget implementation and budget development for the following fiscal years.

Budget preparation and formulation involve four steps, updating MTFS, developing draft MTEC, developing agency business plans, reviewing agency business plans and developing budget estimates. The first step is to update MTFS, which involves MFEM updating the Cook Islands' Medium-term Fiscal Strategy, developing government expenditure priorities, establishing the aggregate expenditure ceilings, and issuing budget circulars to the line ministries to inform them of the updated government priorities and fiscal targets and inviting them to submit their operating and capital expenditure requests through a Tarai Vaka Process (TVP). At this step, MFEM also presents the updated MTFS and budget policy statement to the Parliament through the release of HYEFU. The MTFS and budget policy statement set out the Cook Island Government's medium-term fiscal policy objectives, MTFS economic and fiscal forecasts, Medium-term national priorities, etc., for the next four fiscal years.

The second step is to develop MTEC. At this step, the budget team from MFEM conducts interviews with each government agency to enable them to raise funding concerns and strategic priorities for consideration through the draft Medium-term Expenditure Ceilings (MTEC's). The government agencies develop their sector-specific capital investment concept notes, Capital Investment Activity Planning Document. MFEM develops draft government agency MTECs for the Cabinet approval and circulates agency MTECs to the government agencies.

The third step is to develop agency-specific business plans. At this step, the government agencies develop draft agency business plans based on MTFS and draft MTEC, the OPSC reviews draft agency business plans, and the agencies come up with final Medium-term Business Plans submitted to MFEM. Sectoral budgeting is guided by the Financial Policies and Procedures Manual.

The fourth step is to review agency business plans and develop budget estimates. At this step, the Infrastructure Committee and Budget Support Group review agencies' Medium-term Business Plans and prioritize Capital and operating expenditures and come up with recommendations for the Cabinet to consider; MFEM develops the budget estimates. After being presented to and approved by the Cabinet, the budget estimates are ready to be tabled at the parliament.

At the budget approval stage, budget estimates, together with a Fiscal Strategy Report, are tabled at the parliament. The budget estimates are then reviewed by the PAC and debated by the Parliamentarians. Once Parliament agrees on a budget, it will pass a final Appropriation Act, typically in June or July. The Appropriation Act contains the approved appropriation of funds, broken down by Government Departments, for the financial year starting on July 1 of that year.

3.3.2 Development Partner Coordination

Development cooperation management functions and systems are well established in the Cook Islands. The Development Coordination Division (DCD) within the Ministry of Finance and Economic Development coordinates and manages all donor resources in the Cook Islands by integrating official development cooperation into the national budget. DCD also manages the annual donor roundtables to discuss development and development effectiveness issues with development partners. Development Coordination is also facilitated through developing NIIP, with contributions from all major development partners, such as New Zealand, Australia, Japan, ADB, the World Bank, and the EU.

The Cook Islands has achieved country ownership of development cooperation projects, with almost all development cooperation being adequately recorded in the government budget, nearly all development cooperation using national procedures for budget execution and financial reporting, and relying on the national procurement system.

DCD has an Aid Management Accounting Section to capture all development cooperation – including from South-South cooperation partners such as China – and publishes most of the project details online at the MFEM website and in MFEM's HYEFU.

3.3.3 Dialogue and Accountability

Strong mechanisms for dialogue and accountability, through transparent, fair, and integral public service delivery, will ensure that the private sector, development partners, NGOs, and CSOs have trust in the government's decisions and actions to mobilize their contributions toward national development goals and SDGs. Dialogue with the private sector is particularly important for understanding the challenges businesses face and prioritizing reforms to support more impactful private sector development.

In the Cook Islands, dialogues and accountability have been facilitated mainly through dialogue between government and the general public, between government and private sector participants, between government and development partners, and through the public's scrutiny of the government's decisions and actions.

Dialogue and accountability between the government and the general public have been facilitated through public consultation and disclosing relevant planning and fiscal information to the general public directly. One good example of Public-Private Dialogue is the broad public consultation in developing EDS. The public consultation takes various forms, including consulting with individual stakeholders from all walks of life, online survey, invitation of written submissions, and Economic Development Conference with more than 160 delegates representing businesses, communities, and government agencies. The public consultation aims to initiate discussions on the Economic Development Strategy and to gather further information on the challenges facing the economy. The Government also regularly disclose information to the public, such as the Citizens Budget Guide, Quarterly Government Financial Outputs, Half-Year Economic and Fiscal Update, etc.

Dialogue and accountability between the government and the general public have also been facilitated through the Parliament's approval of the government's development plans, annual budgets, policy initiatives, and scrutiny of the government's Half Year Economic and Fiscal Updates (HYEFU) and annual reports. In budgeting, the Cook Islands Government engages the parliament from the early stages of budget preparation and formulation through the Parliament's reviewing and scrutinizing of the Budget Policy Statement released through HYEFU. However, the Parliament focuses only ondetailedexpenditurevotes[68] inbudgetformulationandapproval,anditdoesnotscrutinizetheauditedannualreports[69].

