THE COOK ISLANDS

Pre-election Economic and Fiscal Update 2014

Te turanga moni a te Kavamani o te Kuki Airani I mua ake I te Ikianga Maata

Government of the Cook Islands

30 April 2014

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MINISTER OF FINANCE

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30 April 2014

STATEMENT OF RESPONSIBILITY

Pursuant to section 17 of the Minister of Finance and Economic Management (MFEM) Act 1995/96, I hereby make available a Pre-election Economic and Fiscal Update. The information in this document is based primarily on the latest data since the publication of the 2014/15 Budget Policy Statement and the 2013/14 Economic and Fiscal Update in December 2013.

I have made available to the Financial Secretary all relevant information regarding policies of the Government that could materially affect this economic and fiscal update.

The economic and fiscal information included in this update is based on the best professional judgement that we have at this period of time. I accept the overall responsibility for the integrity of the Pre-election Economic and Fiscal Update and its compliance with the Ministry of Finance and Economic Management Act 1995/96.

Kia Manuia,

Honourable Mark Brown

Minister of Finance

MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT
GOVERNMENT OF THE COOK ISLANDS

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30 April 2014

STATEMENT OF RESPONSIBILITY

Section 17 of the Ministry of Finance and Economic Management Act 1995/96 requires that the Minister of Finance publish a report containing an economic and fiscal update within fourteen days of the appointment of a polling date in relation to a general election.

The purpose of the Pre-election Economic and Fiscal Update is to provide up to date information on the state of the economy and the financial position of Government. The information provided in the update takes in to account as much as possible all Government decisions and other circumstances that may have material effect on economic and fiscal conditions.

I have received the assurance of the Minister of Finance that he has disclosed all relevant information regarding Government policies that could materially affect the update.

The Pre-election Economic and Fiscal Update primarily reflect significant factors that have changed since the publication of the 2014/15 Budget Policy Statement and the 2013/14 Economic and Fiscal Update in December 2013.

As Financial Secretary, I accept full responsibility for the integrity of the information provided.

Kia Manuia,

Richard Neves
Financial Secretary

1 SUMMARY OF FISCAL AND ECONOMIC UPDATE

1.1 Overview

Section 17 of the MFEM Act requires that within 14 days of the appointment of the polling day in relation to any general election of members of Parliament, the Minister shall cause to be prepared a report containing an economic and fiscal update as at the date of the appointment of the polling dates. The date of appointment of the polling dates was made on the 16 April 2014.

The purpose of providing this update is to provide the general public information on the state of the economy and governments associated fiscal position.

Prior to this publication, the most recent Economic and Fiscal Update was published and made available on 18 December 2013 alongside the 2014/15 Budget Policy Statement. This update includes various updates to operating revenues and expenditures for 2013/14 through to 2016/17.

1.1.1 Fiscal Setting Overview

Estimated Underlying Budget Balance 2013/14

The 2013/14 Budget was initially developed under tight fiscal circumstances. At that stage, it was projected that the Budget would have a small net underlying operating surplus of $0.046 million. The estimate of the underlying operating balance at the time of the 2013/14 Half Year Economic and Fiscal Update (HEYFU) worsened to a deficit of $1.9 million as it included a number of decisions and actions around the tax reform package. The 2013/14 net underlying operating position has improved, and is now projected to be a $0.112 million deficit.

The key factors in reducing the operating deficit for 2013/14 were the $1.5 million saving in the underwrite of the longhaul services to Rarotonga, and a $1.1 million saving in un-programmed capital (previously appropriated to the Ports Authority).

Offsetting these savings are lower than anticipated taxation revenue.

Estimated Underlying Budget Balance 2014/15 to 2016/17

Recent adjustments, along with changes in the economic forecasts, have resulted in revised net underlying operating deficits of $0.739 million in 2014/15 and $1.468 million in 2015/16. The Budget is then expected to return to a net underlying surplus of $3.506 million in 2016/17 due to a recovery in revenues.

The development of the 2014/15 Budget will need to be undertaken in a tight fiscal environment with limited fiscal space for new initiatives without the inclusion of revenue or savings measures (to offset any intentions of increased spending).

Future policy objectives will need to be pursued within the established principles in the fiscal responsibility ratios (FRRs). The FRRs establish the long term parameters for fiscal management and ongoing Budget development, with a focus on the level of expenditure on Crown debt. Broadly, the fiscal performance of the Cook Islands against the FRRs has been good.

However, the growing cost of the public service is concerning and future policy measures will be required to reduce growth and extract greater productivities in this area. Ultimately, the 2014/15 Budget will operate under tight fiscal conditions – competing policy objectives will require prioritisation.

1.1.2 Economic Setting Overview

Since the last public update in December 2013 tourism arrivals have fallen marginally short of forecasts. Nevertheless, they remain above the arrivals for the same period in the previous year (2013). Economic growth prospects for the Cook Islands remain positive in the short term, due in part to the much lower than expected inflation outcomes so far this year (March quarter inflation 2014 was just 0.9 per cent compared to March 2013).

The decline in Cook Islands Government capital spending and the implementation of aid projects are the main risks to the economy outside of changes in tourism arrivals. Offsetting this somewhat are the economic gains stemming from the Cook Islands Government 2013 Tax Review, which adds significantly to gross domestic product (GDP) in 2014/15and the last quarter of 2013/14.

Nominal GDP growth is estimated at 4.8 per cent for 2013/14, due largely to increased Government capital spending and the implementation of the Tax Review offsetting a slight slowing in tourism growth. Growth falls to 3.9 per cent in 2014/15 due to the benefits of the Tax Review and improved tourism growth being partially offset by declines in capital spending.

Inflation as measured by the Cook Islands Consumer Price Index (CPI) was 2.6 per cent in 2012/13, however, year average inflation from March 2013 to March 2014 was only 1.5 per cent (with through the year inflation even lower, at just 0.9 per cent). With the exception of the once-off increase in the VAT on 1 April 2014, inflation is expected to adjust towards its long-term trend. The year average CPI is forecast to increase 2.3 per cent in 2013/14 due to the change in VAT affecting the June quarter, before increasing to 4.6 per cent in 2014/15.

2 FISCAL UPDATE

2.1 Overview

Section 17 of the Ministry of Finance and Economic Management (MFEM) Act 1995/96 requires the Minister of Finance and Economic Management to publish a report containing an economic and fiscal update within 14 days of the appointment of a polling date in relation to a general election.

To control the impacts of fiscal policy on fiscal and macroeconomic stability, the Government of the day must operate within the fiscal responsibility principals outlined in the MFEM Act as follows:

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

The purpose of the Fiscal Update is to revise the fiscal forecasts underpinning the 2014/15 Budget Policy Statement and the 2013/14 Economic and Fiscal Update published in December 2013. In updating the fiscal forecasts the following factors have been considered:

- year to date assessment of revenues and expenditure patterns against the 2014/15 Budget Policy Statement and the 2013/14 Economic and Fiscal Update; and
- updated economic forecasts which have impact on forecasted government revenues.

Since the 2013/14 Half Year Fiscal and Economic Update total :

- operating revenue has increased by $0.6 million; and
- expenditure will increase by $0.485 million.

The impact of these changes will move the underlying budget balance for 2013/14 from a deficit $1.5 million projected in the 2013/14 HYEFEY, to a reduced deficit of $0.112 million for the remainder of the 2013/14 financial year.

Table 2.1 Reconciliation Table, changes since BPS & HYEFEU December 2013 ($'000)

Statement of Government Operations	2013/14 Forecasts	2014/15 Forecasts	2015/16 Forecasts	2016/17 Forecasts
Net Underlying Operating balance Budget 2013/14 June 2013	**46**	**-1,068**	**606**	**606**
Revenue Parameter Changes	-180	216	-1,074	4,097
Revenue Decisions	-512	2,726	2,726	2,726
Expenditure Parameter Changes	0	0	0	0
Expenditure Decisions	868	2,603	2,603	2,603
Net Underlying Operating balance Budget BPS & HYFEU December 2013	**-1,514**	**-730**	**-346**	**4,825**
Revenue Parameter Changes	-641	827	-283	-38
Revenue Decisions	876	-381	-385	-385
Expenditure Parameter Changes	0	0	0	0
Expenditure Decisions	1,587	455	455	455
Expenditure Savings	-2,753	0	0	0
Current Net Underlying Operating balance Budget 2013/14	**-112**	**-739**	**-1,468**	**3,948**

2.1.1 Changes to Revenue

Overall changes to revenue since the publication of the 2013/14 HYEFU have seen an increase in revenue from $117.8 million to $118.4 million, an increase of $0.6 million. This is predominantly due to the sale of additional 300 days catch revenue to the US under the Fisheries Treaty. It is important to note that this fisheries revenue is only a one off adjustment for 2013/14 and has not been factored into the outer year estimates. Included in these revenue adjustments are movements in taxation which have been reduced to reflect year to date actuals.

Offsetting this were reductions in estimated revenue from Big Eye Tuna quota with the EU of $0.203 million. Overall fisheries revenue has increased by $1.2 million for 2013/14. Additionally, there was an increased dividend from Bank of Cook Islands of $0.070 million which was a result of improved profit performance.

Other adjustments to revenue include the reduction in immigration fees by $0.330 million as the new proposed fee structure was not implemented as proposed at the time of the 2013/14 Budget.

In terms of tax revenue, the parameter changes are the combined effect of five additional months of 2013/14 collections and new economic information.

At the time of the 2013/14 HYEFEU, the actual revenue received from import levies in the 2012/13 year exceeded expectations, resulting in a $2.1 million upward revision in import levy forecasts for 2013/14. It was assumed that this is due to tobacco importers avoiding the 33 per cent increase in tobacco levies by stockpiling tobacco before the scheduled levy increases on 1 July. Actual collections since the publishing of the 2013/14 HYEFEY have shown a much larger fall in import levies than can be explained by this effect, and hence, the estimates have been revised again to try and account for the use of local inventories rather than additional imports. Combined with lower import volumes of levied goods, import levies have been revised down by $2.8 million in 2013/14, $0.934 million in 2014/15, and $2.5 million in 2015/16 (due to importers avoiding the final increase in the levy in that financial year, but not facing an increase in 2016/17).

Other changes in tax forecasts are due to the combined effects of year to date collections for 2013/14 and parameter changes.

Table 2.2 Changes to Revenue ($'000)

Revenue Changes	2013/14 Forecasts	2014/15 Forecasts	2015/16 Forecasts	2016/17 Forecasts
Revenue Parameter Changes BPS & HYFEU vs 2013/14 Budget	**-180**	**216**	**-1,074**	**4,097**
VAT Adjustments	475	771	659	2,047
Income Adjustments	-2,792	-1,612	-1,190	221
Import Levies Adjustments	2,097	1,873	403	1,986
Company Tax Adjustments	1,074	713	681	1,079
Departure Tax Adjustments	-1,333	-1,529	-1,626	-1,236
Withholiding Adjustments	300	0	0	0
Revenue Decisions BPS & HYFEU vs 2013/14 Budget	**-512**	**2,726**	**2,726**	**2,726**
Cancellation of pork levies	-57	-229	-229	-229
Cancellation of shipped eggs levies	0	0	0	0
Cancellation of ice cream levies	-26	-106	-106	-106
Increase in the VAT	1,959	7,835	7,835	7,835
Decrease in personal income rates and raising the tax-free threshold	-2,888	-5,775	-5,775	-5,775
Remove international airline exemption	250	500	500	500
Include interest earnings as part of general income	250	500	500	500
Revenue Changes at BPS & HYFEU	**-692**	**2,941**	**1,652**	**6,822**
Current Revenue Parameter Changes vs BPS & HYFEU	**-641**	**827**	**-283**	**-38**
IMO Subscription-MCI	63	63	63	63
Shipping Registration	22	22	22	22
Court Services	10	10	10	10
Circulating Currency	50	0	0	0
Bank of the Cook Islands - dividend	70	0	0	0
Trade Shows	254	200	200	200
Apostiles	12	12	12	12
VAT Adjustments	465	658	721	192
Income Adjustments	213	126	431	240
Import Levies Adjustments	-2,844	-934	-2,456	-1,340
Company Tax Adjustments	-301	-84	42	-37
Departure Tax Adjustments	838	754	672	601
Withholiding Adjustments	508	0	0	0
Current Revenue Decisions vs BPS & HYFEU	**876**	**-381**	**-385**	**-385**
Immigration Fees	-336	-381	-385	-385
Fisheries Catch Revenue				
Catch Revenue additional 300 days increase - USA	1,900	0	0	0
Catch Revenue additional 100 days increase - USA	600			
EU Partnerships - Big Eye Tuna Quota	-700	0	0	0
Reduction in Purseine Revenue	-230	0	0	0
Fishing Licences Revenue				
Increase in Albacore Tuna Licence Fees	442	0	0	0
Reduction in Big Eye Tuna Licenses	-800	0	0	0
Current Revenue Changes	**235**	**446**	**-668**	**-423**
Total Revenue Changes from BPS & HYFEU to Current Budget 13/14	**-457**	**3,387**	**984**	**6,400**

Note: a negative number indicates a negative impact on the Budget (a decline in revenue)

2.1.2 Changes to Expenditures

Total operating expenditure estimated for 2013/14 has reduced to $118.5 million, a $1.2 million reduction compared to $119.8 million at the time of the Budget Policy Statement in December 2013.

Gross operational expenditure by Ministries has increased by $0.485 million, from $63.5 million to $64.1 million.

Identified Savings

Up until April MFEM identified expenditure savings totalling $2.8 million — mainly resulting from the improved performance of the underwrite of the long haul services operated by Air New Zealand and $1.1 million in unprogrammed capital that was previously appropriated for the Ports Authority. Personnel expenditure has also been reduced by $0.136 million as result of delays in recruitment for vacancies, it is anticipated that even further savings may be made in 2013/14 and will be utilised to accommodate the operations of Government at the commencement of 2014/15 if there are delays in an appropriation bill being passed by the Parliament. Further details of current savings are provided in Table 2.3.

Table 2.3 Savings in 2013/14 ($'000)

Savings in 2013/14		2013/14 Forecasts	2014/15 Forecasts	2015/16 Forecasts	2016/17 Forecasts
Air New Zealand POBOC	-	1,450	0	0	0
SOPAC Conference Savings	-	50	0	0	0
Police Conference Savings	-	6	0	0	0
Standard and Poors	-	1	0	0	0
Ports Authority non programmed capital	-	1,110	0	0	0
Personnel Savings from Ministries	-	136	0	0	0
Total Savings 2013/14	**-**	**2,753**	**0**	**0**	**0**

Additionally, further savings of $0.927 million were identified in Capital expenditure which are summarised below:

- the fit out of the Auckland Consulate general in Manukau of - $0.008 million;
- changes to the procurement of an ambulance for Rarotonga - $0.110 million
- deferral of Road Network Maintenance - $0.150 million
- deferral of Water Network Maintenance - $0.110 million
- deferral of Mangaia Water and Roads - $0.084 million
- deferral of National Education Renewal Program - $0.190 million
- deferral of National Health Renewal Program - $0.135 million
- deferral of Deferral of further improvements in the CI Government Procurement Website - $0.140 million

Operating expenditure has increased by $2.455 million to accommodate critical expenditures which were approved by an Order in Executive Council following the dissolution of the Parliament.

- $0.868 million in welfare adjustments as a result of the Tax Review;
- $0.280 million increase to the Contingency Fund;
- $0.121 million for premiums to fund Pacific Catastrophe Risk Insurance;
- $0.297 million for security operations following fire damage at Avatea Primary School and Nukutere College;
- $0.025 million for the ongoing work of the Infrastructure Committee;
- $0.035 million to assist the hosting of the Pacific Leaders Meeting in mid May;
- $0.010 million for the Working Group on United Nations membership;
- $0.254 million in tourism trade shows (which has been offset by Tourism trading revenue);
- $0.063 million for expenditure associated with the International Maritime Organisation (which has been offset by revenue from Maritime Cook Islands);
- $0.008 million for Debt Servicing interest;

- $0.050 million for Airport Authority;
- $0.060 million to assist Cook Islands Netball to run the Trans-Pacific Netball series;
- $0.078 million to CISNOC to reimburse the funds used for the Rugby League World Cup and Netball in Paradise event;
- $0.060 million increase to the Patient Referrals POBOC;
- $0.160 million for General Elections to be held in July 2014;
- $0.025 million to assist MFEM prepare a policy paper in regard to ongoing Government ownership of Telecom Cook Islands;
- $0.015 million for the running of the Police Womens’ Conference in Rarotonga; and
- $0.046 million for the remuneration of Clerk of House of Ariki.

Additional expenditure and development in capital which has been re-appropriated and re-prioritised amongst all capital projects originally budgeted as follows:

- Vaimaru Water Upgrade $0.050 million
- Mangaia Excavator $0.084 million
- Mauke Manea Games $0.138 million
- Turangi Clean Up Project $0.060 million
- Emergency Mission – Pukapuka Airport Repairs $0.375 million
- Emergency Mission – Mitiaro Salvage Excavator and Airport Repairs $0.099 million
- Emergency Mission – Atiu Airport Repairs and Upgrade $0.074 million
- ICI Upgrades $0.030 million
- Education building completion $0.123 million
- Aitutaki Fuel Storage Facility $0.070 million
- RMS Web Lodgement System $0.200 million

Table 2.4 – Changes to Expenditure ($'000)

Expenditure Changes	2013/14 Forecasts	2014/15 Forecasts	2015/16 Forecasts	2016/17 Forecasts
Expenditure Parameter Changes BPS & HYFEU	**0**	**0**	**0**	**0**
Expenditure Decisions BPS & HYFEU	**868**	**2,603**	**2,603**	**2,603**
Tax Review Welfare Payments				
Increase 60-69 pension by 25%	404	1,212	1,212	1,212
Increase 70+ by 25%	345	1,035	1,035	1,035
Increase child benefit by 10%	86	258	258	258
Increase destitue by 10%	13	40	40	40
Increase Caregivers by 10%	17	50	50	50
Increase Power Subsidy by 10%	3	9	9	9
Expenditure Changes at BPS & HYFEU	**868**	**2,603**	**2,603**	**2,603**
Current Expenditure Parameter Changes	**0**	**0**	**0**	**0**
Current Expenditure Decisions	**1,587**	**455**	**455**	**455**
Contingency				
Murienua by-election	10	0	0	0
Oriental Fruit Fly Eradication	30	0	0	0
Superannuation Fund - Consitutional Challenge Legal Costs	110	0	0	0
Boat Repairs Manihiki Indian Grant Co Financing	30	0	0	0
Additional Costs Associated with the Gender Conference	11	0	0	0
Donation to Investiture of Tinomana Tokerau Ariki	1	0	0	0
Legal advice- Superannuation Constitution	62	0	0	0
Rakahanga Fuel Costs	18	0	0	0
Increase Contingency Crown	0	0	0	0
Seabed Minerals-Legal Fees	8	0	0	0
Payment of Behalf of Crown				
Pacific Catastrope Risk Insurance	121	121	121	121
CISNOC Reimbursement - Rugby League World Cup	60	0	0	0
CISNOC Reimbursement - Netball	18	0	0	0
Pacific Netball Series	60	0	0	0
Infrastructure Committee	25	25	25	25
IMO POBOC	63	63	63	63
CI Police Womens Conference	15	0	0	0
Remuneration for Clerk of HOA	46	46	46	46
Government Ownership of TCI policy development	25	0	0	0
Operating				
Fire damage-Avatea Primary School and Nukutere College	297	0	0	0
Trade Shows	254	200	200	200
Pacific Leaders Meeting	35	0	0	0
Working Group UN Membership	10	0	0	0
Other				
Natural Disaster top up	0	0	0	0
Debt Servicing Interest	8	0	0	0
Airport Authority	50	0	0	0
Increase Patient Referrals	60	0	0	0
General Elections	160	0	0	0
Current Expenditure Changes	**1,587**	**455**	**455**	**455**
Total Expenditure Changes from BPS & HYFEU to Current Budget 13/14	**2,455**	**3,058**	**3,058**	**3,058**

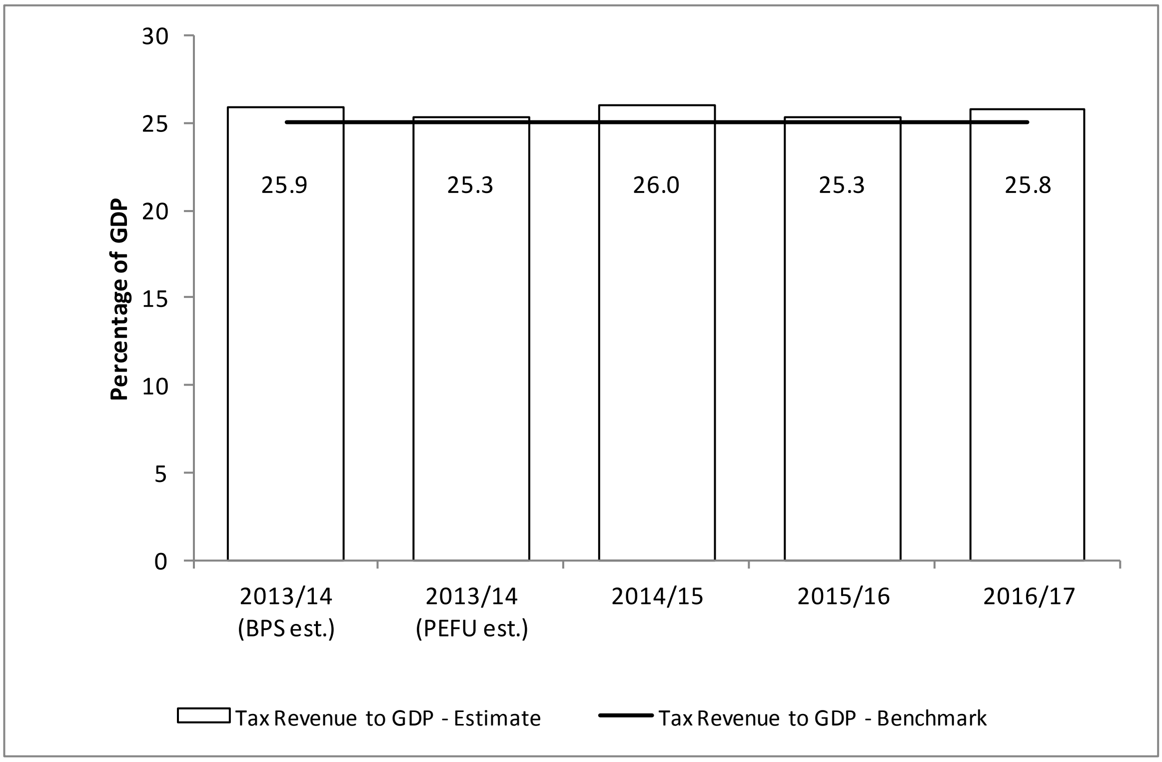
Note: a negative number indicates a reduction in expenditure which indicates identified savings

2.1.3 Tax Revenue to GDP

This ratio establishes boundaries on the collection of revenue and ensures government limits the diversion of resources away from the private sector. The benchmark that current and previous governments have agreed to work within is to maintain collections to within 25 per cent of GDP. The expected performance against this benchmark is illustrated in Chart 2.1 below. It is important to note that following an IMF mission to the Cook Islands, Departure tax has been reclassified as a tax rather than an administration fee.

Current forecasts estimate that the Government will exceed the agreed benchmark in 2013/14 and the forward estimates, due almost entirely to the increase in VAT exceeding the personal income tax cuts (as the VAT also pays for the increases to social welfare that were approved as part of the overall tax package presented in the Tax Review).

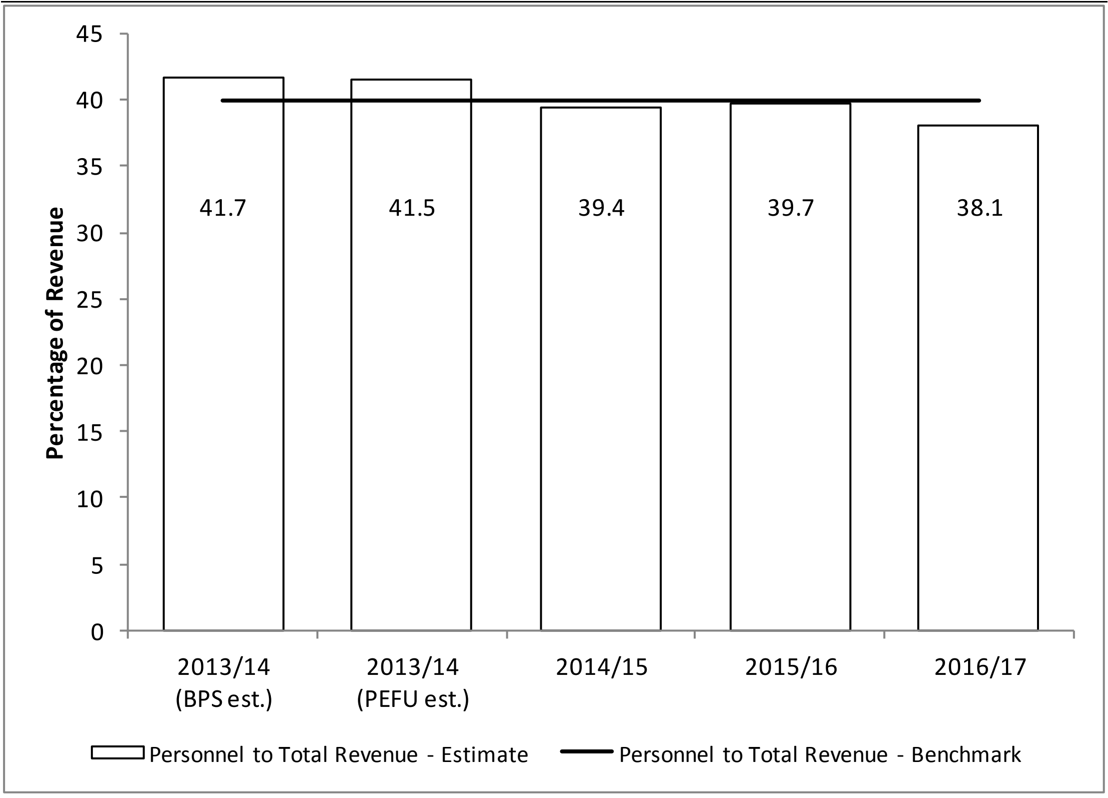
Chart 2.1 Tax Revenue to GDP, 2013/14 to 2016/17



2.1.4 Personnel Expenditure to Revenue

This ratio is aimed at controlling the expansion in the size of the public service as the largest expenditure item of Government. The benchmark that current and previous governments agreed to work within is maintaining the expenditure on personnel within 40 per cent of total revenues. As illustrated in Chart 2.2, the Government is expecting to bring the overall ratio down to 40 per cent by 2014/15. Over the medium term it is expected to come within the benchmark on the basis that the economy and revenue continues to expand as forecasted.

Chart 2.2 Personnel Expenditure to Revenue 2013/14 to 2016/17

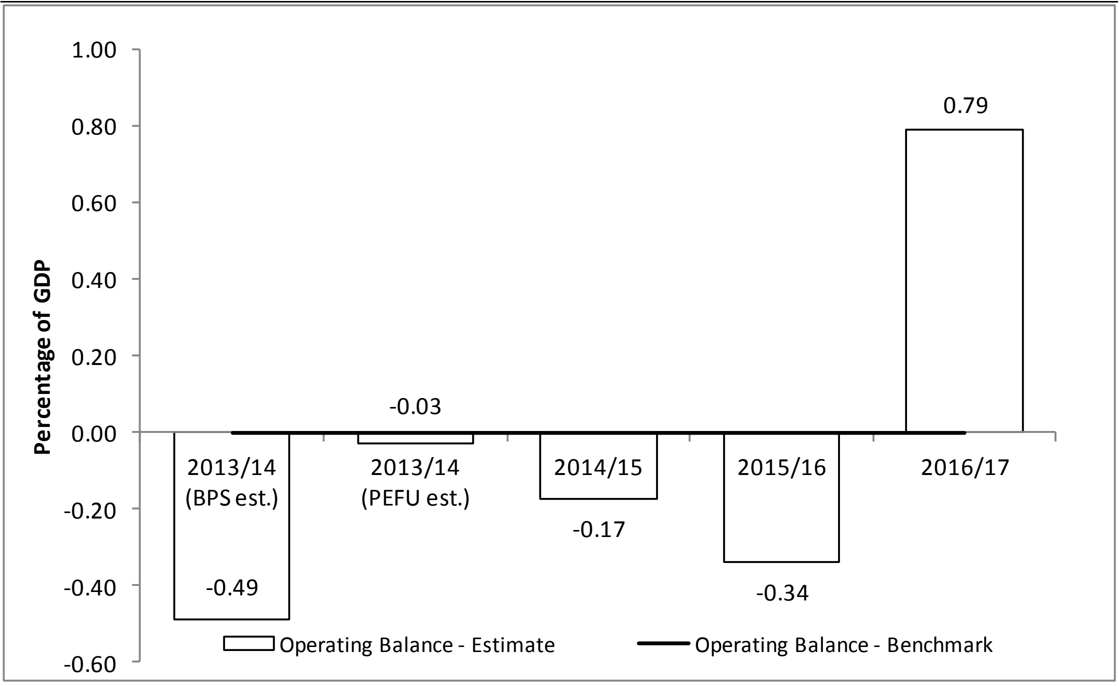


2.1.5 Underlying Net Operating Balance

Maintaining a positive operating balance indicates that Government is able to afford the operational costs of performing the functions of government from its own revenue streams. Government has set a benchmark of running an operating surplus in each Budget. As illustrated below, it is anticipated that Government has an underlying operating deficit of $0.112 million in 2013/14 due to the phasing of the Tax Review.

