ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 50212-001
November 2016

Proposed Policy-Based Loan
Cook Islands: Disaster Resilience Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 10 October 2016)

Currency unit	–	New Zealand dollar (NZ$)
NZ$1.00	=	$0.7169
$1.00	=	NZ$1.395

ABBREVIATIONS

Cat DDO	–	catastrophe deferred drawdown option
DRM	–	disaster risk management
GDP	–	gross domestic product
PBL	–	policy-based loan
PCRAFI	–	Pacific Catastrophe Risk Assessment and Financing Initiative
PFM	–	public financial management

NOTES

(i) The fiscal year (FY) of the Government of the Cook Islands ends on 30 June. "FY" before a calendar year denotes the year in which the fiscal year ends, e.g., FY2016 ends on 30 June 2016.

(ii) In this report, "$" refers to US dollars unless otherwise stated.

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PROGRAM AT A GLANCE

1. Basic Data			**Project Number:** 50212-001
Project Name	Disaster Resilience Program	**Department /Division**	PARD/PAUS
Country	Cook Islands	**Executing Agency**	Ministry of Finance & Economic Management
Borrower	Cook Islands		

2. Sector	**Subsector(s)**	**ADB Financing (NZ$ million)**
✓ **Public sector management**	Public expenditure and fiscal management	13.95
	Total	**13.95**

3. Strategic Agenda	**Subcomponents**	**Climate Change Information**	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
Environmentally sustainable growth (ESG)	Disaster risk management		

4. Drivers of Change	**Components**	**Gender Equity and Mainstreaming**	
Governance and capacity development (GCD)	Institutional development Public financial governance	Some gender elements (SGE)	✓

5. Poverty and SDG Targeting		**Location Impact**	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG13		

6. Risk Categorization: Complex

7. Safeguard Categorization **Environment:** C **Involuntary Resettlement:** C **Indigenous Peoples:** C

8. Financing

Modality and Sources	Amount (NZ$ million)
ADB	**13.95**
Sovereign Program loan: Ordinary capital resources	13.95
Cofinancing	**0.00**
None	0.00
Counterpart	**0.00**
None	0.00
Total	**13.95**

9. Effective Development Cooperation

Use of country procurement systems	Yes
Use of country public financial management systems	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan (PBL) to the Cook Islands for the Disaster Resilience Program.[1]

2. The Cook Islands is located in a part of the South Pacific Ocean that is at high risk from natural hazards, particularly cyclones, tsunamis, and floods. To reduce risks from, better plan for, respond to, and recover from disasters, the country is taking important steps to improve its disaster risk management (DRM) system. The proposed program will provide the Government of the Cook Islands rapid access to financing, contingent on a disaster affecting the country.[2] Funds will be used to help meet short-term, post-disaster recovery needs. To establish eligibility to access the contingent financing, the government has undertaken prior policy actions that (i) clarify and implement policy and institutional arrangements for DRM, including the capacity for post-disaster response and recovery; (ii) improve the disaster resilience of physical assets; and (iii) expand disaster risk financing. Post-program monitoring will ensure continued progress toward attaining overall program goals.

II. THE PROGRAM

A. Rationale

3. **Development context.** The Cook Islands has a resident population of about 14,974 dispersed across 15 small islands, comprising a land area of 67 square kilometers spread over 2 million square kilometers of the South Pacific Ocean; 70% of the population lives on the largest island of Rarotonga.[3] The economy is well managed, tax revenues are strong, and fiscal deficits were below 2% of gross domestic product (GDP) during FY2010–FY2015. Although external debt is rising, it remains at a sustainable level (24.8% of GDP in FY2016) and is well within the government's threshold of 35.0% of GDP.[4] The country's average economic growth in FY2010–FY2015 was 2.2% per year, driven largely by strong growth in the tourism sector, which accounts for about 60.0% of GDP.[5] But this average hides annual fluctuations that have seen GDP growth vary from –2.7% to 4.8% during FY2010–FY2015, depending on changing external, trade, and investment conditions.

4. **Disaster risk.** The Cook Islands is highly vulnerable to disasters, and has periodically experienced major cyclones that have caused substantial economic damage and loss of life. (Tables 1 and 2).

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1 The design and monitoring framework is in Appendix 1.

2 Contingent financing was previously used in Asian Development Bank (ADB). 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Public Expenditure Support Facility Program.* Manila.

3 Government of the Cook Islands, Ministry of Finance and Economic Management, Statistics Office. 2012. *Cook Islands 2011 Census of Population and Dwellings: Main Report.* Rarotonga.

4 A debt sustainability analysis, which ADB did based on the World Bank and International Monetary Fund template and guidelines, assumes long run growth of 2.0%, declining fiscal deficits from 0.5% to 0.1%, and inflation at 2.0% over the long term (ADB. 2016. *Cook Islands: Macroeconomic Assessment.* Consultant's report. Manila [TA 8565-REG]).

5 The Cook Islands is not a member of the International Monetary Fund or the World Bank Group. In place of the International Monetary Fund's assessment letter, a Macroeconomic Assessment Summary (accessible from the list of linked documents in Appendix 2) has been prepared based on a detailed assessment carried out by ADB at the request of the Government of the Cook Islands (ADB. 2016. *Cook Islands: Macroeconomic Assessment.* Consultant's report. Manila [TA 8565-REG]).

