Why does the Cook Islands Still Need Overseas Aid?

Geoff Bertram
Institute for Governance and Policy Studies
Victoria University of Wellington
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Outline

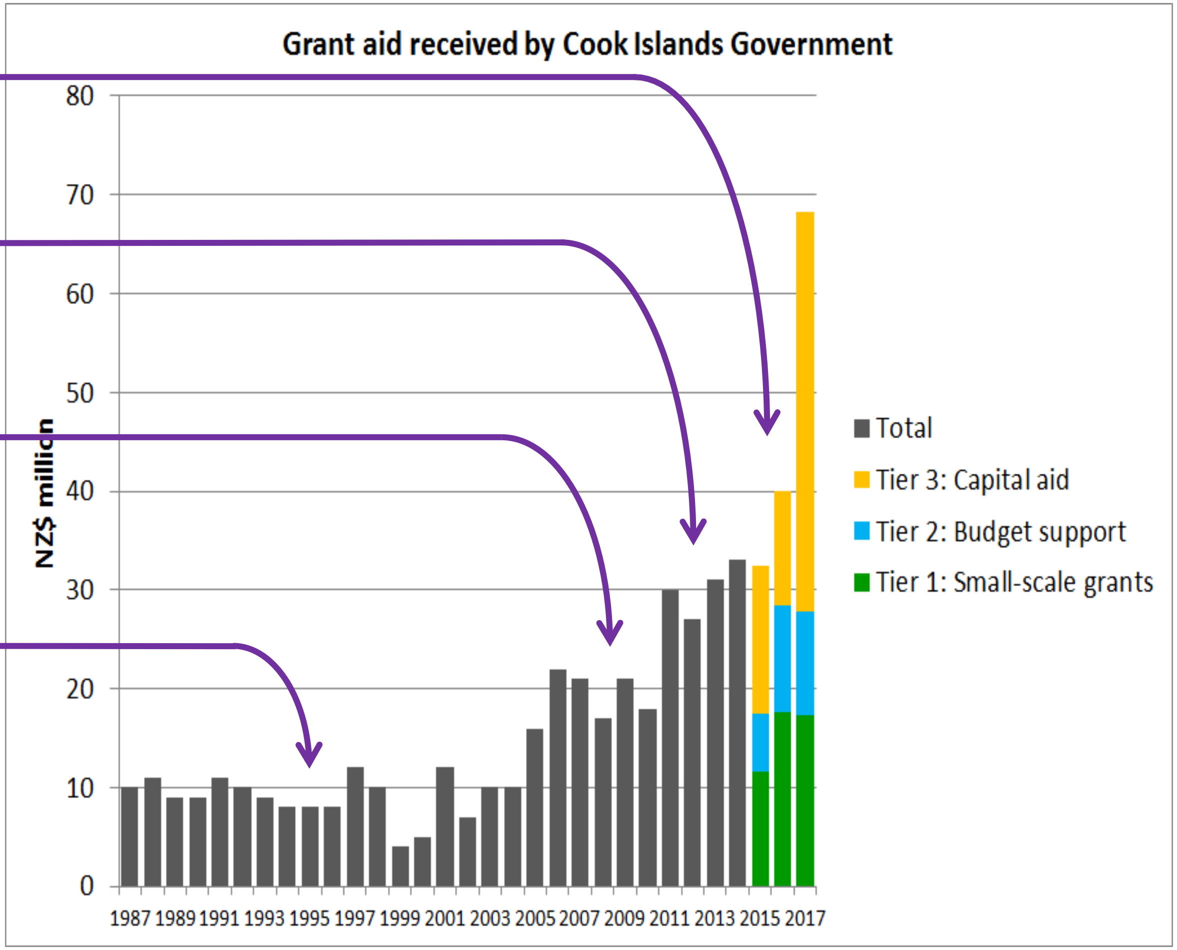
- The “Shock Doctrine” and the 1998 fiscal package
- Aid over the past 30 years
- A long-run look at aid in relation to:
  - Population
  - GDP (but not GNI!)
  - Balance of payments
  - Government finance
- The MIRAB => SITE transition
- Is the growing GDP
  - trickling down?
  - trickling across?
- Why can’t the government fund its own spending?
  - the 1995-96 crisis
  - the 1998 austerity package
  - the present-day effects of permanent (revenue) austerity
- Conclusion: Cook Islands in perspective: Greece, Ireland, Puerto Rico…

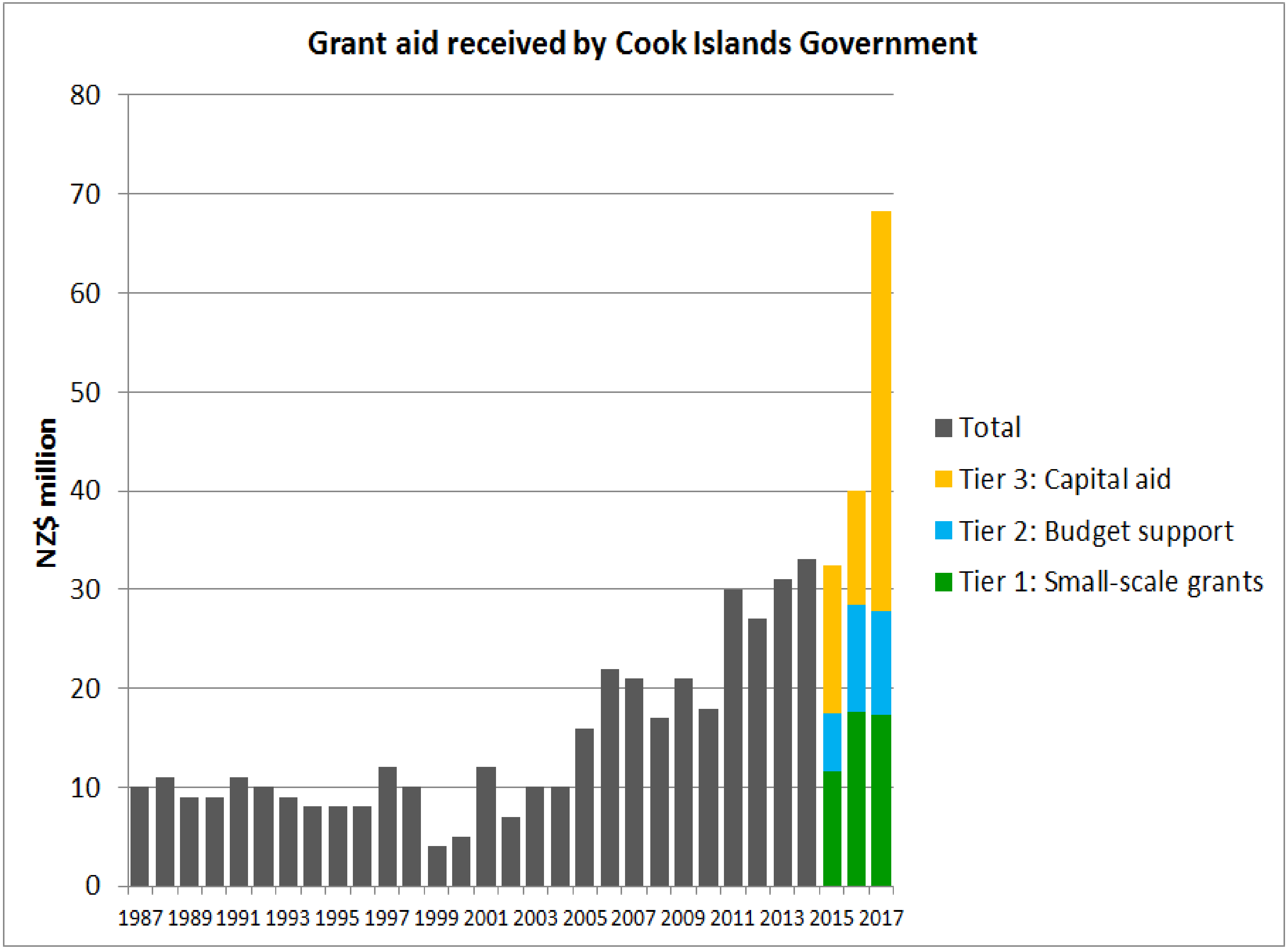
The "Shock Doctrine" (Klein 2007)

- "Using moments of collective trauma to engage in radical social and economic engineering" (Klein p.8)
- Various types of shocks – natural disasters, political crises, wars and revolutions, price shocks and 'debt shocks'.
- 1997-98 Asian financial crash (Klein p.10) typified the "era of structural adjustment" and the Washington Consensus
- Largely below the radar was the Cook Islands' 1995-96 debt shock and the subsequent 1996-98 structural adjustment programme agreed with New Zealand and the ADB

Cook Islands grant aid receipts over past three decades

- Then up over $40 million p.a.
- Then up to around $30 million p.a. until 2015
- Then up to around $20 million p.a. until 2010
- Around $10 million p.a. until 2005
- Driven by big capital works plus rising small-scale grants

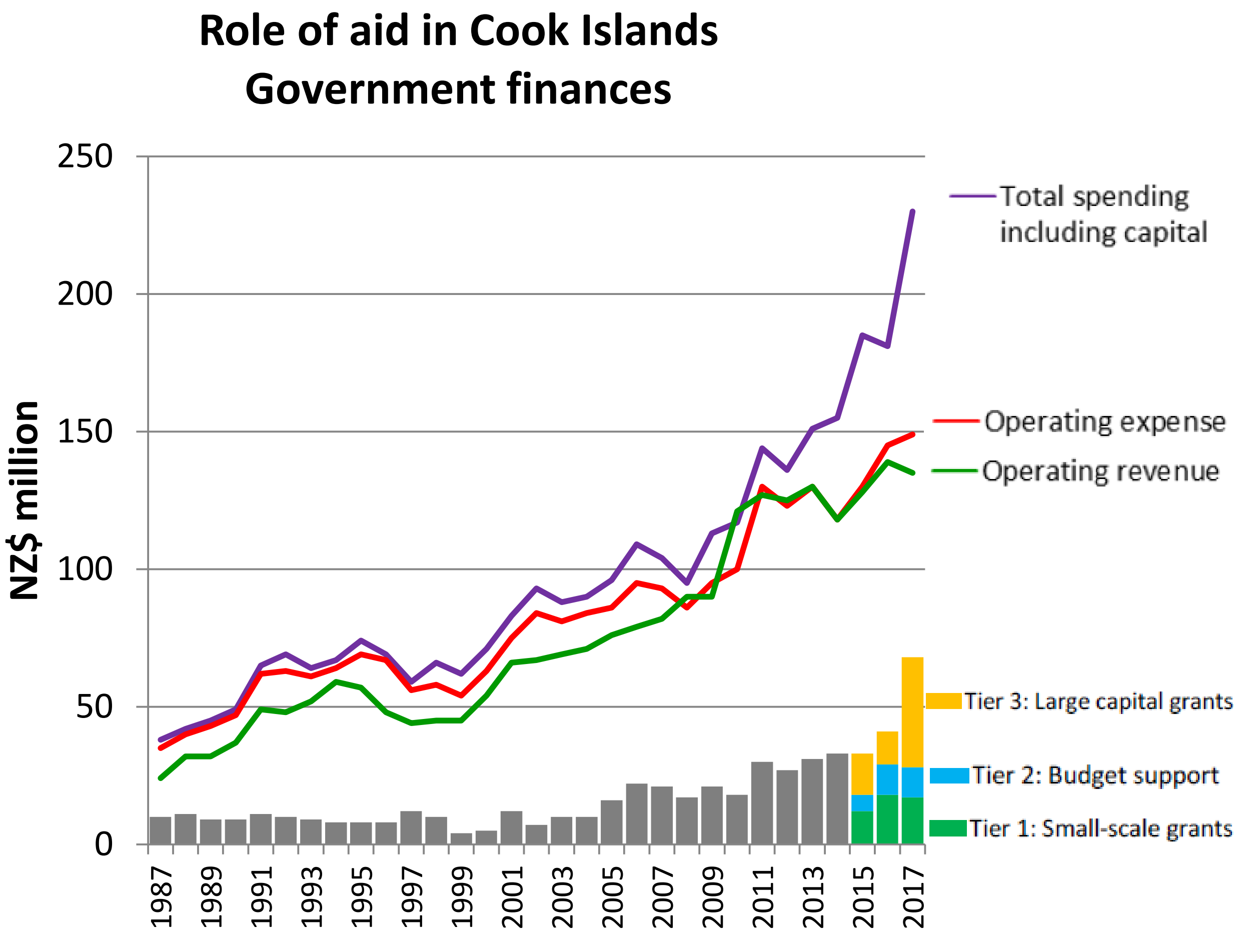




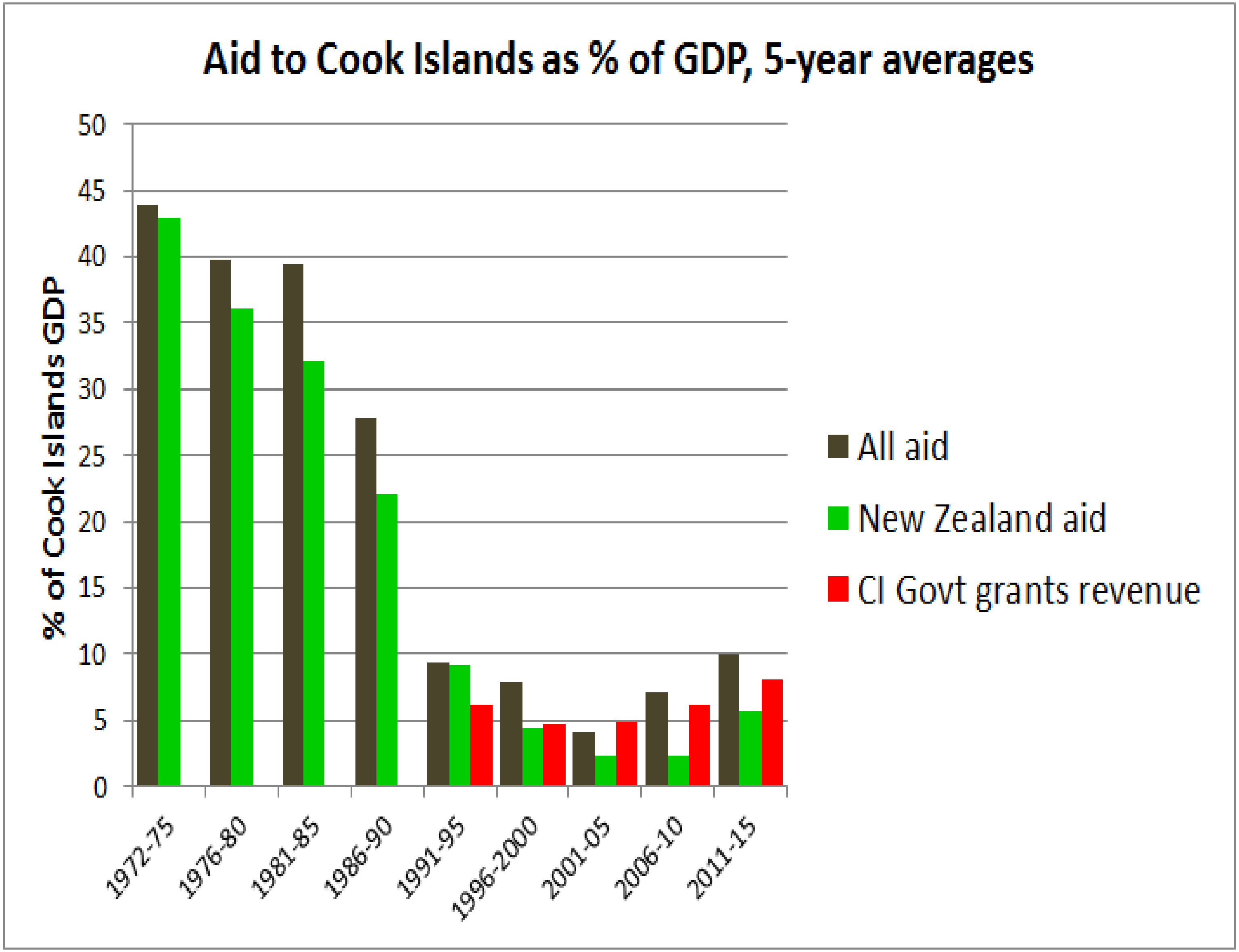
Grant aid received by Cook Islands Government
NZ$ million
80
70
60
50
40
30
20
10
0
1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011 2013 2015 2017
Total
Tier 3: Capital aid
Tier 2: Budget support
Tier 1: Small-scale grants

The rise in aid has coincided with a sharp increase in government spending (in nominal terms), especially on capital works

- It's the current big works programme that has produced the latest spending peak in spending
- Aid is playing a central role in funding these projects
- Mainly core infrastructure: water supply, sewage, port works, telecoms, schools, roading
- Urgent need flows from economic growth, esp. tourism
- Aid is <u>following</u> economic 'success', not leading it…
- Why then can't public-sector investments be funded onshore?