Going forward, changes in expenditure and revenue estimates are predicted to result in a $0.739 million operating deficit in 2014/15 and a $1.468 million deficit in 2015/16, before returning to a surplus of $3.506 million in 2016/17.

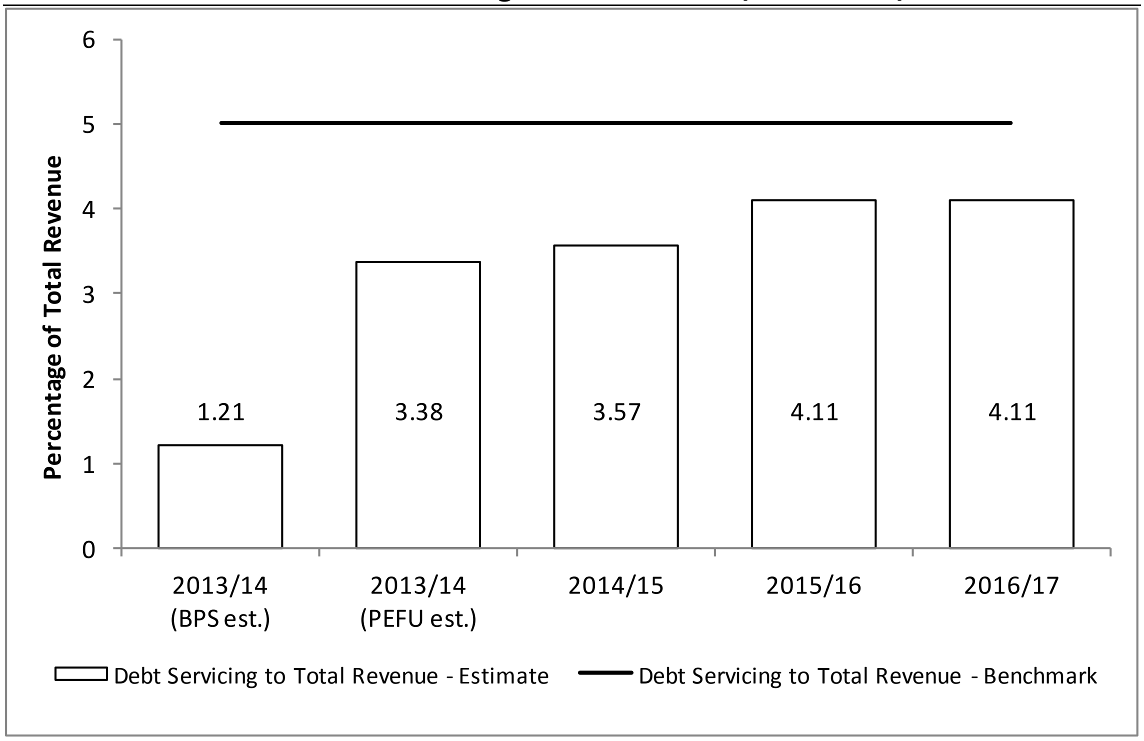
Chart 2.3 Underlying Operating Balance 2013/14 to 2016/17



2.1.6 Net Debt Servicing to Revenue

Debt servicing to total revenue measures the ability of Government to service its debt obligations from revenue collected. Debt servicing includes both interest and principle, and is now net of draw-downs in earmarked loan reserves to more accurately reflect the ability of Government to service its debt obligations. As shown in Chart 2.4, the ratio of debt servicing over the short to medium term is maintained within the benchmark of 5 per cent of total revenue.

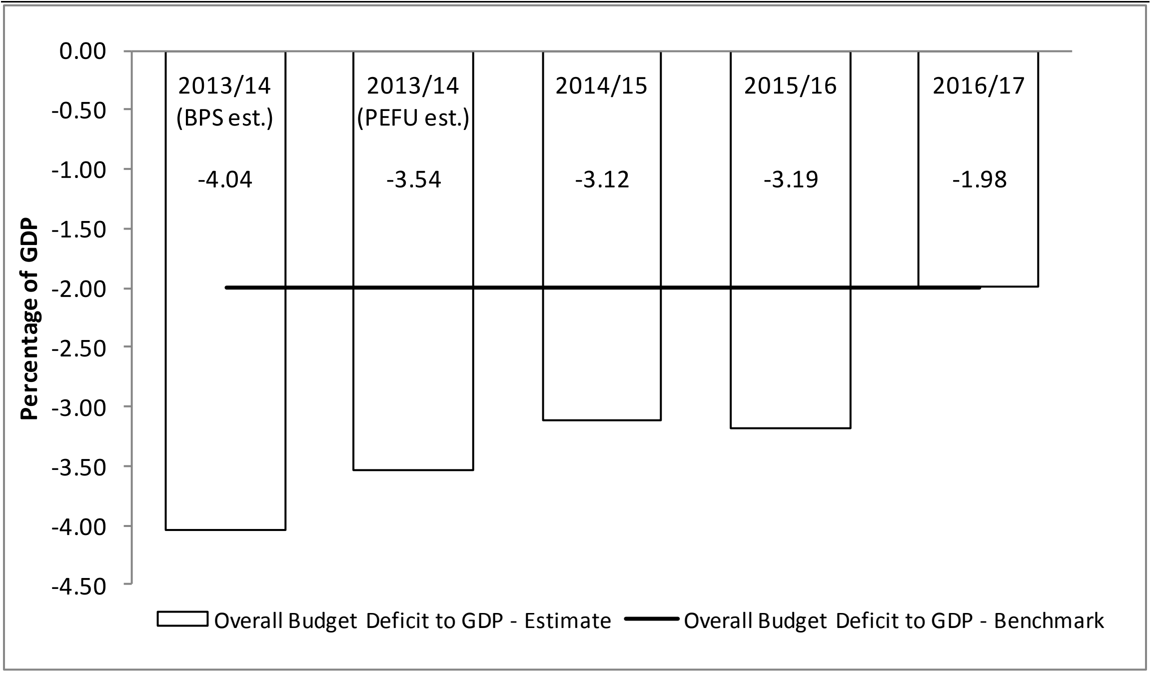
Chart 2.4 Debt Servicing to Revenue 2013/14 to 2016/17



2.1.7 Budget Overall Balance to GDP

Budget Overall Deficit is the operating balance less non-operating expenditure (purchase of assets and repayment of liabilities). Where the budget overall balance is in deficit, it must be serviced through lending or a drawdown of reserve funds. The benchmark is set to be maintained within -/+2 per cent of GDP to ensure that government does not accumulate debt too quickly, and taken together with the debt servicing to total revenue and net debt to GDP ratios, ensures that debt is managed and taken on within sustainable levels. Chart 2.5 illustrates that Government breaches the overall Budget balance in the short term due to large scale infrastructure projects, which are financed by concessional lending. This is expected to be a relatively short term trend due to the short term nature of the projects in question, as evidenced by a smaller overall deficit in 2016/17.

Chart 2.5 Budget Overall Balance to GDP 2013/14 to 2016/17



2.1.8 Net Debt to GDP

Net debt to GDP measures the level of debt relative to national income and is intended to control the overall level of debt taken on by Government including SOE's. The benchmark agreed to by Government is to maintain net debt within 35 per cent of GDP. This would represent total borrowings of $132 million estimated in 2011/12. Chart 2.6 illustrates that Government is well within the benchmark over the short and medium term.

Chart 2.6 Net Debt to GDP Ratio 2013/14 to 2016/17

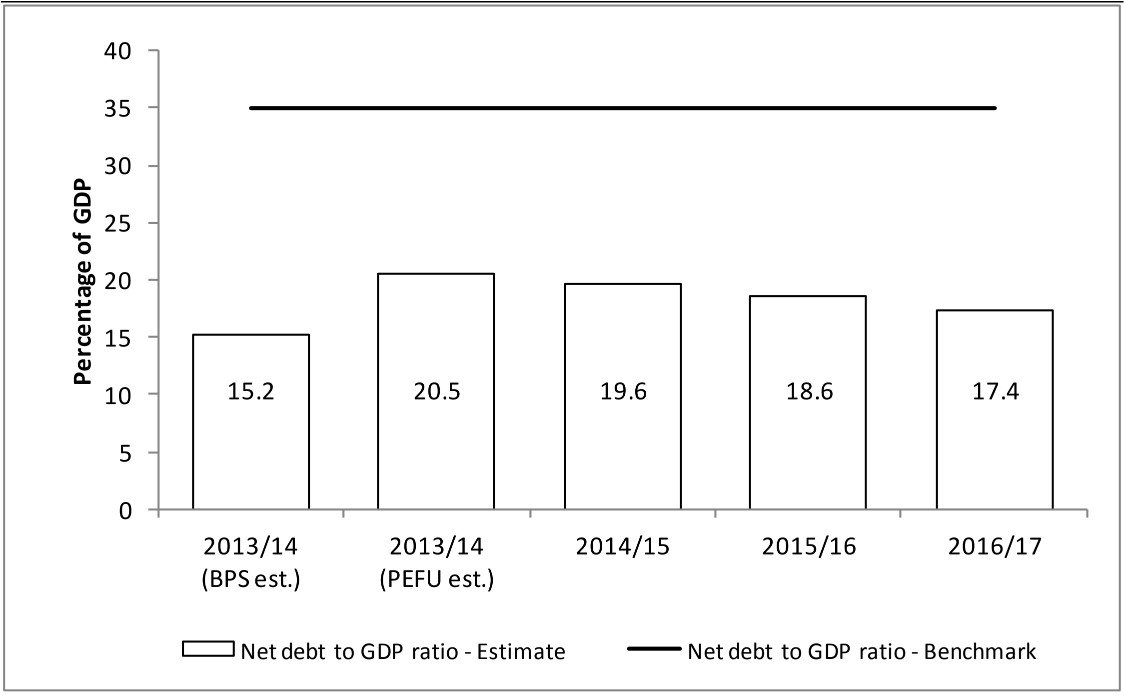


Table 2.5 Fiscal Indicators Update ($ millions)

	FY13/14 BPS Estimate	FY13/14 PEFU Estimate	FY14/15 Proj	FY15/16 Proj	FY16/17 Proj
Statement of Financial Performance					
Taxation Underlying Revenue ($m)	104.5	103.4	110.4	109.7	114.7
Social Contributions ($m)	0.1	0.1	0.1	0.1	0.1
Other Underlying Revenue ($m)	13.3	15.0	14.0	14.1	14.1
Total Operating Underlying Revenue ($m)	**117.9**	**118.4**	**124.5**	**123.8**	**128.8**
Total Underlying Underlying Revenue Percentage of GDP ($m)	29.2	29.0	29.3	28.6	29.0
Tax Underlying Revenue Percentage of GDP ($m)	25.9	25.3	26.0	25.3	25.8
Personnel ($m)	**49.2**	**49.2**	**49.1**	**49.1**	**49.1**
Percentage of Total Underlying Revenue	41.7	41.5	39.4	39.7	38.1
Total Operating Underlying Expenditure ($m)	**119.8**	**118.6**	**125.3**	**125.3**	**125.3**
Percentage of GDP	29.6	29.0	29.5	29.0	28.2
Percentage of Operating Underlying Revenue	101.7	100.1	100.6	101.2	97.3
Reappropriation of Previous Years Funds for Capital ($m)	-	-	-	-	-
Underlying Operating Balance ($m)	**(1.963)**	**(0.112)**	**(0.739)**	**(1.468)**	**3.506**
Percentage of GDP	(0.5)	(0.0)	(0.2)	(0.3)	0.8
Non Operating Balance ($m)	(14.4)	(14.4)	(12.5)	(12.3)	(12.3)
Underlying Overall Surplus/(Deficit) ($m)	**(16.3)**	**(14.5)**	**(13.2)**	**(13.8)**	**(8.8)**
Percentage of GDP	4.0	3.5	3.1	3.2	2.0
Statement of Financial Position ($m)					
Assets ($m)	477.4	476.2	483.9	486.3	492.3
Liabilities ($m)	104.5	104.0	98.3	96.0	93.4
Crown Balance ($m)	369.1	372.3	385.6	390.3	398.9
Percentage of GDP	91.3	91.1	90.8	90.2	89.8
Statement of Borrowings ($m)					
Gross Debt end of FY ($m)	102.3	100.0	98.1	94.0	89.2
Percentage of GDP	25.3	24.5	23.1	21.7	20.1
Net Crown Debt, end of FY ($m)	61.6	83.8	83.3	80.5	77.1
Percentage of GDP	15.2	20.5	19.6	18.6	17.4
Loan Repayment Reserves Held ($m)	16.3	16.2	14.8	13.5	12.1
Development Partner Support ($m)					
Grants ($m)	59.4	59.4	56.2	55.7	17.6
Percentage of GDP	14.7	14.5	13.2	12.9	4.0
Net Debt Servicing1 ($m)	1.4	4.0	4.4	5.1	5.4
Percentage of Total Underlying Revenue	1.2	3.4	3.6	4.1	4.1
Memo item: Nominal GDP ($m)	404.2	408.8	424.5	432.8	444.4

Note: The underlying operating balance of -$1.963 million published at the time of the BPS has been adjusted to reflect movements of $0.363 million (Immigration Fees) in ROBOC's and estimated contingency expenditure of $0.094 million from BPS adjustments to pre-election adjustments. These items have been included in the PEFU to reflect all detailed adjustments committed by the contingency fund.

3 GOVERNMENT FINANCIAL STATISTICS (GFS) OPERATING STATEMENT

The Operating Statement reflects the financial performance of Government and discusses general trends and revisions of forecasts for operating revenues, operating expenditures and the resultant operating balance.

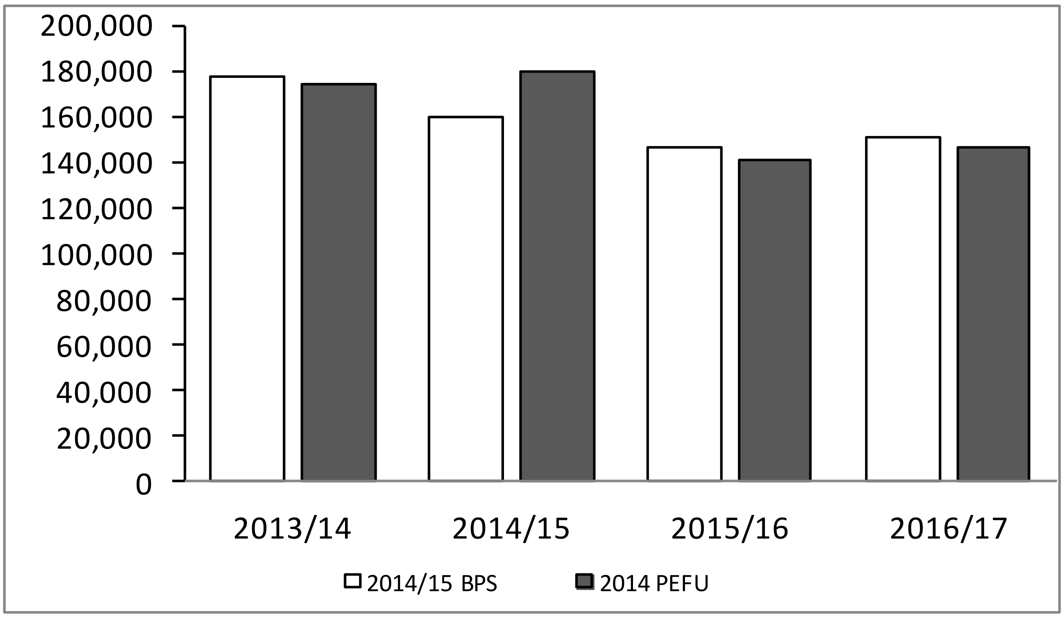
Table 3.1 GFS Operating Statement 2013/14 to 2016/17, ($000)

Statement of Government Operations	2013/14 BPS Estimates	2013/14 PEFU Estimates	2014/15 Forecasts	2015/16 Forecasts	2016/17 Forecasts
TRANSACTIONS AFFECTING NET WORTH					
REVENUE	**177,221**	**174,631**	**180,183**	**141,422**	**146,396**
Taxes	104,512	103,409	110,403	109,682	114,656
Social contributions	75	75	75	75	75
Grants	59,364	56,185	55,666	17,601	17,601
Current	12,098	12,098	10,771	10,716	10,716
Capital	47,266	44,087	44,895	6,885	6,885
Other revenue	13,271	14,964	14,039	14,064	14,064
EXPENSE	**131,918**	**130,657**	**136,027**	**136,005**	**136,005**
Compensation of employees	49,173	49,108	49,133	49,054	49,054
Use of goods and services	37,393	38,720	36,719	36,724	36,724
Depreciation	8,899	8,899	10,900	10,900	10,900
Interest	1,429	1,437	1,520	1,520	1,520
Subsidies	16,086	14,636	15,026	15,026	15,026
Grants	0	0	0	0	0
Social benefits	15,506	15,472	17,441	17,450	17,450
Other expense	3,432	2,385	5,286	5,330	5,330
NET OPERATING BALANCE	**45,304**	**43,975**	**44,156**	**5,417**	**10,391**

3.1 GFS Operating Revenue

Operating revenues are made up of taxation receipts (59 per cent), Grants/ODA (32 per cent) and other revenues, which include ministry trading revenues, interest and dividend receipts (9 per cent). These revenue streams are used to finance the on-going operational expenditure of government, with surpluses used for investing activities such as infrastructure development projects (where relevant) or cash reserves.

Chart 3.1 Total Operating Revenue 2013/14 to 2016/17, ($000)



At the time of the 2014/15 Budget Policy Statement published in December 2013, GFS Operating revenues in 2013/14 were estimated to total $177.2 million, of which $104.5 million was expected to be collected in taxes over the financial year.

Since December 2013, total movements in revenue have resulted in a downward revision of operating revenues by $2.6 million to $174.6 million, due to both parameter and policy changes.

Total tax receipts are for 2013/14 are expected to be $1.1 million lower than estimated at the time of the 2014/15 BPS, due largely to personal income tax cuts preceding the increase in VAT by three months, as well as lower than expected tax revenues so far this year.

Adjustments to indirect taxation include an increase of $1.2 million to Fisheries revenue as a result of additional catch days awarded to the US for 2013/14.

The large increase in total revenue in 2014/15 is due almost entirely to an increase in aid flows, particularly capital grants.

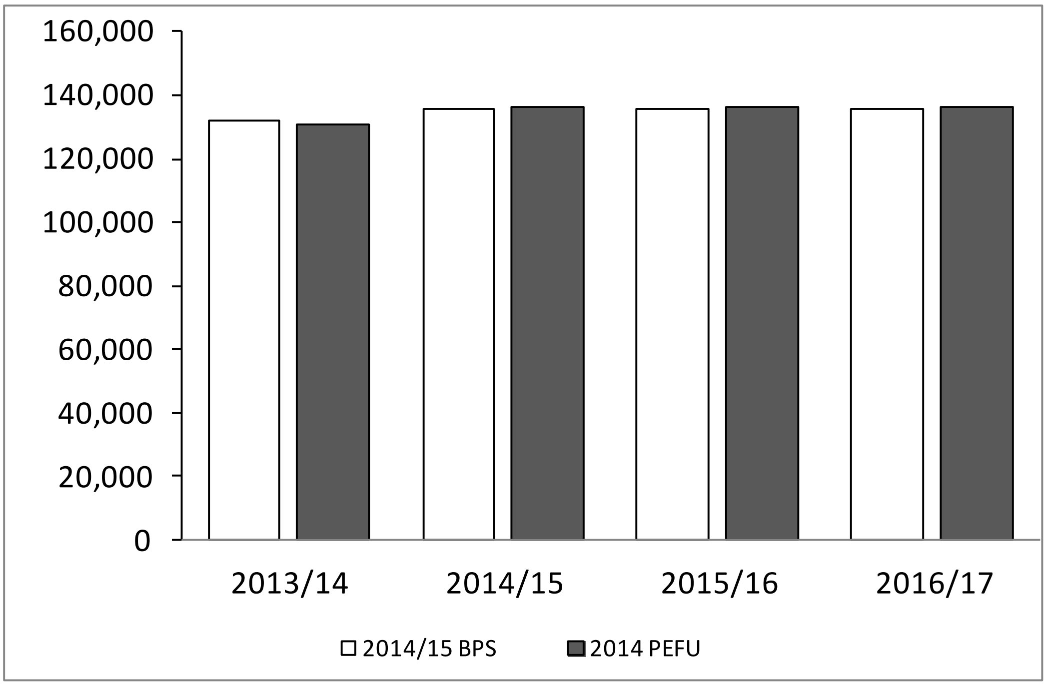
There is little to no movement on estimates for other revenue apart from Immigration fees which have been reduced by $0.4 million (reflected by delayed implementation of new the fee structure), and a $0.25 million reduction in drivers' license fees (due to tourists being able to use their national licenses instead of purchasing the local licenses). The $0.6 million annual forecast for immigration fees takes into account increase in capital infrastructure projects and influx of foreign workers, namely the Te Mato Vai project.

Total revenue is forecast to decrease in the outer years, due largely to a reduction aid flows from the completion of infrastructure projects.

3.2 GFS Operating Expenditure

Operating expenditure is made up of Compensation of Employees (37 per cent), Use of Goods and services (30 per cent), Social Benefits (12 per cent), Subsidies (11 per cent), Depreciation (7 per cent), and other expenses including interest expenses (3 per cent).

Chart 3.2 Total Operating Expenditure 2013/14 to 2016/17, ($000)



Operating expenditures at the time of the 2014/15 Budget Policy Statement published in December 2013 were estimated at $131.9 million, these have been revised downwards to reflect a decrease of $1.3 million in total expenditures which is mainly driven by the reduction in the Air New Zealand Underwrite of $1.5 million and the reduction of the Ports Authority non-programmed capital of $1.1 million, as well as savings in other areas.

Significant increases in operating expenditure from 2014/15 onwards are due to the $2.6 million a year increase to the local Cook Island social welfare payments. On 1 March 2014, the Government increased all pensions by 25 per cent. Those who are aged over 70 will now collect $625 per month (a $125 increase), and those who are between 60 and 70 will now collect $500 per month (a $100 increase). This takes the 70+ pension closer to the Government's promise to double the 70 plus pension to $800 per month.

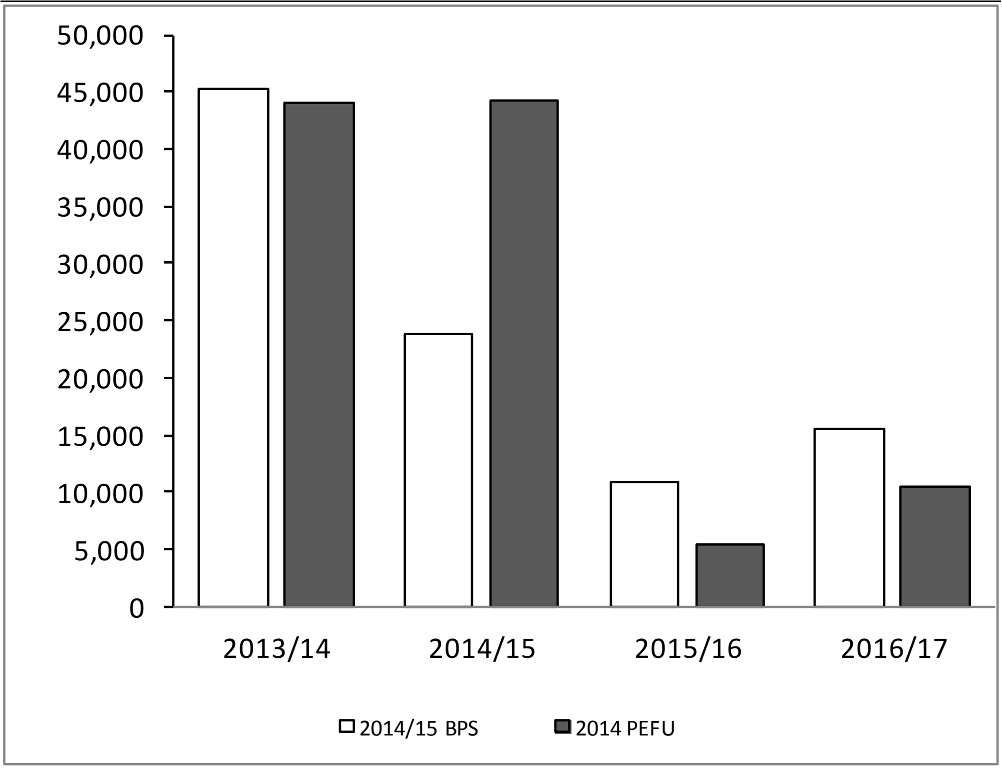
As compared to the 2014/15 Budget Policy Statement, the difference in forecast expenditure from 2014/15 onwards is due to the $0.12 million from the Pacific Catastrophe Risk Insurance program (signed up to in late 2013), and recognising $0.2 million in operating expenditure for Tourism Corporation trade shows (Budget neutral, as it is matched by increased trading revenue). Other increases relate to a $0.134 million increase in other POBOCs.

3.3 GFS Net Operating Balance

The GFS operating balance is the balance of operating revenues minus operating expenditure as prescribed by the MFEM Act. Given the analysis provided in sections 3.1 and 3.2, the GFS net operating balance in 2013/14 at the time of the 2014/15 BPS was estimated at $45.3 million. Considering the revised estimates mentioned above, the net operating balance has been revised to $44.0 million.

Going forward, changes in expenditure and revenue estimates are predicted to result in a $44.2 million operating balance for 2014/15, $5.4 million in 2015/16 and $10.4 million in 2016/17. GFS Net Operating balance is demonstrated below in Chart 3.3.

Chart 3.3 GFS Net Operating Balance 2013/14 to 2016/17, ($000)



Changes to the GFS operating balance and the underlying operating balance since the time of the 2014/15 BPS are shown below in Table 3.1, Table 3.2, and

Table 3.3, respectively.

Table 3.2 Changes to GFS Operating Balance since 2014/15 BPS ($000)

	2013/14	2014/15	2015/16	2016/17
GSF Operating Balance as at 2014/15 BPS	**45,304**	**23,829**	**10,829**	**15,558**
Change to Operating Revenues	-2,590	20,782	-4,957	-4,712
Change to Operating Expenditures	-1,261	455	455	455
GSF Operating Balance as at 2014 PEFU	**43,975**	**44,156**	**5,417**	**10,391**

Note: The table above summarises total movements in operating revenues and operating expenditure since the time of the Budget Policy Statement in the GFS format published in December 2013.

Table 3.3 Reconciliation of GFS Operating Balance and the Underlying Net Operational Balance 2014/15 to 2016/17 ($000)

Statement of Government Operations	2013/14 BPS $'000	2013/14 PEFU $'000	2014/15 Projected $'000	2015/16 Projected $'000	2016/17 Projected $'000
NET GFS Operating Balance	**45,304**	**43,975**	**44,156**	**5,417**	**10,391**
GFS Revenue	177,221	174,631	180,183	141,422	146,396
Remove ODA Revenue	59,364	56,185	55,666	17,601	17,601
Underlying Revenue	**117,857**	**118,447**	**124,516**	**123,821**	**128,795**
GFS Expenditure	131,918	130,657	136,027	136,005	136,005
Remove ODA Revenue	12,098	12,098	10,771	10,716	10,716
Underlying Expenditure	**119,820**	**118,559**	**125,256**	**125,289**	**125,289**
Underlying Budget Balance	-1,963	-112	-739	-1,468	3,506
FINAL UNDERLYING NET OPERATING BUDGET BALANCE	**-1,963**	**-112**	**-739**	**-1,468**	**3,506**

Note: The underlying operating balance of -$1.963 million published at the time of the BPS has been adjusted to reflect movements of $0.363 million (Immigration Fees) in ROBOC's and estimated contingency expenditure of $0.094 million from BPS adjustments to pre-election adjustments. These items have been included in the PEFU to reflect all detailed adjustments committed by the contingency fund.

The table above provides an updated reconciliation on the net operating balance between the GFS framework and the previous budget framework, recognising the two different budget measures.