Table 1: Significant Cyclones in the Cook Islands

Year	Cyclone Name	Severity[a]	Estimated losses ($ million)	Estimated losses (% of GDP)
1987	Sally	Category 2	24.6	51.6
1997	Martin	Category 3	7.5	7.6
2005	Meena	Category 4	10.0[b]	5.5
	Nancy	Category 4		
	Olaf	Category 5		
	Percy	Category 5		
2010	Pat	Category 2	7.8	3.2

GDP = gross domestic product.
[a] Severity is measured following the Saffir–Simpson hurricane wind scale. Cyclones above category 3 are considered major cyclones because of their potential for significant loss of life and damage.
[b] Combined estimated losses for all four cyclones in 2005.
Sources: Asian Development Bank. 2006. *Draft Final Report: Strengthening Disaster Management and Mitigation (Component 2: Preventive Infrastructure Master Plan)—Volume 4: Climate Change Considerations*. Consultant's report. Manila (TA 4605-COO); and World Bank. 2015. *The Cook Islands: Disaster Risk Financing and Insurance*. Washington, DC.

Table 2: Potential Cyclone Loss by Return Period

Return period (years)	Estimated potential losses ($ million)	Estimated potential losses (% of GDP)
1-in-10	10.0	4.1
1-in-50	56.8	23.3
1-in-100	103.0	42.2
1-in-250	198.1	81.2

GDP = gross domestic product.
Source: World Bank. 2015. *The Cook Islands: Disaster Risk Financing and Insurance*. Washington, DC.

5. The country's high exposure to disaster risk is due to (i) its geographic location in the South Pacific cyclone belt; (ii) the remoteness and low-lying nature of many of its islands; and (iii) the proximity of many buildings and infrastructure services to the coast, especially on the largest island of Rarotonga. In addition, the heavy reliance on revenues from the tourism sector makes the economy vulnerable to the impact of disasters.

6. The financial resources for short-term recovery[6] needed to reduce the economic and social impact of disasters through swift action are likely to be significant. However, the Government of the Cook Islands currently has few options for accessing sufficient post-disaster financing, leaving the country vulnerable to the impact of disasters. For example, in addition to the overall impact on the economy indicated in Table 1, annual GDP growth fell from 2.2% in 2004 to –1.1% in 2005, after four cyclones in early 2005, before it recovered to 5.0% in 2006. The average quarterly GDP growth was 0.8% in 2009, dropped to –2.7% following Cyclone Pat in 2010, and recovered to 0.7% in 2011.

7. **Government strategy.** To mitigate the economic risk posed by disasters, the government has put in place arrangements to cover different layers of disaster risk financing. A disaster emergency trust fund—established in 2011[7] with a current balance of NZ$1.5 million—

[6] Short-term recovery focuses on activities that continue beyond the emergency period to reestablish lifelines, and may typically include providing temporary shelter, restoring power and water, clearing debris, providing small business loans and work assistance, and delivering critical stress debriefing to emergency responders and victims.
[7] Government of the Cook Islands. 2011. *Policy Governing the Establishment and Operation of the Cook Islands Disaster Emergency Trust Fund.* Rarotonga.

was created to serve as an initial source of government-allocated funds to respond to disasters. The government has also taken out insurance coverage under the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI) for cyclones, with a 1-in-10-year probability of occurrence and payout based on the assessed severity of a specific cyclone.[8] The country has not experienced a cyclone triggering a payout since it joined PCRAFI in 2014, but continues to purchase cover as an element of a broader risk financing framework. However, having the disaster emergency trust fund in place and the potential for an insurance payout through PCRAFI is unlikely to be sufficient for the Government of the Cook Islands to finance the cost of short-term recovery needs following a significant disaster.

8. In addition to taking steps to reduce financial exposure to disaster risk, the government has put in place an improved DRM policy and institutional arrangements. Major DRM policy and planning documents have been prepared. For example, the current national development plan includes a specific measurable goal to strengthen resilience to combat the impacts of climate change and natural disasters.[9] The Cook Islands was among the first countries in the Pacific to prepare a joint action plan that integrated DRM and climate change adaptation, including implementation arrangements to link national and local planning systems.[10] The Disaster Risk Management Act, 2007 defines legal responsibilities for DRM and specifies the procedures for the formal declaration of a state of disaster.

9. **ADB engagement and lessons learned.** The Asian Development Bank (ADB) has provided financial support to the Cook Islands to assist with post-disaster reconstruction following previous cyclones, including for the procurement of materials and equipment, transport supplies and personnel to disaster areas, civil works, and the restoration of major productive activities, such as pearl farming, fishing, and agriculture.[11] The Pacific Regional Infrastructure Facility[12] supported the development of a 10-year, $211 million, national infrastructure investment plan that embedded strengthened disaster-resilient principles into broader development investments, and was endorsed by the cabinet in April 2015.[13] The plan identified priority infrastructure investments, estimated to cost $57.8 million, that are designed to reduce and manage disaster and climate risks, including risk mitigation measures.