Now take a longer-term view: growing out of the need for aid 1972-2005?



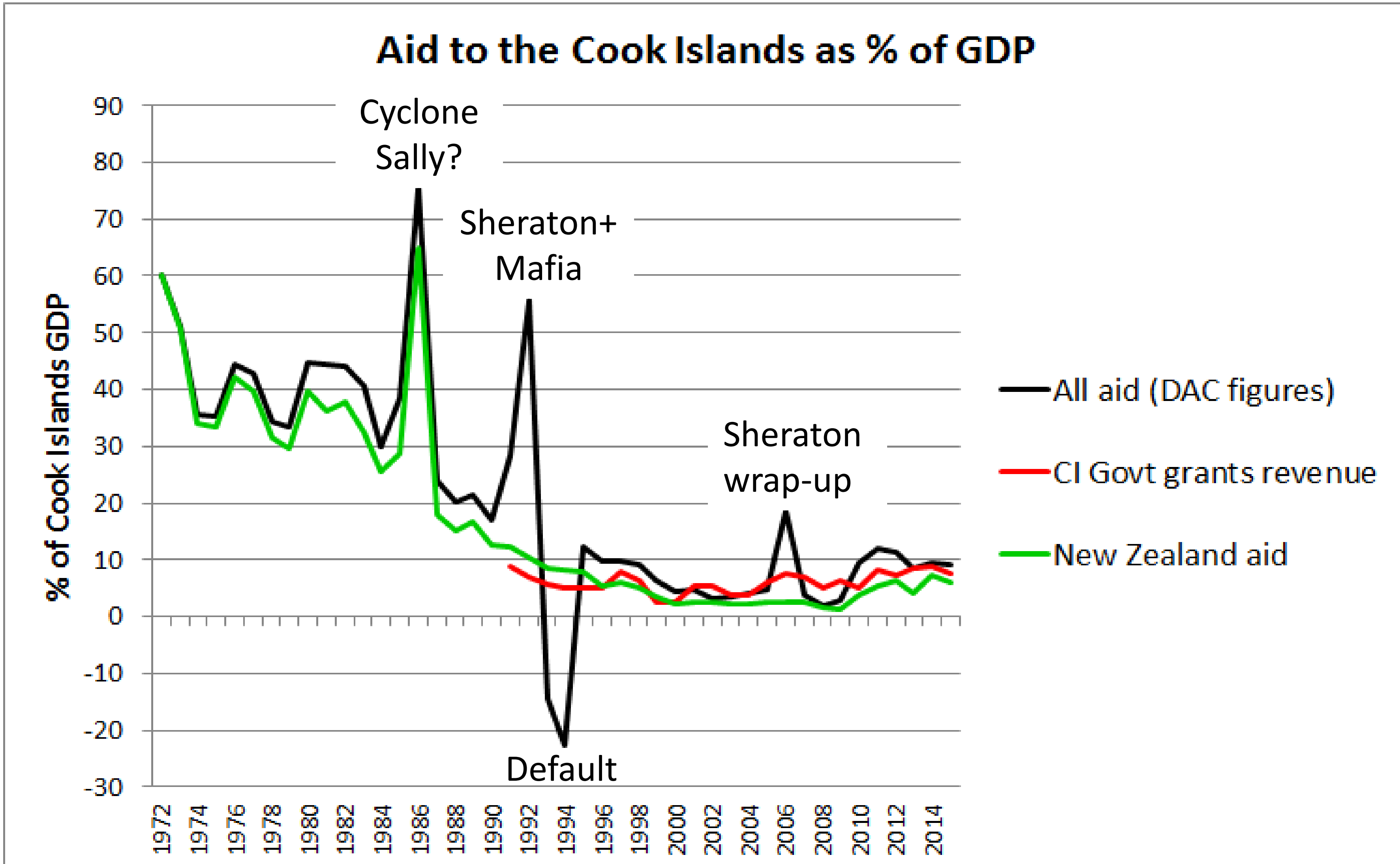
New Zealand aid no longer dominates the Cook Islands economy

- In 1965 transfers from New Zealand paid for over half of total imports and accounted for nearly two-third of GDP

- By 2000 aid from New Zealand was 2% of GDP and aid from all donors combined was just 3%.

- NZ aid bottomed at 1.3% of Cook Islands GDP in 2009.

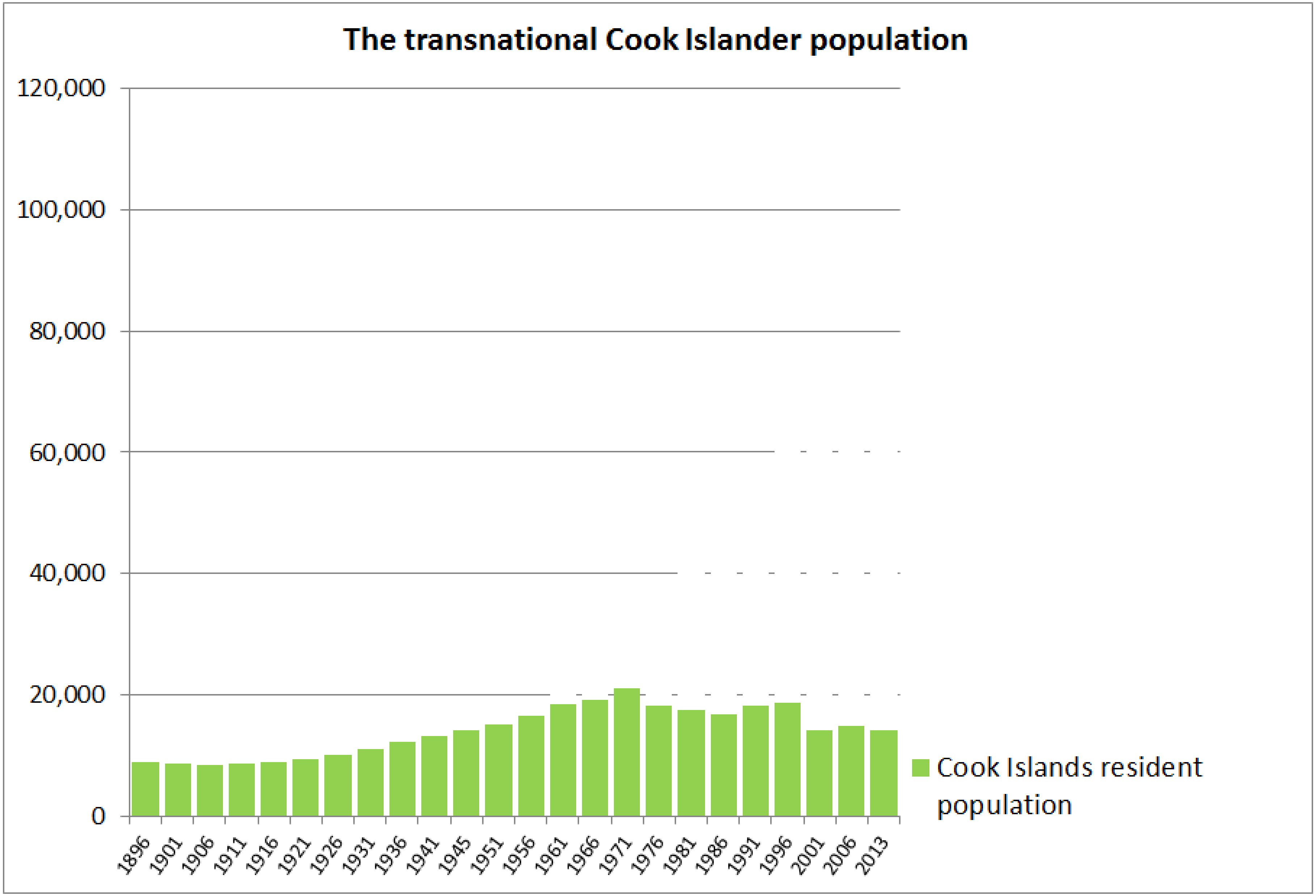
Detail (with bumps)



- So aid dependence has dropped sharply since the 1980s
- Since 2000, aid is less than 5% of GDP apart from the big projects
- Is that, or is it not, the sort of amount that the local economy could sustain out of its savings?
- Is aid performing some function beyond pure finance?

Long run perspectives on the Cook Islands economy:

1. POPULATION


The transnational Cook Islander population
120,000
100,000
80,000
60,000
40,000
20,000
0
1896
1901
1906
1911
1916
1921
1926
1931
1936
1941
1945
1951
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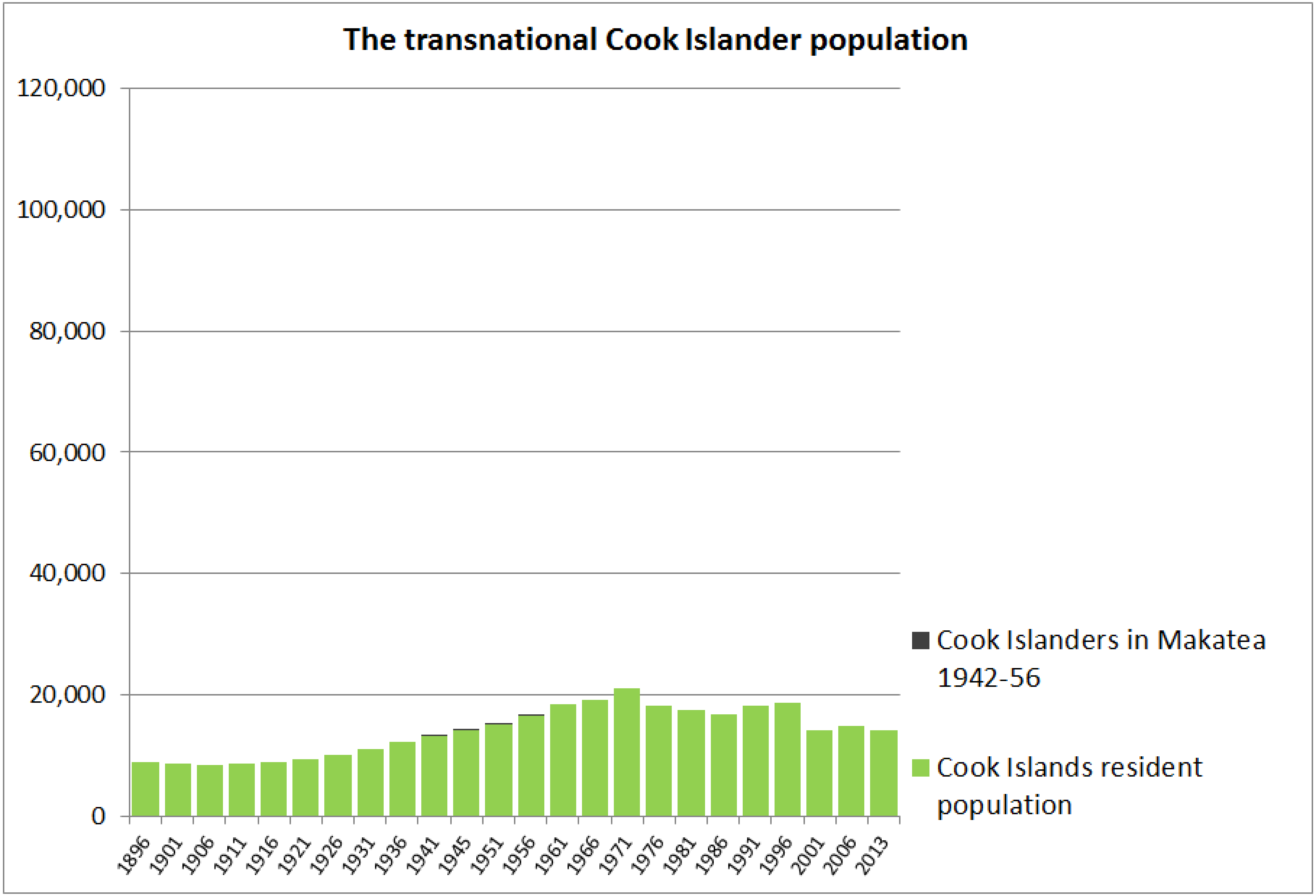
1966
1971
1976
1981
1986
1991
1996
2001
2006
2013
Cook Islands resident population