The Cook Islands is considering updating the Parliament standing orders in relation to budget formulation and approval to require referral to the PAC after the first reading, which may enable the Parliament to focus not just on detailed expenditure votes but also on fiscal policies, medium-term fiscal forecasts, and aggregate expenditures. In addition, the Cook Islands could improve the effectiveness of the Parliament's scrutiny by enhancing the parliament's capacity to conduct budget analysis and scrutinise budget and budget execution reports.

The private sector is the engine of economic growth and job creation. Dialogue between the government and the private sector has been facilitated through the consultation of the Chamber of Commerce and private sector stakeholders in developing national development plans and policies. Cook Islands Business Trade Investment Board is a government- funded agency responsible for promoting trade, investment and business in the Cook Islands and advocating the development of enabling business environment in the Cook Islands.

[68] Cook Islands PEFA 2021
[69] Cook Islands PEFA 2021

The Cook Islands could strengthen PPD by establishing a formal public-private dialogue platform with a solid structure and representative participation. For example, to facilitate investment policy reform, the Cook Islands could establish a Public-Private Dialogue platform, such as an investment policy reform task force, comprising representatives from the public sector, private sector, and relevant stakeholders, scoping and proposing reform options, overseeing and championing the implementation of investment policy reform. Public-Private Partnership is another mechanism that can enhance PPD and facilitate private sector investment. The Government is in the process of developing a PPP policy to facilitate the implementation of PPPs.

Several issues have been identified in Cook Islands' transparency and accountability, including weak external scrutiny and audit, weak accounting and reporting, and weak parliamentary scrutiny of the budget. For example, PEFA[70] scored D+ for external audits and D for Legislative scrutiny of audit reports. Currently, the Audit Office does not submit audited annual reports to the Parliament for review, and the Parliament does not scrutinize audited annual reports. Furthermore, PEFA scored D+ for fiscal data integrity, D for In-year budget reports, and D+ for annual budget reports.

[70] Cook Islands PEFA 2021

4. Summary of Findings and Recommendations for the INFF Roadmap

The DFA is conducted to examine the current and future financial resources available to meet the Cook Islands' financial demand for its development and achieving its SDG goals, assess how public and private finance could contribute to the implementation of EDS 2030 and NSDA 2020+ and achieving national development goals and SDGs, and identify ways to strengthen the linkage between the aspirations of EDS 2030, NSDA, and SDGs with development finance and short and medium-term policymaking. The DFA also aims to identify ways to address these challenges across several aspects of government policy and operations about development financing.

The current and future development finance available to the Cook Islands originate broadly from four sources:

- Domestic - public: tax revenues and other public revenues;
- Domestic - private: gross domestic savings as well as the increased credit from the domestic financial market due to the deepening of the financial market;
- International - public: Official Development Assistance (ODA), Other Official Flows (OOF) and South-South Cooperation (SSC).
- International - private: foreign direct investment (FDI), funds from the Cook Island diaspora, philanthropic finance, and borrowing from international capital markets.

The mobilization of these financial resources is made possible through the public finance management system and the public policy-influenced financial system. Through public finance management, the government raises funds from domestic and foreign sources and allocates them for economically and socially productive investments. The financial system provides incentives to save and channel those savings to productive activities.

In achieving the visions and goals set out in EDS 2030 and NSDA 2020+, the Cook Islands faces the challenges of diversifying its economy, addressing capacity and business environment constraints to strong economic growth, long- term population and labor supply decline, adapting to climate changes, etc. All these are compounded by the challenges of recovering from the damage of the global pandemic. For the Cook Islands, the timing of its recovery from the Global Pandemic will impact the ability of the government to raise public finance, reduce public debt, and shift its funding from supporting the economy to funding new development infrastructure.

Addressing these challenges will require the strategic mobilization of resources and coordination of efforts across various public and private actors. Strengthening an integrated approach to raising and using resources can help the Cook Islands government develop and deliver a strategic, holistic approach toward financing for addressing these challenges.

The main recommendation from this DFA is to establish an Integrated National Financing Framework (INFF) that links aspirations of EDS 2030, NSDA 2020+, and SDGs to the government policies and operations that will mobilize the necessary financing. An INFF could facilitate the mobilisation of all available finance and the exploration of new and innovative finance in supporting the Cook Islands' efforts in achieving EDS 2030, NSDA 2020+, and SDGs. It could bring together actors from across government and partners and guide the strategic approach that can be taken to mobilize and effectively invest these public and private flows.

While elements of the INFF have already existed explicitly or implicitly in the Cook Islands, there is scope for the Cook Islands to strengthen all aspects of its INFF system. The remaining section will summarize the main findings and recommendations.

4.1 Establishing an overall Financing strategy

4.1.1 Aligning the budget with the national plan and SDGs

The Cook Islands have endorsed the UN proposed 2030 Agenda and SDGs, the principles of which have long been the underlying principles of Cook Islands' national development strategies. However, SDGs goals and targets have only been inexplicitly integrated into the national plans. The Cook Islands has not explicitly considered the affordability, cost and financial resources needed to achieve National development strategies and SDGs.

Cook Islands may consider:

- Integrating SDG targets and indicators explicitly into EDS 2030, NSDA 2020+, sectoral strategies and plans, and M&E frameworks.
- Estimating the finance requirement for implementing the national strategy and achieving development goals, which will be crucial in prioritizing resource allocations and meeting the Cook Islands' SDG commitment.