10. In 2015, ADB conducted a macroeconomic assessment (footnote 5) and recommended that the government "continue to build up its resilience and readiness to natural disasters and explore financial options to support its cash position in the event of a disaster."[14] By putting in

[8] Payouts under PCRAFI are determined parametrically based on the assessed severity of a specific disaster. Payouts commence with events of a 1-in-10-year severity; less severe events do not attract a payout.
[9] Government of the Cook Islands, Office of the Prime Minister, Central Policy and Planning Office. 2016. *Te Kaveinga Nui: National Sustainable Development Plan, 2016–2020*. Rarotonga.
[10] Government of the Cook Islands, Office of the Prime Minister. 2012. *Joint National Adaptation Plan for Disaster Risk Management and Climate Change Adaptation, 2011–2015.* Rarotonga.
[11] A loan of $7.1 million was provided for the economic restoration of Manihiki, Pukapuka, and Rakahanga islands after Cyclone Martin (ADB. 1997. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Cook Islands for the Cyclone Emergency Rehabilitation Project.* Manila), and a loan of $2.8 million and technical assistance of $0.6 million was provided after the 2005 cyclones (ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to the Cook Islands for the Cyclone Emergency Assistance Project.* Manila).
[12] The Pacific Regional Infrastructure Facility is a multi-donor technical assistance comprising ADB, Australia's Department of Foreign Affairs and Trade, New Zealand's Ministry of Foreign Affairs and Trade, the World Bank Group (including the International Finance Corporation), the European Commission, and the European Investment Bank.
[13] Government of the Cook Islands. 2015. *National Infrastructure Investment Plan.* Rarotonga.
[14] Footnote 5, p. 8, para. 29.

place the contingent financing arrangement, which is supported through the proposed PBL, the government will substantially increase its access to quick-disbursing finance that can be used to meet critical short-term, post-disaster recovery needs.

11. The design of the proposed PBL is based on the World Bank's catastrophe deferred drawdown option (Cat DDO), which is linked to a development policy loan.[15] Although ADB does not have such a financing modality, the provision of financing contingent on a disaster with an option to defer loan drawdown is similar to the precautionary financing option in ADB's policy on PBLs.[16] A PBL has been selected as the preferred lending modality as it is the only instrument currently available that will enable financing to be put in place before a disaster strikes. All other instruments, including emergency assistance loans, are processed only after a disaster happens. Eligibility to access PBL financing is linked to the achievement of prior and continuing actions to strengthen disaster resilience, which is similar to the Cat DDO.

12. Important lessons learned from the World Bank's development policy operations with Cat DDOs have been taken into consideration in designing the proposed PBL to the Cook Islands, including:[17]

(i) Disaster contingent financing is most effective as part of a broader disaster risk financing program, complementing other risk retention tools and risk transfer instruments. The primary benefit of a deferred drawdown is that it is quick-disbursing, providing the government with an immediate source of bridge financing following a disaster.

(ii) For the government to fully benefit from the quick-disbursing nature of contingent financing, specific institutional arrangements need to be in place to enable the submission of a deferred drawdown request for funds post-disaster.

(iii) Fiscal impact studies can help the government understand its expected post-disaster short-term recovery funding gap, which the contingent financing can help to close.

(iv) For DRM policy frameworks with multiple action areas across different sectors, a dialogue should be initiated with various line agencies during project preparation and implementation. Stakeholders, including line agencies, civil society, the private sector, and academia, can contribute to DRM through their regular programs.

(v) Contingent credit is an affordable source of financing that complements existing market-based disaster risk financing instruments. Contingent credit can be used in combination with market-based disaster risk financing to retain the risk from smaller, more frequent events, or to transfer the risk from less frequent, higher-impact events, based on an assessment of risks, desired coverage, available budget, and cost efficiency.

(vi) To optimize the timing and size of drawdowns, the soft trigger for disbursement, which is a standard feature of the Cat DDO instrument, needs to be supported by strong analytics.

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[15] Since 2008, the World Bank has extended development policy loans with a Cat DDO to Colombia, Costa Rica, El Salvador, Panama, Peru, the Philippines, the Seychelles, and Sri Lanka.

[16] ADB. 2011. *Review of ADB's Policy-Based Lending.* Manila, p. 12, para 32.

[17] World Bank. 2015. *Philippines—Disaster Risk Management Development Policy Loan with a Catastrophe Deferred Drawdown Option*. Washington, DC; and World Bank. 2012. *Costa Rica Catastrophe Deferred Drawdown Option (Cat DDO): Providing Countries with Rapid Access to Funds after a Natural Disaster.* Disaster risk financing and insurance case study. Washington, DC.

(vii) As a development policy loan, Cat DDOs provide the opportunity to elevate DRM issues to oversight agencies that may not otherwise be engaged in the policy dialogue, especially finance ministries.
(viii) The implementation of technical assistance to support the policy areas of the Cat DDO can facilitate substantive policy dialogue and effective implementation even after full disbursement of the loan.

13. As the Cook Islands already has an effective public financial management (PFM) system in place and a stable macroeconomic environment, and has taken important actions to improve DRM, it is considered a suitable country to pilot a disaster-contingent financing approach.[18] As a regular ordinary capital resources-only country, the Cook Islands does not have access to concessional financing and has specifically requested disaster-contingent financing through a PBL.