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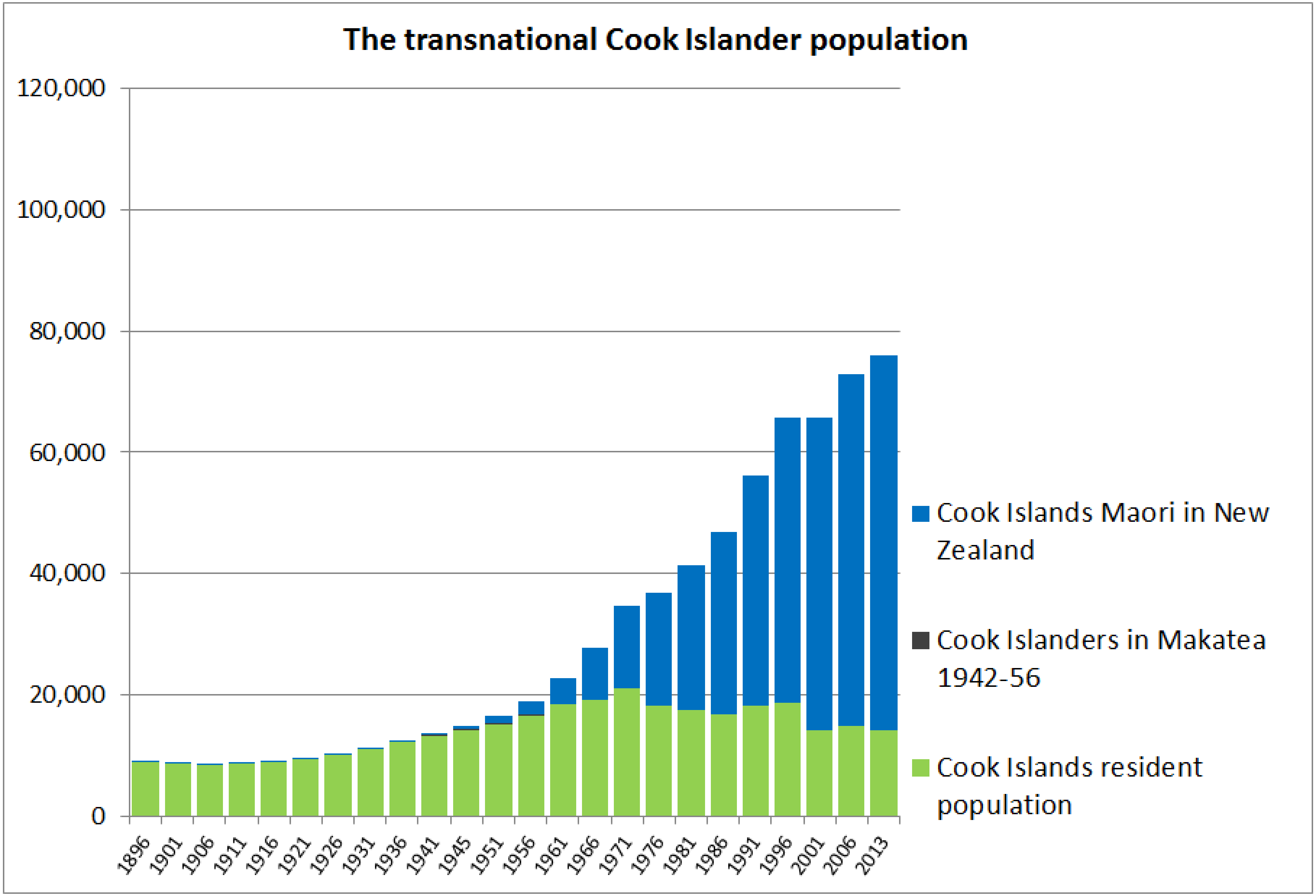
2013
Cook Islanders in Makatea 1942-56
Cook Islands resident population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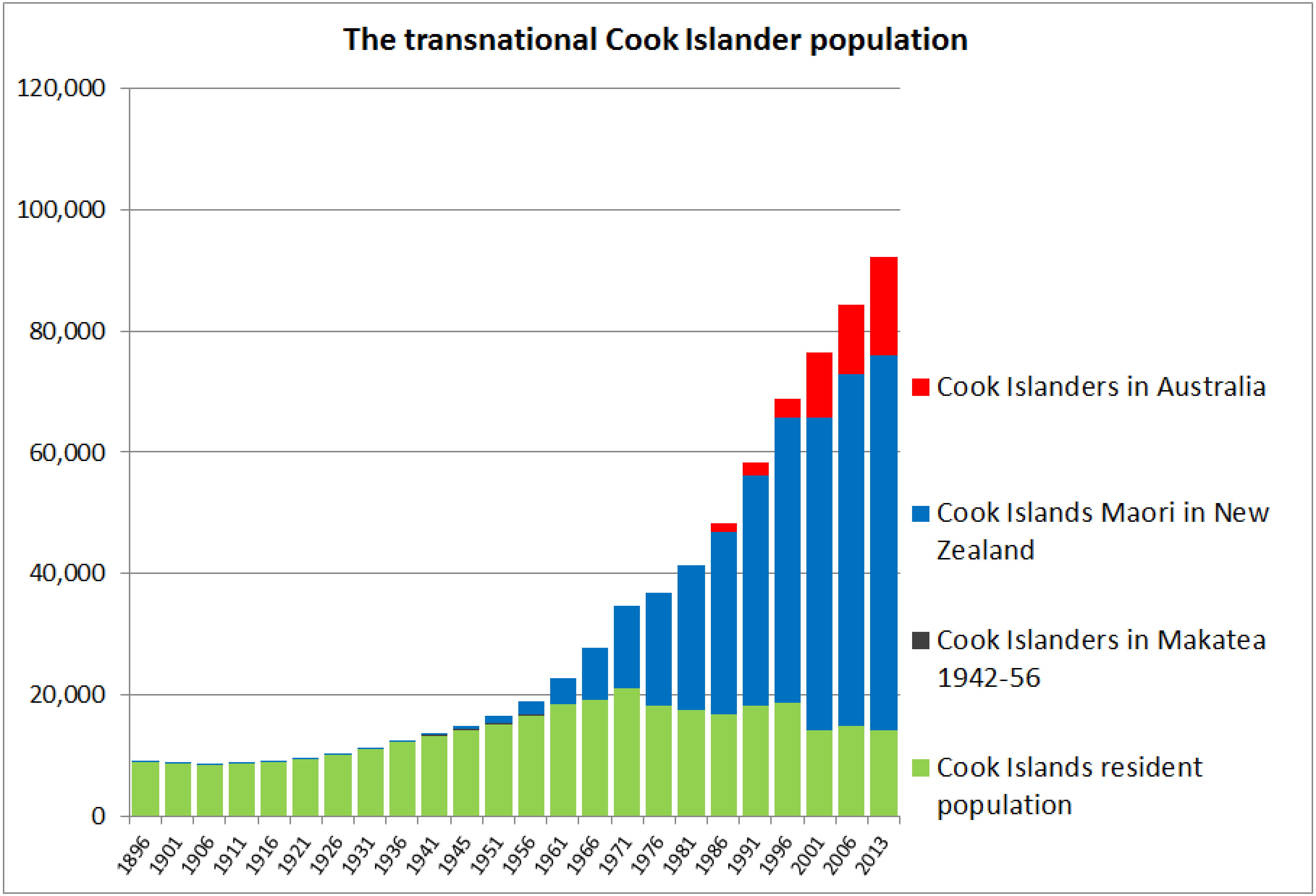
Cook Islands Maori in New Zealand
Cook Islanders in Makatea 1942-56
Cook Islands resident population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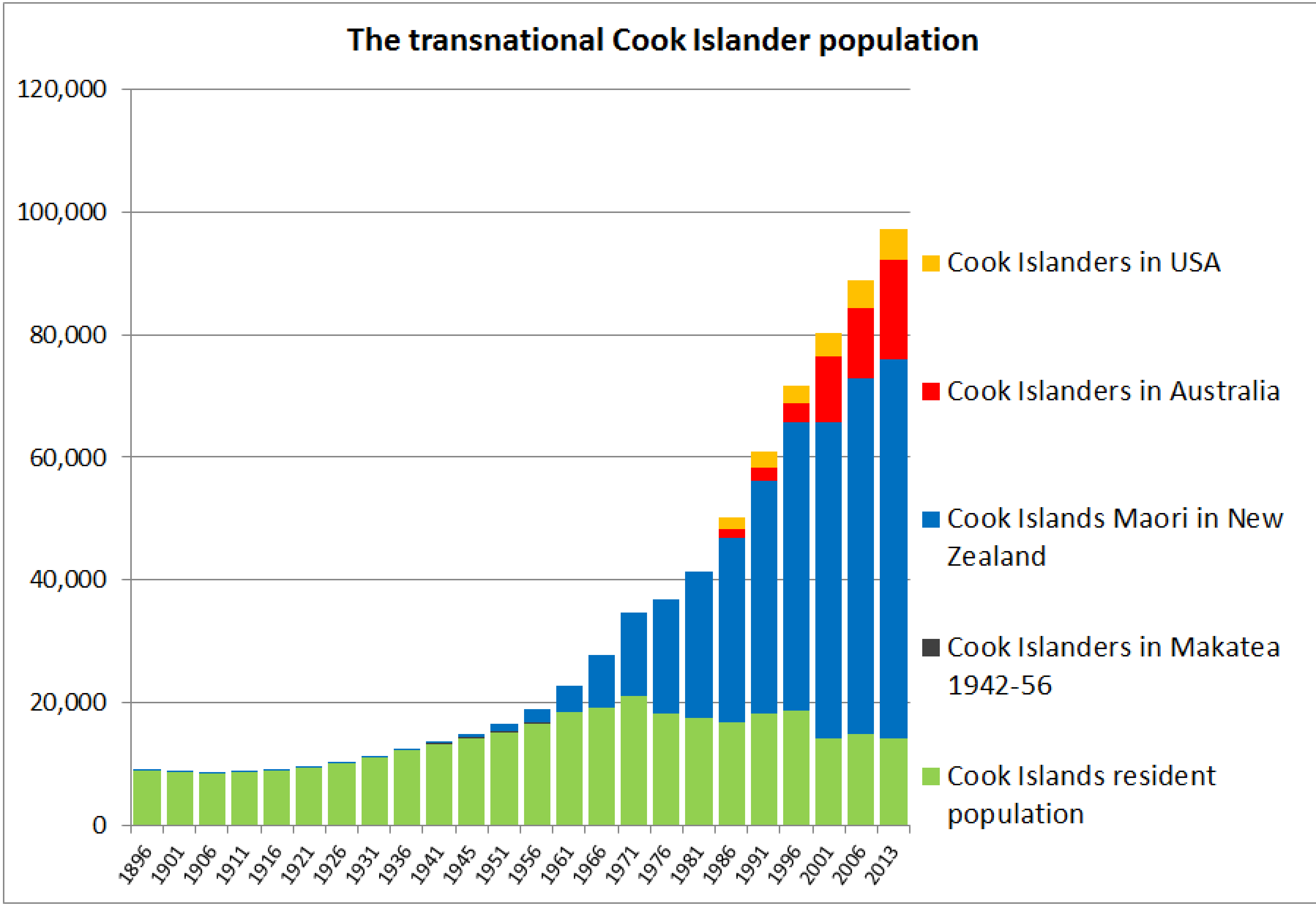
2001
2006
2013
Cook Islanders in Australia
Cook Islands Maori in New Zealand
Cook Islanders in Makatea 1942-56
Cook Islands resident population



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2013
Cook Islanders in USA
Cook Islanders in Australia
Cook Islands Maori in New Zealand
Cook Islanders in Makatea 1942-56
Cook Islands resident population

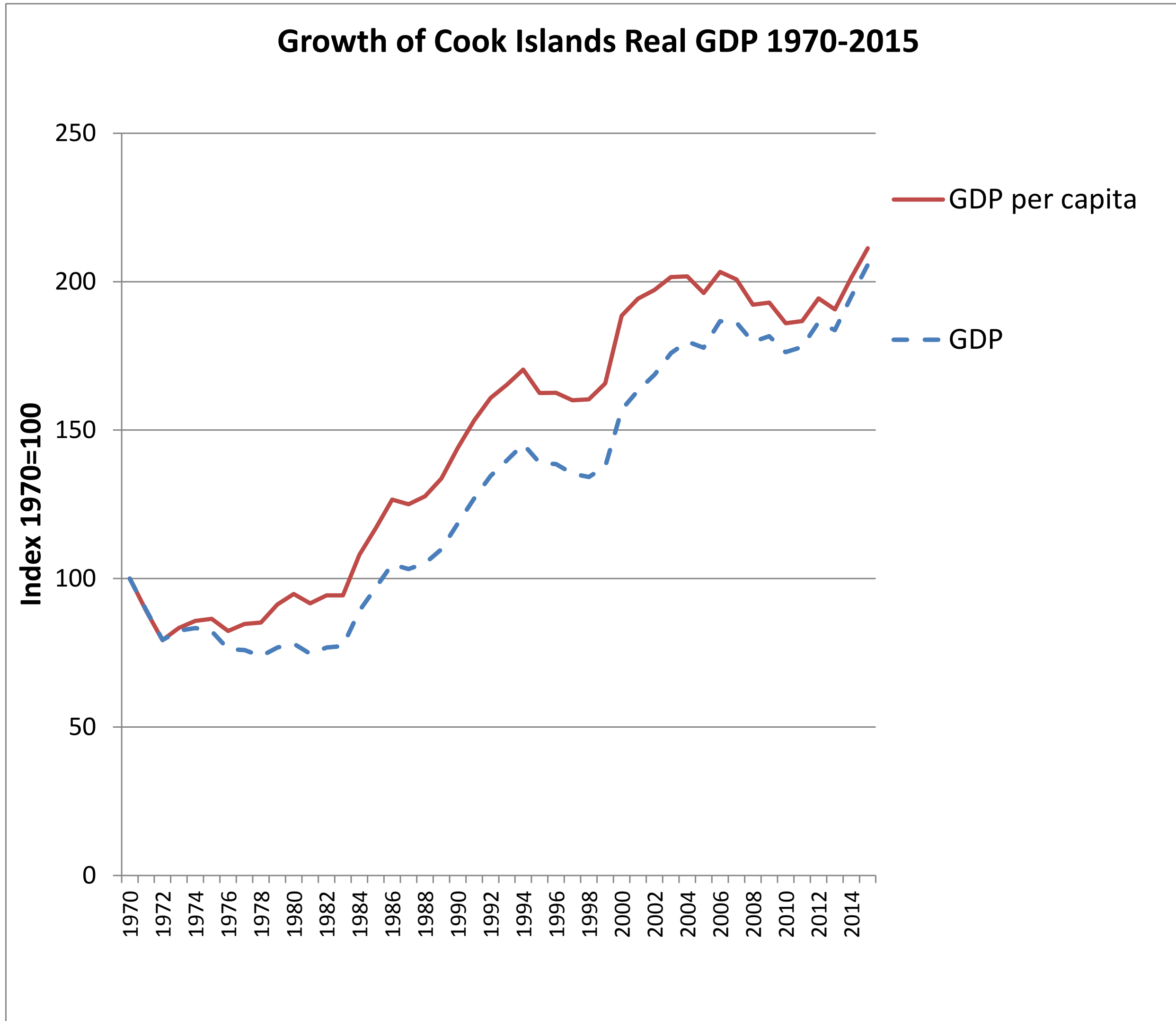
Aid as a check on depopulation?