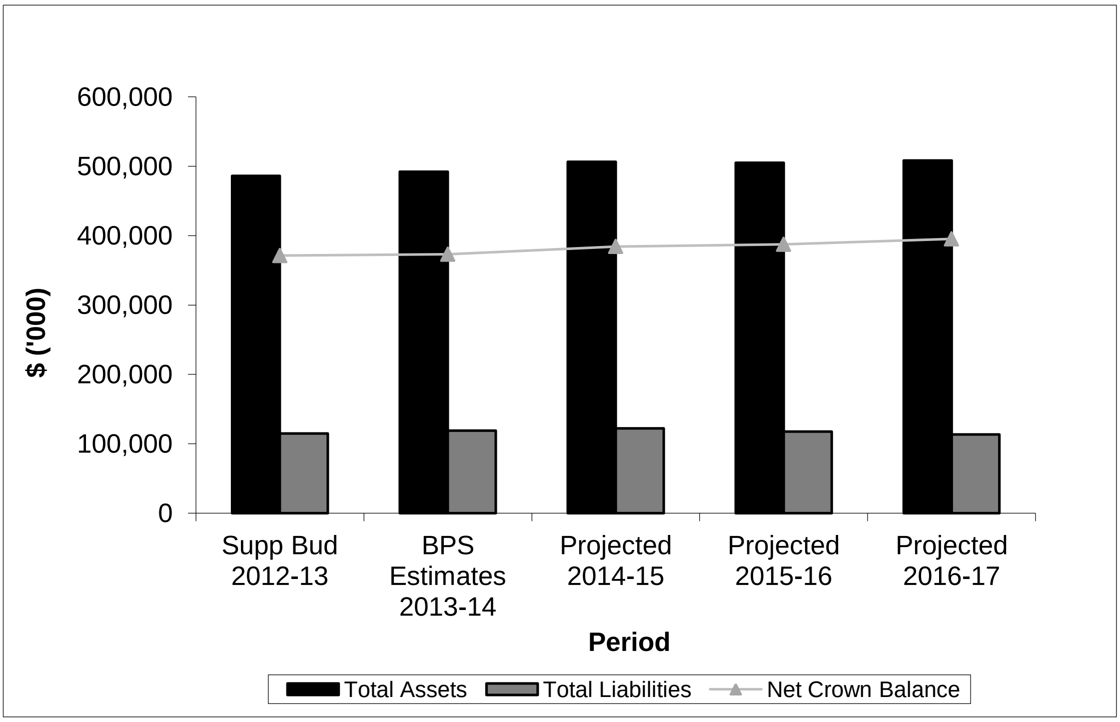
The 2013/14 underlying operating balance takes into account the removal of ODA revenue and expenditure.

The underlying operating balance was initially published at a $1.96 million deficit at the time of the 2014/15 BPS in December 2013. After the revision of revenue and expenditure estimates (as well as measures approved by Executive Order), the 2014 PEFU estimates an underlying budget deficit of $0.112 million for 2013/14. Going forward, changes in expenditure and revenue estimates are predicted to result in a $0.739 million operating deficit in 2014/15, and a $1.468 million deficit in 2015/16. It is anticipated that a recovery in import levies results in the underlying operating balance returning into a surplus of $3.506 million in 2016/17.

4 NET WORTH

Government's net worth is the difference between Crown assets and Crown liabilities providing a snapshot of government's ability/inability to service all its creditors. There are currently no clear guides to determining an optimal level of public sector net worth; however analysing the government's net worth and what causes it to change can lead to understanding the need for appropriate policies.

Chart 4.1 Net Worth 2012/13 to 2016/17, ($000)



The estimated net worth of the Crown as at June 2014 has decreased from the 2014/15 BPS Estimates of $372.9 million to $372.3 million at the time of the 2014 PEFU. This is a net movement of $0.6 million. This was a result of a decrease in the forecasted assets falling by more than the decreases in the Crown's total liabilities, as well as the estimated operating deficit of $0.112 million at the time of the PEFU (in comparison to a budget deficit of $1.963 million at the time of the BPS published in December 2013).

The Crown's net worth is expected to increase in the outer years from 2014/15 as long as there is an estimated operating surplus. Also a major contributor to the forecast upward trend is the decrease in borrowings, decrease in tax receivables and an injection to the Crown's asset from aid donor funding. Further analysis will be provided at the next Budget.

5 SPECIFIC FINANCIAL RISKS

The total quantifiable contingent liabilities are estimated at $17.7 million in 2013/14. This is made up of the following:

Guarantees and Indemnities

- The Government has entered into a program under the New Zealand Aid Programme focused on Pearl Sector Support run through the Cook Islands Pearl Authority. Through the program the CIG has agreed to guarantee up to $0.5 million as security for loans associated with the Pearl Production Credit Scheme. The full guarantee has been included as a contingent liability. There has been no change since the time of the 2013/14 Budget Estimates.

Uncalled Capital

- The Government also holds $1.4 million in the Asian Development Bank - Cook Islands Government Property Corporation. This takes the form of 88 uncalled shares with a par value of US$13,500 each.

Legal Proceedings and Disputes

- Total quantifiable risk to the Crown under legal proceedings and disputes is $15.9 million.
- $14.5 million relates to contingency in recognition of the lawsuit filed against the government regarding its shipping policy in October 2002.
- $1.4 million in relation to smaller legal claims against government departments, namely Police and Health.

6 ECONOMIC UPDATE

6.1 Introduction

The Cook Islands is a small open economy that is largely dependent on tourism. Consumer preferences and economic growth in our major tourist source market of New Zealand (and to a lesser extent, Australia) has a major impact on domestic economic performance. Any international developments affecting New Zealand will eventually impact on the Cook Islands. Not only is New Zealand our largest trading partner and source of tourism, but changes in the New Zealand dollar will also impact our domestic markets and inflation.

Despite being one of the most remote countries in the world, and one of the smallest (even by Pacific standards), the Cook Islands is the third most prosperous country per capita in the Pacific, behind New Zealand and Australia. The Cook Islands has enjoyed a sustained period of economic prosperity following the rapid growth of the tourism industry and a series of reforms following a crisis in 1996 – 2012 was a particularly good year. The dependency on tourism has benefitted the Cook Islands greatly, but a lack of economic diversity or economies of scale make any progress fragile and reversible, and labour market constraints across multiple areas of the economy still present major limitations on economic growth.

The reliance on imports to support local consumption makes the Cook Islands extremely vulnerable to external price shocks – particularly in regards to fuel, as transport costs affect the price of almost all goods. Despite the large imbalance in goods trade, the Cook Islands enjoys a large current account surplus, owing to the significant contribution of estimated tourism receipts (which is counted as a service export).

Global recovery from the 2008 economic crisis continues, with accelerating growth in advanced economies offsetting the somewhat reduced (but still significant) growth forecasts for the emerging markets of China and India. The return of global capital flows towards advanced economies will continue to weigh on emerging market growth prospects, as will the rebalancing of China's growth strategy. The Euro area (as a whole) is out of recession but remains sluggish, while the US recovery seems likely to continue in the near term. Tensions in Ukraine have led to volatility in equity markets (particularly in Russia) but are yet to have any wider implications on commodity prices (such as oil and gas) – something which may lead to higher fuel prices in the Pacific, depending on actions taken on all sides.

The International Monetary Fund (IMF) has revised its forecast for global economic growth in 2014 to 3.6 per cent, a slight upward revision, with the World Bank forecasting 3.7 per cent (an improvement from the 3.0 per cent estimated for 2013). For 2015, the IMF is forecasting that global growth will improved to 3.9 per cent. The ten-year average for world economic growth is 3.4 per cent growth a year.

Official growth forecasts for New Zealand and Australia will not be updated in time for this publication, but the most recent forecasts for 2013/14 are 3.2 per cent and 2½ per cent growth respectively. Continued economic growth in these markets should have positive flow on effects for tourism arrivals, although the recent weakness of the Australian dollar will likely to soften Australian tourist growth.

Since the 2014/15 Budget Policy Statement (December 2013) tourism arrivals have fallen marginally short of forecasts (a monthly average of 88 arrivals less than forecast; around 1 per cent). While the growth prospects for the Cook Islands remain positive in the short term, there have been a slight downward revisions to both tourism and GDP estimates. The decline in the Cook Islands Government capital spending and the implementation of aid projects are the main risks to the economy outside of tourism arrivals. Offsetting this somewhat are the economic gains of the Cook Islands Government 2013 Tax Review, which adds significantly to gross domestic product (GDP) in 2014/15, but also adds to GDP in the last quarter of 2013/14.

Nominal GDP (which includes inflation) is estimated to have grown at 5.2 per cent in 2012/13, higher than the 3.7 per cent forecast at the time of the Budget Policy Statement due to the availability of new data. Nominal growth is expected to continue at an estimated 4.8 per cent in 2013/14, due largely to increased Government capital spending and the implementation of the Tax Review offsetting a slight slowing in tourism growth. Growth falls to 3.9 per cent in 2014/15 due to declines in capital spending more than offsetting the benefits of the Tax Review and 1.9 per cent in 2015/16 due to a reduction in the aid profile (although the reduction is not as much as previously forecast).

Tourist growth has been revised down from the forecasts at the 2014/15 Budget Policy Statement, with this taking some pressure of the capacity constraints that were expected to reduce growth from 2016 onwards. Growth in visitor arrivals is expected to slow from 3.5 per cent in 2012/13 to 1.7 per cent growth in 2013/14 due mainly to a slower growth out of New Zealand and Australia. The forecast for 2014/15 has been similarly revised down from 2.6 per cent to 1.7 per cent growth.

Inflation as measured by the Cook Islands Consumer Price Index (CPI) was 2.6 per cent in 2012/13, however, year average inflation from March 2013 to March 2014 was only 1.5 per cent, with through the year inflation even lower, at just 0.9 per cent. With the exception of the once-off increase in the VAT on 1 April 2014, inflation is expected to adjust towards its long-term trend. The year average CPI is forecast to increase 2.3 per cent in 2013/14 due to the change in VAT affecting the June quarter, before increasing to 4.6 per cent in 2014/15.

Through the year inflation in the June quarter of 2014 (the quarter where the VAT was increased) is expected to be around 3.5 per cent, a 2.6 percentage point increase on the 0.9 per cent through the year inflation experienced in the March quarter 2014.

Table 6.1 Summary of Economic Indicators

Economic Indicators	2011/2012 *Actual*	2012/2013 *Estimate*	2013/2014 *Projected*	2014/2015 *Projected*	2015/2016 *Projected*	2016/2017 *Projected*
Economic Activity						
Nominal GDP ($'000)	370,909	390,020	408,759	424,526	432,773	444,435
Percentage change (YOY)	3.5	5.2	4.8	3.9	1.9	2.7
Real GDP (at Constant 2006 Prices, $'000)	319,728	327,675	335,670	333,400	329,753	328,551
Percentage change (YOY)	0.7	2.5	2.4	-0.7	-1.1	-0.4
Inflation						
Consumer Price Index (base Dec. 2006 = 100)	121.7	124.9	127.8	133.6	137.7	141.9
Percentage change (YOY)	2.8	2.6	2.3	4.6	3.1	3.1
Construction/Capital Investment						
Commercial Building Approvals ($'000)	2,975	1,859	1,859	1,859	1,859	1,859
Residential Building Approvals ($'000)	5,887	6,161	6,032	5,905	5,781	5,660
Public Works ($'000) (includes Dev Partners)	34,011	23,636	38,791	31,677	28,528	-
Productive Sector Indicators						
Visitor Arrivals	116,844	120,900	123,000	125,100	127,400	129,700
Percentage change (YOY)	7.4	3.5	1.7	1.7	1.8	1.8
Estimated Visitor Expenditures ($'000)	209,279	222,100	231,400	246,800	259,200	272,000
Pearl Exports ($'000)	550	291	190	190	190	190
Fish Exports ($'000)	2,564	8,059	12,060	12,060	12,060	12,060
External Sector						
Merchandise Trade Balance ($'000)	(138,075)	(126,170)	(128,400)	(126,000)	(126,800)	(127,800)
Services Trade Balance ($'000)	209,279	222,100	231,400	246,800	259,200	272,000
Exchange Rate (USD/NZD Average, April 2014)	0.757	0.805	0.822	0.824	0.824	0.824
Financial Sector (at end of financial year)						
Government Net Debt Position ($'000)	16,178	58,244	65,758	66,505	65,477	59,832
Private and Public Enterprise Deposits ($'000)	228,949	170,273	178,805	-	-	-
Private and Public Enterprise Loans ($'000)	280,364	266,325	252,655	-	-	-

6.2 Gross Domestic Product (GDP)

The Cook Islands economy grew a nominal 4.7 per cent in 2012 calendar year. Real GDP growth (taking into account changes in price) was 4.4 per cent in 2012, a significant improvement from the 1.0 per cent real GDP growth experienced in 2011. With the arrival of new data for the 2012/13 year, estimates of financial year growth have been revised up from 3.7 per cent at the time of the Budget Policy Statement to 5.2 per cent. This is due largely to the availability of trade data, which was missing at the time of the Budget Policy Statement.

As compared to the Budget Policy Statement, reductions in tourism arrival forecasts have been partially offset by improvements in aid spending and residential building activity. Reflecting this, nominal GDP forecasts for 2013/14 have been revised down from 5.0 per cent growth to an estimated 4.8 per cent.

Nominal GDP growth is then estimated to slow to 3.9 per cent in 2014/15 due to declines in Cook Island Government capital projects offsetting the benefits of the implementation of the Cook Islands Tax Review. By 2015/16, slowing growth in tourism and further declines in the forward aid program and Cook Island Government capital plans lead to a slowing of nominal GDP growth to an estimated 1.9 per cent (although this is an improvement on the forecasts from the Budget Policy Statement).

Table 6.2 GDP growth revisions

	2013/14		2014/15		2015/16	
	2014/15 BPS	**2014 PEFU**	**2014/15 BPS**	**2014 PEFU**	**2014/15 BPS**	**2014 PEFU**
Nominal GDP growth (per cent)	5.0	4.8	2.3	3.9	0.6	1.9
Real GDP growth (per cent)	0.5	2.2	-0.6	-0.7	-2.4	-1.1

Real GDP is forecasted to follow a similar pattern to nominal growth but is lower as it takes inflation into account. At the Budget Policy Statement, real GDP growth for 2013/14 was expected to be 0.5 per cent, but due to the surprisingly low inflation result for the March quarter 2014, estimated real GDP growth for 2013/14 has been revised upwards to a significant 2.2 per cent. Declines in Government capital spending offset the gains from the Tax Review implementation and tourism growth, with real GDP declining 0.7 per cent in 2014/15, a revision from the 0.6 per cent decline forecast at the time of the Budget Policy Statement. This slowing is predicted to continue in the outer years, with real growth falling -1.1 per cent in 2015/16 due to falls in the aid spending profile and a return to trend levels of inflation.

These forecasts are dependent on a number of recent trends continuing. The key risks to GDP growth are:

- the preferences of New Zealand and Australian tourists moving towards other competing tourism markets in the Pacific or Asia (for example recent openings for direct flights to Bali, Honolulu, and Manila from Auckland);
- an economic slowdown in New Zealand and/or Australia;
- poor budget execution of the substantial aid and capital projects planned across the Cook Islands – in particular, any delays in the implantation or the renewable energy or water projects;
- domestic labour market failing to increase through a decline in migrant labour entering the Cook Islands to fill job vacancies, or Cook Islanders continuing to leave the local market;
- external price shocks to our major import categories (fuel or food supplied by New Zealand);

- dramatic changes in consumption patterns due to VAT or import levy changes (above and beyond those already forecast);
- any reductions in projected aid from development partners; and
- on the upside, a return to trend levels of inflation may not occur, as current inflation levels appear to be well below what was expected in previous forecasts.

Chart 6.1 Real GDP at 2006/07 prices, 2002/03 to 2016/17 (‘000)

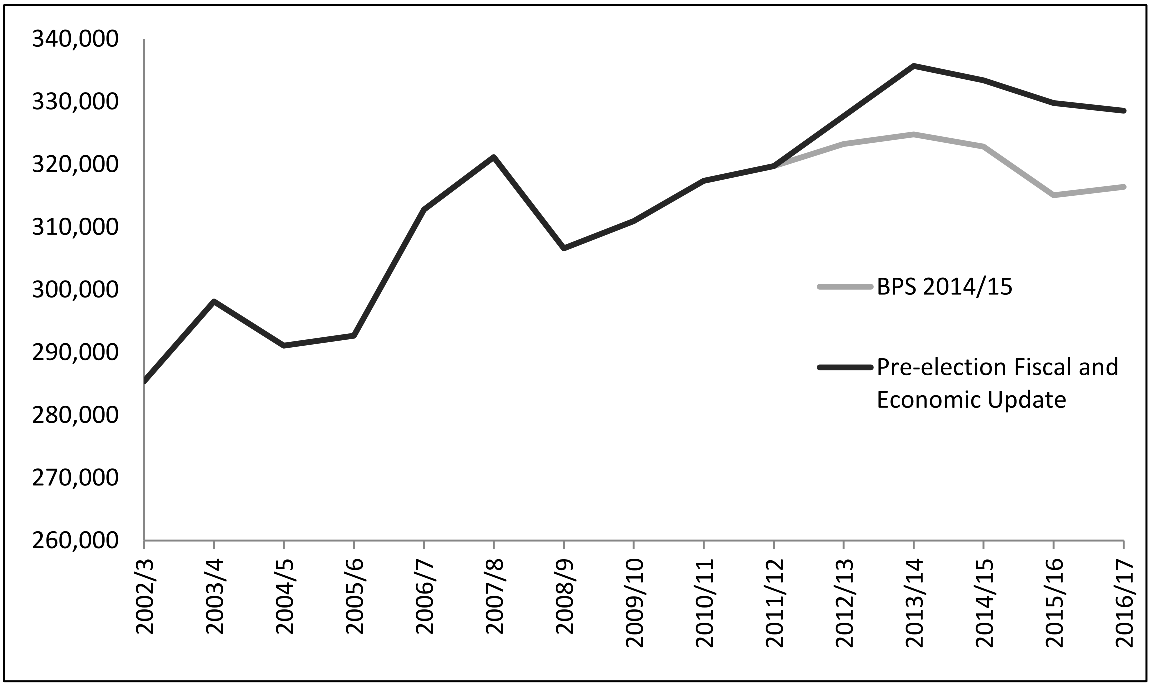


Chart 6.2 Nominal GDP at current prices, 2002/03 to 2016/17 (‘000)

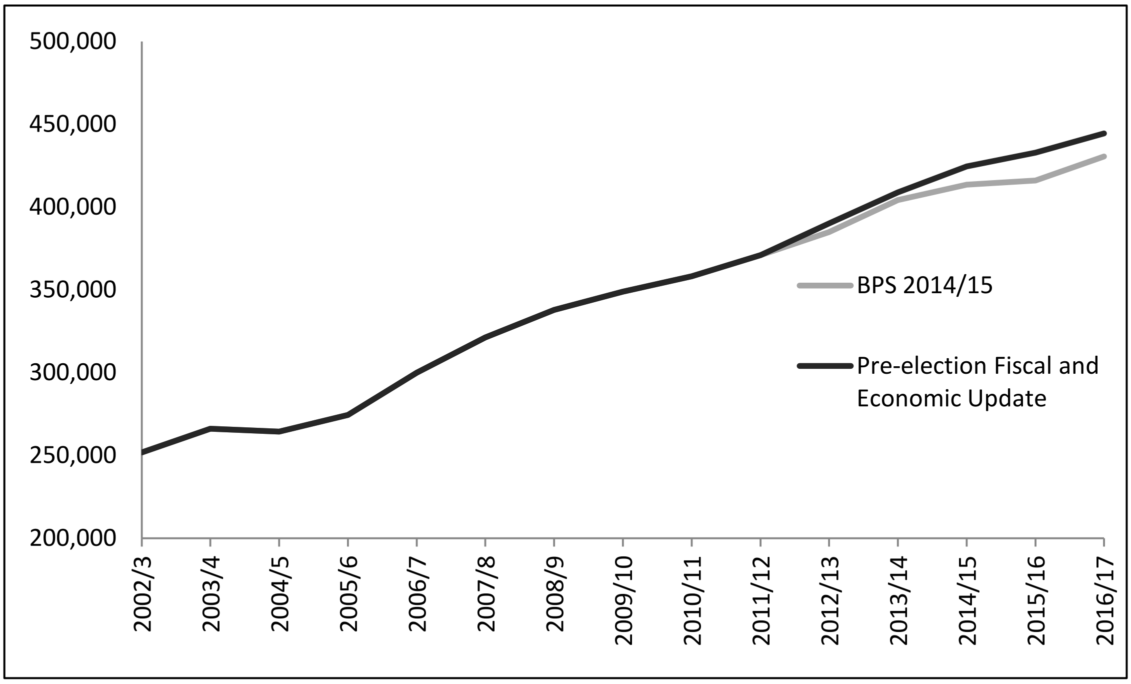
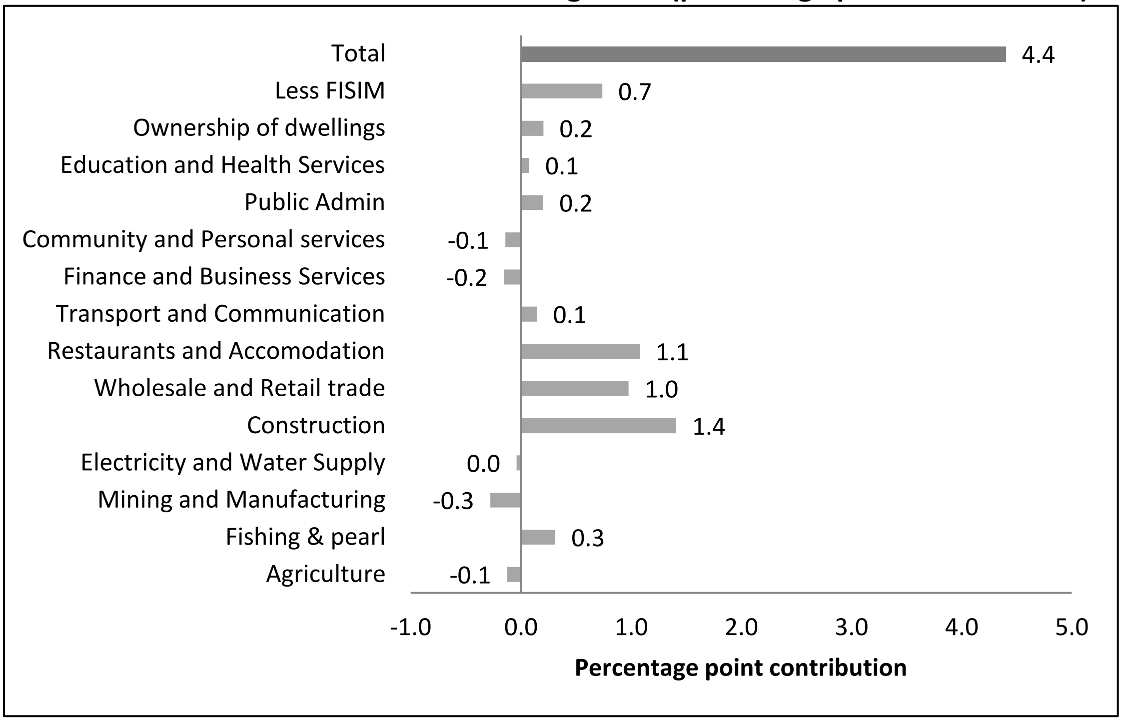


Chart 6.3 Contribution to 2012 real GDP growth (percentage point contribution)



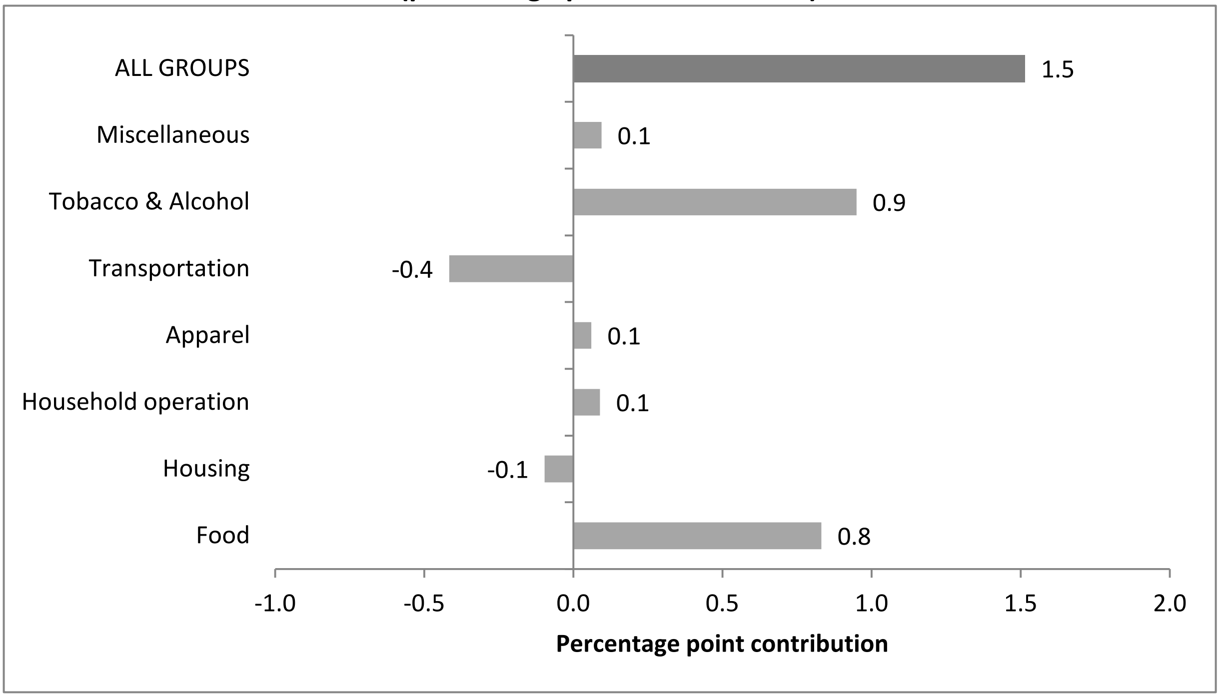
6.3 Consumer Price Index (CPI)

Inflation in the Cook Islands is measured by the Consumer Price Index (CPI) which is reported on a quarterly basis. Over the last ten years, the Cook Islands has enjoyed low and relatively stable inflation due to the use of the New Zealand dollar as the national currency (with the exception of the dramatic increase in global fuel prices which drove inflation to 10.2 per cent in 2008/09).

At the time of publication, the most recent CPI data available was for the March quarter 2014, which showed inflation of 0.9 per cent compared to the March quarter 2013, and average annual inflation of 1.5 per cent for the 12 months to March – the lowest inflation figures since 2010/11.

Average annual inflation up to the March quarter 2014 was driven by a 29.6 per cent increase in tobacco prices (contributing 0.9 percentage points to overall inflation, see Chart 6.4) and a 2.7 per cent increase in Food prices (contributing 0.8 percentage points) being partially offset by 2.2 per cent decrease in the cost of transport (subtracting 0.4 percentage points).

Chart 6.4 Contribution to March quarter 2014 year average inflation (percentage point contribution)



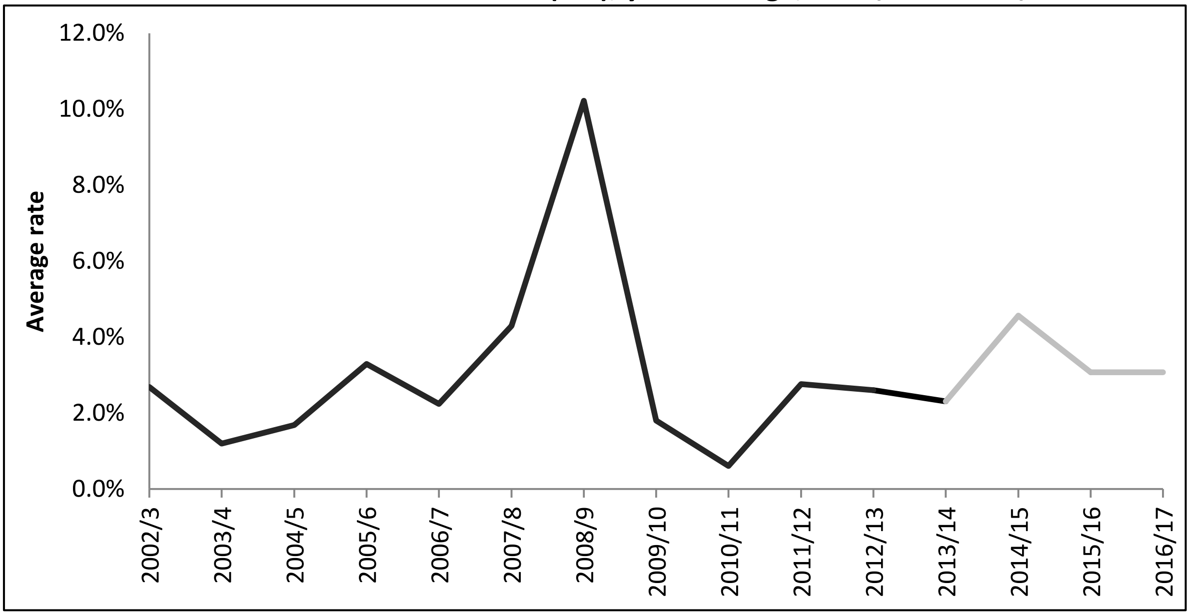
As Chart 6.5 demonstrates, year average inflation is estimated to increase from an average annual rate of 2.3 per cent in 2013/14 to its historical average of 3.1 per cent in the outer years; slightly higher than the New Zealand target rate. The exception to this is 2014/15, which will bear the full inflationary effect of the Tax Review increase to the VAT from 1 April 2014, with an estimated average annual inflation of 4.6 per cent.

There are substantial risks surrounding these forecasts. A decline in the New Zealand dollar from its historic highs would be expected to have an inflationary impact on the Cook Island economy through higher import prices. Similarly, fuel prices have remained relatively stable in recent times, and any increase from current prices could have a dramatic effect on the prices of all imported goods, which make up the bulk of consumer items (as occurred in 2007/08 and 2008/09).[1] Issues surrounding retailers using the increase of the VAT to price gauge also presents a risk, although this has been partially factored into the forecasts for 2014/15.

On the upside, recent quarterly inflation figures have been well below average both in the Cook Islands and New Zealand. If this were to continue, inflationary pressure on the economy may be much less than anticipated over 2013/14 and 2014/15.