14. **Economic impact of the disaster resilience program.** The program supports a series of actions to improve disaster readiness (para. 19). It will only be possible to quantify the full economic impact of the program after a disaster, as the benefits or costs avoided will be determined by the scale of a disaster. However, the following are indicative of the economic benefits that are expected to flow from the program:
(i) a reduction in lives lost and injuries incurred during a disaster, reflecting a wider understanding of what to do in case of an approaching disaster due to improved disaster planning, response preparation, and public training;
(ii) reduced damage and losses to public and personal property due to (a) improved disaster planning, response preparation, and public training; (b) better resilience through improved location, design, and construction of critical public infrastructure and assets; and (c) a strengthened building code;
(iii) faster removal of debris and hazards with flow-on impacts for improved public safety due to pre-contracting and improved availability of post-disaster finance;
(iv) faster restoration of essential services due to improved planning, financing, and pre-contracting of specialized services, allowing for reduced public and private costs through shorter business, office, and public facility closures;
(v) a more effectively coordinated humanitarian response providing temporary shelter, food, water, and sanitation with a reduced risk of outbreaks of waterborne diseases and other negative post-disaster health impacts;
(vi) better targeted humanitarian responses and more efficient spending for recovery through more efficient development of damage and loss assessments;
(vii) rapid access to an increased balance in the disaster emergency trust fund, the PCRAFI insurance premium, and funds from the PBL, which will provide the government with a larger pool of resources to finance its short-term, post-disaster needs in a timely and cost-effective manner, and avoid the opportunity cost associated with government budget or aid program reallocations, and/or any financial costs associated with additional commercial or concessional borrowing that may be urgently needed to meet post-disaster costs; and
(viii) risk of corruption and unapproved or incorrect expenditures of government and donor funds minimized through increased transparency and closer tracking of post-disaster expenditures.

[18] Other developing member countries with access to ordinary capital resources funds in the Pacific (i.e., Fiji and Palau) have also indicated an interest in requesting similar support.

15. **Partner support.** Established in 2013, PCRAFI provides developing member countries in the Pacific with disaster risk modeling and assessment tools, and supports dialogue on and financing for integrated financial solutions to reduce financial vulnerability to disasters and climate change.[19] The Cook Islands joined the PCRAFI insurance pilot in 2014, selecting a level of cover corresponding to a 1-in-10-year disaster—the lowest level of cover with the least costly premium.[20]

16. New Zealand provides DRM support under its bilateral aid program through an arrangement with its Ministry of Civil Defence and Emergency Management. The Pacific Community is implementing Building Safety and Resilience in the Pacific, which is financed by the European Union and implemented locally by Emergency Management Cook Islands. A second phase of PCRAFI is being rolled out as part of the World Bank's regional Pacific Resilience Program.

17. **ADB priorities and contributions.** ADB priorities in the Cook Islands are guided by the Pacific Approach, which serves as the country strategy for the 11 smaller developing member countries in the Pacific.[21] The approach focuses on a three-pronged strategy: reduce costs, manage risks, and enable value creation. ADB's sector priorities in the Cook Islands are public sector management, energy, information and communication technology, and DRM. ADB provides a combination of investment projects, technical assistance, and policy-based lending to improve development outcomes in these sectors. Planned ADB lending to the Cook Islands includes projects for improving internet connectivity and renewable energy.[22]

B. Impact and Outcome

18. The disaster resilience program's impact is aligned with the objectives of the government's National Sustainable Development Plan (footnote 9) to strengthen resilience to combat the impacts of climate change and natural disasters, and build resilient infrastructure. The outcome will be adverse economic and social impact of disasters reduced.

C. Outputs

19. The government has successfully accomplished 12 vital prior actions to improve disaster resilience, which are presented in the policy matrix.[23] These actions provide the basis for establishing eligibility to access contingent credit provided through the proposed PBL. A post-program monitoring framework has been agreed with the government to further strengthen DRM performance. The program has three outputs:

(i) **Output 1: Policy and institutional arrangements for DRM strengthened.** In 2016, the cabinet approved the National Sustainable Development Plan, 2016–2020 (footnote 9), which includes two specific objectives: to strengthen resilience to combat the impacts of climate change and natural disasters, and to build resilient infrastructure. Public consultations on a second joint national action plan

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[19] PCRAFI is a joint initiative of the Pacific Community, through its Applied Geoscience and Technology Division, the World Bank, and ADB, with the financial support of the Government of Japan and the Global Facility for Disaster Reduction and Recovery.
[20] The maximum insurance payout to the Cook Islands for a 1-in-10-year attachment point is about $2.9 million.
[21] ADB. 2016. *Pacific Approach, 2016–2020.* Manila.
[22] ADB. 2016. *Cook Islands: Country Operations Business Plan, 2017–2019.* Manila.
[23] The policy matrix is in Appendix 4.

for DRM and climate change adaptation, which will clarify and formalize the institutional arrangements for DRM, have been completed with cabinet endorsement of the plan expected in 2017,. DRM plans covering arrangements and responsibilities for local governments and communities—a critical first line of defense in responding to disasters—have been prepared for the 10 *Pa Enua* (outer islands) and are being prepared for the 10 *punas* (local government districts) of Rarotonga. The government is ensuring that regular meetings of the National Disaster Risk Management Council take place, with their frequency increased to once per quarter by the end of 2017, in compliance with the DRM Act. The government has taken steps to improve public awareness of disaster risks through the preparation of DRM learning modules for schools, which were first distributed in 2014 and will be further disseminated in 2017; and the development of training modules, targeting key areas of DRM accountabilities relevant to each government agency, that will be disseminated in 2017.