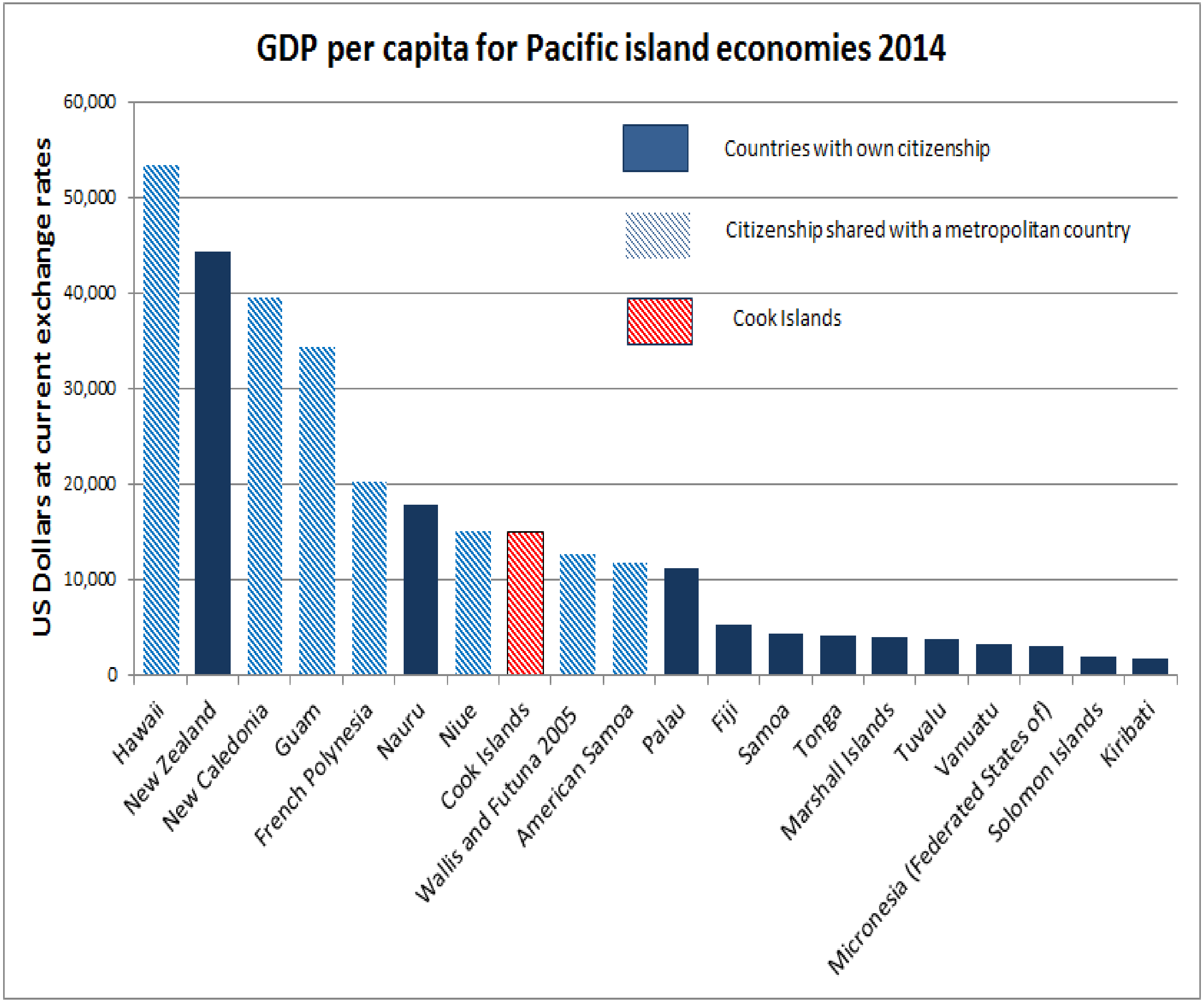
- Probably yes, by sustaining living standards in the islands
- Especially Tier 1 (small-scale grants to front-line agencies)
- There is a large ‘reserve army of labour’ offshore
  - Can be recruited whenever returnees can secure income+lifestyle packages that match opportunities in NZ and Australia
- The migration safety valve has kept open unemployment down

Long run perspectives on the Cook Islands economy:

2. GDP

- 1971-2000 real GDP doubled in both absolute and per capita terms: 3% annual growth
- But a sharp austerity-driven recession in the mid-late 1990s
- Slower growth since 2003 exacerbated by the GFC
- Now looking stronger again

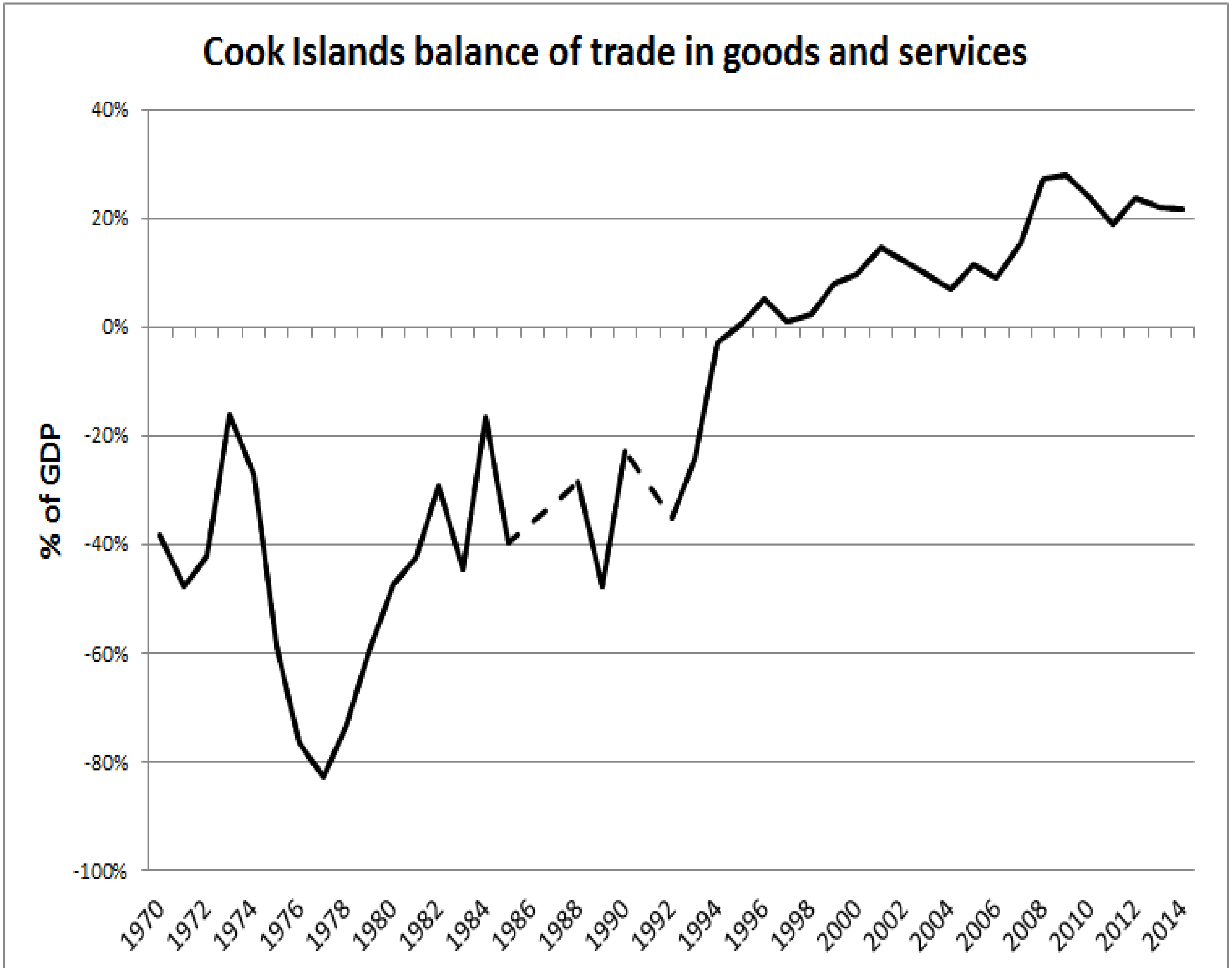



GDP per capita for Pacific island economies 2014
US Dollars at current exchange rates
60,000
50,000
40,000
30,000
20,000
10,000
0
Countries with own citizenship
Citizenship shared with a metropolitan country
Cook Islands
Hawaii
New Zealand
New Caledonia
Guam
French Polynesia
Nauru
Niue
Cook Islands
Wallis and Futuna 2005
American Samoa
Palau
Fiji
Samoa
Tonga
Marshall Islands
Tuvalu
Vanuatu
Micronesia (Federated States of)
Solomon Islands
Kiribati

Long run perspectives on the Cook Islands economy:

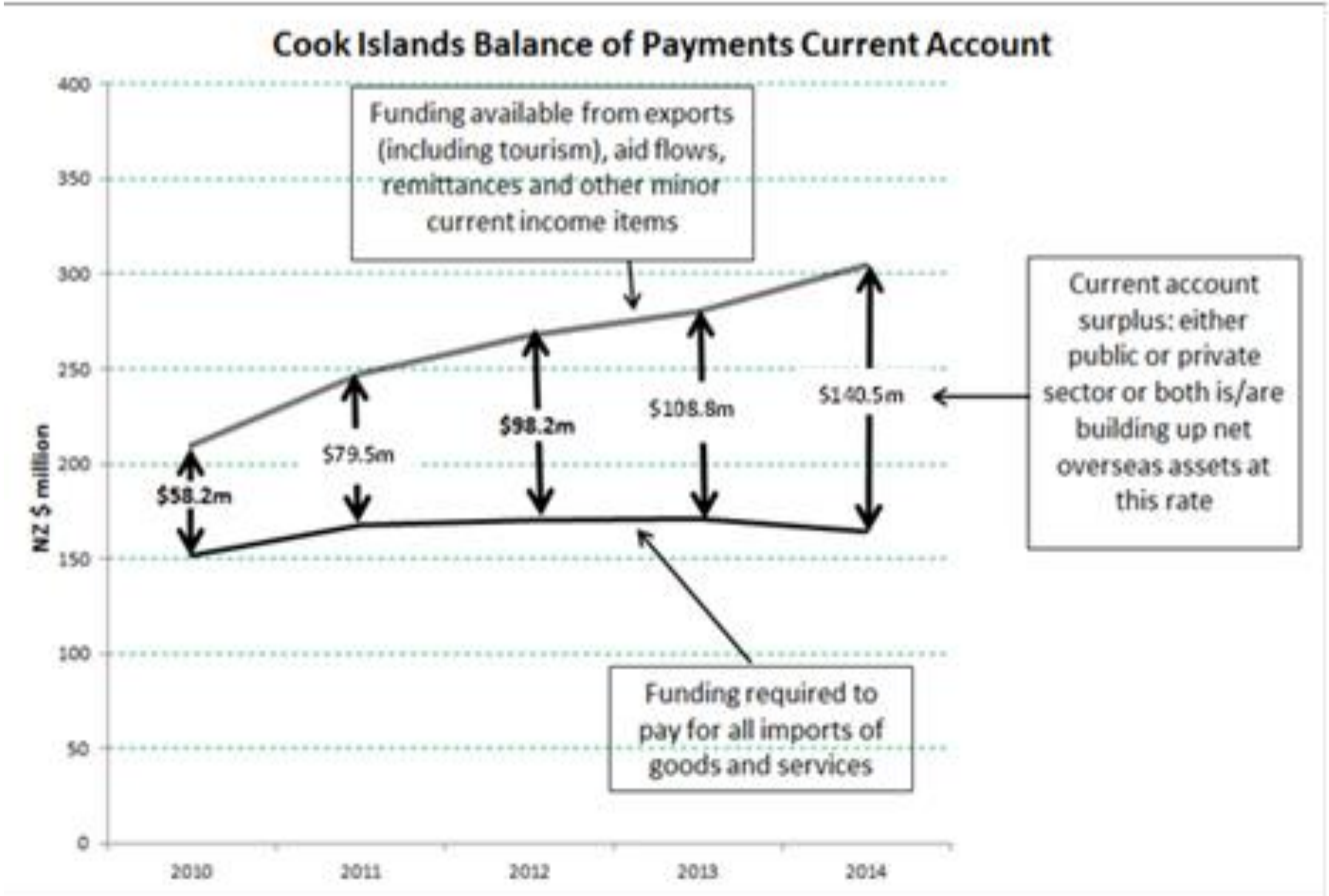
3. Balance of payments since 1970

From deficit to surplus



Cook Islands balance of trade in goods and services
% of GDP
40%
20%
0%
-20%
-40%
-60%
-80%
-100%
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014

Implications: no “savings gap”, no “foreign exchange gap”



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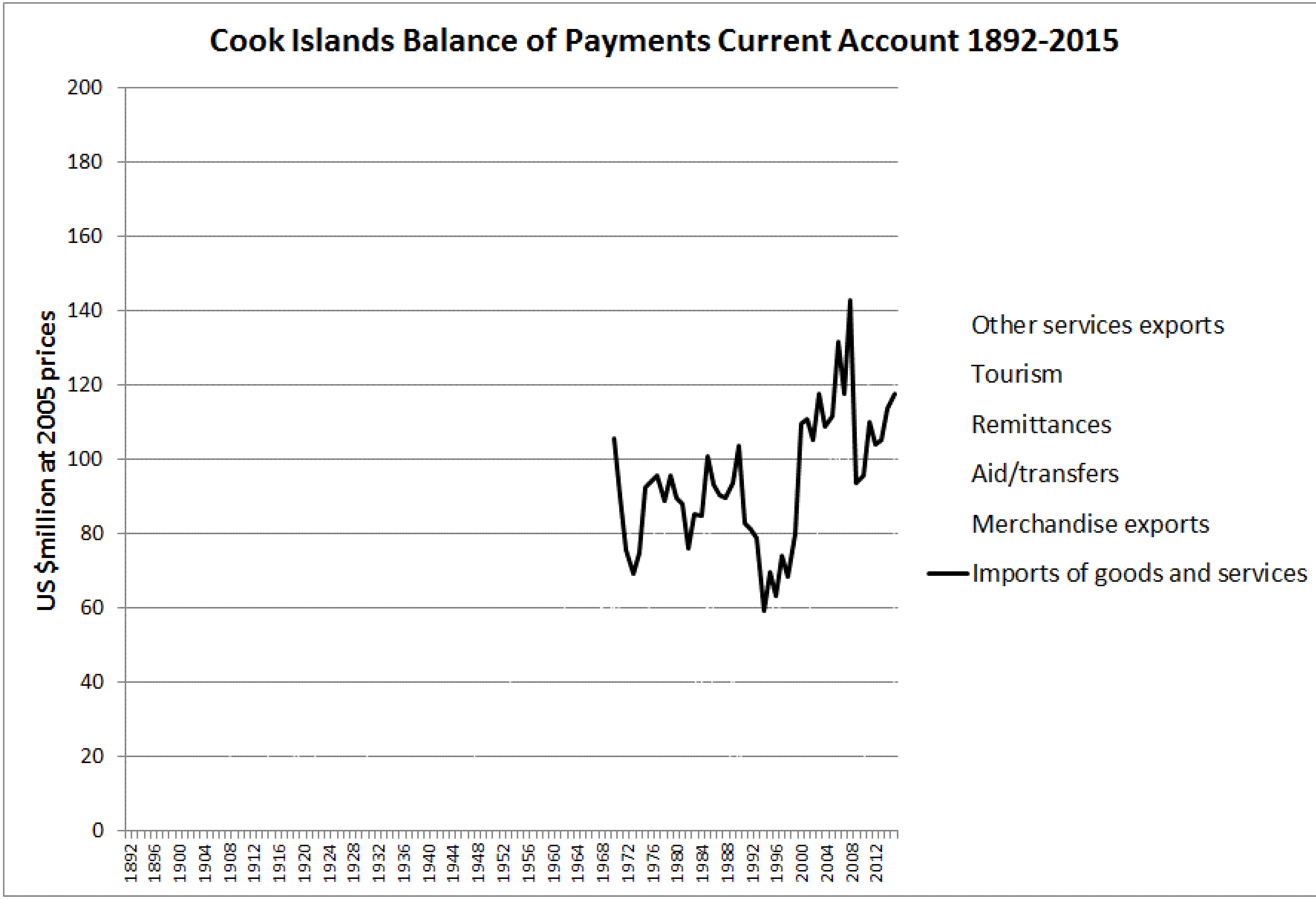