4.1.2 Establishing an overall financing strategy

The Cook Islands has a well-performed Medium Term Fiscal Framework, reflected by excellent scores on three PEFA pillars, B+ for PI-14 (Macroeconomic and Fiscal Reporting), A for PI-15 (Fiscal Strategy) and FPI-16 (Medium Term Perspective in Expenditure Budgeting). The MTFF is supplemented by a NIIP.

The Cook Islands could improve its MTEC by analyzing why forecasts deviate from previous years' forecasts and why actual revenues and expenditures deviate from forecasts. At the same time, the Cook Islands could improve the Medium- Tem Budget by presenting the actual revenues and expenditures for the budget year before the last budget year to evaluate agency revenue and expenditure outturns.

4.1.3 Financing policies for specific financial flows

Tax and Non-Tax revenue

The Cook Islands has a broad-based tax system, with tax revenue being equivalent to nearly 28% of GDP, which is on par with that in New Zealand and higher than the majority of the Pacific Small Island countries. Consequently, the Cook Islands may have little space to increase its overall tax level. The Cook Islands could increase tax revenue through better tax administration and enforcement of tax legislation without increasing the tax burden. The enactment of the International Companies (Removal of Tax Exemption) Amendment Act 2019 will also pose challenges to tax administration and tax compliance.

It is suggested that the Cook Islands develop various SOPs to strengthen tax administration. At the same time, the Cook Islands may conduct a Tax Administration Diagnostic Assessment as well, with the objectives to explore the relative strengths and weaknesses in tax administration systems, processes, and institutions and identify opportunities for improving the effectiveness and efficiency of tax administration.

Non-Tax revenue typically accounts for around 15% of government revenue income. However, the Cook Islands does not have an explicit and consistent policy on how best to mobilize non-tax revenue. A Sovereign Wealth Fund has been established to capture revenues expected in the future from seabed minerals harvesting. A similar instrument could be established for fishing fees, as both are revenues from exhaustible natural resources. The Cook Islands does not have a formal SOE dividend policy, and some SOEs have never paid dividends for the past ten years. A more systematic and transparent approach to dividends can be formalized in an SOE dividend policy.

Development Cooperation

The Cook Islands has achieved a high level of country leadership and development cooperation, with donors' objectives aligned with national development strategies. Nearly all development cooperation is recorded in the budget and uses national institutions and procedures for budget implementation and financial reporting. The Cook Islands has also improved the predictability of development cooperation.

Development cooperation in the Cook Islands still faces a few challenges, such as Capacity constraints and M&E of development cooperation execution. On the one hand, most international donors do not have offices in the Cook Islands, which may affect the effectiveness of development cooperation; on the other hand, domestic agencies are capacity constrained due to overburdened staff and high staff turnover. At the same time, the involvement of the private sector in development cooperation needs to be strengthened.

Development cooperation in the Cook Islands also faces M&E challenges. The implementing agencies are responsible for M&E. Consequently, DCD may not have a complete picture of the progress and impacts of incumbent projects and may be unable to identify the constraints to project implementation.

To improve the effectiveness of development cooperation, the government may consider:

- To develop SOPs to minimize the impacts of high staff turnover and to enhance government agency capacity development;
- To coordinate M&E activities among DCD, implementing agencies, and development partners.
- To conduct regular full reviews of ODA programmes to determine the bottlenecks in delivery.
- To strengthen the involvement of the private sector in development cooperation through public-private dialogue and public-private partnership.

External Debt

Debt financing will be critical for the Cook Islands in financing major projects, accelerating post-COVID recovery, and achieving sustained and inclusive growth. The Cook Islands has not had a Debt Policy yet. The government has used fiscal rules within MTFS in managing external debt.

The Cook Islands may consider developing a Medium-Term Debt Management Strategy to guide the government's debt management decisions and operations in the medium term. Effective debt management can help strike a balance between funding the government's needs with ensuring sustainable debt levels.

At the same time, the Cook Islands may consider building its capacity to strengthen its debt management, make more informed decisions about borrowing and related costs and risks, manage debts prudently, and be mindful of the potential rise in debt service responsibility.

The increased level of public debt presents challenges for financing public infrastructure. The Cook Islands may need to rigorously prioritise public expenditure and explore options and opportunities to undertake infrastructure development in partnership with the private sector.

Foreign Direct Investment

The Cook Islands has a low foreign direct investment. Several factors constrain FDI in the Cook Islands, including

- Lack of a clear and well-defined strategy to provide an overall direction, with specific targets and means to attract and facilitate investment, particularly foreign direct investment;
- Restrictive regulatory framework for Foreign Direct Investment;
- Lengthy foreign investment approval process;
- Difficulty in land access due to the customary land tenure system;
- Issues with employing migrant workers;
- The unfavourable investment climate in general, including weak physical and digital connectivity, weak financial infrastructure, labour shortage, vulnerability to environmental and economic shocks, a long distance from the global market, etc.