(ii) **Output 2: Disaster resilience of physical assets improved.** The government has obtained information from registered contractors on the availability and price of services and goods for post-disaster cleanups, such as debris removal, and the restoration of essential services, including power and water. The National Infrastructure Investment Plan has been prepared that identifies priority infrastructure needed to increase resilience, including risk mitigation measures (footnote 13). The government has also put in place a requirement that all proposals for public investment projects over NZ$150,000 include an assessment of disaster and climate risks. In 2017, the government will further enhance this requirement by designing and implementing a dedicated screening tool for disaster and climate risks. Preparations are underway for a revised building code, which will include specific standards for improving the disaster resilience of public and private assets, with cabinet endorsement expected in 2017.

(iii) **Output 3: Disaster risk financing expanded.** To bolster the fiscal buffers for disaster response, the government established the disaster emergency trust fund and purchased disaster insurance coverage under PCRAFI. To further expand disaster risk financing, the government has committed to continue to increase funding for the trust fund and pay the annual insurance premiums for PCRAFI coverage. The proposed PBL will provide a critical additional and complementary layer, currently absent, for disaster risk financing, which will further increase the government's overall fiscal buffers, enabling the country to better respond to and better cope with the impact of disasters.

D. Development Financing Needs

20. Financing needs for post-disaster response and recovery provided under the PBL have been determined based on (i) the likely fiscal impact of a 1-in-10-year disaster, taking into account the resources likely available from domestic and international sources; (ii) the likelihood of a drawdown during effectivity of the loan; (iii) the need to ensure that the country maintains a sustainable level of debt; and (iv) costs associated with the continued implementation of actions contained in the policy matrix (footnote 23). As the proposed PBL is for contingent financing to support additional public spending associated with short-term post-disaster financing needs such as debris removal, restoration of key public services, and other priority expenditures that the government may determine based on the severity of a disaster, there is no direct correlation between the loan amount and the cost of policy reforms as is the case with typical PBLs.

21. The government has requested a loan of NZ$13.95 million from ADB's ordinary capital resources to help finance the program. The loan will have a 15-year term, including a grace period of 3 years, with repayments calculated based on a disbursement-linked amortization schedule, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions set forth in the draft loan agreement.

E. Implementation Arrangements

22. The Ministry of Finance and Economic Management is the executing and implementing agency, supported by key government agencies, including the Office of the Prime Minister, Emergency Management Cook Islands, and Infrastructure Cook Islands. The cabinet will provide overall strategic guidance. Individual policy actions form part of existing sector strategies that will continue to be discussed with the private sector and civil society groups during program implementation.

23. The program will be implemented up to 31 December 2019. It is designed to give operational flexibility in delivering disaster-responsive financing to the Cook Islands. Eligibility to withdraw loan proceeds will be based on the achievement of prior actions in the policy matrix; however, actual withdrawals would be deferred and only triggered in the event of an official declaration of a state of disaster by the government, as defined in DRM Act, 2007. Following a disaster, but prior to submitting a withdrawal request, the government will consult with ADB to ensure that the size of the requested withdrawal is consistent with the scale of a disaster. During loan effectivity, ADB will periodically monitor the continuing implementation of the agreed policy actions, according to the post-program monitoring framework (footnote 23). Based on the availability of country program resources, ADB—in consultation with the government and other stakeholders—will provide technical assistance to support the strengthening of DRM actions, including activities to improve disaster preparedness and reduce disaster risk.

24. Loan proceeds will be withdrawn following ADB's *Loan Disbursement Handbook* (2015, as amended from time to time). A disbursement-linked repayment schedule will be used. Depending on the assessed severity of a disaster, the government may choose to drawdown only a part of the available program funds.[24] A specific repayment schedule based on the size of the drawdown and the remaining, unutilized funds will be calculated.

III. DUE DILIGENCE

A. Economic and Financial

25. The envisaged reform impacts include (i) a clearer DRM policy and institutional arrangements that will improve the country's preparedness for and response to disasters, (ii) the improved resilience of public and private physical assets to withstand the impact of disasters, and (iii) larger fiscal buffers to meet financial needs during the immediate aftermath and early recovery period of a disaster. Taken together, the policy actions will improve the ability of the Cook Islands to better withstand and cope with the short- and longer-term impacts of disasters.

[24] This is a similar arrangement to that used for the Public Expenditure Support Facility Program for Indonesia, which used installments under a single tranche (footnote 2).