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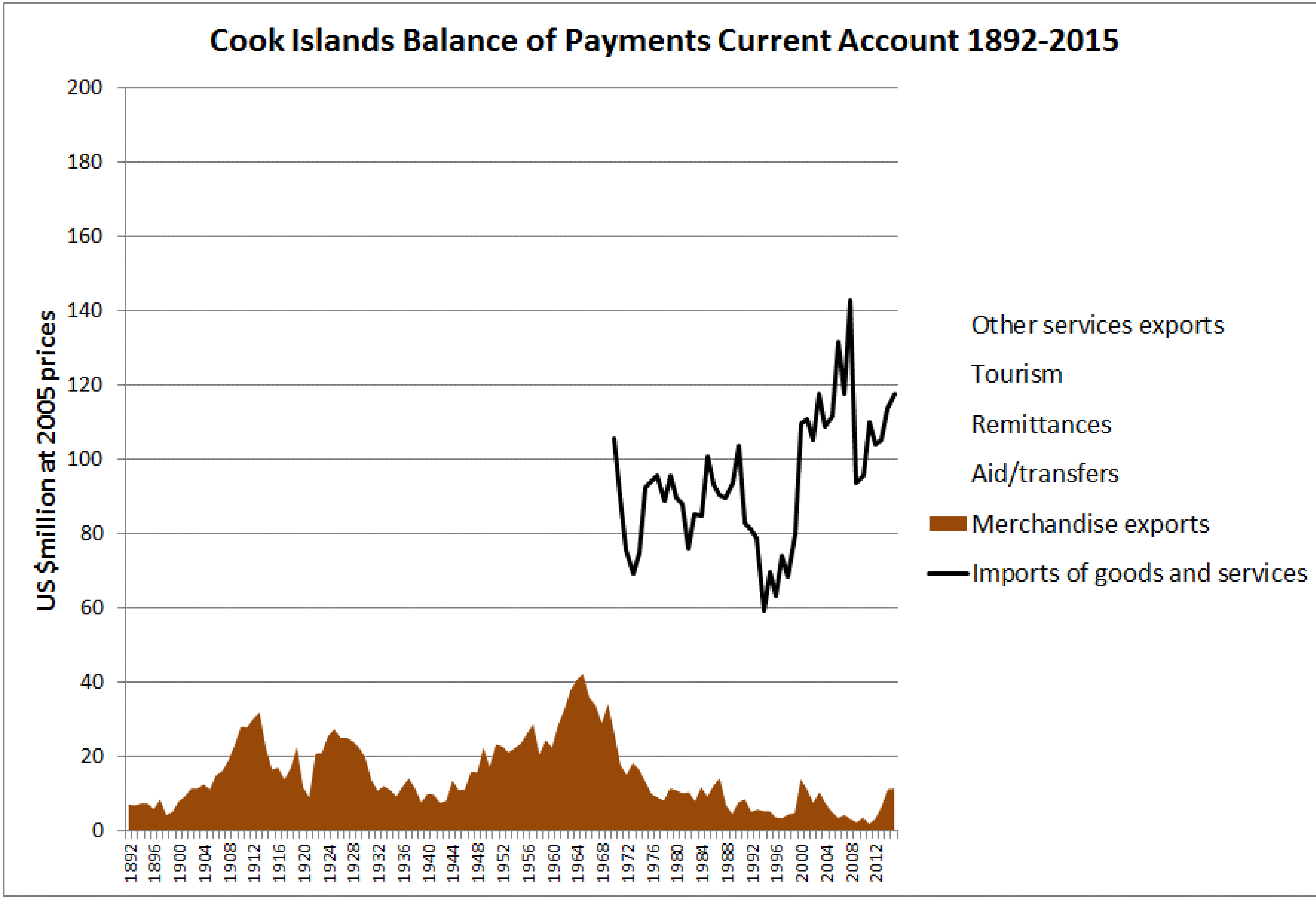

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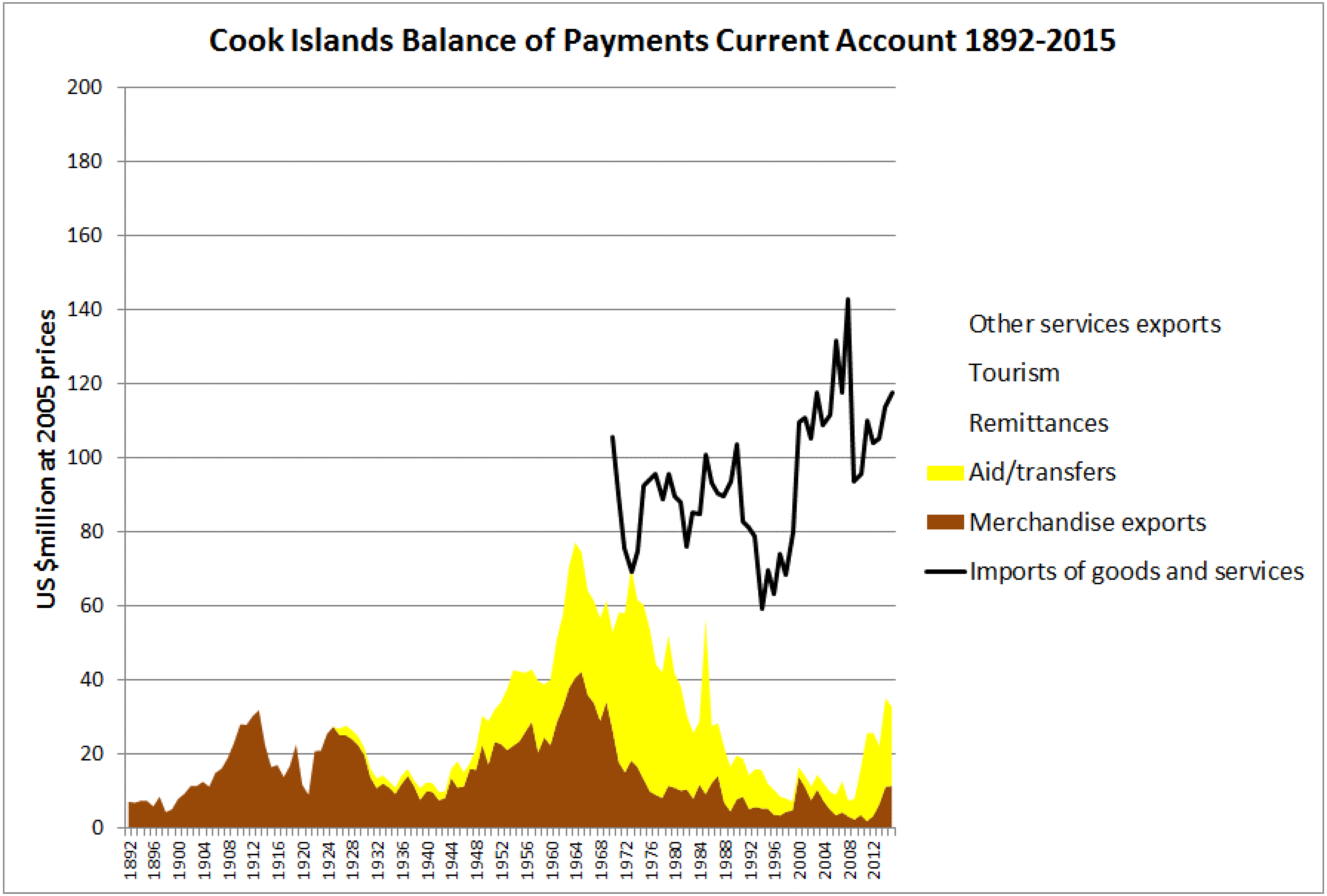

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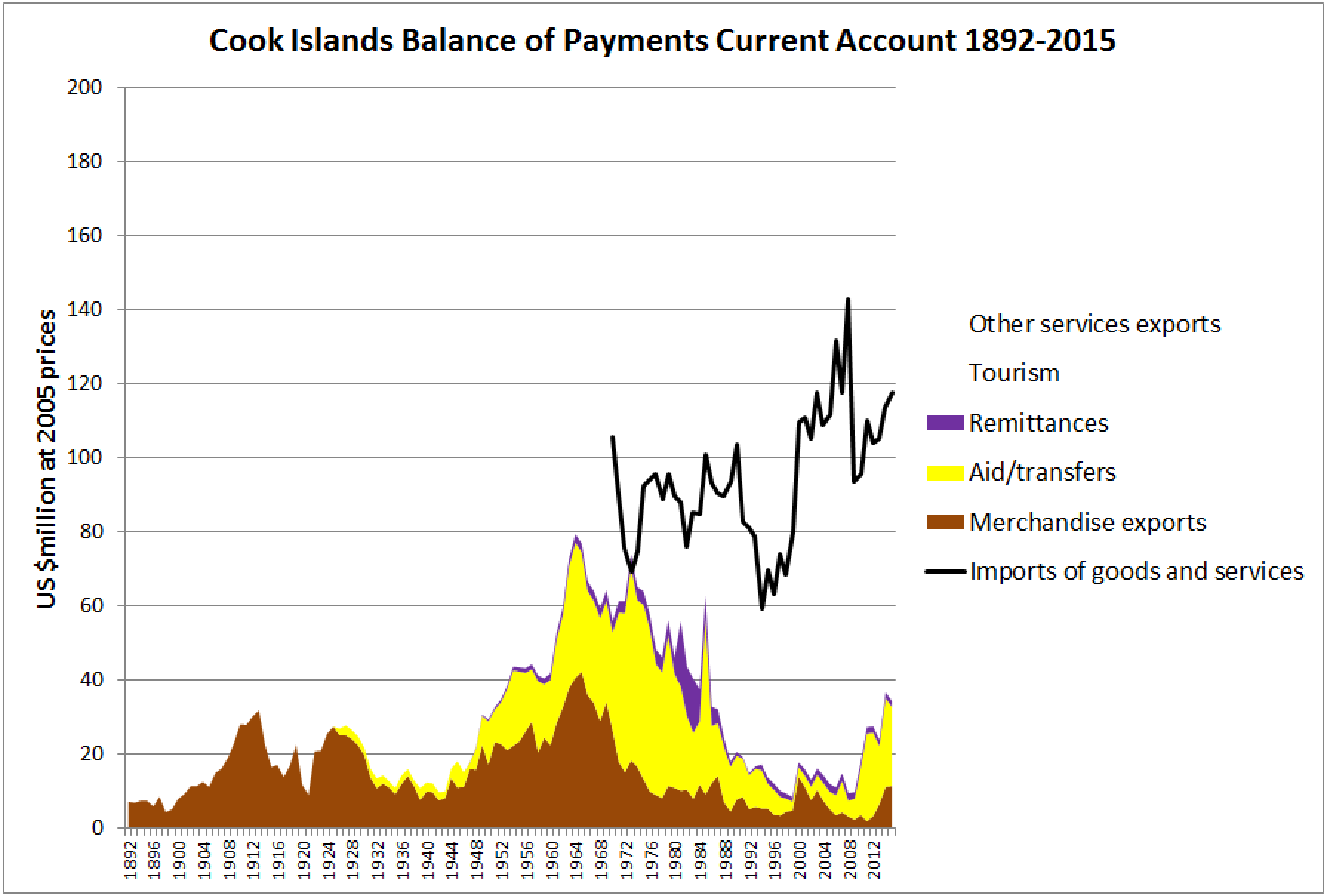

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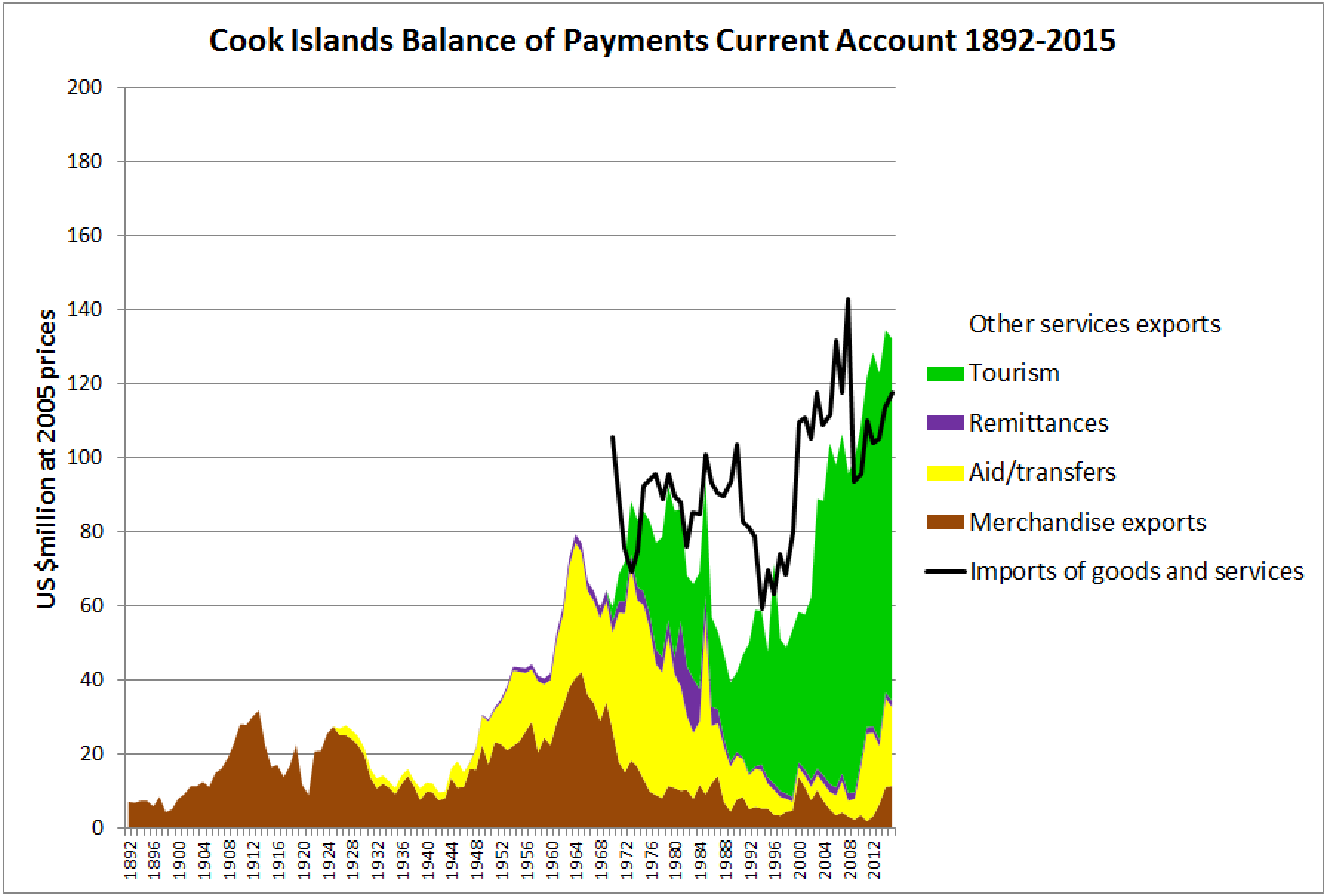