[1] As part of assembling forecasts for this publication, a more thorough analysis of New Zealand's domestic inflation and its impacts on the Cook Islands was undertaken. A regression analysis suggests that around 10 per cent of the variation in current Cook Islands inflation can be related to either the 3-month lag or the current-period New Zealand goods inflation, with up to 80 per cent of the variation being unrelated to New Zealand goods inflation (even when both time periods are used). While this is not a complete analysis, it suggests that price shocks in New Zealand goods may not *always* translate to price shocks in the Cook Islands. Using New Zealand export price indices may provide further guidance in this area and may assist in assembling future forecasts.

Chart 6.5 Consumer Price Index (CPI), year average, 2002/03 – 2016/17



6.4 Tourism

Tourism remains the largest industry in the Cook Islands, accounting for around 60 per cent of the economy (and growing). As predicted at the time of the Budget Policy Statement in December 2013, the strong growth of 7.6 per cent in arrivals in calendar year 2012 was not maintained, with total arrivals in 2013 roughly unchanged from those seen in 2012. The strong growth experienced from New Zealand and Australian markets likely peaked over 2010 to 2012 and a return to double digit growth in the near term appears unlikely. Subsequently, tourist arrival forecasts have been further revised downwards.

Reflecting ongoing softness in key markets, growth in tourist arrivals is forecast to slow to 1.7 per cent in 2014/15 and 1.9 per cent in 2015/16. This is a one percentage point downward revision from the Budget Policy Statement estimates of 2.7 per cent for 2014/15 and 2.8 per cent for 2015/16 due to low than expected arrivals so far this financial year.

Current year to date arrivals (March) are around 1.2 per cent higher than the similar period in 2013.

Despite the slower than expected growth in 2013/14, New Zealand remains by far the largest market at 66 per cent of total arrivals, a slight fall in the share of total arrivals from 2012/13.

Australia has a smaller, but increasing share (18 per cent, up 2.7 percentage points in the last three years) which is offsetting the declines experienced in European markets.

From customs and immigration data, the average stay is estimated at 8.1 days, with this average weighted heavily towards New Zealand and Australian arrivals. The average daily spend is estimated to be around $200-230, but varies by time of year and by tourist source market.

Chart 6.6 Total visitor arrivals (12 month moving average) 2005-2017

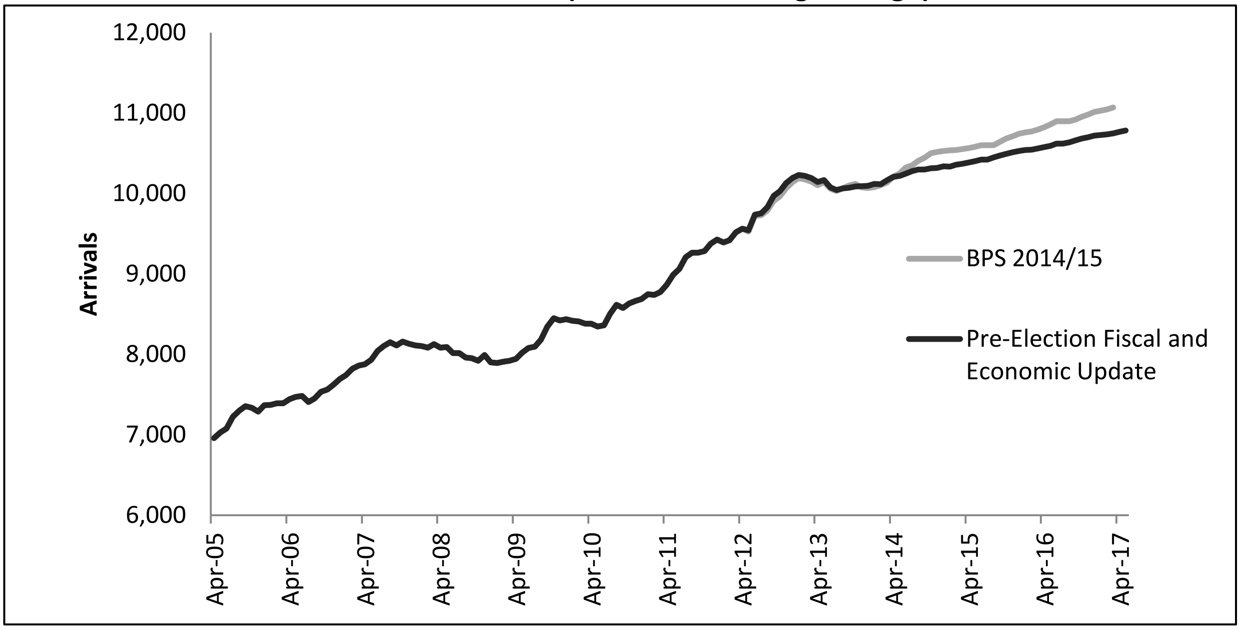


Table 6.3 Actual and forecast total tourism numbers by quarter 2012/13 to 2016/17

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	39,113	31,571	20,493	29,732	120,909
2013/14	39,031	31,902	21,300	30,700	123,000
2014/15	39,700	32,400	21,700	31,300	125,100
2015/16	40,300	33,100	22,000	32,100	127,400
2016/17	40,800	33,800	22,400	32,800	129,700

It was evident in the lead up to the Pacific Island Leaders Forum in July/August 2012, which led to a record number of arrivals, that capacity constraints are an issue in Rarotonga. July 2012 continues to be the benchmark for the maximum number of arrivals that Rarotonga can be expected to reasonably handle until new capacity comes online (which may be as soon as late 2014). Continued private investment will be required to sustain industry growth during the peak months, although the downward revision in tourism forecasts has relieved this pressure somewhat.

Table 6.4 Rising capacity utilisation of Cook Islands tourism sector, 2011/12 – 2016/17

		Months with arrivals of between...				
Year	Average capacity	80-90 per cent	90-94 per cent	95-98 per cent	99-100 per cent	Estimated lost arrivals
2011/12	70.5 per cent	1	1	1	0	
2012/13	73.0 per cent	2	2	0	1	
2013/14	74.2 per cent	2	2	1	0	
2014/15	75.5 per cent	2	1	1	1	525
2015/16	76.9 per cent	2	1	1	1	866
2016/17	78.3 per cent	1	1	1	2	1328

Due to the downward revision in the arrival forecasts, instead of average capacity of 80 per cent being achieved in 2016/17, it is likely that this will occur in 2017/18. This revision is due to additional capacity not being factored into previous estimates. This delay in capacity constraints will hopefully give more time for new investments to come online. However, as before, two months (July and August) are at full capacity from 2016/17, with significant strain in September (95-99 per cent capacity utilisation) and to a lesser extent in June (90-94 per cent capacity utilisation).

By 2016/17, it is expected that one third of the year will be experiencing occupancy rates exceeding 90 per cent (up from one quarter of the year currently). This suggests that the capacity of the tourism sector (be it management capacity or additional capital investment) needs to expand if arrivals are expected to continue during these months. The overall Tourism Corporation strategy of increasing arrivals in non-peak times may be able to increase the capital returns of the industry in the short term, thereby encouraging more investment, but increases in value offerings or capacity will be needed so long as Australia and New Zealand remain the major tourist markets.

6.4.1 New Zealand

New Zealand continues to be the Cook Islands leading market for visitors, accounting for an estimated 66 per cent of the total market (or an estimated 81,000) in 2013/14.

Over the past ten years, New Zealand arrivals have grown an average of 11.1 per cent a year – a phenomenal level of growth with New Zealand arrivals more than doubling over that period (increasing by 139 per cent). Outbound tourism from New Zealand only grew 37.3 in total per cent over the same period, an average of 4.6 per cent a year. This represents a large shift in New Zealand tourist preferences towards the Cook Islands over other destinations. This is supported by the results of the recent visitor survey which estimates that 47 per cent of visitors from New Zealand are return visitors – an impressive achievement for our tourism industry and much higher than other markets.

However, in 2012/13 outbound tourist growth from New Zealand fell to 1.4 per cent, the lowest growth since 2000 (the earliest data publically available). New Zealand arrivals into the Cook Islands followed a similar trend, with growth in New Zealand arrivals falling to 2.9 per cent for 2012/13, the third lowest growth outcome in 12 years, and well below the 8.1 per cent growth experienced in 2011/12.

Going forward, New Zealand arrivals are expected to grow by 1.5 per cent in 2013/14, due largely to lower than expected arrivals so far this year. With the recent performance of New Zealand arrivals, as well as the slowdown in outbound New Zealand tourists, New Zealand arrivals are expected to grow by 2.4 per cent in 2014/15 and 2.6 per cent in 2015/16 – a significant revision. The long term trend is also projected to be much lower than historical performance would suggest, at around 2.5 per cent.

Chart 6.7 New Zealand visitor arrivals (12 month moving average) 2005-2017

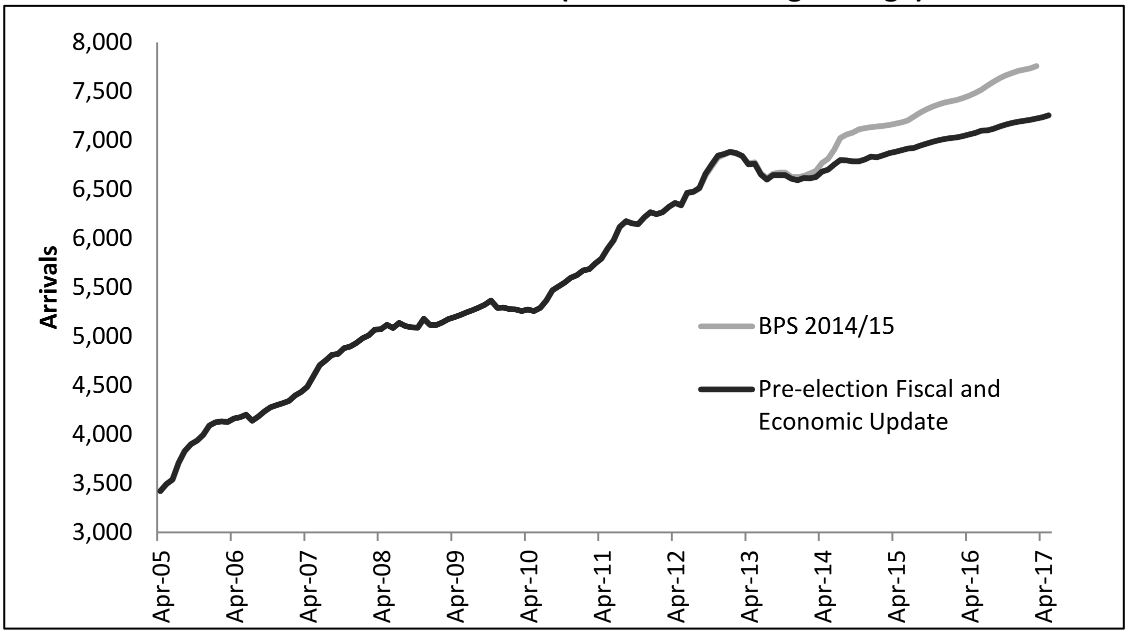


Table 6.5 Actual and forecast New Zealand tourism numbers by quarter 2012/13 to 2016/17

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	28,482	19,933	11,272	20,148	79,835
2013/14	28,382	19,323	11,700	21,700	81,000
2014/15	28,800	19,900	12,100	22,200	83,000
2015/16	29,400	20,500	12,500	22,900	85,200
2016/17	29,900	21,100	12,800	23,500	87,300

6.4.2 Australia

The Australian market is the second largest tourism market to the Cook Islands, accounting for approximately 18 per cent of the total market share.

Australia has been experiencing a boom in outbound tourism growth. In the last 10 years Australian outbound tourism has grown by 112 per cent, an average of 9.3 per cent a year. To compare, Australian arrivals to the Cook Islands have increased 97 per cent, or an annual average of 7.5 per cent. While the growth in tourist arrivals from Australia has been impressive, the main driver of this appears to be the overall growth in Australian tourists, rather than the Cook Islands increasing its market share. Indeed, with the exception of the last two years, the Cook Islands' share of Australian outbound tourism fell across the period.

After growing an impressive 7.0 per cent in 2012/13, Australian arrivals slowed significantly in the last half of 2013, a trend that was expected to continue into 2014. Arrivals in early 2014 were higher than the conservative estimates in the 2014/15 Budget Policy Statement, with our forecasts now estimating around 1.7 per cent growth for 2013/14.

Growth is then assumed to follow the outbound tourist numbers coming out of Australia. Using Australian-based industry forecasts as a proxy for Australian arrivals into the Cook Islands, we estimate that Australian arrivals will grow by 3.0 per cent in 2014/15, before slowing to 2.9 per cent growth in 2015/16 and 2.6 per cent in 2016/17.

These are conservative forecasts. They assume that the Cook Islands' market share of Australian tourists does not change dramatically over the forecast period.

Chart 6.8 Australia visitor arrivals (12 month moving average) 2005-2017

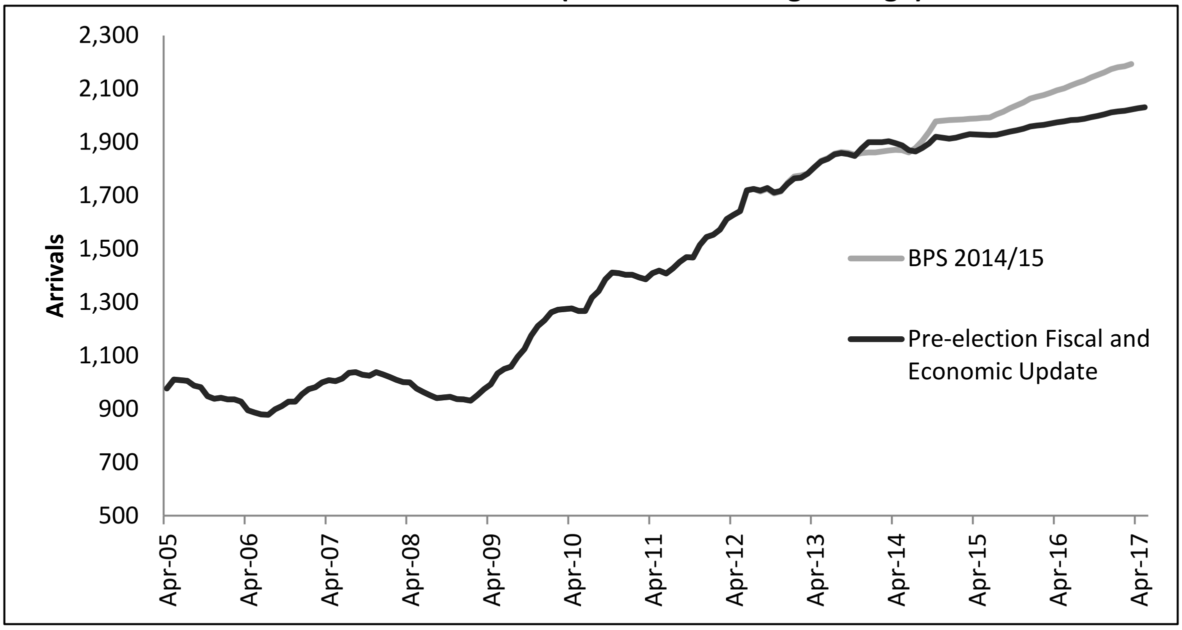


Table 6.6 Actual and forecast Australian tourism numbers by quarter 2012/13 to 2016/17

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	5,854	6,528	4,157	5,513	22,052
2013/14	6,064	7,068	4,200	5,100	22,400
2014/15	6,400	7,300	4,400	5,100	23,100
2015/16	6,500	7,500	4,500	5,200	23,800
2016/17	6,600	7,700	4,700	5,400	24,400

6.4.3 Other major markets

Outside of the two major markets, growth in tourist arrivals remains relatively weak. The European market has continued decline from the historic high in 2000/01, and while North American markets have shown some recent resilience, growth moving forward is expected to be relatively flat. Asia and other markets remain relatively minor contributors.

Arrivals from other major markets grew a revised 2.1 per cent in 2012/13, a rare increase in an otherwise declining trend of arrivals (due almost entirely to falls in European arrivals). These markets are expected to grow by another 2.4 per cent in 2013/14 due largely to better than expected performance so far this year. European arrivals are expected to stay at 9,300 in 2013/14 (unchanged from 2012/13), before falling 6.2 per cent in 2014/15 on the back of relatively weak growth in the European area. US arrivals are expected to grow by 6.2 per cent in 2013/14 to around 4,900, and increase by an additional 1.2 per cent in 2014/15 to reach around 5,000.

Chart 6.9 Other major markets (12 month moving average) 2005-2017

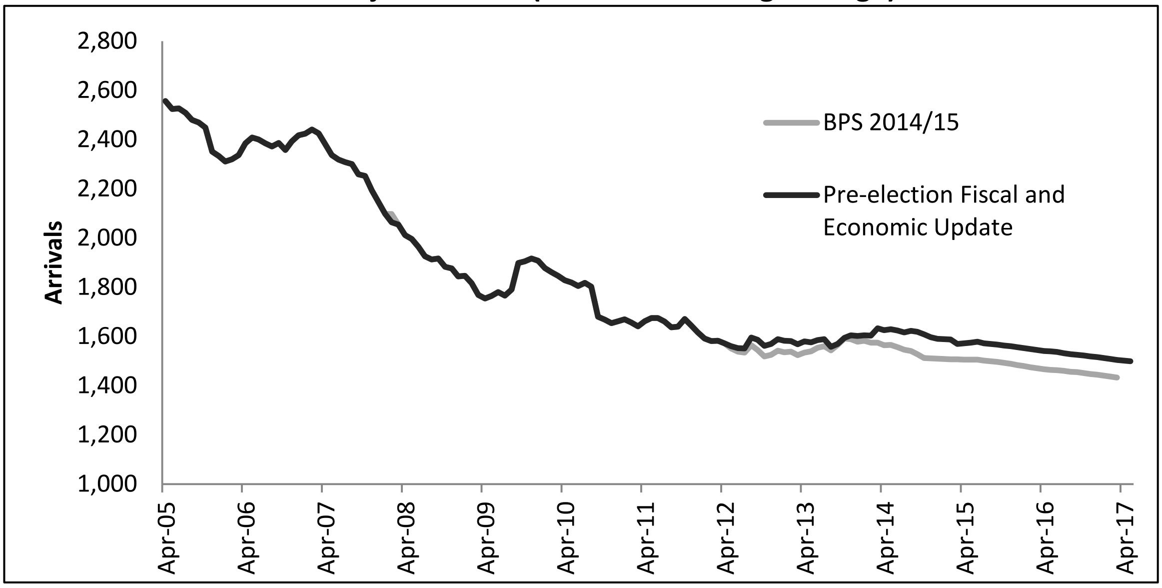


Table 6.7 Actual and forecast tourism numbers by quarter 2012/13 to 2016/17

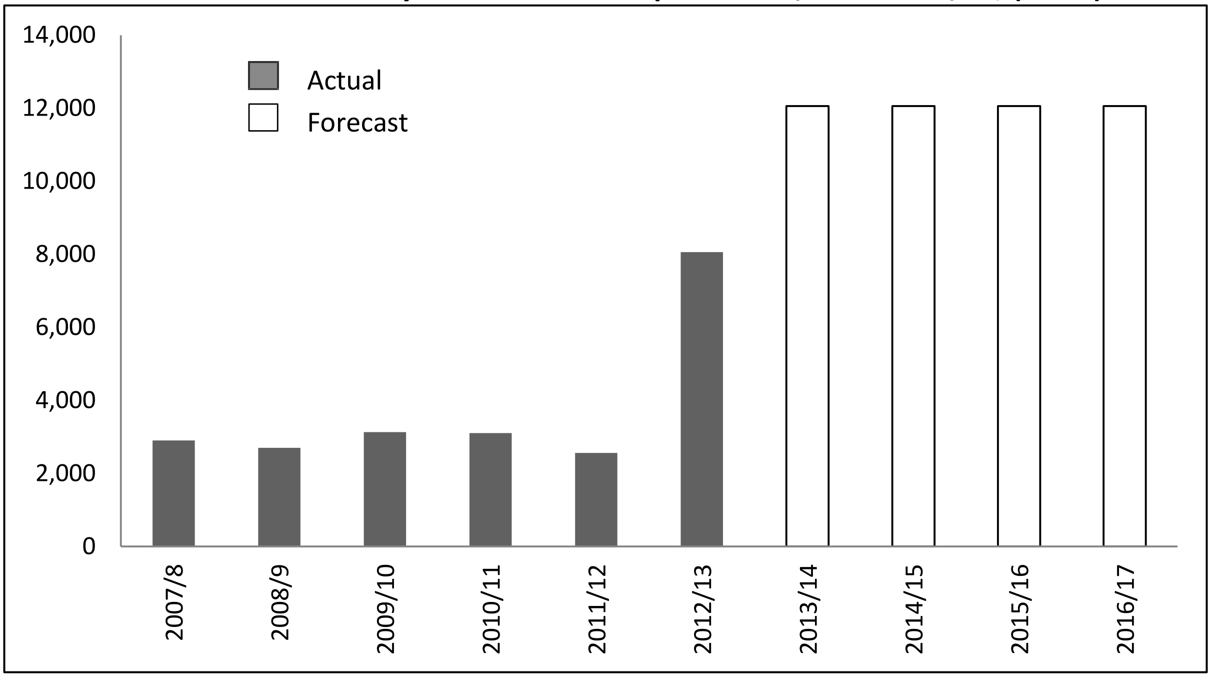
	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2012/13	4,777	5,110	5,064	4,071	19,022
2013/14	4,585	5,511	5,400	4,000	19,500
2014/15	4,500	5,200	5,200	4,100	18,900
2015/16	4,400	5,100	5,000	4,000	18,400
2016/17	4,200	4,900	4,900	3,900	18,000

6.5 Marine Resources

The Cook Islands marine sector continues to be dominated by the tuna fisheries with a small contribution from black pearls. In 2013 fresh fish exports were $12.1 million dollars (93 per cent of total goods exports), an almost 2.5 fold increase from the 2012 total of $5.3 million dollars – due almost entirely to the offloading of Huanan Fishery Ltd into Rarotonga.

The main direct benefit derived from fishing activities continues to be the licensing revenue received by the Ministry of Marine Resources from treaties and fishing licenses – estimated at $5.5 million in 2013/14 (comprising of $2.1 million from foreign purse seiners, $3.0 million from foreign longliners and $0.4 million from Cook Islands flagged longliners).

Chart 6.10 Domestically Processed Fish Exports 2007/08 to 2016/17, ($'000)



6.5.1 Fishing

The Cook Islands EEZ is divided into a northern and southern fishery. The majority of fishing takes place in the northern fishery where the waters are more stable and productive. The main fishing grounds are from Penrhyn in the east, to Pukapuka in the west, and south of Suwarrow.

Since 2002 the main fishery has been long lining for albacore tuna which is offloaded frozen to the cannery in Pago Pago. Many of the fishing vessels are based in Pago Pago or Fiji. From 2009 onwards the albacore fishery has increased significantly from the three thousand tonnes caught in 2008 to the twenty seven thousand tonnes in 2012 (Table 6.8).

In 2013 there was a total of 17 Cook Island flagged longliners, 26 foreign flagged longliners and 17 foreign purse seiners that fished within the Cook Islands waters (Table 6.9). In addition two foreign flagged carrier vessels and 4 Cook Island flagged vessels operated exclusively on the high seas. This brings the total number of licensed offshore fishing vessels managed by the MMR to 66 fishing vessels.

In addition there were 233 vessels recorded in the MMR catch database in the local artisanal fishery and the game charter fishery during 2013 from nine islands.

The albacore tuna dominate the longline fishery whereas skipjack is the dominant catch for purse seining and yellowfin the main catch for the local fishery (Table 6.10).

The total catch for the longline fishery in 2013 was 8,500 tonnes, with an estimated landed value of $28 million dollars (Table 6.11). This is a reduction from 2012 where 15,500 tonnes worth $40 million dollars was caught. This is largely due to a reduced number of fishing vessels in 2013 of 45 longliners compared to 60 longliners in 2012, which was boosted by an additional 17 bigeye tuna exploratory fishing vessels.

The total catch for the purse seine fishery in 2012/13 was 3,800 tonnes with a landed value of $9 million dollars, compared to 11,900 tonnes with a landed value of $25 million dollars in 2012, when there was a spike in interest by US purse seiners in the Cook Islands waters (Table 6.11).

The recorded catches in artisanal and game charter fishery was 212 tonnes but did not have complete coverage of all islands. The total estimated catch in 2013 is 270 tonnes. The landed value assuming an average price of $8 dollars/kilogram of round weight is $2.2 million dollars (Table 6.11).

Table 6.8 Fishery Catches in the Cook Islands EEZ (tonnes)

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Longline Fishery	825	2,151	3,467	3,409	3,115	3,446	3,072	7,047	7,070	8,467	15,500	8,500
Purse Seine Fishery	3,132	1,598	4	45	79	4	205	1,537	245	476	11,900	3,800
Local artisanal and game fishery												270
TOTAL CATCHES (tonnes)	**3,957**	**3,749**	**3,471**	**3,454**	**3,194**	**3,450**	**3,277**	**8,584**	**7,315**	**8,943**	**27,400**	**12,570**

Table 6.9 No. of Licensed and Active Fishing Vessel

	2012	2013
Local artisanal and game fishery		
Total		**223**
Offshore Fishery		
Longliner	60	45
Purse Seiner	16	17
Other Commercial	4	4
Total	**80**	**66**

Table 6.10 Fishery Catches in the Cook Islands EEZ by Species (tonnes)

	2012		2013		
	Longline	Purse Seine	Longline	Purse Seine	Local
Albacore	8,800		6,000		1
Bigeye	2,800	100	500	60	<1
Yellowfin	1,800	800	1,000	300	180
Skipjack		11,000		3,400	10
Other	2,100		1,000		80
Total	**15,500**	**11,900**	**8,500**	**3,760**	**271**

Table 6.11 Landed value of fishery catches (NZD millions)

	2012	2013
Longline Fishery	40	28
Purse Seine Fishery	25	7
Local artisanal and game fishery		2
Total (NZD millions)	**65**	**37**

In 2013 there were 240 tonnes of fresh offshore fishery catches offloaded into Rarotonga for fresh airfreight export and local consumption. Most of the exported tuna are high value bigeye tuna and the export grade yellowfin tuna.

Also in 2013 there were 340 tonnes of frozen offshore fishery catches offloaded by the foreign owned Cook Islands registered company Huanan Fishery Ltd into Rarotonga. These catches were mainly trans-shipped from the fishing vessels into container ships for overseas markets. Approximately 40 tonnes of by-catch was sold locally. It was estimated $430,000 of direct expenditure was incurred during the offloading of the vessels into the local economy through fuel purchases, employment, provisions and port charges. In 2014 the Huanan company intends to expand the offload of catches into Rarotonga port to 2,000 tonnes – if this occurs, then the forecasts for fish exports will need to be revised upwards.

The 2013/14 purse seine catches are already registering peak catches under the US fishery treaty. As of April 2014, nine months into the annual reporting cycle, there have been approximately 16,000 tonnes of catch has been recorded. The Cook Islands have also began a dual payment system of receiving catch revenues whereby a regional portion of the catch is paid on a catch tonnage basis, and additional catch revenues acquired by selling fishing days in advance on a bilateral basis. So far 400 fishing days have been sold to the US treaty under the bilateral arrangement at a rate of USD5,000 a day.

The spike in purse seine fishing activity by the US treaty fleet in the Cook Islands water is attributed to regional quotas newly established by the Western Central Pacific Fisheries Commission (WCPFC) which has assigned a national annual allocation of 30,000 tonnes and 1,250 fishing days to the Cook Islands.

In 2014 the Ministry of Marine Resources is proposing to introduce a quota system to limit the longline catches caught in its EEZ for albacore and bigeye tuna. This will help ensure that catches are restricted to sustainable levels. The Ministry will continue its efforts to seek compatible catch limits on the high seas to ensure overfishing does not occur at the regional level.

There remain significant economic growth prospects for the Cook Islands fishery.

- The local fishery is an important economic activity supporting the game-charter operators, semi-commercial sales and subsistence fishing. The local fishery has recorded good catch rates in 2013 with significantly increased catches around Rarotonga in 2013 attributed to the deployment of fish aggregate devices (FADs). Sustained catches can be expected provided these FADs are properly maintained.
- There is potential for high valued airfreighted export for fresh high quality fish. The medium term targets of 1,000 tonnes per annum are feasible if market demand, particularly in the US and Japan are sustained, and with the provision of regular airfreight links.
- The offloading of frozen longline catches into Rarotonga is expected to continue to expand. A medium term target of 6,000 tonnes offloaded into Rarotonga per annum is feasible. The logistical constraints and costs for offloading into Rarotonga will determine whether there are further

prospects for value added processing activities. Onshore processing is encouraged as this would lead to wider economic benefits.

- The purse seine fishery is likely to become the most significant source of licensing revenue for the offshore fishery. The Cook Island total allowable catch of 1,250 days or 30,000 tonnes equates to a conservative licensing value of around $9 million dollars per annum. Combined with current licensing revenues from the longline fishery of around $3 million dollars, the total licensing revenues are expected to be in the order of at least $12 million dollars per annum.

6.6 Pearls

Cook Islands pearls are sold on both domestic and international markets. The performance of the Cook Islands pearl industry is mainly assessed on the export trends over time because it is difficult to quantify the size of the domestic market.