The Cook Islands may consider taking the following measures to improve its investment climate:

- To develop a clear and well-defined investment strategy to provide an overall direction for investment, with specific targets and means to attract and facilitate investment, particularly foreign direct investment. An effective investment strategy, in general, comprises four components, a National Policy Statement on Investment, a comprehensive Investment Strategy, an Investment Promotion Strategy, and Sectoral investment strategies and implementation plans;
- To review the current investment regulatory framework, identify barriers to investment, identify priority areas of reforms to facilitate and promote investment, and set out a plan for investment policy reforms with options and priorities and an action plan with a concrete timeline.
- To improve Cook Islands' investment climate, including physical and digital connectivity, land access, finance access, access to infrastructure, supply of skilled labour, fair competition, etc.

Remittance and Diaspora

The Cook Islands has a large diaspora population. Consequently, it may consider drawing on the financial resources, human capital, and business networks of diasporas and establishing a coordinated network of diasporas to facilitate Cook Islanders abroad to contribute to the economic development of the Cook Islands. Measures to encourage their participation could include:

- Offering financial products or incentives for diasporas to invest in their home country.
- Encouraging investment and utilising human capital and business network from the diasporas to develop the Cook Islands. To fully leverage this opportunity, the Cook Islands should implement reforms to encourage and facilitate private investments.

- Promoting the Cook Islands as a place for working holidays to the younger diaspora (e.g. after finishing high school or university summer holidays). This could be marketed as an opportunity to understand the Cook Islands' culture better, visit extended family, and earn money to pay for tertiary education. The idea of young people working and travelling overseas is well established in New Zealand and Australia. The younger workers will require little in terms of costly social services.

Public Private Partnership

Financing through PPPs has gradually become a more attractive option, as the Cook Islands has graduated into a developed country status and has increased its external debt level due to the impacts of the Global Pandemic. PPP can drive development that would otherwise be out of reach of the government's financial capacity and be utilized for SOE reforms and improving public service delivery.

The EDS 2030 has proposed to explore the potential for using Public Private Partnerships (PPPs) to deliver public services and/ or assets cost-effectively. In implementing PPP, the Cook Islands may face the following challenges:

- Lack of PPP related laws and regulatory frameworks.
- Stringent investment legislation may constrain the involvement of foreign investment in PPP;
- Inadequate private and public sector capacity in dealing with the complex Public-Private Partnership deals.

To benefit from implementing PPP, the Cook Islands may consider the follows:

- To develop and enforce a Public Private Partnership Policy and establish a related regulatory framework. The Government is finalising a draft PPP policy and reviewing necessary legislative adjustments to enable its implementation.
- To review and reform the current investment regulatory framework to facilitate the engagement of foreign investment in PPP;
- To develop or enhance the private and public sector capacity in dealing with complex Public-Private Partnership deals.
- To develop a list of candidate projects for PPP.

4.1.4 Improving the domestic financial system

The Cook Islands has one of the more developed financial systems among the Pacific Small Island countries. However, Cook Islands' financial sector is comparatively shallow. Domestic private sector credit as a percentage of GDP is significantly lower than the world average.

The structural issues limiting the development of the Cook Islands' domestic financial system and hence its ability to develop the economy include the high cost of domestic credit, issues with creditor protection, the difficulty of using land as collateral for borrowing, and weak domestic financial infrastructures, lack of competition, together with the small size of the economy.

The Cook Islands, in its EDS 2030, has proposed to establish a Banking Taskforce to set the future direction of the domestic banking sector in the Cook Islands. The task force will explore sustainable, structurally sound long-term mechanisms to bring down the cost of credit.

These mechanisms could comprise better integration with the New Zealand banking system, automatization of the current payment systems and improving the payment system efficiency, resolving competition issues within the banking sector and making it more competitive, introducing bankruptcy laws to facilitate financially troubled businesses to restructure their finances, and establishing concessional financing instruments for SMEs and start-ups, etc. Making the banking sector more competitive could be complemented by enhancing banking and financial services to SMEs and Startups, who may have limited knowledge and expertise with financing.

4.1.5 Improving business enabling environment and Promoting Private sector development

The Private Sector accounted for 69% of Cook Islands' Employment. The global pandemic and the border closure to international tourists have impacted the private sector the hardest, particularly the tourism sector.

The recovery and further development of the private sector have been constrained by uncertain economic prospects and an unfavourable business environment, including labour shortage, weak physical and digital infrastructure, difficulties in land access and high cost of accessing finance, the dominance of SOEs in key sectors, and high cost of doing business in general.

To promote the development of the private sector, the Cook Islands may consider conducting a comprehensive review of its current business environment, identifying factors constraining private sector development, identifying priority areas of reforms to facilitate and promote private sector investment, and setting out a plan for policy reforms and action plans with a concrete timeline. The EDS 2030 has proposed to establish an attractive business environment through policy reforms to attract foreign investment, maintain a competitive tax environment, reforms to develop supportive business regulations, facilitate access to finance, provide business information and support, etc.

The Cook Islands could consider developing an integrated program for private sector development, linking the establishment of a business enabling environment with SOE reform, improving labour supply, implementing PPI, promoting FDI, land tenure reform, and developing the domestic financial system.