B. Governance

26. The government is finalizing an updated PFM road map for 2016–2020 that builds on the positive progress analyzed in the 2012 and 2015 public expenditure and financial accountability assessments. The road map will include further improvements to financial management legislation and tighter fiscal responsibility ratios in relation to debt targets, cash balances, and personnel expenses. In 2016, the Ministry of Finance and Economic Management initiated the feasibility stage of procuring a single PFM information system, which will streamline financial management practices across the government. A public sector strategy has been released, which focuses on three areas of public service performance: people, systems, and structures.[25] ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the Ministry of Finance and Economic Management.

C. Poverty and Social

27. Policy actions—based on three outputs designed to strengthen DRM policy and institutional arrangements, improve structural resilience, and expand disaster risk financing—will allow the government to maintain greater fiscal stability in the event of a disaster and enable the government to initiate relief and recovery efforts with minimum delay, mitigating the immediate economic and social impacts. Implementation of the policy actions is expected to continue to strengthen social protection arrangements that are already in place, ensuring communities and vulnerable households, including households headed by women, are able to reach safety in the event of a disaster, have access to sufficient relief supplies to meet their immediate needs, and receive support to rebuild their lives and assets. The PBL is classified *some gender elements*, with positive poverty and social impacts through stronger DRM that will equally benefit both women and men, and the collection of sex-disaggregated data to better monitor the impacts of and response to disasters.

D. Safeguards

28. In line with ADB's Safeguard Policy Statement (2009), the PBL is classified *category C* for the environment, involuntary resettlement, and indigenous peoples. Program activities will be confined to policy and institutional reforms, and none of the activities will result in or lead to involuntary resettlement, nor will they negatively affect indigenous peoples or the environment. Stakeholder dialogue was carried out during the program design and will continue during program implementation.

E. Risks and Mitigating Measures

29. Major risks and mitigating measures are summarized in Table 3 and described in detail in the risk assessment and risk management plan.[26] PFM systems are assessed as strong and generally able to support effective public service delivery. The remaining fiduciary risks will be addressed through policy reforms and technical assistance. The integrated benefits and impacts of the program are expected to outweigh the costs.

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[25] Government of the Cook Islands. 2016. *Cook Islands Government Public Sector Strategy, 2016–2025.* Rarotonga.
[26] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Table 3: Summary of Risks and Mitigating Measures

Risks	Mitigating Measures
External shocks (disasters, economic downturn) damage the economy.	Development partners support the government in building buffers to improve resilience to economic shocks.
Action on the recommendations for improvement from PEFAs is insufficient.	Multi-partner support is ongoing in response to weaknesses identified in the PEFAs.
Parliamentary and community support for DRM action is insufficient.	Broad-based support for the policy actions is developed and regular and systematic policy dialogue between the government and key stakeholders is conducted.
Government agencies fail to prioritize DRM actions.	Development partners provide technical assistance for the capacity building of government counterparts. The National Disaster Risk Management Council provides a monitoring mechanism.
Government agencies lack the capacity and the motivation to implement the policy actions.	Development partners provide technical assistance to develop the capacity of government counterparts. Periodic monitoring to assess and report on the progress of the PBL is conducted. Targeted DRM training for civil servants is developed and implemented.
Political uncertainties slow momentum on policy actions.	Development partners remain ready to engage flexibly and communicate the substance of DRM actions.
Requested loan withdrawal amount exceeds short-term post-disaster financing needs.	The loan agreement includes a provision for the government to consult with ADB prior to submission of a withdrawal request.

ADB = Asian Development Bank, DRM = disaster risk management, PEFA = public expenditure and financial accountability assessment.
Source: Asian Development Bank

IV. ASSURANCES

30. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan documents. The government has agreed with ADB on certain covenants for the program, which are set forth in the loan agreement.

V. RECOMMENDATION

31. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and acting, in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve the loan of NZ$13,950,000 to the Cook Islands for the Disaster Resilience Program, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Stephen P. Groff
Vice-President

10 November 2016

DESIGN AND MONITORING FRAMEWORK

Impacts the Program is Aligned with

Resilient infrastructure built (goal 5 of the National Sustainable Development Plan, 2016–2020)[a]
Resilience to combat the impacts of climate change and natural disasters strengthened (goal 13 of the National Sustainable Development Plan, 2016–2020)[a]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome	By December 2019		
Adverse economic and social impact of disasters reduced	Satisfactory rating in the National Sustainable Development Plan resilience index (baseline: not applicable; target: on track)	Central Policy and Planning Division, Office of the Prime Minister	Political uncertainties slow momentum of policy actions External shocks (disasters, economic downturn) damage the economy
Outputs	By December 2016		
1. Policy and institutional arrangements for DRM strengthened	1a. National development plan that is proactively gender inclusive and incorporates disaster resilience approved by the cabinet 1b. Public consultations on the second JNAP for DRM and climate change adaptation completed 1c. Two meetings of National Disaster Risk Management Council are held 1d. Island DRM plans for 10 *Pa Enua* (outer islands) prepared and being updated, and preparation of plans commenced for 10 *punas* (local government districts) on Rarotonga 1e. DRM learning modules prepared for integration into the school curriculum and phased dissemination to schools throughout the country 1f. Development of training modules targeting key areas of DRM	1a. National Sustainable Development Plan, 2016–2020 1b. Climate Change Cook Islands and Emergency Management Cook Islands 1c. Meeting notes from council meeting 1d. DRM plans of the islands and *punas* 1e–f. Training materials from Emergency Management Cook Islands	Government agencies lack the capacity and the motivation to implement the policy actions Action on the recommendations for improvement from PEFAs is insufficient Parliamentary and community support for DRM action is insufficient Government agencies fail to prioritize DRM actions Insufficient budget allocation for the disaster management office