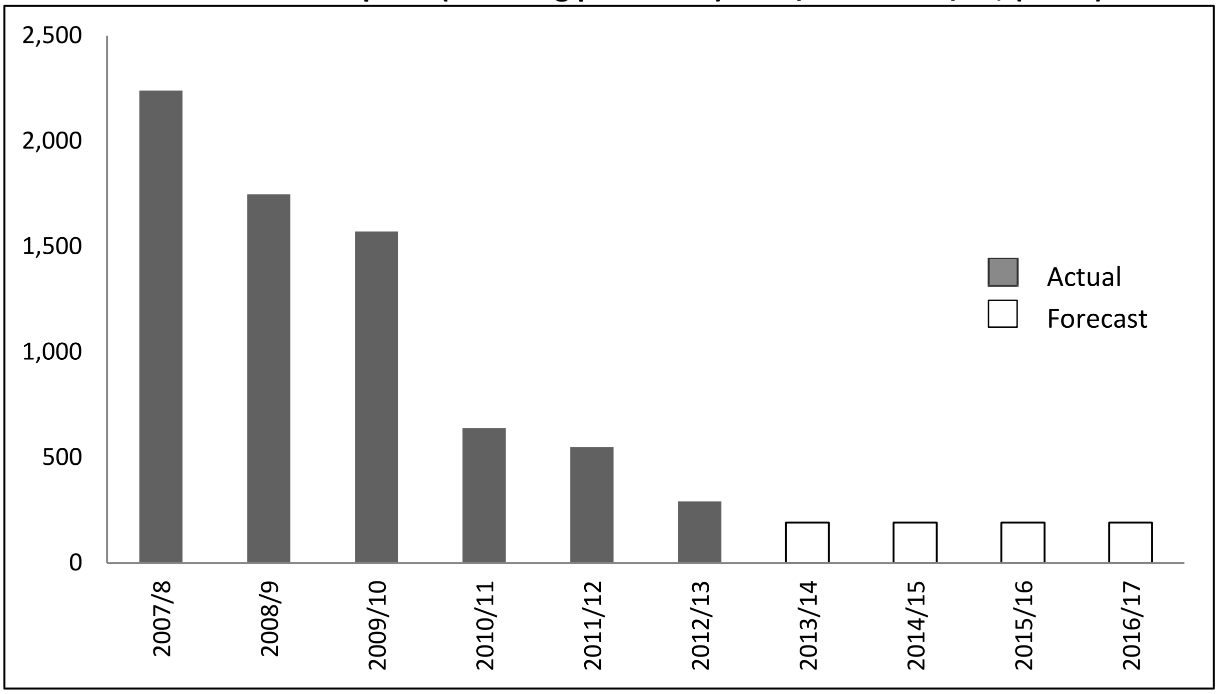
The value of exports continued to decline from $1.6 million in 2009/10 to $0.24 million in 2012/13. However, the production base in terms of seeded oysters during this period has remained relatively stable at around 290,000 – 300,000 shells. In the December 2012 survey, seeded oysters were estimated at 279,000. The saleable pearl crop for 2013/14 is estimated to be 106,000 pearls.

Previously, the bulk of pearls were exported with the domestic market only absorbing around 20 per cent of the annual crop. Since 2009, the declining export figures suggest that an increasing proportion of pearls are being sold on the domestic market where prices are better or being stockpiled at the Pearl Exchange.

The current plan is to increase the production of Cook Islands pearls with the assistance of a revised pearl production revitalisation programme funded by the NZ Aid Programme which was approved in July 2013. Until such time that production increases are evidenced under this programme, the pearl production capacity over the next 2-3 years will continue to be stable and modest at around 270,000-300,000 seeded oysters, estimated to yield 106,000-115,000 saleable pearls.

The decline in international market prices for black pearls since 2009 (current prices are the lowest on record) has had a major impact on the Cook Islands pearl industry. Global economic and financial conditions continue to have an adverse effect on market demand and pearl prices in 2013/14. It is expected that export levels in 2014/15 will not increase and are likely to continue to decline.

Chart 6.11 Pearl Exports (including pearl shell) 2007/08 to 2017/18, ($'000)



6.7 Agriculture

The Agriculture sector accounted 2.7 per cent of GDP in 2012, or approximately $7.7 million (as compared to $7.5 million in 2011). Agriculture production and export trends continue to show a declining pattern since 2008/09 and this trend is expected to continue for the forecast period due to ongoing production issues facing the sector.

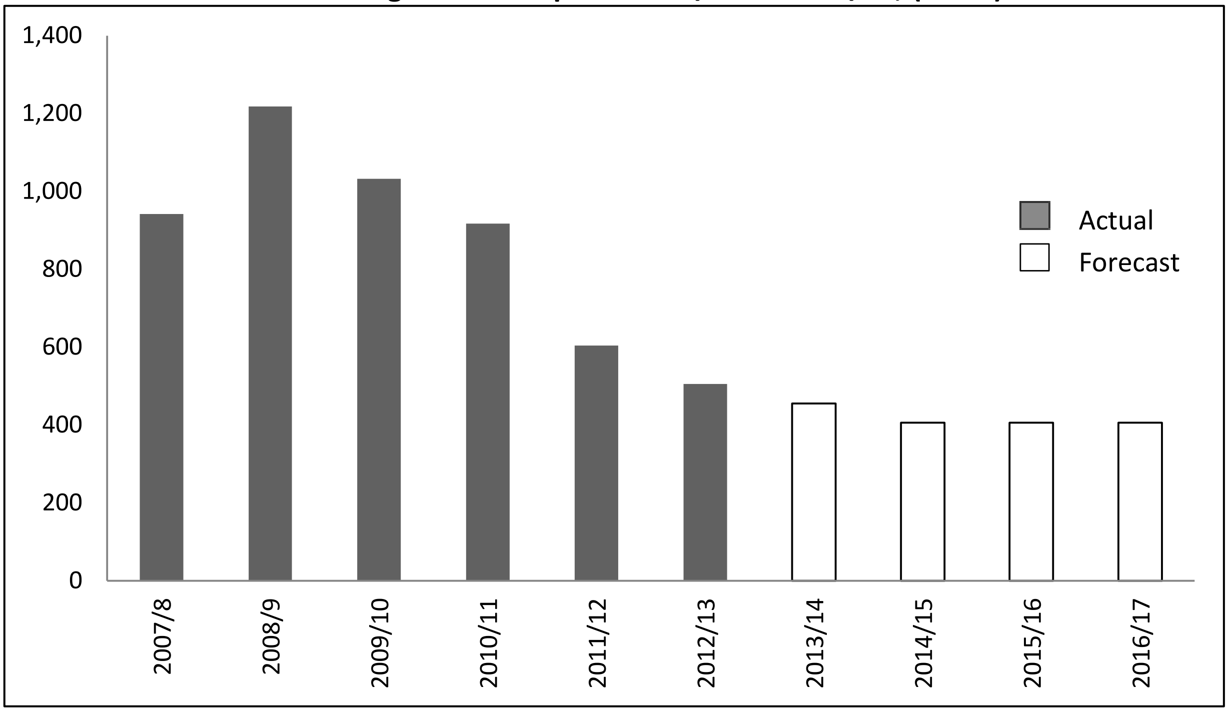
While the decline in agriculture activities were recorded on all the islands including Rarotonga, the number of commercial and semi-commercial farmers has remained constant over the last 25 years. The 1988 Census of Agriculture recorded 238 commercial farmers on Rarotonga compared to 240 for 2011.

The Cook Islands has considerable potential for increased local agriculture production (root crops, fruit and vegetables). However, limitations surrounding local enterprise, substandard facilities for international market access, labour shortages, high local wages, low water supply, coordination failures in supply chains, and high costs of transportation to get produce to markets (from Outer Islands to Rarotonga and onwards) are major constraints.

The Ministry of Agriculture has also noted the need to collaborate with both government (Health and Education) and non-government stakeholders in an attempt to address the issue of non-communicable diseases (NCDs), especially in regards to the nutritional benefits that could be derived from the greater consumption of local crops.

Current initiatives that the Ministry of Agriculture has underway include the establishment of other selected high valued crops such as Vanilla, green house and undercover protection systems for Maire, the use of coconut product virgin oil and body shop cosmetics, the launching of the Cook Islands Delicious Cactai (dragon fruit), and the newly introduced Cook Islands Gold Pineapples (expected to enter the domestic market from 2013/14 onwards). The forecast of agricultural products has been kept conservative until some of these initiatives show some success.

Chart 6.12 Agriculture Exports 2007/08 to 2016/17, ($'000)



In regards to domestic production, there has been a marked increase in the number of hydroponic and semi hydroponic, biological/organic, and aquaponic systems in Rarotonga, Atiu, Mauke, Manihiki and Aitutaki which have been aimed at the supply of salad products. These products include lettuce, herbs, and some other summer vegetables to cater for the high demands from the local restaurants, super markets and hotels. Anecdotal evidence suggests that growth in the tourism industry will further increase the demand for fresh produce on the domestic market, and it is likely that any growth in agricultural output will be absorbed by the local market.

6.8 Exports and Imports

6.8.1 Imports

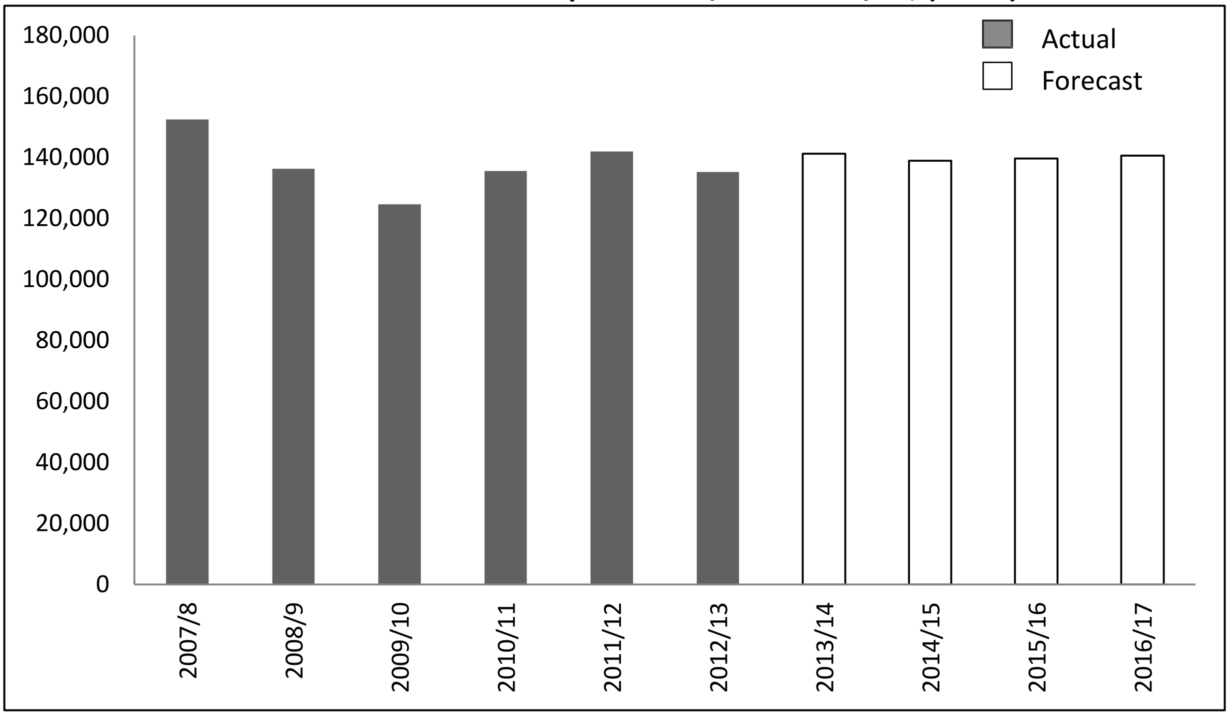
In 2012/13, the total value of imports to the Cook Islands was $135.2 million, a decrease of 4.8 per cent from 2011/12. Imports for 2012/13 were predominantly made up of food and live animals (22.6 per cent); machines, transport & equipment (20.0 per cent); minerals and fuel (19.6 per cent); and miscellaneous manufactured goods (which includes finished or consumer goods) (9.9 per cent).

Data from the 12 months through to September 2013 shows that imports decreased by 0.3 per cent from the year to September 2012. The September quarter 2013 showed 13.9 per cent higher of imports as compared to September 2012, due almost entirely to a 70.7 per cent increase in machinery and equipment. In fact, without the significant contribution from machinery imports (assumedly for construction projects) imports grew just 0.7 per cent from the previous September, and fell 6.7 per cent for the 12 months to September. This is assumed to be a once off importation of equipment for a construction project and is expected to contribute only to the 2013/14 year, before returning to trend levels in 2014/15.

Imports are expected to grow by 4.5 per cent in 2013/14, and then fall by 1.7 per cent in 2015/16 (due to the purchase of machinery in 2013/14 only affecting that one year).

New Zealand continues to be the leading supplier of imports in to the Cook Islands, accounting for approximately 68 per cent of total imports in 2013.

Chart 6.13 Value of total imports 2007/08 to 2016/17, ($'000)



For 2012/13, it is estimated that import leakage from the Cook Islands was approximately 35 per cent – for every dollar spent in the Cook Islands economy, 35 cents went to foreign production. This is because of the Cook Islands heavy reliance on imported products to meet local demand (including that derived from the tourism industry).

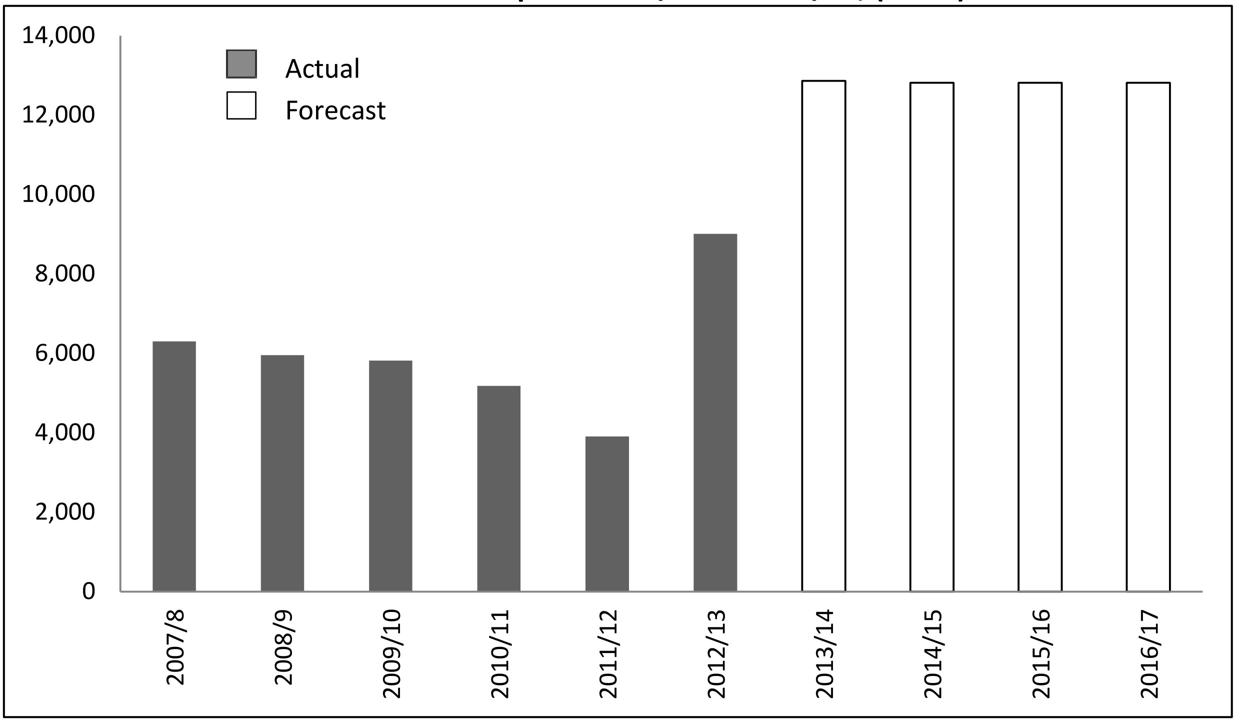
6.8.2 Exports

Driven by a $5.5 million increase in the export of fresh and chilled fish, total exports increased by $5.1 million in 2012/13. The export in fish owes its growth largely to the arrangement with Chinese fishing vessels being able to offload catch at Avatiu harbour via subsidised fuel costs. It is notable that the all the other categories (noni, pearls, maire and other) experienced declines.

For 2012, it is estimated that for every dollar earned in the economy, approximately 59 cents is derived from foreign sources (although this is almost exclusively driven by tourism, with a small contribution from goods exports).

Assuming that the offload of fish catch in Rarotonga by Huanan continues, it is expected that total exports will improve by 42.7 per cent in 2013/14 (albeit from a low base), before declining 0.4 per cent in 2014/15, due largely to declines in non-fish exports. If the arrangement with Huanan is expanded, these forecasts will need to be revised.

Chart 6.14 Total exports 2007/08 to 2016/17, ($'000)



6.8.3 Balance of Trade

A negative merchandise balance of $128.4 million is estimated for 2013/14, a $2.2 million deterioration compared to the better than expected result in 2012/13. The deterioration is largely driven by the one-off importing of capital machinery in later 2013. Going forward, the merchandise deficit is expected to improve to $126.0 million in 2014/15 due a reduction in the import of capital machinery versus a stable forecast for exports.

Tourism dominates the services trade, with estimates for tourism spend reaching $231.4 million for 2013/14.

When estimated services trade is included, the forecast balance of trade is a surplus of $103.0 million for 2013/14. [2] This trade surplus is expected to grow in line with increases in tourism spending rising faster than the associated increases in imports (as most tourism spending is paid to the provision of services).

[2] While there are no official capital account figures, estimates of a trade surplus (when including tourism arrivals) are supported by cash holdings at Banks in Rarotonga having to be transferred to New Zealand for prudential reasons – this prevents the build-up of cash reserves normally associated with trade surpluses.

Chart 6.15 Balance of Merchandise Trade 2007/08 to 2016/17, ($'000)

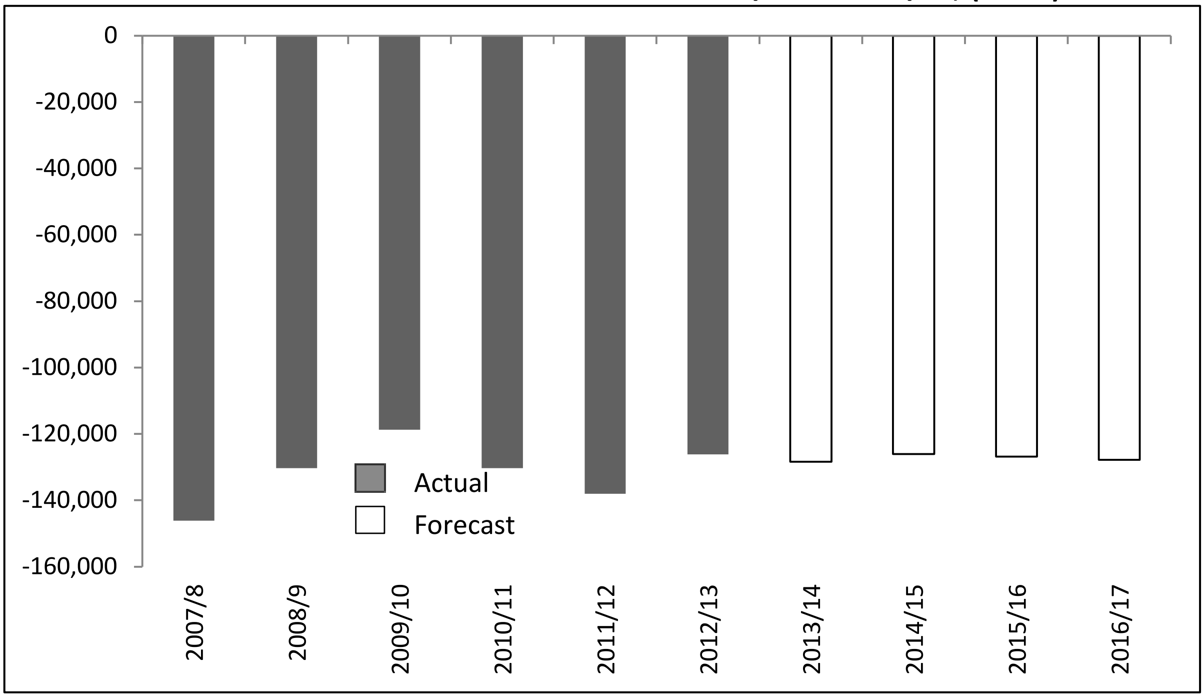
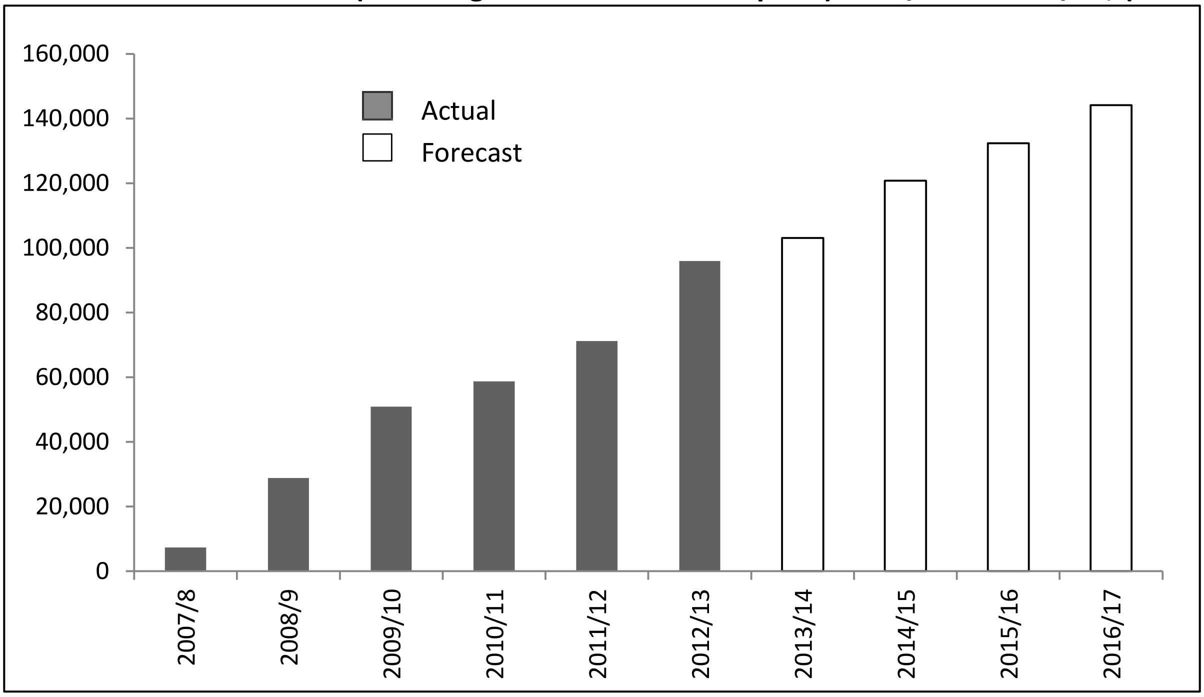


Chart 6.16 Balance of Trade (including estimated tourism spend) 2007/08 to 2016/17, ($'000)



6.9 Banking and Finance

The Reserve Bank of Australia reports that there has been a continued improvement in financial stability with international monetary conditions likely to remain very accommodative for some time. The US Federal Reserve has begun scaling back its asset purchase program, which has had the expected result of repatriating money to US capital markets.

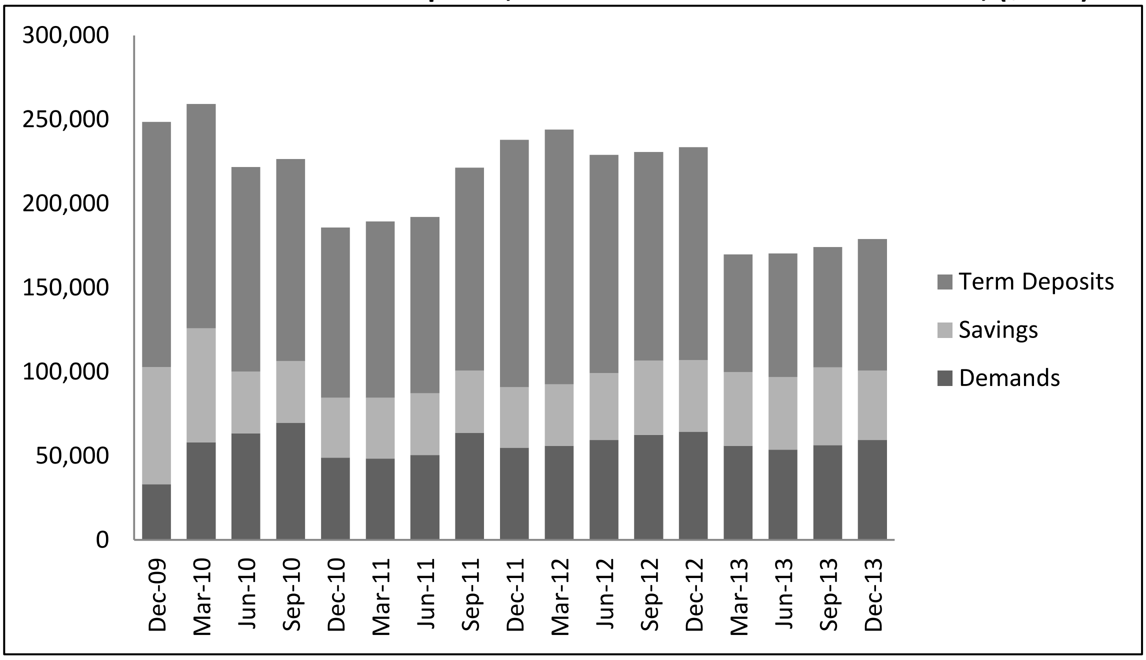
Domestically, non-performing loans and credit rationing remain an issue. The implementation of the Banking Review has been delayed, with future progress likely to be slow.

The revision of Capital Security Bank (CSB) for the Sep 2013 quarter dramatically altered the profile of financial data. Net foreign assets (NFA)[3] in the Cook Islands banking sector have decreased from $86.6 million in the December quarter 2012 to $44.0 million in the December quarter 2013 due to the large increase in foreign liabilities being less-than-matched by a large increase in foreign held assets. Loans to foreign entities no longer appear in the loan figures presented below.

6.9.1 Deposits

During 2013, total deposits showed a continued increasing trend. Total deposits increased from $70.0 million in the March quarter 2013 to $78.1 million in the December quarter 2013. Due to a revision in the historical series only being carried out for the 2013 calendar year, it is difficult to make meaningful comparisons against 2012. This revision include the re-classification of codes where balances owed to other banks have now been removed from term deposits and hence the dramatic decrease in reported deposits from December 2012 to March 2013.

Chart 6.17 Total Value of Deposits, December 2009 to December 2013, ($'000)



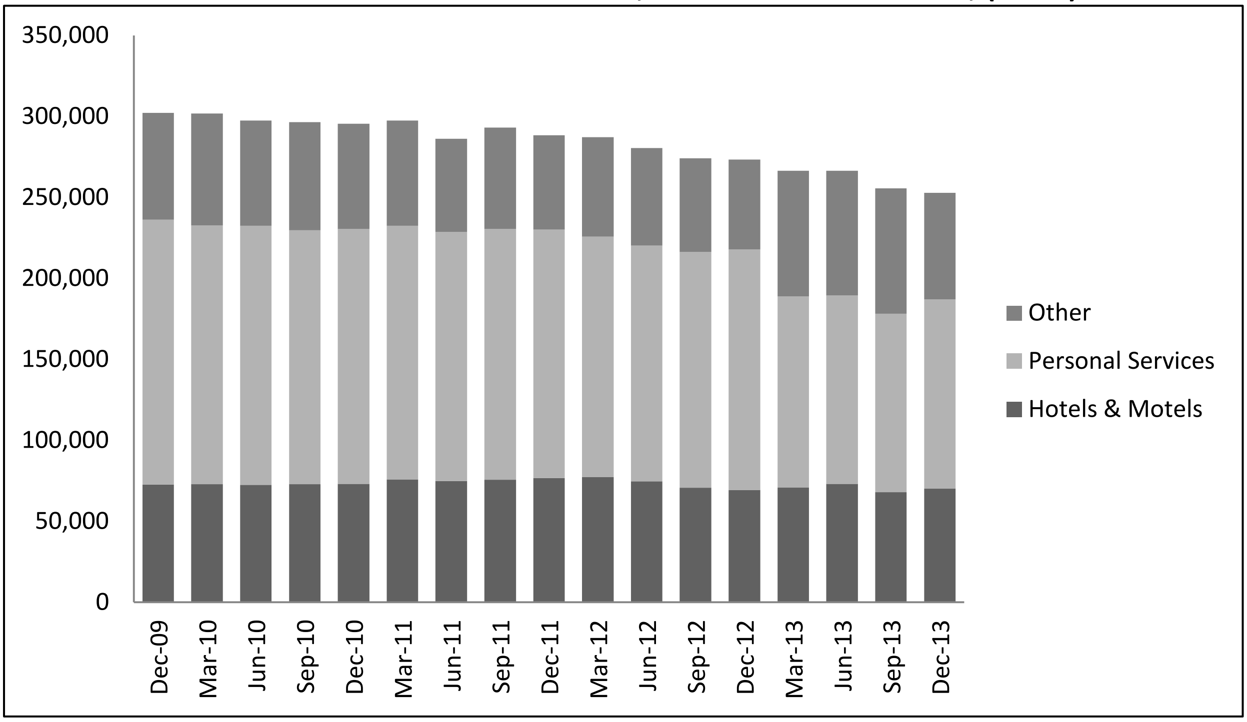
6.9.2 Loans

The overall total value of loans has been in a slow but steady decline since 2008. The addition of the CSB loan portfolio in the September quarter of 2013 increased the overall size of the loan portfolio to $321.9 million, the largest on record. The CSB loan portfolio has now been revised to exclude the foreign component (deposits and loans) from the local loan. With the revision made, the size of the loan portfolio is $255.5 million for the September quarter 2013 (as shown in Chart 6.18), falling to $252.7 million in the December quarter 2013.