Through SOE reform and establishing appropriate competition policy and regulatory frameworks, the Cook Islands could ensure fair competition and create a level playing ground for private businesses. Regulating state-owned monopolistic utility providers may enable private businesses to access utility services at a lower price and improved service quality. SOE reform may also release significant fiscal space to invest in other key areas. In addition to SOE reform, the Cook Islands could consider liberalizing sectors dominated by SOEs, making them accessible to private businesses, and making SOEs and private businesses subject to the same market regulations. The recent liberalisation of the telecommunication sector is a step forward in this direction.

Policies to improve labour supply, promote investment, and promote the development of the domestic financial system will enable private businesses to access the necessary inputs with ease and facilitates the private sector development.

The Cook Islands may consider analysing Cook Islands' existing, emerging, and potential competitive advantages in the regional and world markets, identifying some "niche" sectors that could build on Cook Islands' existing and emerging strengths and have potential competitive advantages in the regional and international markets, and promoting private sector-led economic diversification while maintaining and enhancing its current competitive advantages. Some potential niche sectors may include long-term tourism, virtual tourism or cultural exhibition.

4.1.6 Reforming the current Land Tenure system and facilitating land access

A recurring theme in this DFA is land tenure, and in particular, issues around access to land and limitations on using it as collateral for loans. In many cases, these issues are interwoven and compounded to reduce the financing flows for development. For example, restrictions on overseas investors buying land reduce FDI, which can stimulate development and growth. At the same time, these restrictions make the land sold below its underlying economic value, which reduces the value of the land as collateral and hence limits domestically funded development.

The Cook Islands may consider reviewing the current land tenure system and exploring new and innovative land tenure systems to ensure equitable and efficient access to land as well as productive use of land. One option is to delineate land ownership and the rights to land use and promote the establishment of various types of land trusts, which pool lands or land shares together and manage lands on behalf of landowners.

Another option is to set up a publicly accessible "land bank", with clearly delineated ownership and valuation on land and real estate, available for investment projects in the forms of lease, rental or equity purposes; develop a master plan for the use of these lands, develop appropriate mechanisms for land allocation to ensure efficient land use, and develop related infrastructure facilities for these lands.

Improving the land tenure system will be important in facilitating the more efficient use of this scarce resource in the Cook Islands.

4.1.7 Improving Labour supply

While not a financial flow, labour shortages are potential constraints on the Cook Islands' financial flows. The Cook Islands' EDS 2030 seeks to increase labour force participation rates and encourage the overseas Cook Islands to return home. However, to achieve the labour force required when the economy recovers from COVID-19, the government may need to consider broader options. This could include encouraging overseas Cook Islanders to have working holidays in the Cook Islands and making greater use of short-term workers from other Pacific Island nations.

To meet long-term labour needs, the Cook Islands may consider:

- Implementing policies to increase labour force participation rates, particularly female labour force participation rates. EDS 2030 include policies seeking to address this, such as regulating early child care, improving old-age care, and introducing after-school programs to allow both parents of young children to work.
- Promoting education and vocational training to upskill its labour force. EDS 2030 has proposed policies to address this, including establishing a domestic student loan scheme.

- Encouraging investment and utilisation of human capital and business network from the diasporas to develop the Cook Islands. To fully leverage this opportunity, the Cook Islands should implement reforms to encourage and facilitate private investments.
- Promoting the Cook Islands as a place for working holidays to the young people, including younger diaspora (e.g. after finishing high school or university summer holidays). This could be marketed as an opportunity to understand your culture better, visit extended family, and earn money to pay for your tertiary education. The idea of young people working and travelling overseas is well established in New Zealand and Australia. The younger workers will require little in terms of costly social services.
- Facilitating the employment of foreign workers to fill gaps in the labour force. This could be achieved with a combination of long-term immigration and shorter-term work visas.
- Formalising/expanding short-term work programs with other Pacific Island nations. Reasons for this include the higher wages in the Cook Islands would be attractive to many Pacific people, access to English- speaking workers, shared cultural values, and that these workers could deliver a Pacific experience for tourism.
- Conducting a labour market survey and population study to develop targeted solutions to this gap.

4.2 Strengthening the M&E system to monitor and provide evidence-based support for financing for development

The Cook Islands has established an M&E framework monitoring the implementation of EDS 2030 and NSDA 2020+. However, many aspects of the M&E framework are not fully in place yet and may affect its effectiveness.

For example, at the national level, both EDS 2030 and NSDA 2020+ have incorporated a set of indicators. However, only some baselines for the indicators have been established, with minimal quantitative targets for many of these indicators. For the NSDA 2020+ - this is because that concepts such as Turanga Memeitaki (wellbeing) and the measurement of such concepts require more qualitative analysis, and quantitative targets can be very hard to define in this sphere. At the sector level, some sectors have also set up an M&E system. However, these M&E systems are either not available online or do not have complete information. The Cook Islands started to roll out a centralised Financial Management Information System (FMIS). However, the FMIS is only partially rolled out. The monitoring of private sector activities is weak and needs to be improved. The Cook Islands does not have explicit SDG budgeting but incorporates its NSDA 2020+ in the budgetary processes. Consequently, it is challenging to assess budget alignment with SDGs per se.