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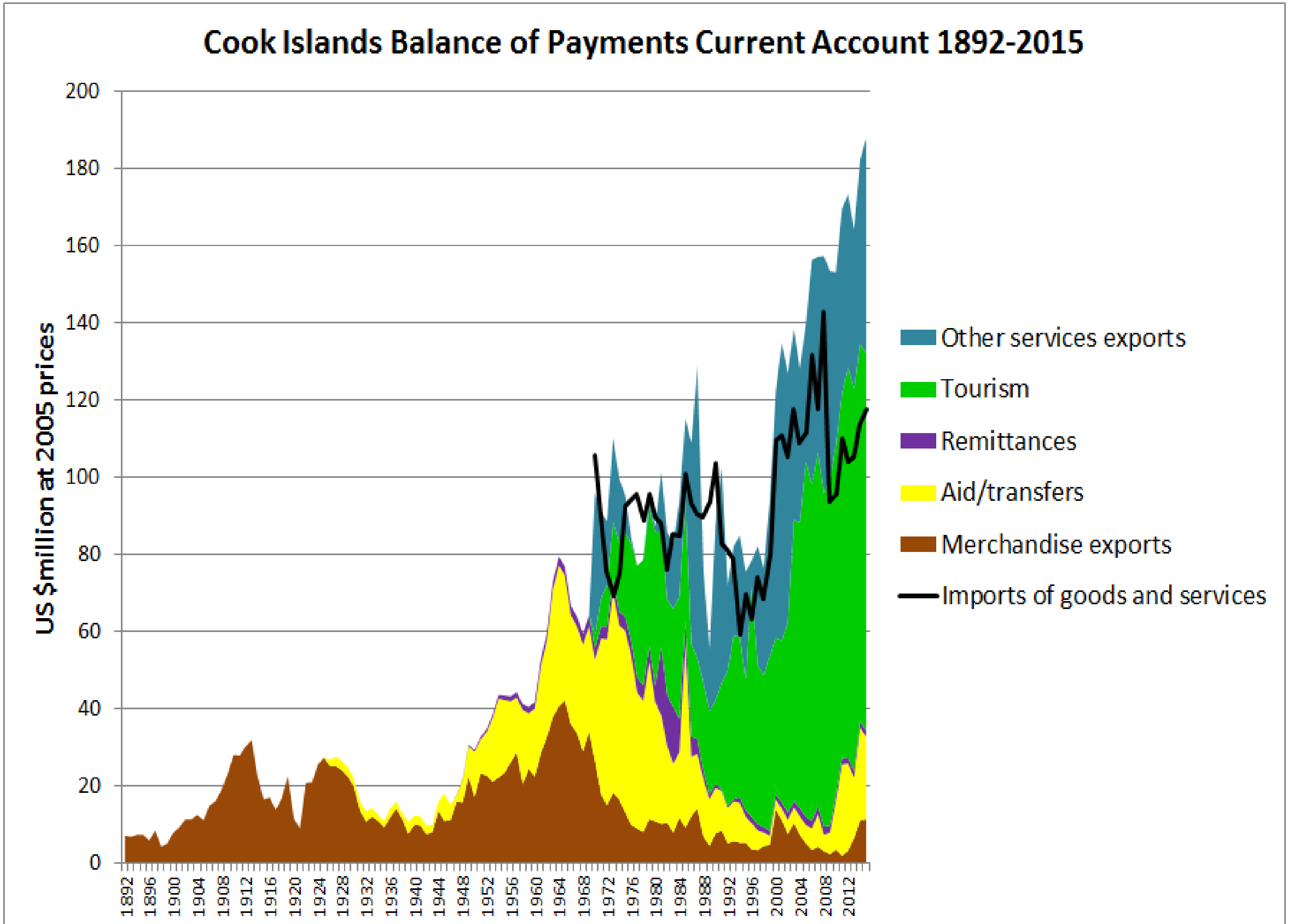
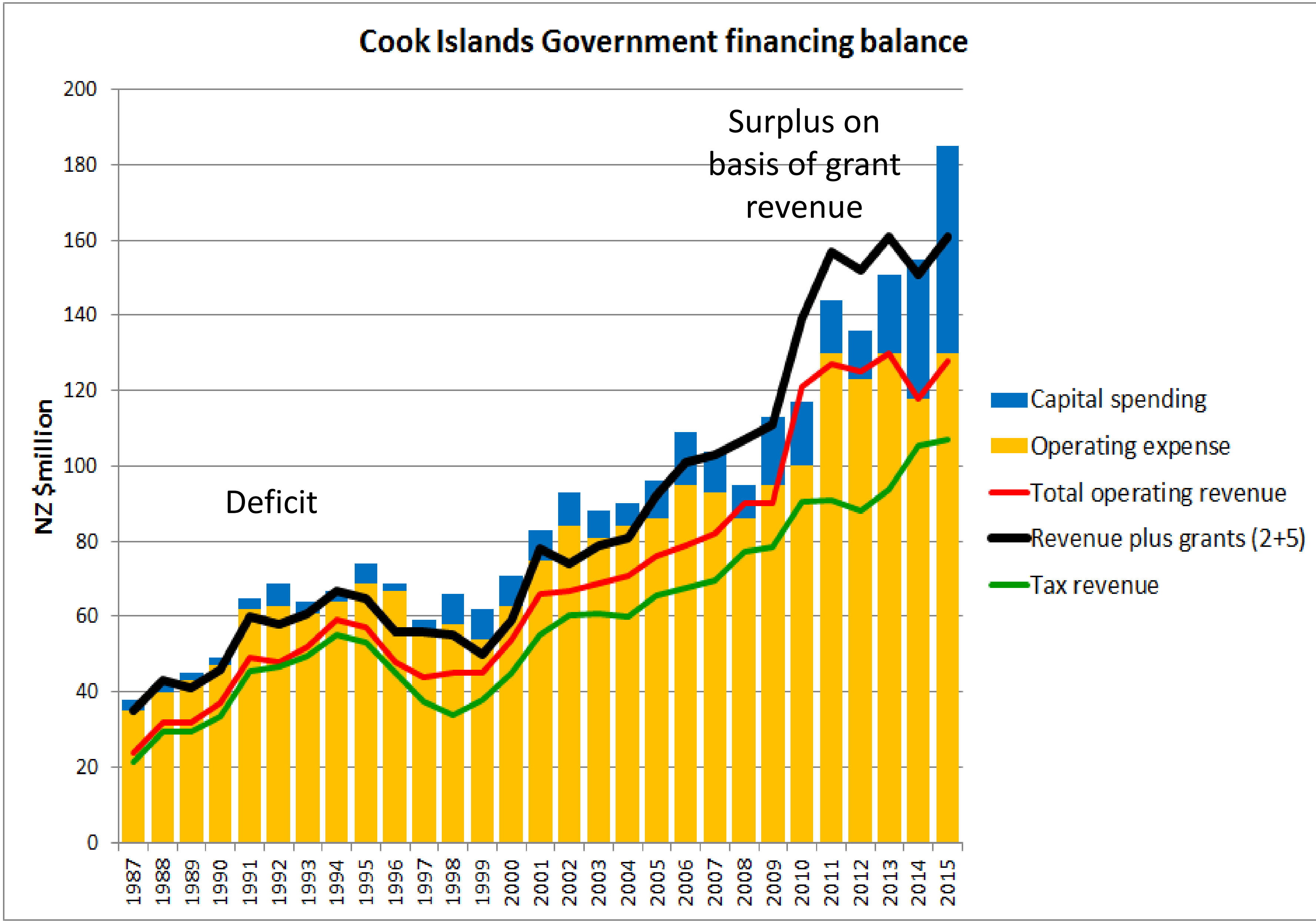


- So overseas aid is no longer required to fill any ‘foreign-exchange gap’

- In prion ciple, the big current account surplus means plenty of real resources to sustain development

Long run perspectives on the Cook Islands economy:

4. Government finance


Cook Islands Government financing balance
NZ $million
200
180
160
140
120
100
80
60
40
20
0
Surplus on basis of grant revenue
Deficit
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
Capital spending
Operating expense
Total operating revenue
Revenue plus grants (2+5)
Tax revenue

The paradox

- Through conventional "development' eyes, a success story
  - Booming leading sector (tourism)
  - High savings rate (40% of GDP if you believe the official b.o.p statistics – comparable with Asian 'tigers')
  - No outright poverty, low overt unemployment
  - Shared citizenship with NZ puts Cook Islands well up the Pacific rankings

- But while more than able to "pay its way" on balance of payments and savings rate, the Cook Islands has to rely on overseas aid to meet urgent infrastructure needs and to sustain its public services

So what is going on?

- Two central features of the contemporary Cook Islands economy:
  - Drift towards a dual economy
  - Lasting impact of austerity policies imposed back in the structural adjustment 1996-98 following the debt shock of 1995-96

Income distribution: two tests

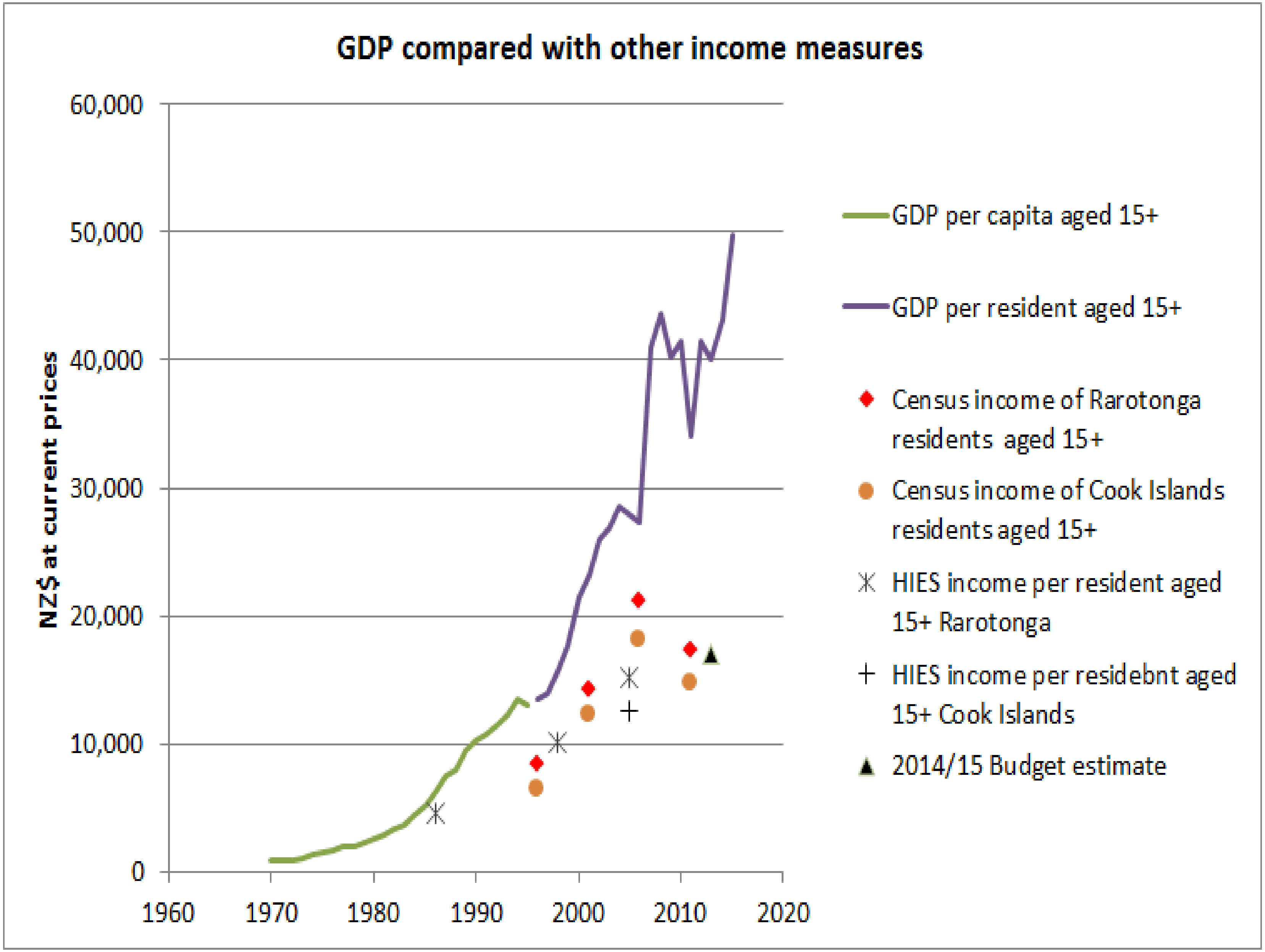
- **‘Trickling-down’**: how well does the booming sector’s prosperity translate to wages, multipliers and linkages for the rest of the economy?

- **‘Trickling across’**: do the surpluses generated by private-sector growth provide the basis for public sector expansion to underpin quality of life?

Trickling down?