[3] Net foreign assets are the value of the assets that Banks own abroad, minus the value of domestic assets owned by foreigners

The on-going portfolio of non-performing loans, together with lenders engaging in credit rationing, is expected to weigh on loan growth going forward. Demand for credit is also assumed to remain weak.

Chart 6.18 The Total Value of Loans, December 2009 to 2013, ($'000)

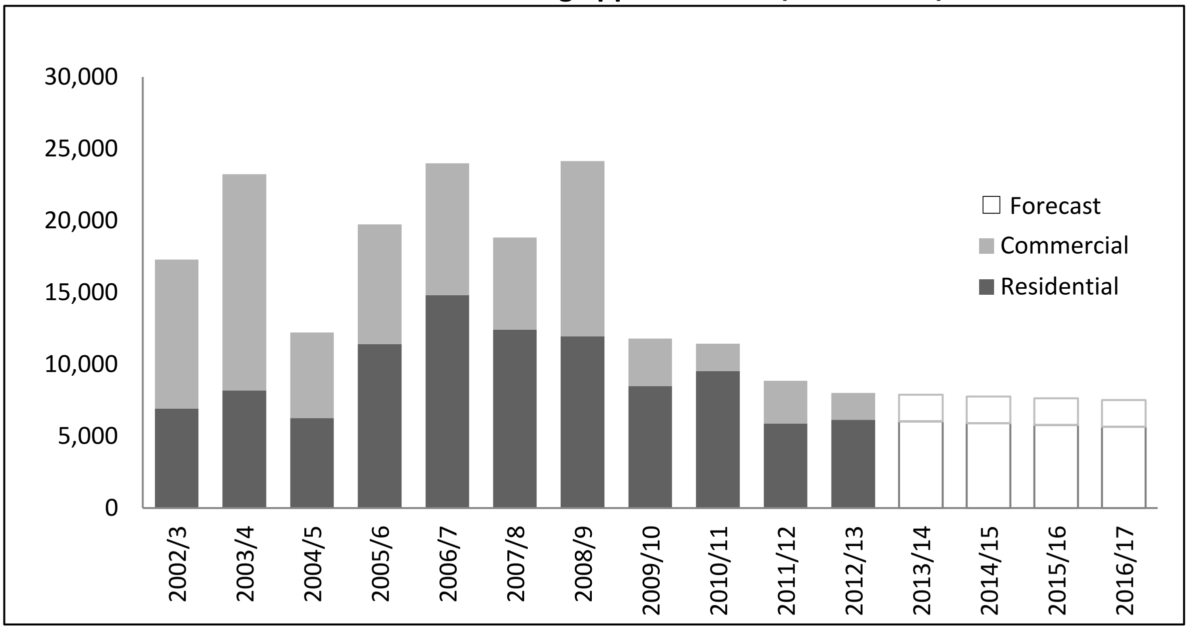


6.9.3 Housing and Construction

The value of building approvals has been in steady decline since 2006/07, with residential approvals falling 40.5 per cent between 2006/07 and 2012/13, and large declines in commercial activity.

Consistent with the positive contribution to 2012 GDP from construction activity, 2012/13 provided a much needed boost to building approvals. In line with this recent improvement, the forecasts for residential building approvals (which account for 73.9 per cent of the total in 2012/13) have been revised upwards for both 2013/14 and 2014/15. The value of approvals for residential construction is currently estimated to fall by an annual average of 2.1 per cent for each of the forecast years. Commercial building approvals were not forecast due to their volatility and sometimes long lead time before construction begins.

Chart 6.19 Value of building approvals 2001/02 to 2015/16



6.10 Financial Services Industry

The financial services industry is estimated to collect fees of a net value of \$1.43 million for services undertaken in 2013/14. In 2014/15, net value of services is expected to be slightly lower at \$1.40 million due to differing forecasted USD exchange rates. Registration fees are generally denominated in USD, which means that some income is subject to exchange rate fluctuations.

There has been slight decline in trust and limited liability company (LLC) registrations and an increase in company registrations for 2013/14. The Financial Supervisory Commission estimates no annual growth in the number of new international companies, LLCs, trusts and foundations registrations in 2014/15. Foundations are being registered at a slow rate. Captive Insurance is the newest service, with legislation passed in June 2013. It is expected that the first captive registration will occur before the end of the financial year with more growth in 2014/15.

New products and services as well as amended legislation for existing services are part of the effort to grow and diversify client markets. The International Companies Act is in the process of being overhauled and is expected to be passed in 2014. Focus continues on promotion of the jurisdiction in Asia, particularly for trusts, foundations, and companies. Promotion of captive insurance in the next year will be targeted to the Australia and New Zealand corporate markets as well as to existing clients of the jurisdiction.

The industry continues to comply with international regulatory standards. At the end of 2013, numerous amendments to existing industry legislation were enacted to address areas of improvement highlighted in the country's 2012 OECD Global Forum Phase 1 Peer Review. The Phase 2 Peer Review will take place in May 2014 and a positive report is expected. New legislation has also been passed to allow banks and trustee companies to comply with international tax information exchange agreements (namely FATCA out of the United States). 2014/15 will see a follow up report to the Asia Pacific Group Mutual Evaluation Report on Anti-Money Laundering and Know Your Customer laws and practices in July 2014.

7 CROWN DEBT

7.1 Gross Debt owed by the Crown

Total gross debt owed by the Crown estimated at end of March 2014 was $100.0 million, a variance of $2.3 million from what was initially estimated during the 2013/14 Half Year Fiscal Update.

Table 7.1 shows Crown is now estimated to owe $100.0 million by the end of June 2014 due to the favorable movement in exchange rate of against the New Zealand Dollar of $2.3 million;

Table 7.1 Reconciliation on 2013/14 Loan Movement

Movement Reconciliation	$ million
Gross debt estimated at half year update	102.3
Unrealised exchange -gain/loss	-2.3
Estimanted gross debt for 30/06/2014	**100.0**

The exchange rate used for this write up reflects the monthly average for the period of March 2014. Past changes in major exchange rates against the New Zealand dollar (NZD) are reflected in Chart 7.1.

Chart 7.1 Changes in Major Exchange Rates

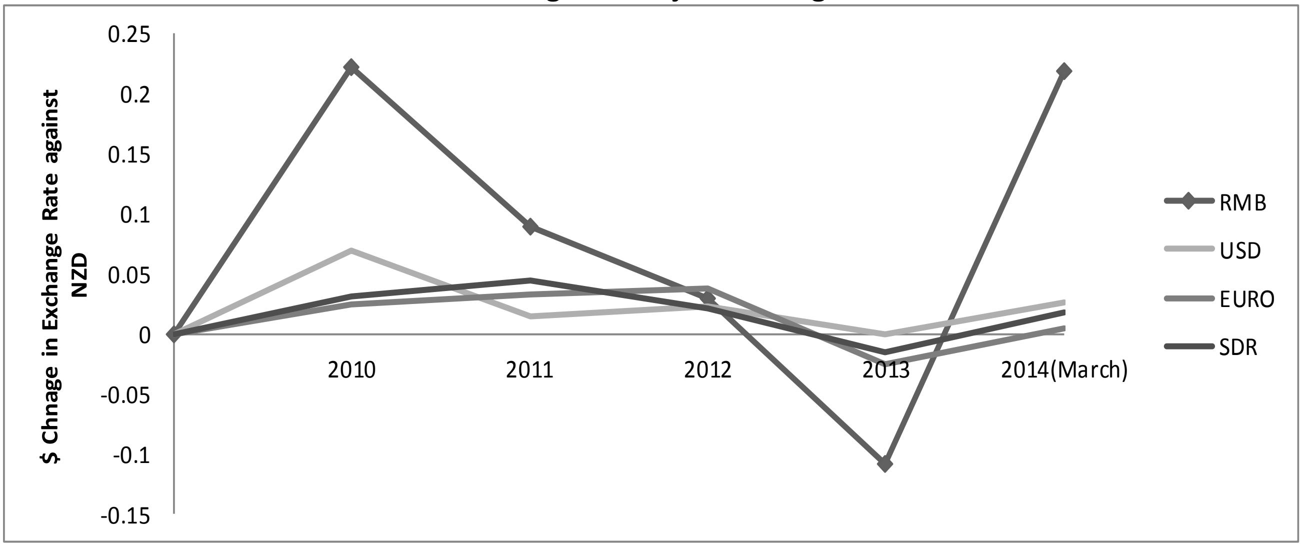


Chart 7.1 illustrates the appreciation of the New Zealand dollar against all trading currencies from 2013 to March 2014.

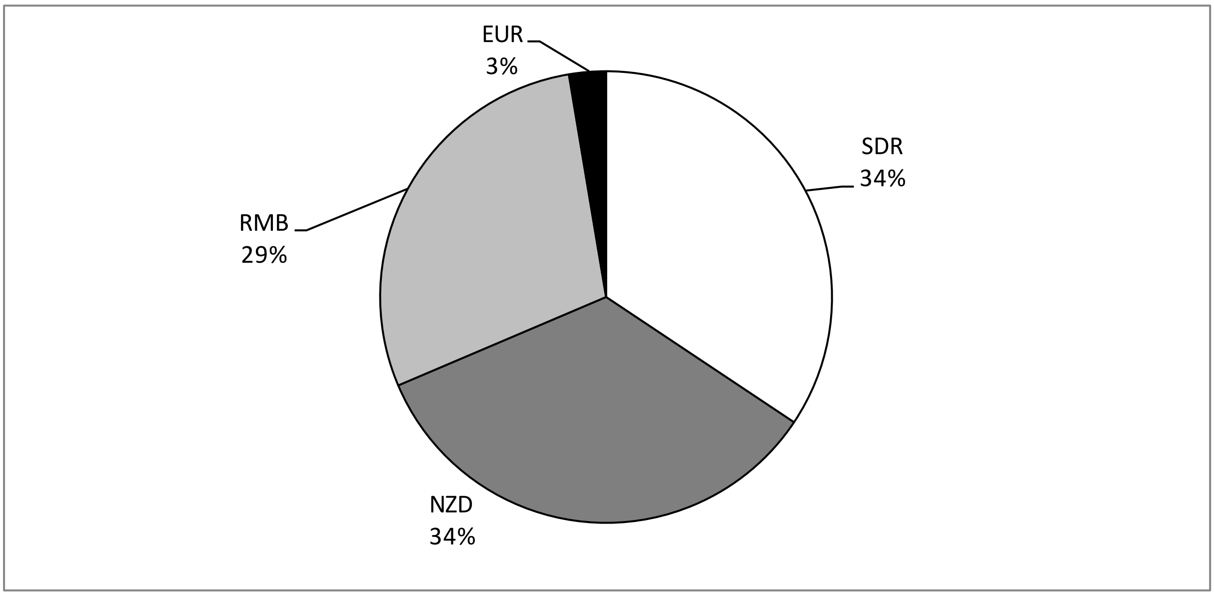
The assumption on the future value of the New Zealand dollar assumes that the trend movement as outlined in the above chart will remain constant into the outer years.

Table 7.2 Average Exchange Rates Used

Foreign Exchange Currency	March 2014 Average	November 2013 Average	changes
EUR	0.6160	0.6125	0.57%
USD	0.8517	0.8265	3.05%
RMB	5.2550	5.0363	4.34%
SDR	0.5509	0.5341	3.15%

Table 7.2 shows the movement between exchange rates used during the 2013/14 the half year fiscal update and this pre-election update. New Zealand dollar (NZD) appreciates against all major trading currencies in which Government debt is denominated.

Chart 7.2 Composition of Crown Debt as at 30 March 2014 by Currency



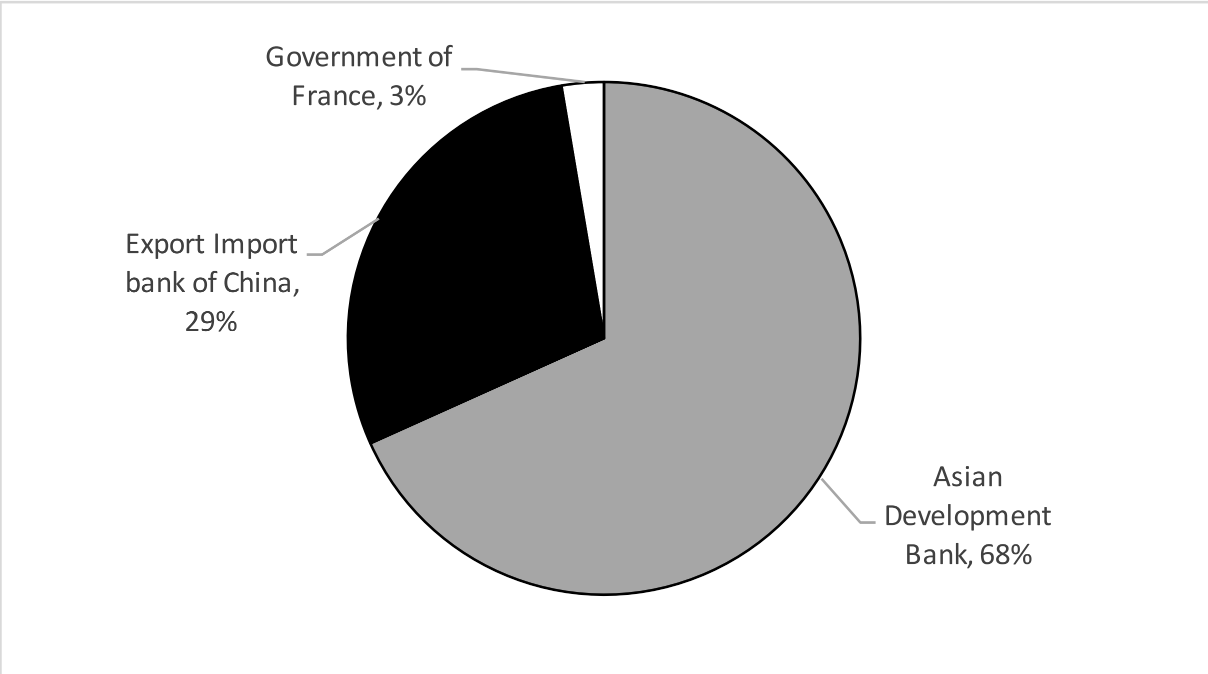
Total Crown debt as reported is mainly denominated in Special Drawing Right (SDR) and NZD with 34 per cent, followed by Renminbi (RMB) 29 per cent and Euro (EUR) three per cent respectively.

As reported during the 2013/14 Budget, the share of NZD have now increased from seven per cent to 34 per cent as a result of recently converted loans held with ADB valued at USD $23.3 million (Ports Authority loan of USD $13.3 million and Economic Recovery Support Program (ERSP) tranche one of USD $10 million) into NZD.

7.1.1 Gross Debt by Lenders

The estimated gross debt by lenders owed to the Crown at the end of March 2014.

Chart 7.3 Gross Debt Estimates by Lenders as at 31 March 2014



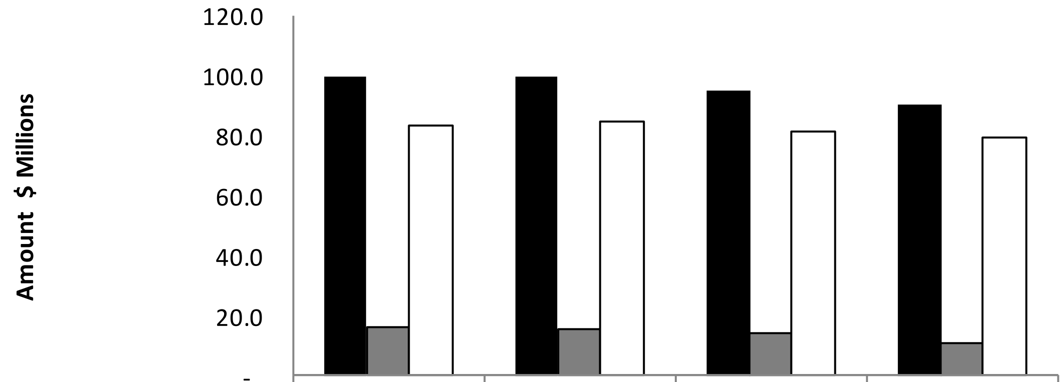
As illustrated in Chart 7.3, the Crown has borrowing with three major creditors, the ADB holding 68 per cent followed by the Export Import bank of China (EXIM Bank) with 29 per cent and the Government of France holding three per cent.

Government have not committed itself to further debt during the time of this write up.

7.1.2 Crown Debt burden

As it stands, total gross debt gradually reduces in the outer years as principle gets repaid, with the assumption that Government is not taking on new loans. The same indication is reflected on the Loan Reserve Fund (LRF) as it continues to reduce as the loans borrowed by the Crown on behalf of State Owned Enterprises (SOEs) are repaid.

Chart 7.4 Cook Islands overall debt burden



	2013/14	2014/15	2015/16	2016/17
Gross Debt	100.0	100.1	95.5	90.5
Loan Reserve	16.3	15.1	13.9	11.0
Net Debt Outstanding	83.6	85.0	81.6	79.5

7.1.3 Status of Government Loan

Table 7.3 shows that the amount estimated to be covered by the loan reserve fund for 2013/14 fiscal year is $13.4 million. The LRF currently has an estimated balance of $16.9 million, resulting in a net positive balance of $3.5 million.

This variance is the result of the overall net appreciation in the NZD against major exchange rates to March 2014 described earlier in this chapter. In the event that the NZD weakened against these major exchange rates, this net balance will be used as a buffer to cover for exchange fluctuation in the outer years.

Table 7.3 Status of Government loans as at 31 March 2014

Loans drawn down	Date loan taken	Original loan amount (000)	Current balance (000) (NZD)	Expected date of repayment	Amount covered by loan reserve
ADB 461 (SD) Multi Project	November, 1980	SDR 1,000	623	August, 2020	-
ADB 567 (SD) CIDB Project	July, 1982	SDR 1,500	562	April, 2022	562
ADB 849 (SD) 2nd Multi-Project	December, 1987	SDR 2,067	1,961	August, 2027	1,961
ADB 1031 (SD) Outer Islands Telecom Project	October, 1990	SDR 3,541	4,582	August, 2030	4,582
ADB 1155 (SD) 2nd CIDB Project	March, 1992	SDR 939	1,150	December, 2031	1,150
ADB 1171 (SD) Emerg. Telecom Rehab Project	August, 1992	SDR 291	396	June, 2032	396
ADB 1309 (SD) Pearl Industry Dev. Project	December, 1994	SDR 336	434	August, 2034	-
ADB 1317 (SD) Educ'n Dev Project	Debruary, 1995	SDR 1,836	2,647	August, 2034	-
ADB 1380 (SD) 3rd CIDB Project	January, 1996	SDR 1,538	2,192	September, 2035	2,192
ADB 1466 (SD) Economic Restructure Program	September, 1996	SDR 3,430	4,840	September, 2036	-
ADB 1588 (SD) Cyclone Emergency Rehab Project	January, 1997	SDR 475	811	January, 2038	-
Restructured Drench Loans	January, 1999	Euro 5,413	2,636	September, 2018	2,636
ADB 1832 (SD) Waste Mgt Project	December, 2001	SDR 1,695	2,275	June, 2033	-
ADB 2174 (SD) Cyclone Emergency Assist Project	June, 2005	SDR 1,895	3,665	June, 2045	-
China - Multi-Dunctional Indoor Sports Stadium	August, 2008	RMB 74,100	13,161	August, 2028	-
ADB 2472 (OCR) Avatiu Port Development Project	September, 2009	NZD 10,309	10,309	November, 2033	-
ADB 2473 (SD) Avatiu Ports Development project	September, 2009	SDR 8,346	8,212	November, 2040	-
ADB 2565 OCR Economic Recovery Support Program 1	January, 2010	NZD 11,053	11,053	October, 2024	-
ADB 2739 (OCR) Amendment Avatiu Port project	December, 2011	NZD 5,614	5,614	November, 2035	-
China - Rarotonga Water Ring Main Upgrade	December, 2012	RMB 118,000	15,597	December, 2032	-
ADB 2565 OCR Economic Recovery Support Program 2	December, 2012	NZD 7,250	7,250	December, 2028	-
Total loans drawn down			**99,970**		**13,479**
Loans committed to but not yet disbursed					
China - Rarotonga Water Ring Main Upgrade	December, 2012	RMB 118,000	6,802	December, 2032	-
Total loans committed to but not yet disbursed			**6,802**		**-**
Total loans commitment			**106,772**		**13,479**

Chart 7.5 Current Bilateral and Multilateral Estimate Loans Outstanding Next 10 Years

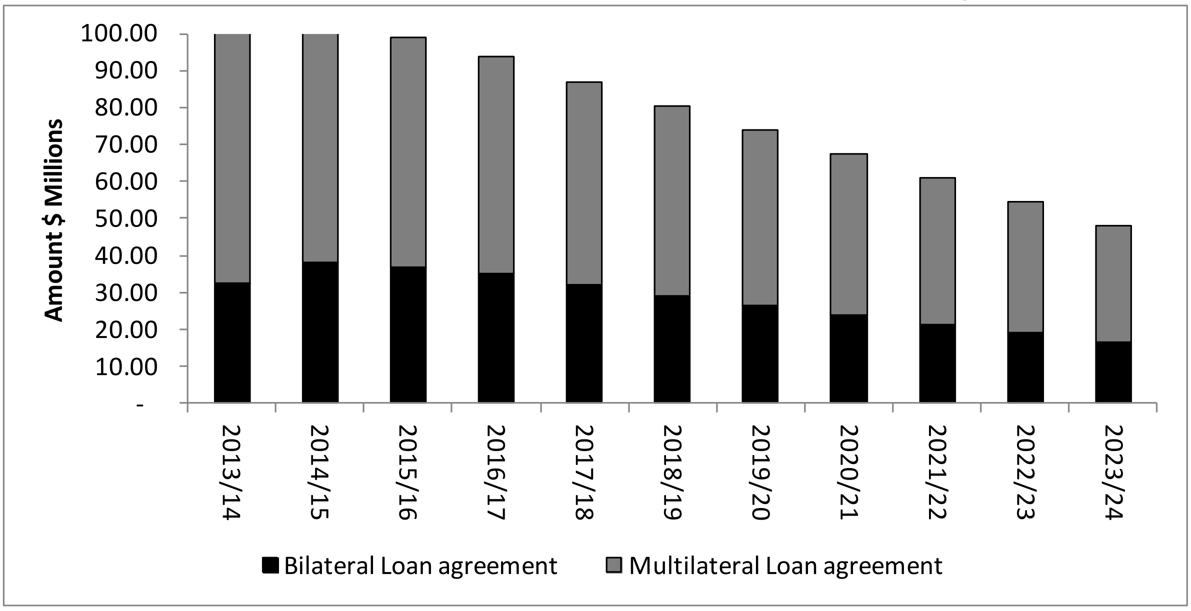


Chart 7.5 shows the bilateral and multilateral amount of borrowings to the Crown has on its record for the next 10 years from 2013/14 to 2023/24. The bulk of the debts are committed from multilateral agreements with the ADB, 68 per cent, compared to bilateral agreements of 29 per cent with the EXIM bank of China and three per cent with the Government of France.

7.2 Crown Loan Reserves (LRF)

The Crown LRF was established in 2001 to enable Government to access to concessional loans and provide these on to State Owned Enterprises (SOEs).

The payment terms with the external lenders which included a grace period of (normally five years) was not extended on to SOEs. SOEs have paid the full debt servicing cost from the initial drawdown of the loan.

In 2001 these funds were put aside into a debt reserve.

The overall objective of the trust fund is to build the total amount to a stage where it fully covers the outstanding amount owed to lenders from the SOE’s.

As at the time of this publication, the objective was met with all SOE loans with Government being fully covered. These SOEs include the Bank of the Cook Islands, Te Aponga Uira, and Cook Islands Telecommunication.

The new loan approved for the Cook Islands Port Authority will be treated as a loan to Government from the ADB. The Cook Islands Port Authority is expected to repay and honour the same loan repayment schedule and terms agreed between the ADB and Government.

It is anticipated that the principle objective of the LRF will be extended beyond the SOE’s to incorporate all Crown debt.

The Government have recently passed the Loan Reserve Fund Bill on 14 April 2014, to be effective on 1 July 2014, to legislate the LRF and formalise the current debt management approach.

Table 7.4 Debt reserve transactions

Debt Reserve Working	Transfer In	Transfer Out	Balance	SOEs Debt
Budgets 2005-2006			17,018	
2006-07 transfer to reserve	1,529	-	18,547	22,390
2007-08 transfer to reserve	1,287	-	19,834	23,497
2008-09 transfer to reserve	1,100	-	20,934	21,018
2009-10 transfer to reserve	1,100	-	22,034	18,465
2010-11 loan repayment	-	1,529	20,505	17,365
2011-12 loan repayment	-	1,429	19,076	16,177
2012-13 loan repayment	-	1,529	17,547	12,541
2013-14 loan repayment	-	1,220	16,327	13,479
2014-15 loan repayment	-	1,220	15,108	12,259
2015-16 loan repayment	-	1,246	13,861	11,013

7.3 Gross debt, net of the LRF

Gross debt net of the LRF, is the difference between the gross debt and monies held in the Crown LRF. This debt is estimated to be $83.6 million (20.5 per cent of GDP) by the end of June 2014, a reduction of $2.3 million since the 2013/14 Half Year Fiscal Update and is predominantly due to the appreciation of the NZD against all major exchange rates reported earlier in this chapter.

Table 7.5 Estimated net debt to 2015/16

	2013/14 Proj	2014/15 Proj	2015/16 Proj	2016/17 Proj
Statement of Borrowings	$m	$m	$m	$m
Gross Crown Debt, End of FY	100.0	98.1	94.0	89.2
... net of loan reserves, End of FY	83.8	83.3	80.5	77.1
as percentage of GDP	20.5%	19.6%	18.6%	17.4%
Loan Repayment Reserves Held	16.2	14.8	13.5	12.1
Gross Debt Servicing	5.6	6.0	6.4	6.9
Net Debt Servicing	4.0	4.1	4.5	4.8
... as percentage of Total Revenue	3.8%	3.5%	3.6%	3.9%

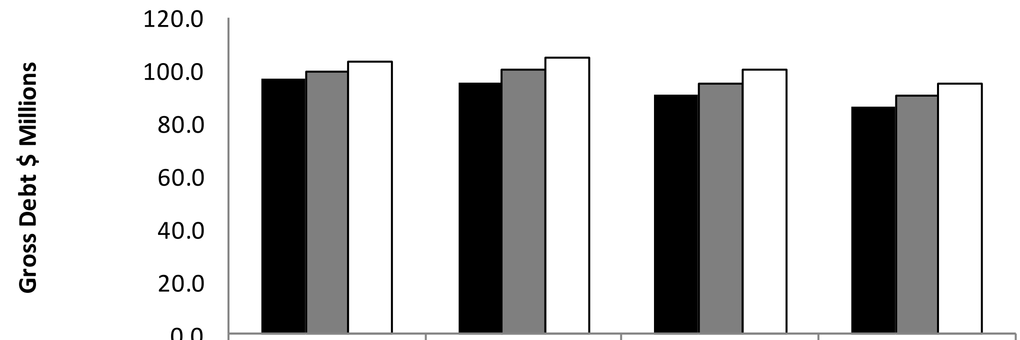
7.4 Crown Debt Sensitivity Analysis

Table 7.6 Base rate used for budget assumption with +/- five per cent

Foreign Exchange Currency	-5%	Budget assumption base rate	+5%
EUR	0.5852	0.6160	0.6468
USD	0.8091	0.8517	0.8943
RMB	4.9923	5.2550	5.5178
SDR	0.5234	0.5509	0.5784

The sensitivity analysis demonstrates the impact of a five per cent appreciation or depreciation in the New Zealand dollar is prepared to determine the impact on the gross borrowings and the debt servicing cost.