Consequently, the Cook Islands may consider developing and implementing a comprehensive M&E system incorporating SDG targets and indicators complementary to its NSDA 2020+. This monitoring system will set the targets, establish baselines, and monitor progress on national development. It will be essential for the Cook Islands to ensure evidence- based policymaking and to ensure effective and efficient mobilization and utilization of various financial resources, and ensure development progress towards national development goals and the SDGs.

The Cook Islands may also continue its effort in:

- Improving the effective monitoring and evaluation of public finance activities. The measures could include continuing the effort to roll out its FMIS system to ensure to automatize public finance data generation and analysis and ensure financial data integrity; systematically tracking information on actual budget allocation and service delivery; tracking SDG budgeting and implementation; improving the audit and parliament scrutiny of government half-year and annual financial reports.
- Improving the monitoring and evaluation of private sector activities through conducting business surveys or generating the private sector data from business registration and taxation records.
- Improving the monitoring and evaluation of development cooperation through more coordinated M&E activities of the government, line ministries, and development partners.

The Cook Islands could consider

- **Conducting a data mapping exercise** after establishing the comprehensive M&E system to identify the currently available data sources and institutional settings and identify any data and institutional gaps for establishing baselines and monitoring national development.
- Then, **developing a strategy to address the gaps and to ensure the implementation of monitoring and evaluation at both the national level and the sector level.** Such a strategy should clearly define the roles and responsibilities of various agencies, ensure the harmonization of information systems and information-sharing across agencies, and avoid duplication and overlaps. It should also establish proper feedback and lesson-learning mechanism to ensure M&E results are fed back into the decision-making process and an information-disseminating mechanism to generate public awareness, public support and political will for national development and to build momentum for future development. The strategy should also address capacity-building gaps and issues.

4.3 Improving Governance and coordination

The Cook Islands has committed to the SDGs. It has integrated the principles of sustainable development into its national development strategies and plans, although SDG targets and indicators are only integrated into EDS 2030 and NSDA 2020+ inexplicitly. Achieving the Cook Islands' national development goals and the SDGs will require high-level political commitment, coherent strategic policy frameworks, effective and well-functioning institutional coordination mechanisms, and the active involvement and alignment of interests of a wide range of stakeholders.

4.3.1 Ensuring leadership and institutional coherence through integrated planning and budgeting process

The coherent strategic policy frameworks and effective and well-functioning institutional coordination mechanisms are achieved through a national planning and budgeting process, which links the aspiration of EDS 2030, NSDA 2020+, and SDGs with development finances.

The budget is shaped by national development strategy (such as NSDA 2020+, EDS 2030, NSDP, MTFF, and NIIP. While the NSDA 2020+, EDS 2030, and NSDP determine the national development targets and priorities, MTFF determines the level of revenue available and baseline budget resource allocation in the medium term (four financial years), and NIIP determines the financing requirements for priority infrastructure projects in the long term (10 years). Sector plans, such as Education Master Plan 2008-2023 and National Health Strategic Plan 2017-2021, also play an important role in determining sectoral development priorities and funding requirements.

Moving forward, the Cook Islands could improve the coherence through:

- Strengthening the M&E system and establishing an effective public sector performance management system would improve coherence between policy setting and policy implementation.
- Improving dialogue and accountability mechanism between the government with the private sector, the general public, and the parliament;
- Improving the capacity constraints faced by the governments, parliament, private sectors, and NGOs

4.3.2 Improving the effectiveness of Development Cooperation

The Cook Islands has achieved country ownership of development cooperation projects, with almost all development cooperation being adequately recorded in the government budget, nearly all development cooperation using national procedures for budget execution and financial reporting, and relying on the national procurement system.

The Cook Islands could enhance its development cooperation by:

- Better coordination between DCD, line ministries, and development partners to improve the predictability of development assistance;
- Improving M&E of development cooperation through joint M&E activities of DCD, line ministries, and development partners;
- Exploring new sources of development finance, such as climate finance, and developing candidate projects.

4.3.3 Building an enabling environment for accountability and dialogue

An enabling environment for accountability and dialogue is essential to build the trust necessary to mobilize non- governmental stakeholders for achieving national development goals and the SDGs. Private sector institutions and NGOs can play a crucial role and become important partners for the government, mobilizing additional finance and improving efficiency in the delivery of government policies and services. Encouraging further engagement of the private sector and NGOs may be helped by inviting their involvement more systematically in the project cycle and ensuring a legal framework is in place.

The Cook Islands has established a framework for dialogue and accountability through dialogue between government and the general public, between government and private sector participants, between government and development partners, and through the public's scrutiny of the government's decisions and actions. One advantage of the Cook Islands' dialogue and accountability is that the government involves the parliament at the very early stage of the budget process so that the parliament can provide formal high-level strategic guidance on budgeting at the start of the budget process.

However, there are still a few issues with dialogue and accountability, including weak external scrutiny and audit, weak accounting and reporting, and weak parliamentary scrutiny of the budget. For example, however, the Parliament focuses only on detailed expenditure votes in budget formulation and approval, and it does not scrutinize the audited annual reports.