- Early signs of
  - widening income and wealth inequality
  - substitution of low-wage migrant labour for local workers
  - stagnating incomes for the mass of the population while GDP rises

- Data are scarce but we have some figures from census and household income and expenditure surveys



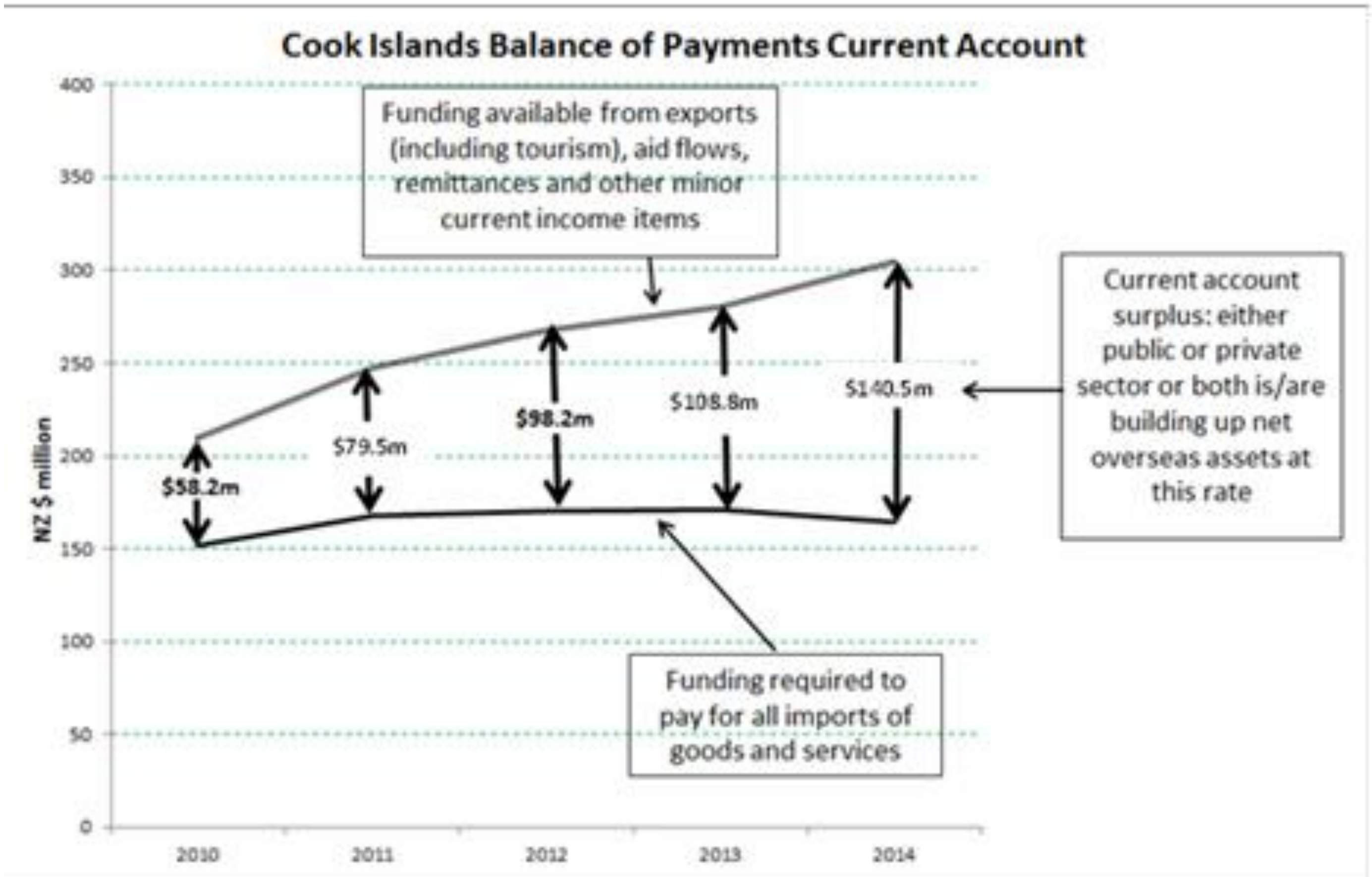
GDP compared with other income measures
NZ$ at current prices
60,000
50,000
40,000
30,000
20,000
10,000
0
1960
1970
1980
1990
2000
2010
2020
GDP per capita aged 15+
GDP per resident aged 15+
Census income of Rarotonga residents aged 15+
Census income of Cook Islands residents aged 15+
HIES income per resident aged 15+ Rarotonga
HIES income per residebnt aged 15+ Cook Islands
2014/15 Budget estimate

GNI < GDP?

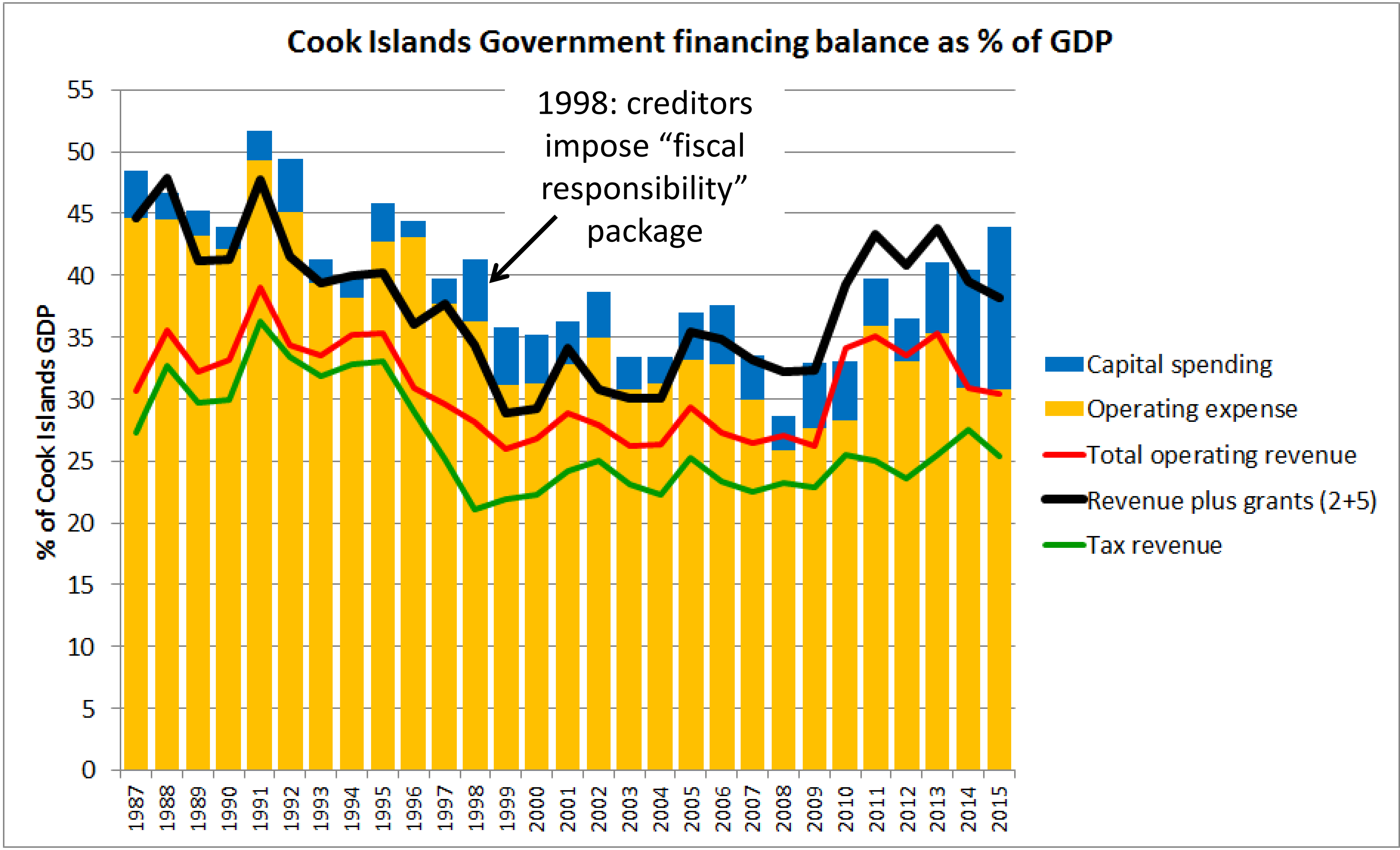
- GDP is output <u>produced</u> locally
- GNI is income <u>received</u> locally
- GNI = GDP minus any income that flows out of the economy
- The two can be very different!

	Bermuda	Bahamas
Per capita GDP	86,000	23,000
Per capita GNI	106,000	20,740
Difference	20,000	-2,260
Difference % of GDP	23%	-10%

That big outflow on the balance of payments raises the question…



Trickling across? Check out that tax revenue line:



The fiscal crisis of 1995-96

- 1984-1994 profligate adventurism by the local elite
  - Cook Islands’ own currency
  - Tax haven (the Winebox)
  - Inflated public sector payroll
  - Heavy offshore borrowing for Sheraton (= money laundering, Mafia)
- 1995-96 collapse
  - Default on debt
  - Civil service cut from 3,200 to 1,868
  - Half of all ministries abolished
  - Offshore posts closed
  - Ministry of Finance and Economic Management Act 1995-96

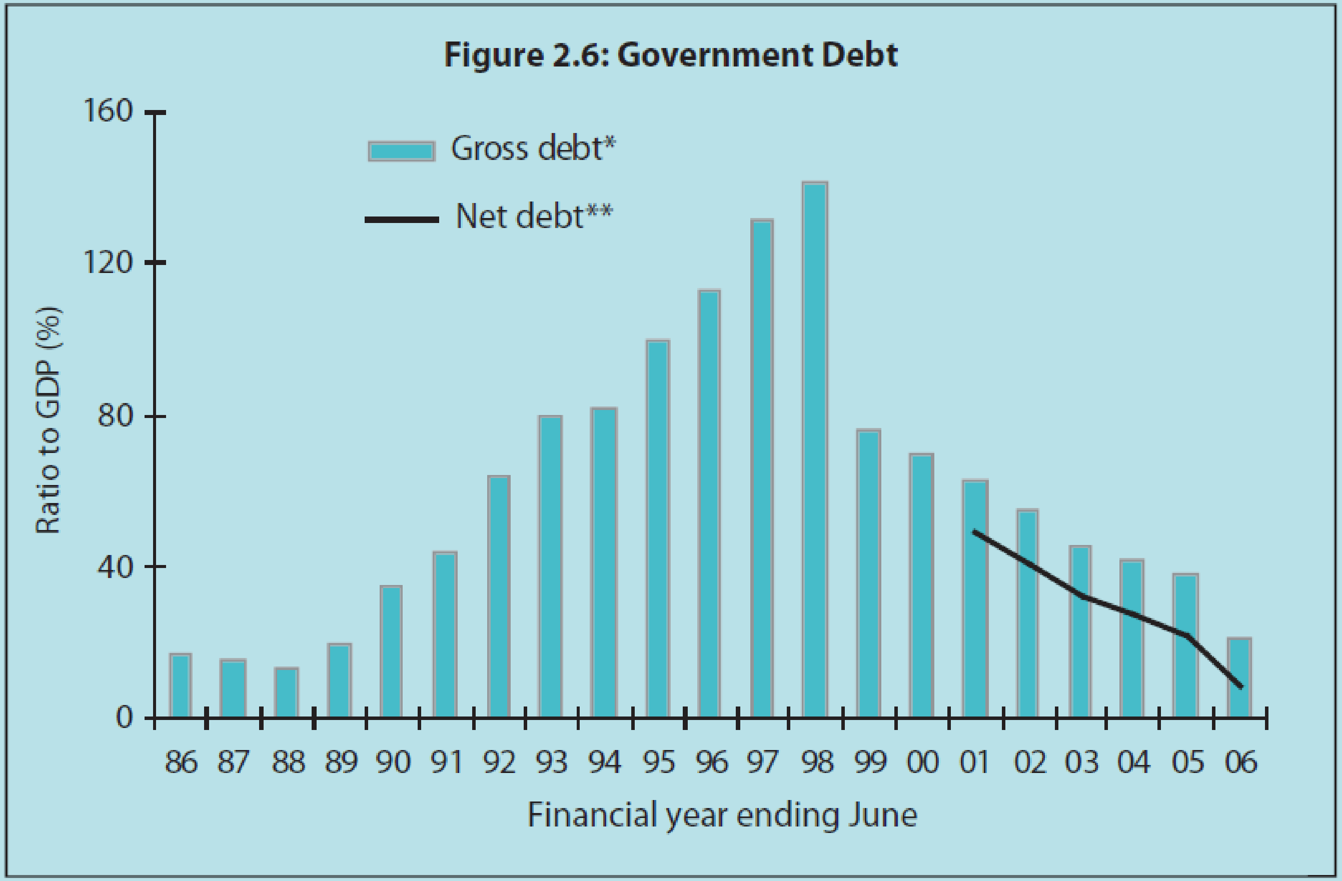
A familar fiscal-prudence list in the MFEM Act

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

Shock Doctrine at work: 1998 Manila Agreement

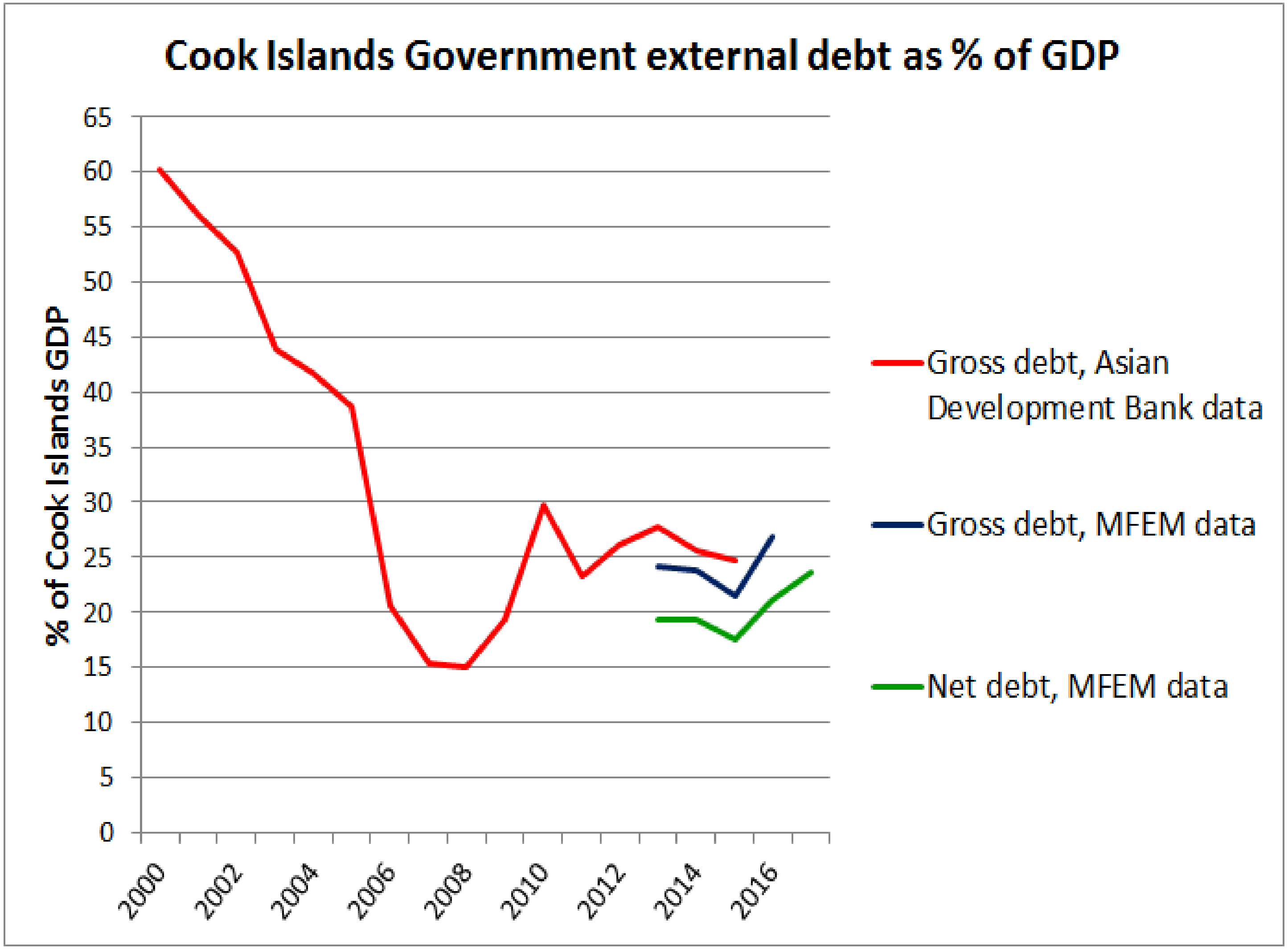
- Three main creditors: New Zealand, Asian Development Bank, Nauru
- Imposed terms:
  - tax revenue should not exceed 25% of GDP ("unless due to better compliance and efficiency");
  - public sector wages and salaries should be capped at 44% of total revenue, falling to 40% over time;
  - debt servicing should not exceed 5% of total revenue;
  - the overall budget deficit should not exceed 2% of GDP; and
  - net debt should not exceed 35% of GDP.