Chart 7.6 Sensitivity of Total Crown Gross Debt

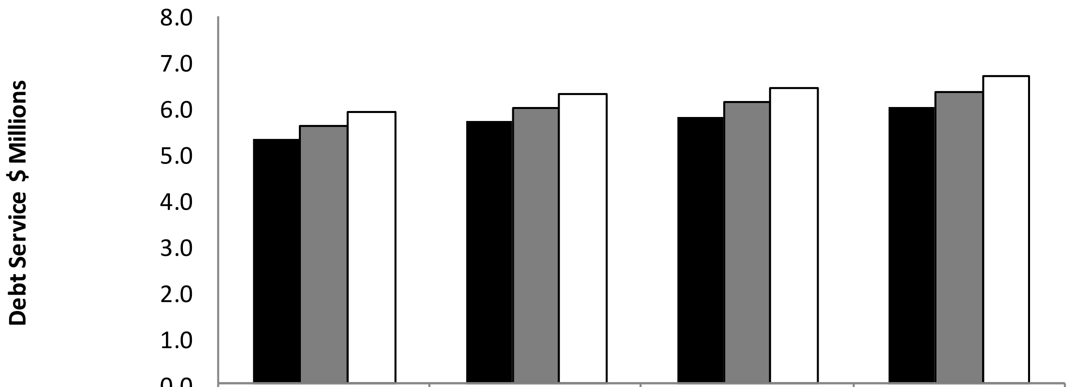


	2013-14	2014-15	2015-16	2016-17
Increase by 5%	96.8	95.3	90.9	86.2
Base Rate	100.0	100.1	95.5	90.5
Decrease by 5%	103.4	105.4	100.5	95.3

Total Crown debt increased by $5.3 million ($5.4 million during the time of the 2013/14 half year fiscal update) compared to a reduction of $4.8 million ($5 million during 2013/14 half year fiscal update) in 2014/15 as the impact of a five per cent depreciation/appreciation of the NZD. This reflects the appreciation of the NZD between the time of the 2013/14 budget and this write up which indicates that our loan portfolio is more sensitive to depreciation than appreciation in the NZD.

A continued depreciation of the New Zealand dollar beyond the five per cent scale reduces the opportunity for further borrowings and increasing debt servicing costs.

Chart 7.7 Sensitivity of Debts Servicing Costs



	2013-14	2014-15	2015-16	2016-17
Increase by 5%	5.4	5.7	5.8	6.1
Base Rate	5.6	6.0	6.1	6.4
Decrease by 5%	5.9	6.3	6.4	6.7

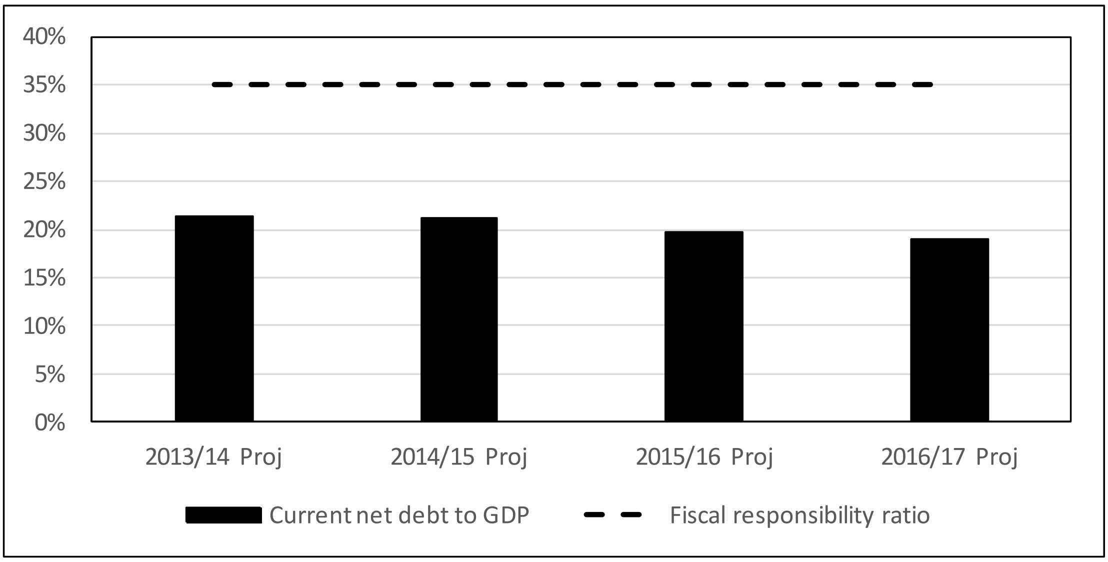
The impact of the five per cent increase or decrease on debt servicing cost is relatively consistent to the impact on gross debts.

Any decision to commit to further bowings should be assessed carefully due to the sensitivity of the New Zealand dollar.

7.5 Future Borrowings and Fiscal Responsibility Ratios relating to Debt

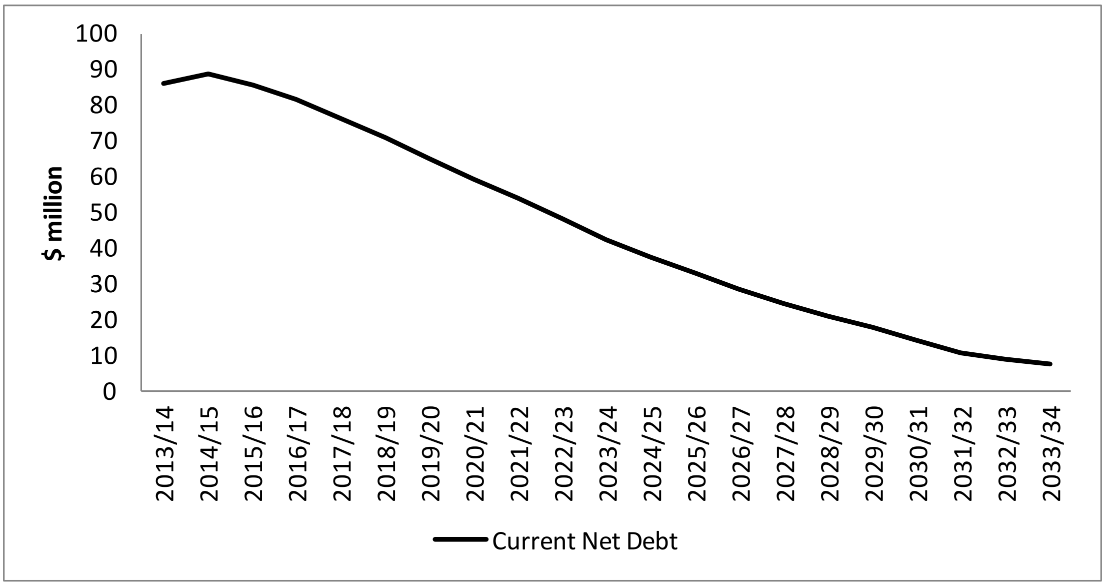
Proposals to take on new loans must be treated under transparent processes as required by the MFEM Act 1995/96. The fiscal responsibility ratios will prudently assist Government to manage the growth of its future borrowing plan.

Chart 7.8 Net Debt as a proportion of GDP



As can be seen from Chart 7.8, Government is well within its fiscal responsibility ratio threshold of 35 per cent.

Chart 7.9 Estimated net debt for next 20 years



However these ratios should not be looked at in isolation, any proposal to take on additional borrowing should be looked at in the context of whole of Government budget and its ability to pay annual debt servicing.

7.5.1 Net debt Service to Total Revenue

This ratio controls the servicing of debt. It primarily ensures that there are sufficient means to service debt from the operating revenue. Taken together with the tax revenue envelope, this ratio measures how much debt servicing is crowding out other components of government spending. Debt servicing includes interest and principal payments.

The benchmark for debt servicing to the total revenue ratio is not to exceed 5 per cent of the Crown total revenue. As reported in Chart 7.10, we do not have much room to move if Government decides to take on additional debt.

Chart 7.10 Net Debt as a proportion of Revenue

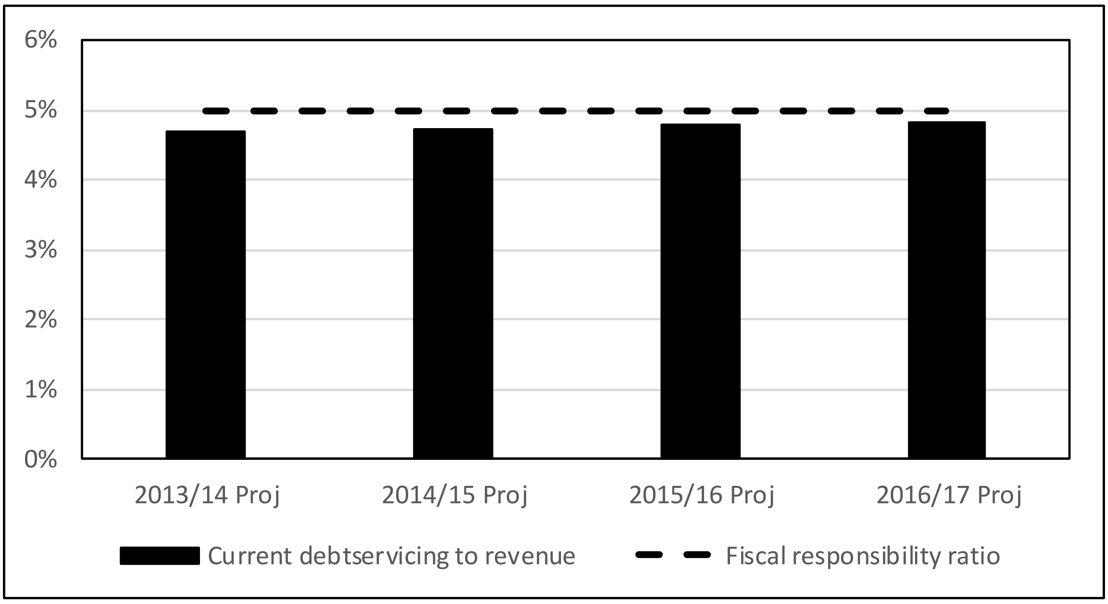
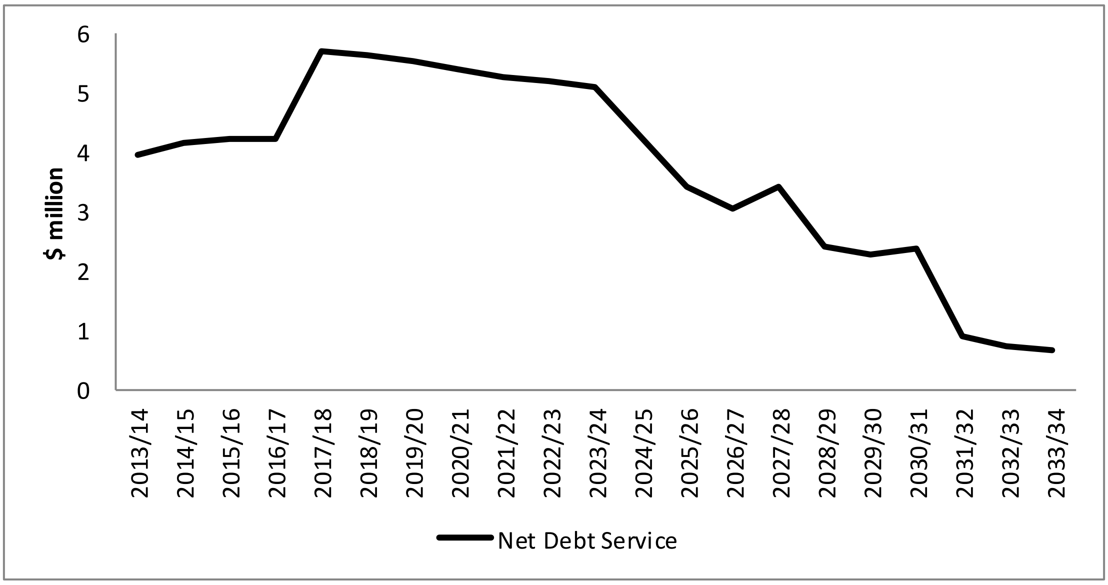


Chart 7.11 Estimated net debt service for next 20 Years



7.6 Other State Owned Enterprise Debt

State Owned Enterprises can take loans directly without Government guarantee, this analysis does not include those loans.

The Airport Authority reported in 2010/11 financial report that it had recently financed its loan with a new provider. The terms of the loan was for $8.1 million taken over a five year term with current interest rate at 5.54 per cent with a drawn amount of $7.3million.

The loan is repayable by monthly installments of $0.07 million which is inclusive of interest and is based on a 15 year amortization term with balloon payment at the end of term.

The loan is secured by registered mortgage debenture over the assets and undertakings of the Airport Authority. A financial covenant will apply where the amount of EBITDA generated less dividend paid will at all times be greater than twice the annual debt servicing commitments. The Covenant will be measured annually in arrears. The Airport Authority is considering additional borrowing of $23 million for further airport upgrades of Rarotonga International Airport.

Te Aponga Uira have also indicated they are considering new borrowings to finance new investments in electricity generation and supply assets including infrastructure aimed at improving renewable energy distribution and supply.

8 OVERSEAS DEVELOPMENT ASSISTANCE (ODA) FLOWS

Total ODA contribution from development partners was estimated at $59.4 million in the 2013/14 Budget.

Major capital projects funded by ODA covering equipment (China grants in kind), water (Te Mato Vai, sanitation) and renewable energy have been progressing slowly in 2013/2014 with recent changes expected to lift results over the remaining 6 months.

Contracts have now been awarded for Te Mato Vai (Rarotonga water upgrade) with AECOM delivering the master plan and KEW contractors (Samoa) providing the project management unit to the Cook Islands government. The Cook Islands renewable energy programme has seen reallocation of Japanese grants (PEC) from Northern Cook Islands to solar panel provision, reallocation of NZ/Australian funding to cover the installation costs and contracting of BECA to facilitate (tender, project manage, report) the installation of these solar systems.

Access to climate change financing opportunities continues to be complex and government continues to advocate for greater use of national systems to deliver climate finance and ODA programmes. MFEM has engaged the services of the Frankfurt School of Finance and Management to develop an application for National Implementing Entity status with the UN Adaptation Fund in 2014. To support this approach, on-going improvements are being made to the Government's public financial management, procurement and activity management systems.

Since July there have been some development partners committing additional funds or signalling changes. These are;

- In addition to a correction in accounting treatment by the EU in the FY 2013/14, the actual payment is now expected to be not later than April 2014. MFEM working on disbursal request using ADB economic assessment, Sanitation policy and 3 year plan. The amount remains unchanged at NZ$1.6 million.
- NZ$3.7m (RMB¥20,000,000) pledge from the People Republic of China announced October 2013. To be channeled into the 2014/15 Budget process for allocation.
- Changes to budget allocations due to cash flow needs of infrastructure projects within the three years Forward Aid Programme with New Zealand and Australia. With 18 months from the end of the current NZ government 3 year budget appropriation cycle these changes will be proposed in the 2013/14 supplementary and 2014/15 Budget process. Overall priorities remain consistent plans and this is not expected to result in a change to the total 3 year contribution.
    - NZ funding for Te Mato Vai will likely be rescheduled to align to timing of cash flow needs. No change to overall NZ$15 million grant pledged.
    - NZ has indicated support for the Apii Nikao school rebuild. The amount is currently under negotiation.
- Australia granted an additional NZ$37,780 to assist fund the SPC's 12th triennial conference on Pacific Women held in October 2013 in Rarotonga.

Some development partners have also indicated emerging funding opportunities. These are;

- Small Island States Fund (regional managed by PIFS). Previously, with only Taiwan supporting fund and the being amount limited, the Cook Islands have used funds to top up the emergency disaster fund. PIFS wanting to reshape the fund's purpose with a link to the Forum compact work (development effectiveness). PIFS have projected US$200,000 over 3 years for CI, but funding is an issue. Support from PICs is important to secure funds.

- France has allocated NZ$100,000 for Renewable Energy monitoring system in Northern Cook Islands. A concept note has been submitted to the French government for consideration.
- New Caledonia grant proposed for Renewable Energy in Aitutaki, NZ$700,000. REDD following up with OPM to clarify proposal.
- Sanitation upgrade rollout to Rarotonga and Aitutaki has been delayed and now likely to start scale up in FY2014/15
- ADB will be making an application on behalf of the Cook Islands for NZ$8.36 million from EU energy sector fund which is proposed to be blended with projected ADB lending ($13.43 million) and existing PEC funding from 2014/15. Currently the EU grant can only be accessed through ADB systems and therefore is paired with the ADB Loan.
- The Republic of Korea has allocated US$200,000 to be aimed at promoting cultural projects.
- Global Environment Fund (GEF6) for the period June 2014 to June 2018 amounts to approximately US$4 million.
- India Grant-in-Aid funding of US$150,000 has been allocated with the aim of supporting community projects that promote or develop social, cultural, or economic development and sustainability within in the community.

The Pacific Islands Forum Secretariat undertook a Peer review of the Cook Islands national development planning and budget processes in October 2013 to:

- promote international best practice in key sectors,
- improve effective budget allocations and implementation to achieve national development priorities; and
- guide support from development partners.

The objective of the peer review process is to guide improvements in development coordination, including by informing discussions at the Pacific Islands Forum and Post Forum Dialogue, through reviews of coordination at a country level. The final report is now available on the MFEM website. The peer review recommended a transition of the relationship between donors and the Cook Islands government from "financial and administrative discussions to bigger picture policy dialogue". The key findings in relation to the management of ODA include:

- Support for the move away from project based approaches and towards sector based or budget support;
- Addressing high rates of staff turnover;
- Need for greater information and accountability for regional ODA flows;
- Need to clarify mandates of ministries and government structures;
- Increase in joint analysis, missions and pooled funds between donors, particularly regional organizations and the CI government; and
- Improving DCD review and quality control practices which are understood and endorsed by line ministries.

In addition, a PEFA self-assessment was undertaken in parallel with the peer review and with the assistance of IMF PFTAC. This has provided an additional level of insight into the public financial management capacity across the Cook Islands government. Based on these results, the 2014 formal PEFA assessment is expected to act as a catalyst for donors to increase the use of national systems.

The Government continues to foster partnerships with local and international partners with the development partners meeting which was held 11-13 February 2014. The meeting allowed Government to present forward priorities, update progress and identify new pledges to inform the national budget process which started in April 2014.

Official Development Assistance budgeted for 2013/2014 has decreased by $3.1 million reflecting changes in delivery times being partially offset by development partners committing additional funds that were not appropriated at the time of the 2013/14 Budget.

Table 8.1 ODA Items

Agency	Development Partner	Budget 2013/14	Supplementary Estimates 2013/14	Variance	Budget 2014/15	Budget 2015/16	Total
CIIC		**200,000**	**100,000**	**-100,000**	**100,000**	**0**	**200,000**
ADB Asset Management Technical Assistance	ADB	200,000	100,000	(100,000)	100,000	0	200,000
Improve infrastructure service delivery technical assistance	ADB	0		0	0	0	0
Pearl Authority		**0**	**0**	**0**	**0**	**0**	**0**
Pearl Industry Revitalisation	NZAID	0		0	0	0	0
Tourism Corporation		**3,000,000**	**3,000,000**	**0**	**2,000,000**	**0**	**5,000,000**
Tourism Sector Support	NZAID	3,000,000	3,000,000	0	2,000,000	0	5,000,000
Foreign Affairs and Immigration		**11,141,000**	**11,141,000**	**0**	**7,700,000**	**0**	**18,841,000**
Pacific Forum Leaders Meeting	AUS	0		0	0	0	0
China grants in kind	CHINA	11,000,000	11,000,000	0	7,700,000	0	18,700,000
PRC Grant	CHINA	20,000	20,000	0	0	0	20,000
Korea Cars	KOREA	121,000	121,000	0	0	0	121,000
Ministry of Finance and Economic Management		**12,906,000**	**11,605,000**	**(1,301,000)**	**12,224,000**	**6,889,000**	**30,718,000**
Public Sector Reform TA Support	ADB	900,000	400,000	(500,000)	600,000	0	1,000,000
EU TCF	EU	80,000	80,000	0	80,000	80,000	240,000
Water & Sanitation General Budget Support	EU	1,600,000	1,600,000	0	2,400,000	1,600,000	5,600,000
India Grant Fund	INDIA	150,000	150,000	0	150,000	150,000	450,000
Automated Border Management System	New Zealand Aid	135,000	135,000	0	135,000	0	270,000
Aid Effectiveness	New Zealand Aid	62,000	62,000	0	0	0	62,000
Te Mato Vai	New Zealand Aid	7,500,000	7,500,000	0	3,500,000	5,000,000	16,000,000
Pac Forum Sec Small Island States	Pacific Islands Forum (PIF)	0		0	0	0	0
TRAC Funds	UNDP	242,000	242,000	0	0	0	242,000

Agency	Development Partner	Budget 2013/14	Supplementary Estimates 2013/14	Variance	Budget 2014/15	Budget 2015/16	Total
Water Security	New Zealand Aid						0
Pearl Industry Revitalisation	CHINA			0	0	0	0
Pearl Industry Revitalisation	NZAID	2,237,000	859,000	(1,378,000)	859,000	59,000	1,777,000
Development Partners Meeting	CI Gov		15,000	15,000			15,000
NIE Accreditation Process	EU SPC GCCA PSIS		62,000	62,000			62,000
Apii Nikao School Rebuild	New Zealand Aid		500,000	500,000	4,500,000		5,000,000
Agriculture		**581,500**	**445,500**	**(136,000)**	**138,500**	**100,000**	**684,000**
Agriculture Census and Statistics, Food and Ornamental Crop	FAO	223,200	223,200	0	0	0	223,200
Forestry Assessment Project	FAO	83,000	83,000	0	0	0	83,000
Crop Enhancement Technical Cooperation	FAO	236,000	100,000	(136,000)	100,000	100,000	300,000
SPC - Water-logging Project	SPC	30,000	30,000	0	38,500	0	68,500
SPC - Taro Revitalisation program	SPC	9,300	9,300	0	0	0	9,300
Ministry of Education		**3,355,000**	**3,355,000**	**0**	**3,460,000**	**3,460,000**	**10,275,000**
Education Sector Partnership	New Zealand Aid	2,657,000	2,657,000	0	2,762,000	2,762,000	8,181,000
Scholarships & Training Awards	New Zealand Aid	613,000	613,000	0	613,000	613,000	1,839,000
Participation Program	UNESCO	85,000	85,000	0	85,000	85,000	255,000
Ministry of Health		**1,556,200**	**1,330,079**	**(226,121)**	**1,393,022**	**858,216**	**3,581,317**
Management & prevention of HIV and STI	Global Fund	96,000	96,000	0	96,000	0	192,000
Strengthening the management, prevention of TB in CK	Global Fund	78,000	57,154	(20,846)	16,180	0	73,334
HIV-New Funding Model	Global Fund		41,800	41,800	49,460	16,330	107,590
Health Specialist Visits Programme	New Zealand Aid	500,000	500,000	0	500,000	500,000	1,500,000
Multi-sectoral approach to combat NCDs and assoc risk factor	Global Fund	0		0	0	0	0
SPC Small Grants	SPC	20,000	20,000	0	20,000	20,000	60,000
Strengthening Reproductive Health	UNFPA	345,000	97,925	(247,075)	194,182	75,886	367,993
Human Resources Development (Fellowships)	WHO	271,200	271,200	0	271,200	0	542,400

Agency	Development Partner	Budget 2013/14	Supplementary Estimates 2013/14	Variance	Budget 2014/15	Budget 2015/16	Total
Technical Cooperation Programme	WHO	246,000	246,000	0	246,000	246,000	738,000
Ministry of Internal Affairs		**1,291,530**	**1,329,310**	**37,780**	**815,570**	**600,000**	**2,744,880**
Social welfare review, protection of the vulnerable	ADB	390,000	390,000	0	100,000	0	490,000
Disability Inclusive Development	AusAID	136,530	136,530	0	115,570	0	252,100
Social Impact Fund (NGO and community initiatives scheme)	New Zealand Aid	765,000	765,000	0	600,000	600,000	1,965,000
12th Treinnial Conf of Pacific Women	AusAID		37,780	37,780			37,780
Infrastructure Cook Islands		**6,042,000**	**3,942,000**	**(2,100,000)**	**5,650,000**	**2,500,000**	**12,092,000**
Penrhyn Coastal Harbour upgrade	Australia Adaptation	0		0	650,000	0	650,000
Northern Water-Community water tank upgrades(2011 carry fwd)	New Zealand Aid	650,000	0	(650,000)	0	0	0
Mangaia water upgrades	Australia Adaptation	0		0	0	0	0
Mangaia Harbour Climate Adaptation	AusAID	610,000	610,000	0	0	0	610,000
Pacific Adaptation to CC (PACC+) Cook Is	UNDP	737,000	737,000	0	0	0	737,000
Mauke & Mitiaro Harbours	New Zealand Aid	260,000	260,000	0	0	0	260,000
Northern Water Improvement program - Household supply	New Zealand Aid	630,000	630,000	0	0	0	630,000
Waste Management and Sanitation improvement program	New Zealand Aid	2,955,000	1,505,000	(1,450,000)	5,000,000	2,500,000	9,005,000
Integrated Water Resources Management (IWRM)	SOPAC	200,000	200,000	0	0	0	200,000
Ministry of Marine Resources		**362,000**	**362,000**	**0**	**362,000**	**0**	**724,000**
CI Fisheries Initiative (CIFI)	Australia Regional	0		0	0	0	0
Fisheries Project Development Fund	FFA	362,000	362,000	0	362,000	0	724,000
National Environment Services		**614,000**	**639,000**	**25,000**	**2,491,400**	**2,342,000**	**5,472,400**
Piloting V & A	AusAID	0		0	0	0	0
Prevention, control and management	Global Environment Facility	162,000	162,000	0	85,600	72,000	319,600

Agency	Development Partner	Budget 2013/14	Supplementary Estimates 2013/14	Variance	Budget 2014/15	Budget 2015/16	Total
Conservation Management of Island Biodiversity	Global Environment Facility	225,000	225,000	0	135,800	0	360,800
UNCCD Data Reporting Project	Global Environment Facility	57,000	57,000	0	0	0	57,000
Ridge to Reef	Global Environment Facility	100,000	100,000	0	2,200,000	2,200,000	4,500,000
Monitoring of Ozone Depletion Substance	Global Environment Facility	70,000	70,000	0	70,000	70,000	210,000
Building Capacity for Sustainable Land management	UNDP	0		0	0	0	0
Persistent Organic Pollutants POPs	UNDP	0		0	0	0	0
State of Environment Report	UN/UNEP		25,000	25,000			25,000
Office of the Prime Minister		**16,089,585**	**16,711,370**	**621,785**	**18,478,500**	**732,000**	**35,921,870**
Renewable Energy TA (Feasibility)	ADB	570,000	570,000	0	0	0	570,000
Institutional Structure Development	AusAID	0		0	0	0	0
Coastal Adaptation	AusAID	0	88,900	88,900	0	0	88,900
SPC EU GCCA PSIS PROJECT	EU	465,000	465,000	0	0		465,000
National Adaptation to CC (3rd Nat Com & 3-4 Nat Rept)	Global Environment Facility	60,000	60,000	0	170,000	170,000	400,000
Renewable Energy program support	New Zealand Aid	6,280,000	12,300,000	6,020,000	12,300,000	0	24,600,000
PV Mini grids	PEC (Japan)	3,390,000	0	(3,390,000)	3,390,000	0	3,390,000
Energy Transformation	SIDS-DOCK	2,330,000	0	(2,330,000)	650,000	0	650,000
Power sector study, EIA, verifications (PIGGAREP)	SPREP	77,000	77,000	0	0	0	77,000
Community Centered Sustainable Development plans	UNDP	0		0	0	0	0
Strengthening Resilience of Island Communities	UN Adaptation Fund	2,708,585	2,708,585	0	1,968,500	562,000	5,239,085
Atiu Generator Renewable Energy	New Zealand Aid	209,000	209,000	0	0	0	209,000
Rarotonga Land Use	SPC		7,885	7,885			7,885
Cook Island Water Shortage Response	New Zealand		225,000	225,000			225,000

Agency	Development Partner	Budget 2013/14	Supplementary Estimates 2013/14	Variance	Budget 2014/15	Budget 2015/16	Total
CI Police Services		**720,000**	**720,000**	**0**	**720,000**	**120,000**	**1,560,000**
CI Police Service HR development	Australian Federal Police	0		0	0	0	0
Police Development Programme	New Zealand Aid	600,000	600,000	0	600,000	0	1,200,000
Te Kukupa TA, operations	New Zealand Defence	120,000	120,000	0	120,000	120,000	360,000
Office of the Public Service Commissioner		**1,000,000**	**1,000,000**	**0**	**0**	**0**	**1,000,000**
CI Technical Assistance Facility	New Zealand Aid	1,000,000	1,000,000	0	0	0	1,000,000
Te Aponga Uira		**409,347**	**409,347**	**0**	**112,150**	0	521,497
Promoting Energy Efficiency in the Pacific	ADB	409,347	409,347	0	112,150	0	521,497
Seabed Mining Authority	Commonwealth Secretariat	**95,000**	**95,000**	**0**	**20,000**		115,000
Total		**59,363,162**	**56,184,606**	**(3,178,556)**	**55,665,142**	**17,601,216**	**129,450,964**

Enhancing Crop Development – Food and Agriculture Organization (FAO)

A total of $293,000 USD has been made available for the project from September 2013- August 2015. The allocation of $100,000 for each FY provides an approximate spending for this project.

Asian Development Bank

The two funded Technical Assistance projects from ADB, Asset Management and Public Sector Reform Support changes simply reflect a split of the technical assistance over two financial years. Asset Management is progressing well, but the spending of funds will also fall into the FY2014/15 which was not initially anticipated. Public Sector Reform is still in concept stage and reflects the need to prioritise across central agencies and acknowledges that the majority of spend will occur in FY2014/15.

Northern Water- community water tank upgrades – New Zealand

This funding has been withdrawn and the community water tank upgrades will be funded by the Cook Islands Government in the 2014/15 Budget.

Sanitation Upgrade Program – New Zealand

The 3 year plan for this program has been revised over the last 6 months and the funding requirement from New Zealand adjusted in coordination with EU budget support and CI Gov funding. Upgrades over the rest of Rarotonga and Aitutaki are expected to be started in March 2014.