To strengthen accountability mechanisms that support transparent and open dialogue between government, the private sector and NGOs, the Cook Islands may consider the following measures:

- Updating the Parliament standing orders on budget formulation and approval to require referral to the PAC after the first reading, may enable the Parliament to focus not just on detailed expenditure votes but also on fiscal policies, medium-term fiscal forecasts, and aggregate expenditures.
- **Improving the effectiveness of the Parliament's scrutiny** by enhancing the parliament's capacity to conduct budget analysis and scrutinise budget and budget execution reports.
- **Establishing an effective review and independent audit mechanism.** The capacity of the Cook Island Audit Office needs to be strengthened, and its independent review function needs to be enhanced to ensure that audited reports are independent and accessible to interested stakeholders and the general public in time.
- **Establishing robust and efficient monitoring, evaluation and learning system** to monitor the allocation, disbursement and movement of various financial flows and the progress of the programmes funded by these financial flows, to evaluate the outcome and impacts of programmes funded by these financial flows, and to provide evidence-based policy advice for government policymaking.
- **Providing creditable, comprehensive and transparent information to civil society and the private sector.** Transparent and credible information dissemination can demonstrate the government's accountability in pursuing policy objectives, signal the government's intended policy action, and generate public awareness and understanding to encourage broader participation, enhancing government policy credibility, garnishing support for policy initiatives, and eventually enhancing the effectiveness of policy initiatives.
- **Setting up a formal mechanism to stimulate multi-stakeholder participation for policy implementation and multi-stakeholder policy dialogue** to identify barriers to and the catalysts for achieving development goals and multi-stakeholder involvement in resolving policy conflicts. For example, establishing a investment policy reform taskforce, involving stakeholders from both the public and private sectors, especially policy champions.

4.4 INFF Roadmap for key actions

This assessment has identified opportunities to improve the Cook Islands' INFF that govern the development finance available to the Cook Islands, the overarching financing framework, and the M&E framework. The Cook Islands' EDS 2030 and NSDA 2020+ have identified many of them. The main message from this assessment is to recommend their prioritization. The INFF Roadmap below, presented in Table 8, summarizes the main actions recommended.

Table 8. INFF Roadmap Recommendations

INFF Bloc	Recommendations	Key Actions
Financing strategy	Aligning the budget with the national plan and SDGs	• Integrate country selected SDG targets and indicators explicitly into EDS 2030, and potentially the NSDA 2020+, sectoral strategies and plans, and M&E frameworks • Estimate the finance requirement for implementing the national strategy and achieving development goals
	Establishing an overall financing strategy	• Improve MTEC by analyzing why forecasts deviate from previous years' forecasts and why actual revenues and expenditures deviate from forecasts • Improve the Medium-Tem Budget by presenting the actual revenues and expenditures for the budget year before the last budget year to evaluate agency revenue and expenditure outturns
	Improving Financing policies for specific financial flows	Tax and non-Tax Revenue policy • Develop various SOPs to strengthen tax administration • Conduct a Tax Administration Diagnostic Assessment as well, with the objectives to explore the relative strengths and weaknesses in tax administration systems, processes, and institutions and identify opportunities for improving the effectiveness and efficiency of tax administration • Establish consistent non-tax revenue policy and procedures
		Development Cooperation • Develop SOPs to minimize the impacts of high staff turnover and to enhance government agency capacity development; • Coordinate M&E activities among DCD, implementing agencies, and development partners • Conduct regular full reviews of ODA programmes to determine the bottlenecks in delivery • Strengthen the involvement of the private sector in development cooperation through public-private dialogue and public-private partnership
		External Debt • Develop a Medium-Term Debt Management Strategy to guide the government's debt management decisions and operations in the medium term • Build its capacity to strengthen its debt management, make more informed decisions about borrowing and related costs and risks, manage debts prudently, and be mindful of the potential rise in debt service responsibility • Prioritise public expenditure and explore options and opportunities to undertake infrastructure development in partnership with the private sector
		Foreign Direct Investment • Develop a clear and well-defined investment strategy, including a National Policy Statement on Investment, a comprehensive Investment Strategy, an Investment Promotion Strategy, and Sectoral investment strategies and implementation plans, to provide an overall direction for investment, with specific targets and means to attract and facilitate investment, particularly foreign direct investment • Review the current investment regulatory framework, identify barriers to investment, identify priority areas of reforms to facilitate and promote investment, and set out a plan for investment policy reforms with options and priorities and an action plan with a concrete timeline