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
	accountabilities relevant to each government agency commenced, in support of Emergency Management Cook Island's mandate under the DRM Act, 2007		
2. Disaster resilience of physical assets improved	2a. Availability and price of services and goods for post-disaster cleanup and the restoration of essential services in the event of a disaster confirmed by registered contractors 2b. Priority infrastructure to reduce climate and disaster risks identified in the national infrastructure development plan 2c. Analysis of disaster and climate risks integrated into review process for all public investment projects over NZ$150,000 2d. Scoping mission conducted, stakeholders consulted and terms of reference prepared to draft revised Cook Islands' building codes that reflect improved disaster resilience	2a. Infrastructure Cook Islands 2b. National Infrastructure Investment Plan, 2015–2020 2c. Guidelines from Central Policy and Planning Division, Office of the Prime Minister 2d. Infrastructure Cook Islands	Staff constraints or shifting priorities delay strategic planning Capacity constraints in a post-disaster environment delay assessments Shift in public expenditure priorities
3. Disaster risk financing expanded	3a. Disaster emergency trust fund established and continues to grow (baseline: NZ$1.50 million; target: NZ$1.65 million) 3b. Sovereign catastrophe insurance cover put in place and continues to be purchased annually	3a. Ministry of Finance and Economic Management 3b. Ministry of Finance and Economic Management	Requested loan withdrawal amount exceeds short-term post-disaster financing needs Revenue shortfall restricts expenditures and ability to save Disasters necessitate drawing down of available fiscal buffers

Key Activities with Milestones
Not applicable
Inputs
ADB: NZ$13.95 million (loan)
Assumptions for Partner Financing
Not applicable

ADB = Asian Development Bank, DRM = disaster risk management, JNAP = joint national action plan, PEFA = public expenditure and financial accountability assessment.

[a] Government of the Cook Islands, Office of the Prime Minister, Central Policy and Planning Office. 2016. *Te Kaveinga Nui: National Sustainable Development Plan, 2016–2020*. Rarotonga.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=50212-001-3

1. Loan Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. Summary Poverty Reduction and Social Strategy
7. Risk Assessment and Risk Management Plan
8. List of Ineligible Items

Supplementary Document

9. Cook Islands–Macroeconomic Assessment Summary

DEVELOPMENT POLICY LETTER

Government of the Cook Islands
Minister of Finance
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31 October 2016

Mr. Takehiko Nakao
President
Asian Development Bank
Manila
PHILIPPINES

Dear President Nakao,

Letter of Development Policy - Disaster Resilience Program

The Cook Islands is subject to a high level of disaster risk from our exposure to a range of natural hazards, particularly cyclones, tsunamis, and flooding. These hazards claim lives, cause human suffering, destroy and damage public and private assets, and disrupt economic and social activities. Recent analysis undertaken by the Pacific Catastrophe Risk Assessment and Financing Initiative (PCRAFI), estimates that the Cook Islands faces an average annual loss of $4.9 million from tropical cyclones alone, with probable maximum losses of $56.8 million, $103.0 million and $198.1 million from 1-in-50, 1-in-100 and 1-in-250 year events respectively. To reduce disaster risk, better plan, and respond to and recover from disaster events, the current Government is taking important steps to improve its overall system for disaster risk management.

In 2007, the Cook Islands launched our country's 2020 visionary framework: *Te Kaveinga Nui*, which defined the national vision for 2020 as being "to enjoy the highest quality of life consistent with the aspirations of our people, and in harmony with our culture and environment". The first National Sustainable Development Plan articulated the national vision, and development outcomes desired by Cook Islanders which would be realized through a three phase medium term (5 yearly) planning approach. The recently approved National Sustainable Development Plan 2016–2020 marks the third and final phase of this journey.

Since its election in November 2010, the Government has taken important steps to strengthen the overall economic resilience of the country. We have achieved an average economic growth rate of 2.2% per annum between FY2010–2015, and projected growth is expected to remain strong. We maintain a balanced budget, sustainable levels of debt, and moderate rates of inflation. Two public expenditure and financial accountability assessments, undertaken in 2012 and 2015, found the Cook Islands had appropriate policy and institutional arrangements in place to ensure an effective public financial management system.

Our economy is driven by an active tourism industry and we have continued to successfully attract a growing number of tourists to the country, reaching 125,132 visitors annually in 2015. The expansion in tourism is helping to increase our revenues and improve local business and employment opportunities for our people.

However, with a high reliance on one economic sector, the Cook Islands remains vulnerable to economic downturns and other risks, especially those stemming from natural hazards. That is why the most recent National Sustainable Development Plan includes two goals that focus specifically on improving resilience to disaster risks: goal 5, which aims to build resilient infrastructure to improve our standard of living, and goal 13, which aims to strengthen resilience to combat the impacts of climate change and natural disasters.