12th Triennial Conference of Pacific Women – Australia

The Secretariat of the Pacific Community hosted the Twelfth Conference of Pacific Women and the Fifth Pacific Ministers for Women meetings jointly with the Government of the Cook Islands and the Pacific Islands Forum Secretariat in Rarotonga, Cook Islands from 20-25 October 2013. The overall aim of the Conference and Ministerial meetings is to bring together Ministers and senior decision makers within governments, development partners, research institutions and civil society organisations to review and develop strategies for accelerating progress in the achievement of gender equality and women's human rights in our region, in line with the Revised Pacific Platform for Action for Gender Equality and the Advancement of Women (RPPA) and other regional commitments on gender equality including most recently the Pacific Forum Leaders Gender Equality Declaration of 2012.

Pearl Industry Revitalisation – New Zealand

In the original GFA it funded production support, marketing support, capacity development and programme management. Due to difficulties experienced in implementing these components, New Zealand and the Cook Islands Government determined that these components would be disestablished and a Revised activity would be designed.

The components of the Revised Activity include: Subsidised grant scheme for materials and equipment, lagoon assessment and cleanup activities (if required), and monitoring, results and evaluation.

Apii Nikao School Rebuild – New Zealand

It has been indicated that NZ will contribute a total of $5 million dollars towards this project and a small portion of those funds will be spent during the planning phase of this projecting during this FY and the remaining funds during the next FY.

Development Partners Meeting – CI Gov

The purpose of the Development Partners Meeting (DPM) 2014 is for Cook Islands government, civil society and private sector development partners to meet with international development partners with the aim of supporting dialogue on development effectiveness while focusing on development results, challenges and ways in which we aim to move forward in partnership.

Additional funds were allocated to extend the meeting to include a trip to the Pa Enua (Atiu), hold sector meetings and increase participation of local partners including private sector and civil society partners.

NIE Accreditation Process – EU/SPC/GCCA/PSIS

The approval for this technical assistance was not received in time for the FY13/14 budget process. This amount reflects the funds now secured to enable MFEM to have the Frankfurt School of Business and Management support its application for National Implementing Entity (NIE) status with the Adaptation Fund Board.

Strengthening Reproductive Health – UNFPA

This initiative aims to strengthen national capacity in delivering sexual and reproductive health services and improve the data available to inform decision-making and policy formation through provision of technical assistance. This is a new grant agreement and a total of $309,000 USD is being provided between January 2014 and December 2015.

Strengthening the management, prevention of TB in CK – Global Fund
(Transitional Funding Mechanism - Multi-Country Program to Fight Tuberculosis)

The goal of this project is to reduce the prevalence and mortality from all forms of TB by half by 2015 relative to 2000, thereby contributing to the achievement of the United Nations Millennium Development Goals. The revised amounts include what has been allocated for the 2013/14 and 2014/15 financial years.

HIV-New Funding Model – Global Fund

The overall goal of this program is to reduce the spread and impact of HIV and other STIs while embracing people living with and affected by HIV in Pacific communities. The program includes but is not limited to improved STI management, increased awareness and behaviour change communication and surveillance and research. The revised amount includes funds that have becoming newly available for the period spanning January 2014 to December 2015.

State of Environment Report – EU/UNEP (SPREP as implementing agency)

Funding has been provided as part of the multilateral agreement support provided to African-Caribbean-Pacific Countries, the last State of the Environment Report for Cook Islands was conducted in 1993

Cook Islands Water Shortage Response- New Zealand

New Zealand previously committed funds for the Cook Islands Cyclone Recovery and Reconstruction (CRRP) under a Grant Funding Arrangement dated 20 July 2007. The signatories have agreed that the funds of $225,000 NZD have been made available to address the emergency shortage of water in the Southern Group.

Coastal Adaptation – Australia

Climate Change Cook Islands received an extension to its PASAP program which was due to be completed in FY12/13. This fund represents the reallocation of funds appropriated in the previous FY under PASAP to this prioritised activity.

PV Mini grids – PEC (Japan) & Energy Transformation – SIDS-DOCK

These funds have been reallocated to renewable energy projects in 2015/2016 as a result of the New Zealand renewable electricity commitment.

Renewable Electricity – New Zealand

This funding agreement was revised 20 February 2014 and now includes increased funding for Northern Cook Islands – One utility-scale photovoltaic(PV) array for the Airport on Rarotonga; Eight PV/diesel hybrid mini-grid systems (each comprising PV arrays, framing, inverters, batteries, cabling, and other balance of system components), a powerhouse and distribution networks and metering, as necessary and as described in the Technical Specifications (CAT Projects Ltd, 2013) distributed among the following islands and atolls of the Northern Group: Pukapuka, Nassau, Manihiki (installations at Tukao and Tauhunu), Rakahanga, Penrhyn (installations at Te Tautua and Omoka) and Palmerston. Under the new agreement New Zealand will procure the construction and supervision services for these installations and the CI Gov will oversee the program.

9 SPECIFIC FINANCIAL RISKS

The total quantifiable contingent liabilities are estimated at $17.7 million in 2013/14. This is made up of the following:

Guarantees and Indemnities

- The Government has entered into a program under the New Zealand Aid Programme focused on Pearl Sector Support run through the Cook Islands Pearl Authority. Through the program the CIG has agreed to guarantee up to $0.5 million as security for loans associated with the Pearl Production Credit Scheme. The full guarantee has been included as a contingent liability. There has been no change since the time of the 2013/14 Budget Estimates.

Uncalled Capital

- The Government also holds $1.4 million in the Asian Development Bank - Cook Islands Government Property Corporation. This takes the form of 88 uncalled shares with a par value of US$13,500 each.

Legal Proceedings and Disputes

- Total quantifiable risk to the Crown under legal proceedings and disputes is $15.9 million.
- $14.5 million relates to contingency in recognition of the lawsuit filed against the government regarding its shipping policy in October 2002.
- $1.4 million in relation to smaller legal claims against government departments, namely Police and Health.

9.1 Assumptions Underlying the Fiscal Projections

Various assumptions must be made to forecast government's fiscal performance and position in the outer years.

- Operating Revenues are forecasted on the basis of recent trends in economic activity as well as one off considerations.
- GDP is updated to the 2012 calendar year while all other data is updated to the June, September or December quarters of 2013, except for tourism arrivals, which include the March 2014 arrival numbers. The data sets used were those available as at 24 April 2013.
- Nominal GDP is expected to grow by:
    - 4.8 per cent in 2013/14
    - 3.9 per cent in 2014/15
    - 1.9 per cent in 2015/16
    - 2.7 per cent in 2016/17
- The general model used to forecast nominal economic growth is based on the expenditure national accounting measure and uses estimates of public final demand (including aid assistance), net merchandise trade, tourism total spending, investment, and domestic consumption.
    - Tourism expenditure is the largest single component of the forecasts, and is based on:
        - An average stay of 7.9 days for New Zealand arrivals, 8.4 for Australia, 7.4 for USA, 8.8 for Canada, 8.6 for the UK and Europe, 6.2 for Asia, and 7.9 for other – an overall average of around 8.0 days depending on the composition of total arrivals in any given month. This data was collected from the Customs and Immigration database of arrivals and departures, which uses the passport numbers of visitors to determine how long an individual passport holder is in the country.
        - Average visitor spend of NZD 227.00 per day, which is estimated from quarterly visitor surveys and a CPI indexation of a basket of tourist services.
    - Public final demand is the second largest single item and is estimated based on the personnel and operating appropriation, as well as the capital expenditure profile, for both Government and aid spending. A realisation (or completion) rate is applied to capital projects to allow for project slippage from one year to the next. This rate sits at around 40 per cent, depending on the year.
        - Government expenditure (including capital, but excluding ODA) is based on the Operating Estimates for 2012/13, Appropriation for 2013/14, and existing government policy, and is expected to grow as follows:
            - 7.7 per cent in 2012/13
            - 11.5 per cent in 2013/14
            - -9.9 per cent in 2014/15
            - -3.4 per cent in 2015/16
            - 0.0 per cent in 2016/17
- Growth in prices measured through movements in the Consumer Price Index to remain around the historical yearly averages, with a small increase in inflation in 2013/14 due to the 2.5 percentage point increase to the VAT offset by lower than expectred inflation results so far this year. The full-year impact of the VAT increase is borne by the 2014/15 year. Year average inflation is forecast to be:
    - 2.6 per cent in 2012/13
    - 2.3 per cent in 2013/14

- 4.6 per cent in 2014/15
- 3.1 per cent in 2015/16
- 3.1 per cent in 2016/17

- Operating Expenditure movements in the outer years are based on actual commitments to movements through the Medium Term Budgeting Framework.
- The level of borrowings is based on average exchange rates in April 2014.

10 FINANCIAL STATEMENTS

Financial Statements
As at 30 June 2014

The forecasted financial estimates of the Crown are set out on the following pages.

(1) Statement of Financial Performance

(2) Statement of Financial Position

(3) Statement of Cash flows

(4) Statement of Borrowings

(5) Summary of Revenue Levied on Behalf of the Crown

(6) Statement of Financial Risks

10.1 Statement of Financial Position

For the years ending 30 June 2014

Statement of Financial Performance
For the years ending 30 June 2014

	BPS Estimate 2013-14 ('000)	Pre-Election Estimate 2013-14 ('000)	Projected 2014-15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)
Revenue					
Taxation revenues	98,942	97,838	104,803	104,082	109,056
Other revenue					
Revenue on behalf of the Crown	8,756	10,113	8,902	8,885	8,884
Sale of goods and services	5,452	5,718	6,226	6,263	6,263
Interest	2,147	2,147	2,171	2,195	2,195
Dividends	2,561	2,631	2,415	2,396	2,396
Total Revenue	***117,858***	***118,447***	***124,516***	***123,820***	***128,794***
Expenditure					
Appropriations to agencies	63,592	64,075	66,012	66,067	66,067
Payments on behalf of Crown	44,097	43,218	46,339	46,555	46,555
Debt-servicing interest	1,429	1,437	1,520	1,283	1,283
Building maintenance	1,800	1,800	1,800	1,800	1,800
Infrastructure depreciation	5,070	5,070	6,904	6,904	6,904
Other expenditure	3,833	2,960	2,680	2,679	2,679
Total Expenditure	***119,821***	***118,560***	***125,255***	***125,288***	***125,288***
NET OPERATING SURPLUS / (DEFICIT)	***-1,963***	***-112***	***-739***	***-1,468***	***3,506***

10.2 Statement of Financial Position

As at 30 June 2014

	BPS Estimates 2013-14 ('000)	Pre-election Estimates 2013-14 ('000)	Projected 2014-15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)
Assets					
Cash and equivalents	20,723	17,718	16,357	14,502	17,881
Loan reserves	16,596	16,494	15,254	13,984	11,514
Trust accounts	7,768	8,257	8,764	9,279	9,794
Inventory	4,395	4,395	4,395	4,395	4,395
Tax receivables	16,647	16,944	16,713	16,480	15,986
Debtors and other receivables	10,699	10,699	10,699	10,699	10,699
Advances to SOEs	27,492	24,393	24,230	23,918	23,398
Investment in SOEs	146,733	146,733	146,733	146,733	146,733
Plant, property, and equipment	226,317	230,600	240,748	246,324	251,900
Total Assets	***477,370***	***476,233***	***483,893***	***486,314***	***492,300***
Liabilities					
Creditors and other payables	10,909	10,412	9,907	9,393	8,879
Trust liabilities	8,013	8,510	9,015	9,529	10,043
Borrowings	85,565	85,057	79,361	77,070	74,489
Total Liabilities	***104,487***	***103,979***	***98,283***	***95,992***	***93,411***
Net Crown Balance	***372,883***	***372,254***	***385,610***	***390,322***	***398,889***

10.3 Statement of Cashflows

For the years ending 30 June 2014

	BPS Estimates 2013-14	Estimate 2013-14	Projected 2014-15	Projected 2015-16	Projected 2016-17
	('000)	('000)	('000)	('000)	('000)
Cashflows from Operating Activities					
Cash provided from:					
Taxation and levies	98,942	97,838	104,803	104,082	109,056
Collection of tax arrears	972	-297	231	233	494
Sale of goods and services	5,452	5,718	6,226	6,263	6,263
Interest	2,147	2,147	2,171	2,195	2,195
Dividends	2,561	2,631	2,415	2,396	2,396
Other income	8,756	10,113	8,902	8,885	8,884
	118,830	*118,150*	*124,747*	*124,053*	*129,288*
Cash applied to:					
Appropriations to agencies (less depn)	59,705	60,189	62,049	62,049	62,049
Payments on behalf of Crown	44,097	43,218	46,339	46,555	46,555
Debt-servicing interest	1,429	1,437	1,520	1,283	1,283
Building maintenance	1,800	1,800	1,800	1,800	1,800
Other expenditure	6,607	3,457	3,185	3,193	3,193
	113,638	*110,100*	*114,893*	*114,880*	*114,880*
Net Operating Activity Cashflows	***5,193***	***8,050***	***9,854***	***9,173***	***14,408***
Cashflows from Investing Activities					
Cash provided from:					
Subsidiary loan repayments	0	0	0	0	0
	0	*0*	*0*	*0*	*0*
Cash applied to:					
Capital expenditure	16,517	7,621	17,437	14,263	14,263
Advances to Subsidiaries	0	0	0	0	0
	16,517	*7,621*	*17,437*	*14,263*	*14,263*
Net Investing Activity Cashflows	***-16,517***	***-7,621***	***-17,437***	***-14,263***	***-14,263***
Cashflows from Financing Activities					
Cash provided from:					
Loans drawn down	6,946	6,946	16,946	9,000	9,000
Cash drawn from loan reserves	1,243	1,335	1,243	1,270	1,270
	8,189	*8,281*	*18,189*	*10,270*	*10,270*
Cash applied to:					
Loan repayments	4,281	11,226	11,461	6,521	6,521
Loan reserves	0	0	0	0	0
Other reserves	498	489	507	514	514
	4,779	*11,715*	*11,968*	*7,035*	*7,035*
Net Financing Activity Cashflows	***3,410***	***-3,434***	***6,221***	***3,235***	***3,235***
Net cash movements	-7,914	-3,005	-1,362	-1,855	3,380
Add: Opening Cash and Equivalents	28,638	20,723	17,718	16,357	14,502
Closing Cash and Equivalents	***20,723***	***17,718***	***16,357***	***14,502***	***17,882***

10.4 Statement of Borrowings

As at 30 June 2014

	BPS Estimates 2013-14 ('000)	Pre-election Estimates 2013-14 ('000)	Projected 2014-15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)
Total Gross Borrowings	***85,565***	***85,057***	***79,361***	***77,070***	***74,489***
Assets Held Against Borrowings:					
Advances to subsidiaries	27,492	24,393	24,230	23,918	23,398
Loan reserves	16,596	16,494	15,254	13,984	11,514
Total Assets Held Against Borrowings	***44,088***	***40,887***	***39,484***	***37,902***	***34,912***
Net Borrowings of the Government	***41,477***	***44,170***	***39,877***	***39,168***	***39,577***

Note: the net borrowing figures presented here will not match Section 7 (Crown Debt), as that section quantifies all debt commitments whether they are drawn down or not – this table refers to the amount of debt actually drawn down. Gross debt net of the LRF (Loan Reserve Fund) is equal to total debt commitments minus assets held in the Loan Reserves.

This table will also not match the net debt figure presented in Table 6.1 (Economic Indicators), as that number is equal to total gross debt commitments minus funds held in the LRF and *uncommitted cash reserves.*

10.5 Revenue Levied on behalf of the Crown

For the years ending 30 June 2014

	BPS Estimates 2013-14 ('000)	Pre-Election Estimates 2013-14 ('000)	Projected 2014-15 ('000)	Projected 2015-16 ('000)	Projected 2016-17 ('000)
Taxation					
Income tax	22,304	22,516	21,411	22,382	23,160
Company tax	12,136	11,835	12,156	12,350	12,670
Import levies	15,201	12,376	14,288	11,788	14,488
Departure tax	6,872	7,710	7,998	8,312	8,631
VAT	41,529	41,993	48,949	49,249	50,107
Withholding tax	900	1,408	0	0	0
Total Revenue Levied on Behalf of the Crown	***98,942***	***97,838***	***104,803***	***104,082***	***109,056***

10.6 Statement of Fiscal Risks

As at 30 June 2014

	('000)
Quantifiable Contingent Liabilities	
Guarantees and indemnities	500
Uncalled capital	1,377
Legal proceedings and disputes	15,909
Total Quantifiable Contingent Liabilities	***17,786***

Guarantees and indemnities relate to the following:

Government has entered into a program under the New Zealand Aid Programme focused on Pearl Sector Support run through the Cook Islands Pearl Authority. Through the program the Government has agreed to guarantee upto $0.5million as security for loans associated with the Pearl Production Credit Scheme. The full guarantee has been included as a contingent liability.

Uncalled capital relates to shares in the Asian Development Bank - Cook Islands Government Property Corporation owns 88 uncalled shares with a par value of US$13,500 each.

Legal proceedings and disputes relate to current cases against the Crown.

10.7 Statement of Accounting Policies

There have been no changes since the Budget Policy Statement 2013/14. There are no major changes to accounting policies anticipated in the foreseeable future.

10.7.1 Basis of Preparation

Reporting Entity

These financial statements are for the Government of the Cook Islands. These consist of:

- Ministers of the Crown
- Ministries
- Island Administrations
- Offices of Parliament
- Public Enterprises and Other Authorities

A schedule of the entities included in these financial statements is detailed on page 23.

Statement of Compliance

These financial statements have been prepared in accordance with the Ministry of Finance and Economic Management Act 1995/96 and with the International Public Sector Accounting Standards issued by the International Public Sector Accounting Standards Board (IPSASB).

Measurement Base

The financial statements have been prepared on the going concern assumption and the accounting policies have been applied consistently throughout the period except where stated elsewhere in this Statement of Accounting Policies.

These financial statements have been prepared using the historical cost method to report results, cash flows and the financial position of the Crown. The financial statements have been prepared under the accrual basis of accounting and are presented in New Zealand dollars rounded to the nearest thousand dollars.

10.7.2 Significant Accounting Policies

The following accounting policies, which significantly affect the measurement of financial performance, financial position and cash flows, have been applied:

Recent Standards of significant relevance to the Crown is the recent development of new standards at the IPSASB. These include:

	STANDARDS	EFFECTIVE DATE
A.	IPSAS 25 Employee Benefits	1/01/2011
B.	IPSAS 26 Impairment of Cash Generating Assets	1/04/2009
C.	IPSAS 27 Agriculture	1/04/2011
D.	IPSAS 28 Financial Instruments: Recognition and Measurement	1/01/2013
E.	IPSAS 29 Financial Instruments: Presentation	1/01/2011
F.	IPSAS 30 Financial Instruments: Disclosure	1/01/2013
G.	IPSAS 31 Intangible Assets	1/04/2011

These new standards have been issued but are not yet effective for the consolidated Crown accounts as the preparation of the 30 June 2010 accounts are currently in progress – the 30 June 2009 consolidated accounts were completed and audited on 24 May 2012. The Crown will have to consider these new standards in future years. Crown has not yet determined the effect of these new standards.

Basis of Consolidation

The Government Ministries, Public Enterprises and Other Authorities (including State Owned Enterprises (SOEs)) comprising the reporting entity are consolidated involving addition of like items of assets, liabilities, revenues and expenses on a line by line basis.

The effect of all material inter-entity transactions and balances are eliminated on consolidation.

Commitments and contingent liabilities of Public Enterprises and Other Authorities are reported in the Statements of Commitments and of Contingent Liabilities.

Associate

An associate is an entity over which the Crown has significant influence where the entity is neither a subsidiary nor an interest in a joint venture. Investment in an associate is recognised at cost and the carrying amount is increased or decreased to recognise the Crown's share of the surplus or deficit after the date of acquisition. When the Crown transacts with an associate, all surplus and deficits related to the Crown are eliminated. Distributions received from an associate reduce the carrying value of the investment in the Crown Financial Statements.

Revenue

Revenue is measured at fair value of the consideration received or receivable.

Revenue Levied through the Crown's Sovereign Power

Payment of tax does not of itself entitle a taxpayer to an equivalent value of services or benefits; such revenue is received through the exercise of the Crown's sovereign power. Revenue arising through taxes is recognised when the taxable event occurs and when the criteria for recognition of an asset are met.

Revenue Type	**Revenue Recognition Point**
Individual Income Tax	When an individual earns income that is subject to PAYE or provisional tax. This also includes withholding taxes.
Company Income Tax	When the corporate community earns taxable income.
Value Added Tax	When the liability to the Crown is incurred. For example, the liability arising from sales in June being paid in July however recognised as revenue in June.
Customs levies	When goods liable to duty are assessed, except for Oil Companies which are accounted for when the liability to the Crown is incurred.
Departure Tax	When departure tax coupons are purchased.
Other Revenue	When the debt to the Crown arises.

Revenue Earned Through Operations

Revenue from sales of goods is recognised when the product is sold to the customer.

Fines

Fines are economic benefits or services potential received by the Crown from an individual or other entity, as determined by a court or other law enforcement body, as consequence of the individual or other entity breaching the requirements of laws and regulations.

Investment Income
Investment income is recognised in the period in which it is earned.

Gains
Realised gains arising from sale of assets or from the early settlement of a liability are recognised in the Statement of Financial Performance in the period in which the transaction is concluded.

Dividends
Dividends are recognised when the right to receive the payment has been established.

Aid Revenue
Revenue is recognised when donor funds are expensed on approved projects.

Expenses
Expenses are recognised when incurred and are reported in the financial period to which they relate.

Welfare Benefits
Welfare benefits are recognised in the period which the payment of these benefits relates to.

Grants and Subsidies
Where grants and subsidies are discretionary until payment, the expense is recognised when the payment is made. Otherwise, the expense is recognised when the specified criteria have been fulfilled and notice has been given to the Crown.

Losses
Realised losses arising from sales of assets or the early settlement of a liability are recognised in the Statement of Financial Performance in the period in which the transaction is concluded.

Foreign Currencies

Transactions in foreign currencies are translated into New Zealand dollar using the exchange rate on the date of the transaction. Foreign exchange gain and losses arising from these transactions are included in the Statement of Financial Performance.

Any monetary assets and monetary liabilities held at year end are translated at the exchange rate at the balance sheet date.

Aid Expenses
Expenses are recognised when incurred on approved projects and are reported in the financial period to which they relate.

Depreciation

Each part of an item of plant, property, and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

Depreciation of plant, property, and equipment is provided on a straight line basis so as to allocate the cost of assets to their estimated residual value over their estimated useful lives. Typically, the estimated useful lives are:

Office and computer equipment	3 – 4 years
Motor vehicles	5 years
Furniture and fittings	4 – 10 years
Plant and Equipment	5 – 15 years
Buildings and improvements	10 years
Coastal protection	25 years
Power distribution network	20 years
Roading network	30 years
Water network	15 years
Airport runways	15 – 100 years
Harbour and ports structures	10 – 20 years
Waste management facilities	15 years

Non-Current Assets

Plant, Property, and Equipment

Plant, property and equipment are recorded at cost less accumulated depreciation.

The cost of purchased plant, property, and equipment is the value of the consideration given to acquire the assets and the value of other directly attributable costs which have been incurred in bringing the assets to the location and condition necessary for their intended service.

The cost of assets constructed by the Crown includes the cost of all materials used in construction, direct labour on the project, financing costs that are directly attributable to the project and an appropriate proportion of variable and fixed overheads. Costs cease to be capitalised as soon as the asset is ready for productive use and do not include any inefficiency costs.

Disposals

When an item of plant, property and equipment is disposed, the gain or loss (disposal proceeds less carrying value) associated with that item will be recognised in the Statement of Financial Performance.

Additions

The cost of an item of plant, property and equipment is recognised as an asset if, and only if, there will be future economic benefits evident and where these benefits will flow to the Crown and the cost of the item can be measured reliably.

Work in Progress

Work in Progress is recognised as cost less impairment and is not depreciated.

Infrastructure Assets

Infrastructure assets are recorded at cost less accumulated depreciation.

The cost of purchased infrastructure assets is the value of the consideration given to acquire the assets and the value of other directly attributable costs which have been incurred in bringing the assets to the location and condition necessary for their intended service.

The cost of assets constructed by the Crown includes the cost of all materials used in construction, direct labour on the project, financing costs that are directly attributable to the project and an appropriate proportion of variable and fixed overheads. Costs cease to be capitalised as soon as the asset is ready for productive use and do not include any inefficiency costs.

Infrastructure assets include: roading networks, water networks, power distribution networks, coastal protection systems, harbour and ports structures and waste management and airport assets.

IPSAS 17 allows a choice of accounting model for an entire class of property, plant and equipment. The Crown has changed the accounting policy from the cost to revaluation model for the following classes of assets:

- Power network
- Harbours & ports
- Airports

These assets are now carried at re-valued amounts which are the fair value at revaluation date less subsequent depreciation and impairment losses.

When an infrastructure asset is disposed of, the gain or loss (disposal proceeds less carrying value) associated with that item will be recognised in the Statement of Financial Performance.

Work in Progress is recognised as cost less impairment and is not depreciated.

Intangible Assets

Intangible assets are software acquisition costs.

Intangible assets are recorded at cost less accumulated amortisation.

The cost of purchased intangible assets is the value of the consideration given to acquire the assets and the value of other directly attributable costs which have been incurred in bringing the assets to the location and condition necessary for their intended service.

Intangible assets might include: databases, software purchased, or software developed.

When an intangible asset is disposed of, the gain or loss (disposal proceeds less carrying value) associated with that item will be recognised in the Statement of Financial Performance.

Amortisation of intangible assets is on a straight line basis so as to allocate the cost of assets to their estimated residual value over their estimated useful lives. Typically, the estimated useful lives are:

Software, databases: 3 - 5 years

Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less and bank overdrafts.

Receivables and Advances including Debtors and Other Receivables

Receivables and advances are recorded at cost.

After initial recognition, loans and receivables are measured at amortised cost less any provision for impairment. Gains and losses when assets are impaired or derecognised are recognised in the statement of financial performance.

Inventories

Inventories held for distribution or consumption in the provision of services that are not supplied on a commercial basis is measured at cost. Where inventories are acquired at no cost of for nominal consideration, the cost is the current replacement cost at the date of acquisition.

Inventories held for use in the production of goods and services on a commercial basis are valued at the lower of cost and net realisable value.

Investments

Investments in associate are accounted in the consolidated financial statements using the equity method. That is, investment in an associate is initially recognised at cost and the carrying amount is increased or decreased to recognise the Crown's share of the surplus or deficit of the associate after the day of acquisition.

Banking portfolio investments

Loans are valued at net realisable value after provisions. Applicable security is obtained depending on the size and nature of loans. Non-performing loans are reviewed monthly on a case by case basis.

Provision for doubtful debts

Provision is made for taxation debt where recovery is considered doubtful. There is no general provision against taxation debt.

Provision is made for banking portfolio Investments (specific loans) where recovery is considered doubtful or they have become non-performing. There is no general provision against banking portfolio Investments.

All bad debts are written off against specific provisions in the period in which they become classified as irrecoverable.

Aid Assets

Donor funds are deposited into bank accounts until expensed on approved assets.

Liabilities

Borrowings

Borrowing liabilities are accounted for at amortised cost. Any changes are recognised in the Statement of Financial Performance.

Pension Liabilities

Pension liabilities, in respect of the contributory service of current and past Members of Parliament, are recorded at the latest (30th June 1997) actuarial value of the Crown's liability for pension payments.

There are no pension liabilities accruing to the Crown as a result of Government employees' membership of the Government Superannuation Fund (New Zealand).

Employee Entitlements

These include salaries and wages accrued up to balance date, annual level earned but not yet taken at balance date. A long service bonus is paid out on the completion of 3 years continuous service within the Government. The bonus is equivalent to a fortnight pay of the employee.

Other Liabilities

All other liabilities are recorded at the estimated obligation to pay. No liability for ongoing welfare payments has been recognised because no legal entitlement is considered to exist beyond the end of the current financial year until a new Appropriation Act is passed.

Aid Liabilities

Funds received from various donors are treated as liabilities until expensed on approved projects at which stage the funding is included within the Statement of Financial Performance as revenue.

Cash Flow

A cash flow statement identifies the sources of cash inflow, the items on which cash was utilised and the cash balance at the reporting date for Crown. Included in the cash flow statements are financing activities which are activities that result in the change of size and composition of the contributed capital and borrowings of the Crown. Investing activities are the acquisition and disposal of long term assets and other investments and operating activities identifies how much the Crown received from its actual operations.

Cash flow information allows users to ascertain how the Crown raised the cash it required to fund its activities and the manner in which that cash was utilised.

Leases

Finance leases transfer, to the Crown as lessee, substantially all the risks and rewards incidental on the ownership of a leased asset. The obligations under such leases are capitalised at the present value of minimum lease payments. The capitalised values are amortised over the period in which the Crown expects to receive benefits from their use.

Operating leases, where the lessors substantially retain the risks and rewards of ownership, are recognised in a systematic manner over the term of the lease.

The cost of leasehold improvements is capitalised and amortised over the lesser of the leasehold improvements useful life or the original lease term.

Commitments

The Statement of Commitments discloses those operating and capital commitments arising from non-cancellable contractual or statutory obligations. Interest commitments on debts and commitments relating to employment contracts are not included.

Contingent Liabilities

Contingent liabilities are recorded when a possible obligation has arisen from an event in the past and which the existence will only be confirmed through the occurrence or non-occurrence of future events. Such liabilities will be disclosed if they are deemed to materially affect the reading of the presented financial statements.