Certainly dealt to debt:



FY = fiscal year, GDP = gross domestic product, MFEM =Ministry of Finance and Economic Management, % = percent.
* The gross debt ratios are based on the book value of debt. Nearly all-current debt is held on concessionary terms with ADB. The net present value of the gross debt, which determines the effective value of the debt, is much lower than shown, notably for the post-1998 period.
** Gross debt at book value less cash holdings.
Source: Authors' estimates based on data supplied by MFEM and MFEM budget estimates, Part I, Appropriation Bill, Appropriations and Commentary, various years.

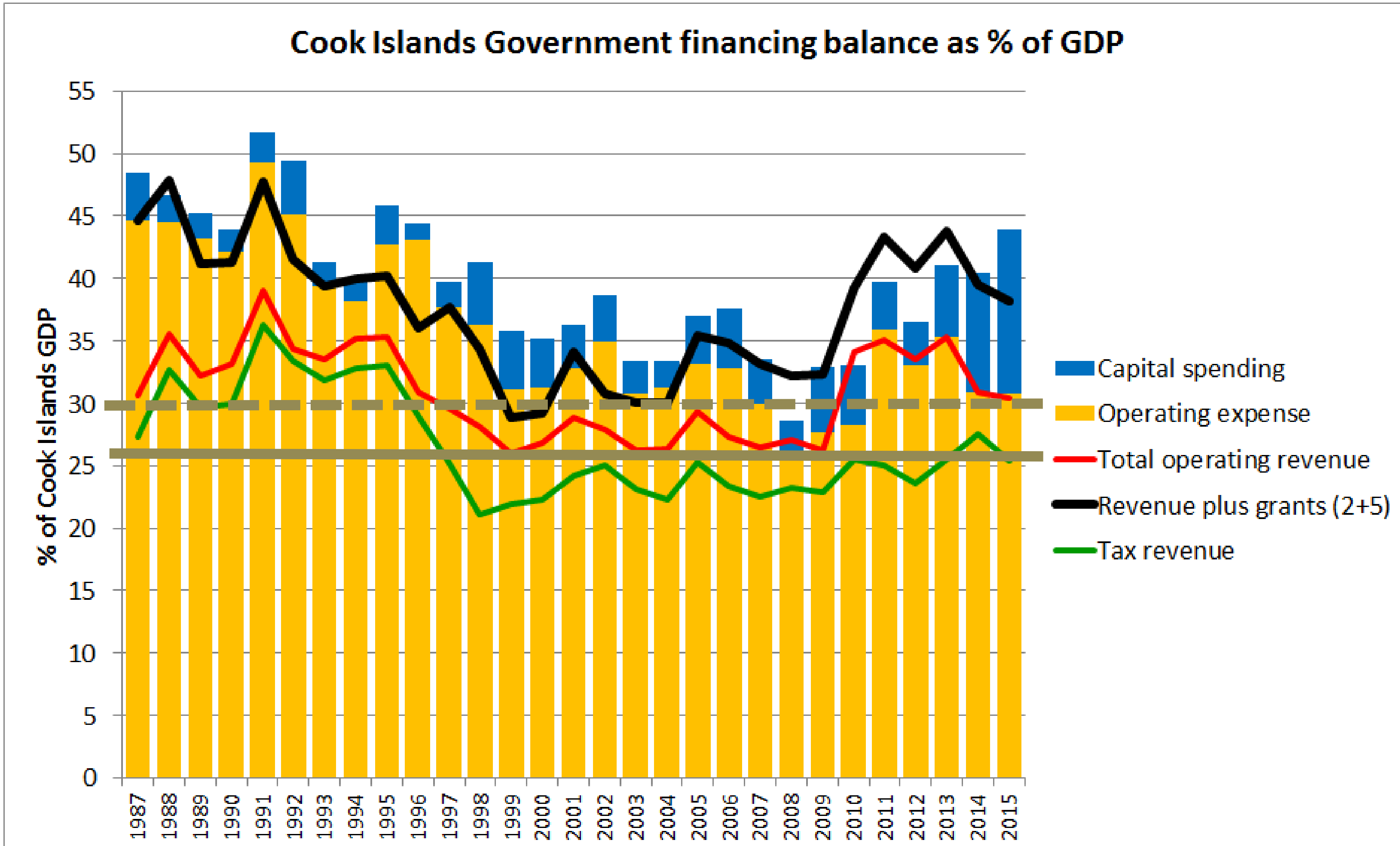
Debt remains firmly under control => offshore borrowing to fund infrastructure is a non-starter



The real killer is the tax revenue ceiling

- Government spending is 40% of GDP
- Tax revenue is capped at 25% of GDP
- Non-tax revenue averages about 5% of GDP
- The missing 10% is the aid requirement

Raising the tax revenue ceiling from 25% to 30% would enable ongoing operational spending to be tax-financed, but would require the consent of the Manila creditor parties – and capital works would still require aid



The bottom line

- The Cook Islands Government has effectively zero savings - so all the saving indicated by the balance of payments current account surplus (if those figures are correct) is private-sector

- The big private-sector economic surplus is not “trickling across” to Government, and taxes can’t be raised to capture it without breaching the Manila Agreement

- Without grant assistance, the Cook Islands Government is not able to balance its budget at current spending levels without either borrowing, or raising taxes, or both

- The 1998 Manila fiscal straightjacket rules out both of these

In other words…

The Cook Islands economy

- has a booming private tourism sector
- has overflowing ‘foreign exchange’ inflow
- has massive private savings
- but only a capped part of the surplus is available to government.

The options if aid were to stop

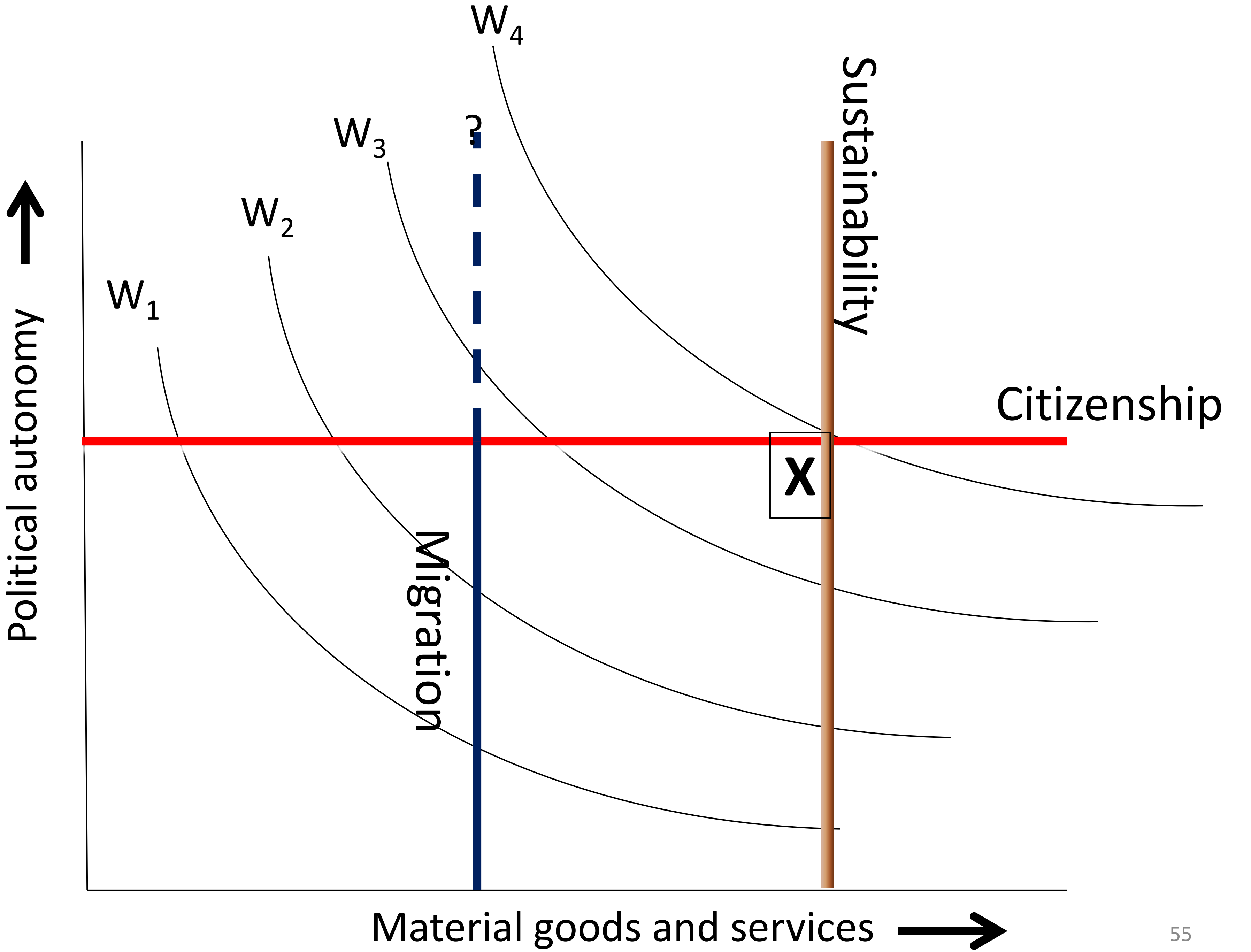
- Greek-style austerity
  - but out-migration far more responsive than in Greece
- Non-tax revenue rises by 5-10% of GDP
  - E.g. seabed mining royalties or massive increase in fishing royalties: not in the near future
- Cut corporate welfare
  - $12 million annual subsidy to Air New Zealand (2.8% of GDP – but net gain would be less)
- Renegotiate Manila

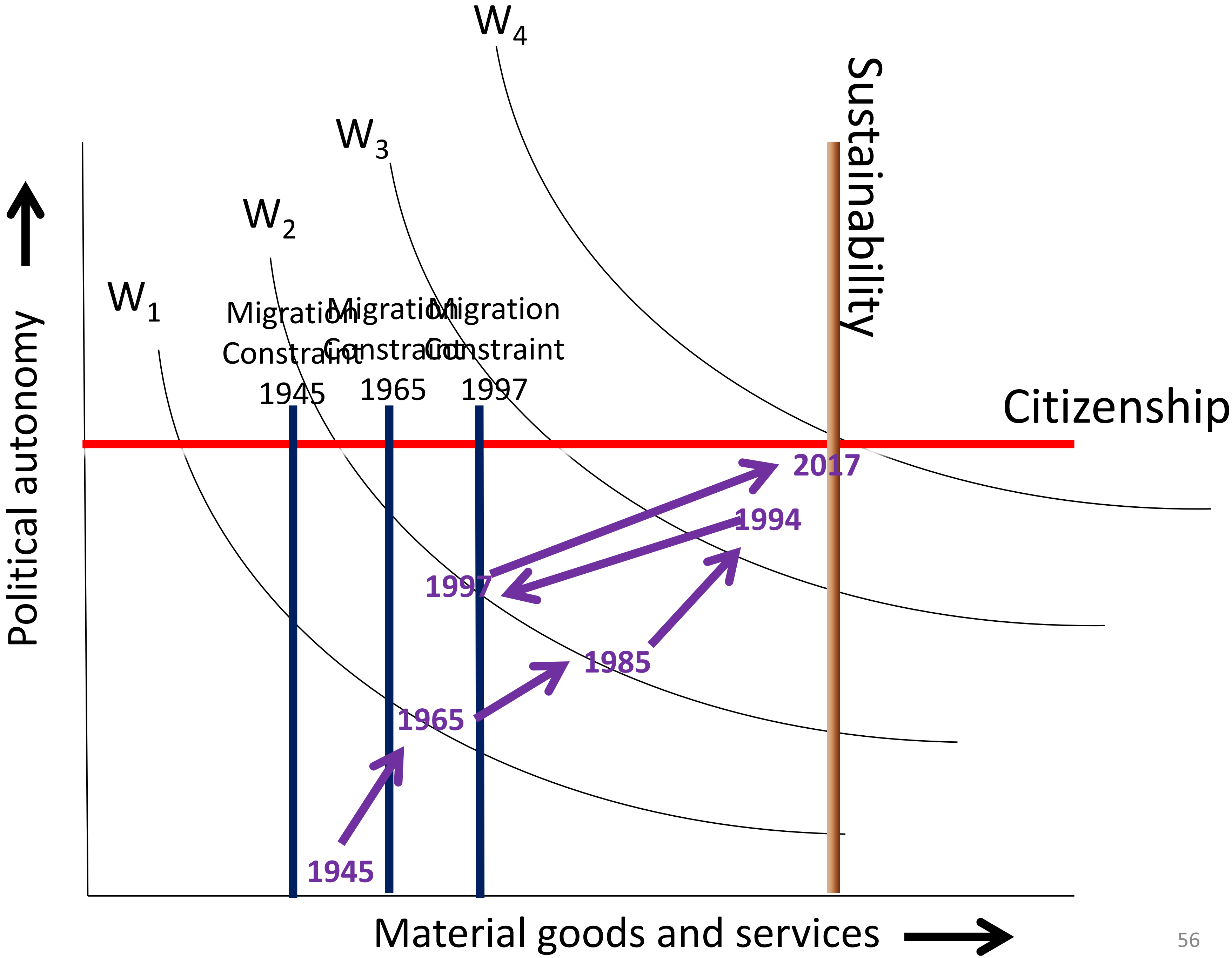
So the function of aid is to keep the Cook Islands Government solvent without raising taxes

Implications:

1) aid functions as a subsidy to Cook Islands taxpayers whose free-rider status is underwritten by donors, and

2) aid sustains the ideological project of a limited state sector


W4
W3
?
W2
W1
Sustainability
Citizenship
X
Migration
Political autonomy
Material goods and services


W1
W2
W3
W4
Sustainability
Migration Constraint 1945
Migration Constraint 1965
Migration Constraint 1997
Citizenship
2017
1994
1997
1985
1965
1945
Political autonomy
Material goods and services