The Cook Islands has taken steps to improve our resilience to disaster risks by (i) strengthening the policy and institutional arrangements for disaster risk management, (ii) improving the resilience of physical assets to disaster and climate risks, and (iii) expanding the range of instruments for disaster risk financing. In line with these focus areas, the Government of the Cook Islands commits to undertaking the following specific policy actions in advance of loan effectiveness which is which is scheduled on or before 15 December:

(i) completion of public consultations on the second JNAP for disaster disk management and climate change adaptation;
(ii) holding two meetings of the National Disaster Risk Management Council in 2016;
(iii) continuing to update Island DRM plans for the 10 *Pa Enua* (outer islands), and preparing plans for 10 *punas* (districts) on Rarotonga;
(iv) preparing learning modules on disaster risk management for integration into the school curriculum and phased dissemination to schools throughout the country;
(v) commencing development of training modules targeting key areas of DRM accountabilities relevant to each government agency, in support of EMCI's mandate under the DRM Act 2007;
(vi) confirming with registered contractors the availability and price of services and goods for post-disaster clean-up and the restoration of essential services in the event of a disaster;
(vii) improving the monitoring and assessment of disaster impacts by commencing development of a damage and loss database to ensure post-disaster expenditures are tracked and reported;
(viii) identifying priority infrastructure to reduce climate and disaster risks in a national infrastructure development plan
(ix) requiring an analysis of climate and disaster risks for all proposed public investment projects over NZ$150,000;
(x) conducting a scoping mission, consulting stakeholders, and preparing a terms of reference to draft revised building codes that reflect improved disaster resilience;
(xi) committing, through the FY2017 annual budget, further financial resources to the disaster response trust fund that earmarks the use of funds for immediate use in the event of a disaster striking the country; and
(xii) committing, through the FY2017 annual budget, to continued payment of the annual insurance premium through PCRAFI.

These actions all form part of the Cook Islands broader disaster risk management efforts that will be built upon further in future years. The Government remains firmly committed to the program presented in the policy matrix to further strengthen the resilience of the Cook Islands to disaster risk. The program will put in place a disaster contingent financing mechanism that will enable the Government to rapidly access critical short-term, post-disaster resources should a disaster strike the country. The Government looks forward to continued active engagement of its development partners, including the Asian Development Bank, in supporting the Cook Islands efforts to increase its resilience to disaster risk.

Yours sincerely,

Mark Brown
Finance Minister

POLICY MATRIX

Outputs	Policy Actions by December 2016	Post-Program Monitoring Framework
1. Strengthened policy and institutional arrangements for disaster risk management	1.1 National development plan incorporating disaster resilience that is gender inclusive approved by cabinet	Government to sustain and advance efforts to strengthen the policy and institutional arrangements for disaster risk management by (i) cabinet endorsement of the second JNAP and reporting on implementation progress, (ii) holding quarterly meetings of the National Disaster Risk Management Council, and (iii) implementation and periodic updating of local disaster risk management plans. These measures should provide a sound environment for disaster risk management.
	1.2 Public consultations on the second JNAP for disaster disk management and climate change adaptation completed	
	1.3 Two meetings of the National Disaster Risk Management Council held in 2016.	
	1.4 10 *Pa Enua* (outer islands) have prepared and are currently updating their Island DRM plans, and plans are under preparation for 10 *punas* (districts) on Rarotonga.	
	1.5 Learning modules on disaster risk management prepared for integration into the school curriculum and phased dissemination to schools throughout the country.	Government will continue to raise public awareness of disaster risk management.
	1.6 Commencing development of training modules targeting key areas of DRM accountabilities relevant to each government agency, in support of Emergency Management Cook Island's mandate under the DRM Act 2007.	
2. Improved resilience of physical assets to disaster and climate risks	2.1 Availability and price of services and goods for post-disaster clean-up and restoration of essential services in the event of a disaster confirmed by registered contractors.	Government will continue to obtain confirmation of the availability and prices for services and goods for post-disaster clean-up and restoration of essential services on an annual basis before the beginning of each cyclone season.
	2.2 Priority infrastructure to reduce climate and disaster risks identified in national infrastructure development plan.	Between 2017-2019, the government will continue to allocate resources on an annual basis to implement priority infrastructure for disaster risk reduction identified in the national infrastructure development plan subject to the availability of fiscal resources.
	2.3 Analysis of disaster and climate risks required for all proposed public investment projects over N$150,000.	In 2017, the government will develop a specialized climate and disaster risk screening tool.
	2.4 Scoping mission conducted, stakeholders consulted and terms of reference prepared to	Government will complete task of developing and having the revised building code endorsed by cabinet in

	draft revised building codes that reflect improved disaster resilience.	2017.
3. Expanded range of instruments for disaster risk financing	3.1 Additional financial resources committed to the disaster emergency trust fund through the FY2017 budget	Government will continue to commit resources to the disaster emergency trust fund and make an allocation for PCRAFI premium in future annual national budgets to ensure a cost-effective layered application financing instruments to support the fiscal management of disaster risk.
	3.2 Continued commitment to PCRAFI through allocation for annual insurance premium in the FY2017 budget	