INFF Bloc	Recommendations	Key Actions
		• Improve the Cook Islands' investment climate, including physical and digital connectivity, land access, finance access, access to infrastructure, supply of skilled labour, fair competition, etc.
		Remittance and Diaspora • Offer financial products or incentives for diasporas to invest in their home country • Encourage investment and utilising human capital and business network from the diasporas to develop the Cook Islands • Promote the Cook Islands as a place for working holidays to the younger diaspora (e.g. after finishing high school or university summer holidays)
		Public Private Partnership • Develop and enforce a Public Private Partnership Policy and establish a related regulatory framework. The Government is finalising a draft PPP policy and reviewing necessary legislative adjustments to enable its implementation • Review and reform the current investment regulatory framework to facilitate the engagement of foreign investment in PPP; • Develop or enhance the private and public sector capacity in dealing with complex Public-Private Partnership deals • Develop a list of candidate projects for PPP
	Improving the domestic financial system	• Review the current situation of the financial sector • Explore sustainable, structurally sound long-term mechanisms to bring down the cost of credit, including o Better integration with the New Zealand banking system, o Atomization of the current payment systems and improving the payment system efficiency, o Resolving competition issues within the banking sector and making it more competitive, o Introducing bankruptcy laws to facilitate financially troubled businesses to restructure their finances, o Establishing concessional financing instruments for SMEs and start-ups, etc. o Reforming land tenure system; o Explore opportunities for using other types of assets as collaterals
	Improving business enabling environment and Promoting Private sector development	• Conduct a comprehensive review of its current business environment, identifying factors constraining private sector development, identifying priority areas of reforms to facilitate and promote private sector investment, and setting out a plan for policy reforms and action plans with a concrete timeline • Develop an integrated program for private sector development, linking the establishment of a business enabling environment with SOE reform, improving labour supply, implementing PPI, promoting FDI, land tenure reform, and developing the domestic financial system • Continue SOE reforms and establish appropriate competition policy and regulatory frameworks, to ensure fair competition and create a level playing ground for private businesses • Liberalize sectors dominated by SOEs, making them accessible to private businesses, and making SOEs and private businesses subject to the same market regulations

INFF Bloc	Recommendations	Key Actions
	Reforming the current Land Tenure system and facilitating land access	• Review the current land tenure system and explore new and innovative land tenure systems to ensure equitable and efficient access to land as well as productive use of land o One option is to delineate land ownership and the rights to land use and promote the establishment of various types of land trusts, which pool lands or land shares together and manage lands on behalf of landowners o Another option is to set up a publicly accessible "land bank", with clearly delineated ownership and valuation on land and real estate, available for investment projects in the forms of a lease, rental or equity purposes; develop a master plan for the use of these lands; develop appropriate mechanisms for land allocation to ensure efficient land use, and develop related infrastructure facilities for these lands
	Improving Labour supply	• Implement policies to increase labour force participation rates, particularly female labour force participation rates; • Promote education and vocational training to upskill its labour force • Encourage investment and the utilisation of human capital and business network from the diasporas to develop the Cook Islands • Promote the Cook Islands as a place for working holidays to the young people, including younger • Facilitate the employment of foreign workers to fill gaps in the labour force • Formalise/expand short-term work programs with other Pacific Island nations • Conduct a labour market survey and population study to develop targeted solutions to this gap
M&E	Strengthening the M&E system to monitor and provide evidence-based support for financing for development	• Improve the effective monitoring and evaluation of public finance activities, including o Rolling out its FMIS, o Systematically tracking information on actual budget allocation and service delivery; o Tracking SDG budgeting and implementation; o Improving the audit and parliament scrutiny of government half-year and annual financial reports • Improve the monitoring and evaluation of private sector activities through conducting business surveys or generating the private sector data from business registration and taxation records • Improve the monitoring and evaluation of development cooperation through more coordinated M&E activities of the government, line ministries, and development partners • **Conducte a data mapping exercise** to identify the currently available data sources and institutional settings and identify any data and institutional gaps for establishing baselines and monitoring national development • Then, **develope a strategy to address the gaps and to ensure the implementation of monitoring and evaluation at both the national level and the sector level**
Improving Governance and coordination	Ensuring leadership and institutional coherence through integrated planning and budgeting process	• Strengthen the M&E system and establishing an effective public sector performance management system would improve coherence between policy setting and policy implementation • Improve dialogue and accountability mechanism between the government with the private sector, the general public, and the parliament;

INFF Bloc	Recommendations	Key Actions
		• Improve the capacity constraints faced by the governments, parliament, private sectors, and NGOs
	Improving the effectiveness of Development Co-operation	• Better coordination between DCD, line ministries, and development partners to improve the predictability of development assistance; • Improve M&E of development cooperation through joint M&E activities of DCD, line ministries, and development partners; • Explore new sources of development finance, such as climate finance, and develop candidate projects
	Building an enabling environment for accountability and dialogue	• Update the Parliament standing orders in relation to budget formulation and approval to require referral to the PAC after the first reading. • **Improve the effectiveness of the Parliament's scrutiny** by enhancing the parliament's capacity to conduct budget analysis and scrutinise budget and budget execution reports • **Establish an effective review and independent audit mechanism and enhance** the independence and capacity of the Cook Island Audit Office • **Establish robust and efficient monitoring, evaluation and learning system** • **Provide creditable, comprehensive and transparent information to civil society and the private sector** • **Set up a formal mechanism to stimulate multi- stakeholder participation for policy implementation and multi-stakeholder policy dialogue**

Source: DFA team

The actions listed above may require systemic reforms and involve a wide variety of areas, from public administration to good governance and the strengthening of the management capacity of the central government and line ministries.

Implementing them all at once will be a big challenge. Therefore, the government should consider the prioritization of these policy areas and develop a realistic roadmap of interventions based on the outcomes of this assessment and other government priorities. Implementing the prioritized agenda will require leadership and coordination from the highest levels of the government.